

CODORUS VALLEY BANCORP INC  
Form 10-K  
March 15, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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 (I.R.S.  
jurisdiction of Employer  
incorporation Identification  
or organization)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
<b>Common Stock, \$2.50 par value</b>	<b>NASDAQ Stock Market LLC</b>

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.  
Yes No

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

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

Indicate by check mark 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 if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in the definitive

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proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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

The aggregate market value of Codorus Valley Bancorp, Inc.’s voting stock held by non-affiliates was approximately \$155,106,213 as of June 30, 2016.

As of March 1, 2017, Codorus Valley Bancorp, Inc. had 8,431,256 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 16, 2017.

**Codorus Valley Bancorp, Inc.**

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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, as amended. PeoplesBank, A Codorus Valley Company (“PeoplesBank”) is its wholly owned bank subsidiary. The Corporation’s business consists primarily of managing PeoplesBank, and its principal source of income is dividends received from PeoplesBank. The Corporation also wholly-owns two non-bank subsidiaries, SYC Realty Co., Inc., a subsidiary for holding certain foreclosed assets pending liquidation, and CVLY Subsidiary Corp., which may be used, as needed, for the financial and legal management of acquisition transactions. On December 31, 2016, Codorus Valley had total consolidated assets of \$1.61 billion, total deposits and other liabilities of \$1.46 billion, and total shareholders’ equity of \$154,957,000.

#### Bank Subsidiary

PeoplesBank, organized in 1934, is a Pennsylvania chartered bank that offers a full range of business and consumer banking services. As of December 31, 2016, PeoplesBank operated twenty-six full service financial centers located in York, Cumberland and Lancaster Counties in Pennsylvania, and in Baltimore, Harford and Carroll Counties, and Baltimore City, in Maryland. PeoplesBank, with origins dating back to 1864, is focused on acquiring and nurturing financial relationships with small and mid-sized businesses. It also provides personal banking, mortgage banking, wealth management 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, 2016, PeoplesBank had total gross loans of \$1.27 billion, excluding loans held for sale, and total deposits of \$1.26 billion. PeoplesBank had the second largest share of deposits in York County, Pennsylvania, with deposits totaling 14.1 percent of the market as of June 30, 2016, the latest available measurement date.

PeoplesBank is not dependent on deposits of, or exposed to a loan concentration to, a single client, or a small group of clients. Therefore, the loss of a single client, or a small client group, would not have a material adverse effect on the financial condition of PeoplesBank. At December 31, 2016, the largest indebtedness of a single PeoplesBank client was approximately \$21,390,000 or 1.7 percent of the total loan portfolio, which was within PeoplesBank’s 2016 regulatory lending limit of \$26,224,000.

Most of the Corporation’s business is with clients in York County, Pennsylvania and northern Maryland. Although this market area may pose a concentration risk geographically, we believe that the diverse local economy and our detailed

knowledge of the client base lessens this risk. At December 31, 2016, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor represented 19.2 percent of the portfolio; residential real estate investor represented 14.4 percent of the portfolio; and builder and developer represented 11.7 percent of the portfolio. At December 31, 2015, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor represented 17.1 percent of the portfolio; residential real estate investor represented 14.3 percent of the portfolio; and builder and developer represented 11.9 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

## **Nonbank Subsidiaries of PeoplesBank**

PeoplesBank had six wholly-owned nonbank subsidiaries as of December 31, 2016, that were consolidated for financial reporting purposes.

Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors, a subsidiary that sells non-deposit investment products in Pennsylvania, began operations in January 2000, and previously operated as SYC Insurance Services, Inc. until the change to the current name in December 2005.

Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors, a subsidiary that sells non-deposit investment products in Maryland, was acquired through the merger with Madison Federal Savings Bank (which was completed on January 16, 2015), and previously operated as Madison Financial Services Corp until the change to the current name in December 2016.

SYC Settlement Services, Inc. is a subsidiary that has provided real estate settlement services since January 1999.

Periodically, PeoplesBank creates nonbank subsidiaries for the purpose of temporarily holding certain foreclosed assets pending liquidation. On December 31, 2016, two of three of these foreclosed asset subsidiaries were active.

### **Nonbank Subsidiaries of Codorus Valley Bancorp, Inc.**

In 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 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 junior subordinated debt on the Corporation's balance sheet.

In 1991, SYC Realty Co., Inc. was incorporated as a wholly owned subsidiary of Codorus Valley, and originally commenced operations in October 1995. Codorus Valley created this nonbank subsidiary primarily for the purpose of holding certain foreclosed properties obtained by PeoplesBank pending liquidation of those properties. SYC Realty was inactive during the entire reporting period of 2016.

In 2015, CVLY Subsidiary Corp., a wholly owned subsidiary of Codorus Valley and known formerly as Madison Bancorp, Inc., was the surviving merged entity resulting from the acquisition of Madison Bancorp, Inc. (which was completed on January 16, 2015). This entity was inactive during the entire reporting period of 2016 but may be used, as needed, for acquisition or other legal activities.

## **Employees**

At year-end 2016, PeoplesBank employed 269 full-time employees and 35 part-time employees, which equated to approximately 306 full-time equivalent employees. Employees are not covered by a collective bargaining agreement, and PeoplesBank 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 not significant 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 highly competitive. PeoplesBank competes through service and 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

The Corporation is subject to extensive regulation under federal and Pennsylvania banking laws, regulations and policies, including prescribed standards relating to capital, earnings, dividends, the repurchase or redemption of shares, loans or extensions of credit to affiliates and insiders, internal controls, information systems, internal audit processes, loan documentation, credit underwriting, asset growth, impaired assets, and loan-to-value ratios. The bank regulatory framework is intended primarily for the protection of depositors, federal deposit insurance funds and the banking systems as a whole, and not for the protection of security holders.

The following summary sets forth certain of the material elements of the regulatory framework applicable to bank holding companies and their bank subsidiaries and provides certain specific information about Codorus Valley and PeoplesBank. It does not describe all of the provisions of the statutes, regulations and policies that are identified. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by express reference to each of the particular statutory and regulatory provisions. A change in applicable statutes, regulations or regulatory policy may have a material effect on the business of the Corporation.

### *Bank Holding Company Regulations*

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 and Securities must also approve certain similar transactions. 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 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, and 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.

#### *Regulation of PeoplesBank*

PeoplesBank is a Pennsylvania chartered bank that is not a member of the Federal Reserve System, and its deposits are insured (up to applicable limits) by the Federal Deposit Insurance Corporation (“FDIC”). Accordingly, PeoplesBank’s primary federal regulator is the FDIC, and PeoplesBank is subject to the extensive regulation and examination by the FDIC and the Pennsylvania Department of Banking and Securities.

State and federal 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 non-deposit investment products by the bank and its subsidiaries.

As the primary federal regulator of PeoplesBank, the FDIC regularly examines banks in such areas as capital, asset quality, management, earnings, liquidity and sensitivity to market risk and other aspects of operations and requires that PeoplesBank furnish annual and quarterly reports. Examinations by the FDIC 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 maximum insurance amount is \$250,000 per depositor.

Effective January 1, 2012, PeoplesBank became subject to FDIC regulation 363.3(b), which requires depository institutions with total assets of \$1 billion or more to engage an independent public accountant to examine, attest to, and report on the assertion of management concerning the institution's internal control structure and procedures for financial reporting.

The Pennsylvania Insurance Department, the Securities and Exchange Commission (“SEC”) and the Financial Industry Regulatory Authority (“FINRA”) control and supervise the licensing and activities of employees engaged in the sale of non-deposit investment products.

#### *Federal Deposit Insurance and Premiums*

PeoplesBank pays deposit insurance premiums to the FDIC based on a risk-based assessment formula established by the FDIC for Deposit Insurance Fund (DIF) member institutions. Institutions are classified into one of four risk categories and pay premiums according to perceived risk to the FDIC’s DIF. PeoplesBank has consistently been a risk category I institution, the least risky category. Institutions in risk categories II, III and IV are assessed premiums at progressively higher rates.

In February 2011, the FDIC announced its final rule pertaining to, among other things, changes in the computation of risk-based insurance premiums as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rule, which took effect April 1, 2011, changed the assessment base from domestic deposits to average assets minus average tangible equity, i.e., Tier 1 capital, and lowered assessment rates. For insured member institutions below \$10 billion in total assets, the four risk categories framework mentioned earlier continues to apply. For the least risky category I institutions, such as PeoplesBank, the assessment rate range of 7 to 24 basis points on domestic deposits decreased to 2.5 to 9 basis points on total average assets minus average tangible equity. The final rule eliminated risk categories for large institutions with total assets of \$10 billion or more. Instead, their assessment rates are now calculated using a scorecard that combines regulatory ratings and certain forward financial measures to assess the risk a large institution poses to the DIF.

On April 26, 2016, the FDIC adopted a rule amending small institution pricing for deposit insurance, which is effective the quarter after the Reserve Ratio reaches 1.15 percent. The reserve ratio reached 1.15 percent effective June 30, 2016, so the lower rates became effective July 1, 2016. The initial base assessment rates for all insured institutions were reduced from 5 to 35 basis points to 3 to 30 basis points. Total base assessment rates after possible adjustments were reduced from 2.5 to 45 basis points to 1.5 to 40 basis points. For insured institutions under \$10 billion in total assets, the new pricing system eliminates all risk categories and uses the Financial Ratios Method to determine assessment rates. CAMELS composite ratings are used to set minimum and maximum assessment rates for an institution. In addition, the new pricing system revises the Financial Ratios Method so that it is based on a statistical method eliminating the probability of failure over three years; and updates the financial measures used in the financial Ratios Method so the measures are consistent with the statistical method. Generally, the change in the assessment methodology by the FDIC lowered deposit insurance premiums for community banks like PeoplesBank.

#### *Dividend Restrictions*

The Corporation is a legal entity separate and distinct from PeoplesBank. Declaration and payment of cash dividends by the Corporation depends upon cash dividend payments to the Corporation by PeoplesBank, which is the Corporation's primary source of revenue and cash flow. Accordingly, the right of the Corporation, and consequently the right of our creditors and shareholders, to participate in any distribution of the assets or earnings of any subsidiary is necessarily subject to the prior claims of creditors of the subsidiary, except to the extent that claims of the Corporation in its capacity as a creditor may be recognized.

As a Pennsylvania chartered bank, PeoplesBank is subject to regulatory restrictions on the payment and amounts of dividends under the Pennsylvania Banking Code of 1965, as amended. Further, the ability of banking subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements.

The payment of dividends by PeoplesBank and the Corporation may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it is already undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. Federal banking regulators have the authority to prohibit banks and bank holding companies from paying a dividend if the regulators deem such payment to be an unsafe and unsound practice. More information about dividend restrictions and capital requirements can be found in Note 9 – Regulatory Matters, to the consolidated financial statements.

*Other Laws and Regulations Affecting the Corporation and PeoplesBank*

**Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)** In July 2010, the Dodd-Frank Act was enacted to improve accountability and transparency in the financial system, to attempt to end “too big to fail” pertaining to large, troubled financial institutions, to protect the American taxpayer by ending governmental bailouts, to protect consumers from abusive financial services practices, and for other purposes. The Dodd-Frank Act is broad and complex legislation that puts in place a sweeping new financial services regime that will have significant regulatory and legal consequences for banks now and for years to come. The effects of the Dodd-Frank Act on the financial services industry will depend, in large part, upon the extent to which regulators exercise the authority granted to them under the Dodd-Frank Act and the approaches taken in implementing regulations. Additional uncertainty regarding the effect of the Dodd-Frank Act exists due to the potential for additional legislative changes to the Dodd-Frank Act. The Corporation, like all financial institutions, has been and will continue to be impacted by the Dodd-Frank Act in the areas of corporate governance, deposit insurance assessments, capital requirements, risk management, stress testing, and regulation under consumer protection laws.

Among other things, the Dodd-Frank Act:

Provides extensive authorities to the federal bank regulatory agencies and, in particular, the Federal Reserve, to take proactive steps to reduce or eliminate threats to the safety of the financial system, impose strict controls on large bank holding companies (\$50 billion or more) and nonbank financial companies to limit their risk, and take direct control of troubled financial companies considered systemically significant;

Increases bank supervision by restructuring the supervision of holding companies and depository institutions; establishes the equivalent of a prompt corrective action program for large bank holding companies; requires that capital requirements for holding companies be at least as strict as capital requirements for depository institutions; disallows new issuances of trust preferred securities from qualifying for Tier 1 capital treatment; directs federal bank regulators to develop specific capital requirements for holding companies and depository institutions that address activities that pose risk to the financial system, such as significant activities in higher risk areas, or concentrations in

assets whose reported values are based on models;

Established the Consumer Financial Protection Bureau as an independent entity within the Federal Reserve System that has assumed responsibility for supervision and enforcement of most consumer protection laws, and has authority to supervise, examine and take enforcement action with respect to depository institutions with more than \$10 billion in assets and nonbank mortgage industry participants and other designated nonbank providers of consumer financial services;

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Places certain limitations on investment and other activities by depository institutions, holding companies and their affiliates. Expands the coverage of Section 23A of the Federal Reserve Act to include the credit exposure related to additional transactions, including derivatives; and

Significantly increases the regulation of residential mortgage lending and servicing by banks and nonbanks by requiring, among other things, mortgage originators to ensure that the consumer will have the capacity to repay the loan; and requires mortgage loan securitizers to retain a certain amount of risk, unless the mortgages conform to the new regulatory standards as qualified residential mortgages.

**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 were 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, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates 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 requires publicly held companies to document, test and certify that their internal control systems over financial reporting are effective.

Effective December 31, 2014, the Corporation is subject to the independent attestation requirement under Section 404 of the SOA. PeoplesBank remains subject to independent auditor attestation under FDIC regulation 363.3(b), which is a similar independent attestation requirement to Section 404 of the SOA.

**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.

#### *Future Laws and Regulations*

Periodically, various federal and state legislation is 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, Codorus Valley's and PeoplesBank's business is particularly susceptible to being affected by federal legislation and regulations. The general cost of compliance with numerous federal and state laws and regulations has had, 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, the Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports and other filings by Codorus Valley with the SEC may be obtained electronically at PeoplesBank's website at [www.peoplesbanknet.com](http://www.peoplesbanknet.com) (select "Investor Relations", then select "SEC Filings", then select "Documents"), or the SEC's website at [www.sec.gov](http://www.sec.gov). Copies can also be obtained without charge by writing to: Treasurer, Codorus Valley Bancorp, Inc., 105 Leader Heights Road, York, PA 17403.

Where we have included web addresses in this report, such as the Corporation's web address, we have included these web addresses as inactive text references only. Except as specifically incorporated by reference into this report, information on those websites is not part hereof.

## Item 1A: Risk Factors

Before investing in our common stock, you should carefully consider the risks described below, in addition to the other information contained in this report and in our other filings with the SEC. Unless the context otherwise requires, references to "we," "us," "our," "Codorus Valley Bancorp, Inc.," "Codorus Valley" or the "Corporation" refer to Codorus Valley Bancorp, Inc. and its direct or indirect owned subsidiaries, and references to the "Bank" refer to PeoplesBank, a Codorus Valley Company, the wholly-owned banking subsidiary of the Corporation.

The risks and uncertainties described below are not the only ones facing the Corporation. Additional risks and uncertainties that we are not aware of or focused on, or that we currently deem immaterial, may also impact our business and results of operations. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition and results of operations could be materially and adversely affected. If this were to happen, the market price of our common stock could decline significantly, and you could lose all or part of your investment.

### Risks Related to Our Business and Industry

*Weakness in the economy may materially adversely affect our business and results of operations.*

Our results of operations are materially affected by conditions in the economy generally, which continue to be uncertain and include sluggish economic growth, accompanied by historically low interest rates. Dramatic declines in the housing market following the 2008 financial crisis, with falling home prices and increasing foreclosures and unemployment, resulted in significant write-downs of asset values by financial institutions. While conditions have improved, a return to a recessionary economy could result in financial stress on our borrowers that would adversely affect consumer confidence, a reduction in general business activity and increased market volatility. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets could adversely affect our business, financial condition, results of operations and stock price. Our ability to properly assess the creditworthiness of our clients and to estimate the losses inherent in our credit exposure would be made more complex by these difficult market and economic conditions. Accordingly, if market conditions worsen, we may experience increases in foreclosures, delinquencies, write-offs and client bankruptcies, as well as more restricted access to funds.

***Deterioration in our local and regional economy or real estate market may adversely affect our business.***

Substantially all of our business is with clients located within York County, Cumberland County, and Lancaster County, Pennsylvania and Harford County, Baltimore County, Baltimore City and Carroll County, Maryland. As a result of this geographic concentration, our results depend largely on economic conditions in these and surrounding areas. Deterioration in economic conditions in these markets could:

increase loan delinquencies;  
increase problem assets and foreclosures;  
increase claims and lawsuits;  
decrease the demand for our products and services; and

decrease the value of collateral for loans, especially real estate, in turn reducing clients' borrowing power, the value of assets associated with nonperforming loans and collateral coverage.

Generally, we make loans to small and mid-sized businesses whose success depends on the regional economy. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. Adverse economic and business conditions in our market area could reduce our growth rate, affect our borrowers' ability to repay their loans and, consequently, adversely affect our financial condition and performance. For example, we place substantial reliance on real estate as collateral for our loan portfolio. A sharp downturn in real estate values in our market area could leave many of our loans inadequately collateralized. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings could be adversely affected.

***If our allowance for loan and lease losses is not sufficient to cover actual loan and lease losses, our earnings would decrease.***

We are exposed to the risk that our borrowers may default on their obligations. To absorb probable, incurred loan and lease losses that we may realize, we recognize an allowance for loan and lease losses based on, among other things, national and regional economic conditions, historical loss experience, and delinquency trends. However, we cannot estimate loan and lease losses with certainty, and we cannot assure you that charge-offs in future periods will not exceed the allowance for loan and lease losses. If charge-offs exceed our allowance, our earnings would decrease. In addition, regulatory agencies, as an integral part of their examination process, review our allowance for loan and lease losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. Factors that require an increase in our allowance for loan and lease losses, such as a prolonged economic downturn or continued weakening in general economic conditions such as inflation, recession, unemployment or other factors beyond our control, could reduce our earnings.

*Our exposure to credit risk, which is heightened by our focus on commercial lending, could adversely affect our earnings and financial condition.*

There are certain risks inherent in making loans. These risks include interest rate changes over the time period in which loans may be repaid, risks resulting from changes in the economy, risks inherent in dealing with borrowers and, in the case of a loan backed by collateral, risks resulting from uncertainties about the future value of the collateral if a disposition is necessary.

Commercial loans, including commercial real estate, are generally viewed as having a higher credit risk than residential real estate or consumer loans because they usually involve larger loan balances to a single borrower and are more susceptible to a risk of default during an economic downturn. Our consolidated commercial lending operations include commercial, financial and agricultural lending, real estate construction lending, and commercial mortgage lending. Construction financing typically involves a higher degree of credit risk than commercial mortgage lending. Risk of loss on a construction loan depends largely on the accuracy of the initial estimate of the property's value at completion of construction compared to the estimated cost (including interest) of construction. If the estimated property value proves to be inaccurate, the loan may be inadequately collateralized.

Because our loan portfolio contains a significant number of commercial real estate, commercial and industrial loans, and construction loans, the deterioration of these loans may cause a significant increase in nonperforming loans. An increase in nonperforming loans could cause an increase in loan related legal fees and expenses, loan charge-offs and a corresponding increase in the provision for loan losses, which could adversely impact our financial condition and results of operations.

***We depend primarily on net interest income for our earnings, and changes in interest rates could adversely impact our financial condition and results of operations.***

Our ability to make a profit, like that of most financial institutions, substantially depends upon our net interest income, which is the difference between the interest income earned on interest earning assets, such as loans and investment securities, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. Changes in interest rates can increase or reduce net interest income and net income.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a period, an increase in market rates of interest could reduce net interest income. When interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could reduce net interest income. Changes in market interest rates are affected by many factors beyond our control, including inflation, unemployment, money supply, international events, and events in the United States and other financial markets.

We attempt to manage risk from changes in market interest rates, in part, by controlling the mix of interest rate sensitive assets and interest rate sensitive liabilities. However, interest rate risk management techniques are not exact and a rapid increase or decrease in interest rates could adversely affect our financial performance. In the event that one or more of these factors were to result in a decrease in our net interest income, we do not have significant sources of fee income to make up for decreases in net interest income.





***We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.***

The banking industry is heavily regulated, and such regulations are intended primarily for the protection of depositors and the federal deposit insurance fund, not shareholders. As a bank holding company, we are subject to regulation by the Federal Reserve. Our bank subsidiary is also regulated by the Federal Deposit Insurance Corporation, or FDIC, and is subject to regulation by the Pennsylvania Department of Banking and Securities and recently, by regulations promulgated by the Consumer Financial Protection Bureau (CFPB) as to consumer financial services and products. These regulations affect lending practices, capital structure, investment practices, dividend policy, and growth. In addition, we have non-bank operating subsidiaries from which we derive income. One of these non-bank subsidiaries, Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors, engages in providing investment management and insurance brokerage services, industries that are also heavily regulated on both a state and federal level. In addition, newly enacted and amended laws, regulations, and regulatory practices affecting the financial service industry may result in higher capital requirements, higher insurance premiums and limit the manner in which we may conduct our business. Such changes may adversely affect us, including our ability to offer new products and services, obtain financing, attract deposits, make loans and leases and achieve satisfactory spreads, and may also result in the imposition of additional costs on us. As a public corporation, we are also subject to the corporate governance standards set forth in the Sarbanes-Oxley Act of 2002, as well as any applicable rules or regulations promulgated by the SEC and The NASDAQ Stock Market, LLC.

Compliance with such current and potential regulation and scrutiny may significantly increase our costs, impede the efficiency of our internal business processes, affect retention of key personnel, require us to increase our regulatory capital, require us to invest significant management attention and resources and limit our ability to pursue business opportunities in an efficient manner.

***Additional requirements imposed by the Dodd-Frank Act could increase our costs of operations.***

The Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, has significantly changed the current bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, some of the details and impact of the Dodd-Frank Act may not yet be known. Our operating and compliance costs have materially increased and it is expected that the legislation and implementing regulations will continue to increase our operating and compliance costs.

The Dodd-Frank Act created the Consumer Financial Protection Bureau, or CFPB, as an independent bureau of the Federal Reserve with broad powers to supervise and enforce consumer protection laws. In addition, the CFPB has rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions,

including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB’s qualified mortgage rule, or “QM Rule,” became effective on January 10, 2014. The QM Rule is designed to clarify how lenders can manage the potential legal liability under the Dodd-Frank Act, which would hold lenders accountable for insuring a borrower’s ability to repay a mortgage. Loans that meet the definition of “qualified mortgage” will be presumed to have complied with the new ability-to-repay standard. The QM Rule and similar rules could limit the Bank’s ability to make certain types of loans or loans to certain borrowers, or could make it more expensive and time-consuming to make these loans, which could limit the Bank’s growth or profitability.

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments. It also provides that the listing standards of the national securities exchanges shall require listed companies to implement and disclose “clawback” policies mandating the recovery of incentive compensation paid to executive officers in connection with accounting restatements. The Dodd-Frank Act also directs the Federal Reserve to promulgate rules prohibiting excessive compensation paid to bank holding company executives. Compliance with these rules will likely increase our overall regulatory compliance costs and may have an adverse effect on our ability to recruit and retain executive officers for the Company and the Bank.

***We recently became subject to more stringent capital requirements.***

The Dodd-Frank Act required the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the Final Capital Rule, that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-Frank Act. Certain capital requirements mandated by the Final Capital Rule became effective January 1, 2015. The Final Capital Rule establishes a minimum common equity Tier I capital ratio of 6.5 percent of risk-weighted assets for a “well capitalized” institution and increases the minimum Tier I capital ratio for a “well capitalized” institution from 6 percent to 8 percent. Additionally, the Final Capital Rule requires an institution to maintain a 2.5 percent common equity Tier I capital conservation buffer over the 6.5 percent minimum risk-based capital requirement for “adequately capitalized” institutions, or face restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. For bank holding companies under \$15 billion in assets as of December 31, 2009, the Final Capital Rule permanently grandfathered trust preferred securities issued before May 19, 2010, subject to a limit of 25 percent of Tier I capital. The Final Capital Rule increases the required capital for certain categories of assets, including high-volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

***The soundness of other financial services institutions may adversely affect our credit risk.***

Our ability to engage in funding transactions could be adversely affected by the actions and failure of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual funds, and other institutional clients. As a result, defaults by, or even questions or rumors about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or other institutions. Many of these transactions expose us to operational and credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. Losses related to these credit risks could materially and

adversely affect our results of operations or earnings.

***We are required to make a number of judgments in applying accounting policies and different estimates and assumptions in the application of these policies could result in a decrease in capital and/or other material changes to our reports of financial condition and results of operations.***

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and reserve for unfunded lending commitments, the effectiveness of derivatives and other hedging activities, and the fair value of certain financial instruments (securities, derivatives, and privately held investments), income tax assets or liabilities (including deferred tax assets and any related valuation allowance), and share-based compensation. While we have identified those accounting policies that are considered critical and have procedures in place to facilitate the associated judgments, different assumptions in the application of these policies could result in a decrease to net income and, possibly, capital and may have a material adverse effect on our financial condition and results of operations.

From time to time, the Financial Accounting Standards Board, or FASB, and the SEC change the financial accounting and reporting guidance that governs the preparation of our financial statements. These changes are beyond our control, can be difficult to predict, and could materially impact how we report our financial condition and results of operations. We could be required to apply new or revised guidance retrospectively, which may result in the revision of prior financial statements by material amounts. The implementation of new or revised guidance could result in material adverse effects to our reported capital.

***We may elect or need to seek additional capital in the future, but that capital may not be available when needed.***

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. In the future, we may elect or need to raise additional capital. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed on acceptable terms. If we cannot raise additional capital when needed, our ability to expand our operations through internal growth or acquisitions could be materially impaired.

***Risks associated with system failures, interruptions, or breaches of security could negatively affect our earnings. Information technology systems are critical to our business.***

We use various technology systems to manage our client relationships, general ledger, securities investments, deposits, and loans. We have established policies and procedures to prevent or limit the impact of system failures, interruptions, and security breaches (including privacy breaches and cyber-attacks), but such events may still occur or may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter clients

from using our products and services. Although we take protective measures, the security of our computer systems, software, and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious code and cyber-attacks that could have an impact on information security.

In addition, we outsource a significant amount of our data processing to certain third-party providers. If these third-party providers encounter difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of their not providing us their services for any reason or their performing their services poorly, could adversely affect our ability to deliver products and services to our clients or otherwise conduct our business efficiently and effectively. Replacing these third party vendors could also entail significant delay and expense. Threats to information security also exist in the processing of client information through various other vendors and their personnel.

There have been increasing efforts on the part of third parties, including through cyber-attacks, to breach data security at financial institutions or with respect to financial transactions. There have been several recent instances involving financial services and consumer-based companies reporting the unauthorized disclosure of client or customer information or the destruction or theft of corporate data. In addition, because the techniques used to cause such security breaches change frequently, often are not recognized until launched against a target and may originate from less regulated and remote areas around the world, we may be unable to proactively address these techniques or to implement adequate preventative measures. The ability of our clients to bank remotely, including online and through mobile devices, requires secure transmission of confidential information and increases the risk of data security breaches.

The occurrence of any system failures, interruption, or breach of security could damage our reputation and result in a loss of clients and business thereby subjecting us to additional regulatory scrutiny, or could expose us to litigation and possible financial liability. Any of these events could have a material adverse effect on our financial condition and results of operations.

***Our controls and procedures may fail or could be circumvented.***

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures in order to ensure accurate financial control and reporting. Any system of controls, no matter how well designed and operated, can only provide reasonable, not absolute assurance that the objectives of the system are met. Any failure or circumvention of our controls and/or procedures could have a material adverse effect on our business and results of operation and financial condition.

***We may incur fines, penalties and other negative consequences from regulatory violations, possibly even inadvertent or unintentional violations.***

We maintain systems and procedures designed to ensure that we comply with applicable laws and regulations. However, some legal/regulatory frameworks provide for the imposition of fines or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though there was in place at the time systems and procedures designed to ensure compliance. For example, we are subject to regulations issued by the Office of Foreign Assets Control, or OFAC, that prohibit financial institutions from participating in the transfer of property belonging to the governments of certain foreign countries and designated nationals of those countries. OFAC may impose penalties for inadvertent or unintentional violations even if reasonable processes are in place to prevent the violations. There may be other negative consequences resulting from a finding of noncompliance, including restrictions on certain activities. Such a finding may also damage our reputation as described below and could restrict the ability of institutional investment managers to invest in our securities.



***The inability to hire or retain key personnel could adversely affect our business.***

Our success is dependent upon our ability to attract and retain highly skilled individuals. We face intense competition from various other financial institutions, as well as from non-bank providers of financial services, such as credit unions, brokerage firms, insurance agencies, consumer finance companies and government organizations, for the attraction and retention of key personnel, specifically those who generate and maintain our client relationships and serve in other key operation positions in the areas of finance, credit oversight and administration, and wealth management. These competitors may offer greater compensation and benefits, which could result in the loss of potential and/or existing substantial client relationships and may adversely affect our ability to compete effectively. The unexpected loss of services of one or more of these or other key personnel could have a material adverse impact on our business because of their skills, knowledge of the markets in which we operate, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

***Damage to our reputation could significantly harm our business, including our competitive position and business prospects.***

We are dependent on our reputation within our market area, as a trusted and responsible financial corporation, for all aspects of our relationships with clients, employees, vendors, third-party service providers, and others, with whom we conduct business or potential future business. Our ability to attract and retain clients and employees could be adversely affected if our reputation is damaged. Our actual or perceived failure to address various issues could give rise to reputational risk that could cause harm to us and our business prospects. These issues also include, but are not limited to, legal and regulatory requirements; properly maintaining client and employee personal information; record keeping; money-laundering; sales and trading practices; ethical issues; appropriately addressing potential conflicts of interest; and the proper identification of the legal, reputational, credit, liquidity and market risks inherent in our products. Failure to appropriately address any of these issues could also give rise to additional regulatory restrictions and legal risks, which could, among other consequences, increase the size and number of litigation claims and damages asserted or subject us to enforcement actions, fines and penalties and incur related costs and expenses.

***We continually encounter technological change, and we may have fewer resources than our competitors to continue to invest in technological improvements, which could reduce our ability to effectively compete.***

Our future success depends, in part, on our ability to effectively embrace technological efficiencies to better serve clients and reduce costs. Many of our competitors have substantially greater resources to invest in technological improvements. There can be no assurance that we will be able to effectively implement new technology-driven products and services, which could reduce our ability to effectively compete. Failure to keep pace with technological change could potentially have an adverse effect on our business operations and financial condition.



***Competition from other financial institutions in originating loans, attracting deposits and providing various financial services may adversely affect our profitability.***

Our banking subsidiary faces substantial competition in originating loans, both commercial and consumer. This competition comes principally from other banks, savings institutions, mortgage banking companies, and other lenders. Many of our competitors enjoy advantages over us, including greater financial resources and higher lending limits, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. This competition could reduce our net income by decreasing the number and size of loans that our banking subsidiary originates and the interest rates it may charge on these loans.

In attracting business and consumer deposits, our bank subsidiary faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of our competitors enjoy advantages over us, including greater financial resources, more aggressive marketing campaigns and better brand recognition and more branch locations. These competitors may offer higher interest rates than we do, which could decrease the deposits that we attract or require us to increase our rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect our ability to generate the funds necessary for lending operations. As a result, we may need to seek other sources of funds that may be more expensive to obtain and could increase our cost of funds.

Our banking and non-banking subsidiaries also compete with non-bank providers of financial services, such as brokerage firms, consumer finance companies, credit unions, insurance companies and governmental organizations which may offer more favorable terms. Some of our non-bank competitors are not subject to the same extensive regulations that govern our banking operations. As a result, such non-bank competitors may have advantages over our banking and non-banking subsidiaries in providing certain products and services. This competition may reduce or limit our margins on banking and non-banking services, reduce our market share, and adversely affect our earnings and financial condition.

***We may not be able to successfully maintain and manage our growth.***

We continue to execute on our acquisition and organic branching initiatives, which are intended to develop our branch infrastructure in a manner more consistent with the expansion of lending markets and to fill in and grow our branch footprint. As we continue to grow through our acquisitions, branching and other strategic initiatives, we cannot be certain as to our ability to manage increased levels of assets and liabilities. We may be required to make additional investments in equipment and personnel to manage higher asset levels and loans balances, which may adversely impact our efficiency ratio, earnings and shareholder returns.

***The financial impact and difficulties in integrating future acquisitions could adversely affect our business.***

The efficient and effective integration of any businesses we acquire into our organization is critical to the financial success of an acquisition transaction. Any future acquisitions involve numerous risks, including difficulties in integrating the culture, operations, technologies and personnel of the acquired companies, the diversion of management's attention from other business concerns and the potential loss of clients. Failure to successfully integrate the operations of any future acquisitions could also harm our business, results of operations and cash flows.

## Risks Related to Our Common Stock

*The market price of our common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.*

The market price of our common stock on the NASDAQ Global Market constantly changes. We expect that the market price of our common stock will continue to fluctuate and there can be no assurance about the market prices for our common stock.

Stock price volatility may make it difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond our control. These factors include, among others:

- actual or anticipated variations in quarterly results of operations or quality of our assets;
- recommendations by securities analysts;
- operating and stock price performance of other companies that investors deem comparable to us;
- any failure to pay dividends on our common stock or a reduction in cash dividends;
- continued levels of loan quality and volume origination;
- the adequacy of loan loss reserves;
- the willingness of clients to substitute competitors' products and services for our products and services and vice versa, based on price, quality, relationship or otherwise;
- interest rate, market and monetary fluctuations;
- declines in the fair value of our available-for-sale securities that are deemed to be other-than-temporarily impaired;
- the timely development of competitive new products and services by us and the acceptance of such products and services by clients;
- changes in consumer spending and saving habits relative to the financial services we provide;
- relationships with major clients;
- our ability to continue to grow our business internally and through acquisition and successful integration of new or acquired entities while controlling costs;
- news reports relating to trends, concerns and other issues in the financial services industry, including the failures of other financial institutions in the current economic downturn;
- perceptions in the marketplace regarding us and/or our competitors;
- rapidly changing technology, or new technology used, or services offered, by competitors;
- deposit flows;
- changes in accounting principles, policies and guidelines;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- changes in and compliance with laws and government regulations of federal, state and local agencies;
- geopolitical conditions such as acts or threats of terrorism or military conflicts;

failure to retain or attract key personnel;  
operating results that vary from the expectations of management, analysts and investors;  
future sales of our equity or equity-related securities;  
the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and  
developments with respect to financial institutions generally; and  
the relatively low trading volume of our common stock.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results as evidenced by the current volatility and disruption of capital and credit markets.

***The trading volume of our common stock may not provide adequate liquidity for investors and is less than that of other financial services companies.***

Our common stock is listed under the symbol “CVLY” on the NASDAQ Global Market. The average daily trading volume for shares of our common stock is less than larger financial institutions. As a result, sales of our common stock may place significant downward pressure on the market price of our common stock. Furthermore, it may be difficult for holders to resell their shares at prices they find attractive, or at all.

***We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing shareholders.***

In order to maintain our capital at desired or regulatory-required levels or to replace existing capital, we may be required to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. Generally, we are not restricted from issuing such additional shares. We may sell any shares that we issue at prices below the current market price of our common stock, and the sale of these shares may significantly dilute shareholder ownership. We could also issue additional shares in connection with acquisitions of other financial institutions or in connection with our equity compensation plans. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both.

***Offerings of debt and/or preferred equity securities may adversely affect the market price of our common stock.***

We may attempt to increase our capital resources or, if our or our subsidiary bank’s capital ratios fall below the required minimums, we could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings are likely to receive distributions of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

Our board of directors is authorized to issue one or more classes or series of preferred stock from time to time without any action on the part of the shareholders. Our board of directors also has the power, without shareholder approval, to set the terms of any such classes or series of preferred stock that may be issued, including voting rights, dividend rights, and preferences over our common stock with respect to dividends or upon our dissolution, winding up and liquidation and other terms. If we issue preferred stock in the future that has a preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.



***Our common stock is subordinate to our existing and future indebtedness and preferred stock, and effectively subordinated to all the indebtedness and other non-common equity claims against our subsidiaries.***

Shares of our common stock are equity interests in us and do not constitute indebtedness. As such, shares of our common stock rank junior to all of our indebtedness and to other non-equity claims against us and our assets available to satisfy claims against us, including in our liquidation. Additionally, holders of our common stock could be subject to the prior dividend and liquidation rights of holders of our preferred stock. Furthermore, our right to participate in a distribution of assets upon any of our subsidiaries' liquidation or reorganization is subject to the prior claims of that subsidiary's creditors.

We may attempt to increase our capital resources or, if our or the Bank's capital ratios fall below the required minimums, we could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust-preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings are likely to receive distributions of our available assets prior to the holders of our common stock.

We are currently authorized to issue up to 15,000,000 shares of common stock of which 8,426,873 shares were outstanding as of December 31, 2016, and up to 1,000,000 shares of preferred stock, none of which were outstanding as of December 31, 2016. Our board of directors has authority, without action or vote of the shareholders of common stock, to issue all or part of the authorized but unissued shares. Authorized but unissued shares of our common stock or preferred stock could be issued on terms or in circumstances that could dilute the interests of other shareholders.

***Regulatory and contractual restrictions may limit or prevent us from paying dividends or repurchasing, or we may choose not to pay dividends on or repurchase, our common stock.***

The Company is an entity separate and distinct from its principal subsidiary, PeoplesBank, and we derive substantially all of our revenue in the form of dividends from that subsidiary. Accordingly, we are and will be dependent upon dividends from PeoplesBank to pay the principal of and interest on our indebtedness, to satisfy our other cash needs and to pay dividends on our common and preferred stock. The Bank's ability to pay dividends is subject to its ability to earn net income and to meet certain regulatory requirements. In the event PeoplesBank is unable to pay dividends to us, we may not be able to pay dividends on our common or preferred stock. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors, including those of its depositors.

As described below in the next risk factor, the terms of our outstanding junior subordinated debt securities prohibit us from paying dividends on or repurchasing our common stock at any time when we have elected to defer the payment

of interest on such debt securities or certain events of default under the terms of those debt securities have occurred and are continuing. These restrictions could have a negative effect on the value of our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, as and if declared by our board of directors.

Although we have historically paid cash dividends on our common stock, we are not required to do so and our board of directors could reduce, suspend or eliminate our common stock cash dividend in the future. No determination has been made by our board of directors regarding whether or what amount of dividends will be paid in future quarters. Additionally, there can be no assurance that regulatory approval will be granted by the Federal Reserve Board to pay dividends. Future payment of cash dividends, if any, will be at the discretion of our board of directors and will be dependent upon our financial condition, results of operations, capital requirements and such other factors as the board may deem relevant and will be subject to applicable federal and state laws that impose restrictions on our and our bank subsidiary's ability to pay dividends, as well as guidance issued from time to time by regulatory authorities.

Under guidance issued by the Federal Reserve, as a bank holding company we are to consult the Federal Reserve before declaring dividends and are to strongly consider eliminating, deferring, or reducing dividends we pay to our shareholders if (1) our net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends, (2) our prospective rate of earnings retention is not consistent with our capital needs and overall current and prospective financial condition, or (3) we will not meet, or are in danger of not meeting, our minimum regulatory capital adequacy ratios.

***If we defer payments of interest on our outstanding junior subordinated debt securities or if certain defaults relating to those debt securities occur, we will be prohibited from declaring or paying dividends or distributions on, and from making liquidation payments with respect to, our common stock.***

As of December 31, 2016, we had outstanding approximately \$10,000,000 aggregate principal amount of junior subordinated debt securities issued in connection with the sale of trust preferred securities by certain of our subsidiaries that are statutory business trusts. We have also guaranteed those trust preferred securities. There are currently two separate series of these junior subordinated debt securities outstanding, each series having been issued under a separate indenture and with a separate guarantee. Each of these indentures, together with the related guarantee, prohibits us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock at any time when (i) there shall have occurred and be continuing an event of default under the indenture or any event, act or condition that with notice or lapse of time or both would constitute an event of default under the indenture; or (ii) we are in default with respect to payment of any obligations under the related guarantee; or (iii) we have deferred payment of interest on the junior subordinated debt securities outstanding under that indenture. In that regard, we are entitled, at our option but subject to certain conditions, to defer payments of interest on the junior subordinated debt securities of each series from time to time for up to five years.

Events of default under each indenture generally consist of our failure to pay interest on the junior subordinated debt securities outstanding under that indenture under certain circumstances, our failure to pay any principal of or premium on such junior subordinated debt securities when due, our failure to comply with certain covenants under the indenture, and certain events of bankruptcy, insolvency or liquidation relating to us or the Bank.



As a result of these provisions, if we were to elect to defer payments of interest on any series of junior subordinated debt securities, or if any of the other events described in clause (i) or (ii) of the first paragraph of this risk factor were to occur, we would be prohibited from declaring or paying any dividends on our common stock, from redeeming, repurchasing or otherwise acquiring any of our common stock, and from making any payments to holders of our common stock in the event of our liquidation, which would likely have a material adverse effect on the market value of our common stock. Moreover, without notice to or consent from the holders of our common stock, we may issue additional series of junior subordinated debt securities in the future with terms similar to those of our existing junior subordinated debt securities or enter into other financing agreements that limit our ability to purchase or to pay dividends or distributions on our capital stock, including our common stock.

***Our common stock is not insured by any governmental entity.***

Our common stock is not a deposit account or other obligation of any bank and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, any other governmental entity or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section and elsewhere in this document and our other filings with the SEC, and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

***Anti-takeover provisions and restrictions on ownership could negatively impact our shareholders.***

Provisions of federal and Pennsylvania law and our amended and restated articles of incorporation and bylaws could make it more difficult for a third party to acquire control of us or have the effect of discouraging a third party from attempting to acquire control of us. These provisions could make it more difficult for a third party to acquire us even if an acquisition might be in the best interest of our shareholders. In addition, the Bank Holding Company Act of 1956, as amended, or the BHCA, requires any bank holding company to obtain the approval of the Federal Reserve prior to acquiring more than 5 percent of our outstanding common stock. Any person other than a bank holding company is required to obtain prior approval of the Federal Reserve to acquire 10 percent or more of our outstanding common stock under the Change in Bank Control Act. Any holder of 25 percent or more of our outstanding common stock, other than an individual, is subject to regulation as a bank holding company under the BHCA.

Our articles of incorporation and bylaws contain certain provisions that may have the effect of deterring or discouraging an attempt to take control of the Company. Among other things, these provisions:

empower our board of directors, without shareholder approval, to issue shares of our preferred stock the terms of which, including voting power, are set by our board;

divide our board of directors into three classes serving staggered three year terms;  
authorize our board of directors to oppose a tender or other offer for the Company's securities if the board determines that such an offer should be rejected;  
require the affirmative vote of holders of at least 75 percent of the outstanding shares of our common stock to approve merger, consolidation, liquidation or dissolution of the Company, or any sale or other disposition of all or substantially all of the assets of the Company, excepting transactions described above that are approved by at least 80 percent of the members of the Board of Directors, where such transactions shall only require shareholder approval by a majority of the votes cast at the shareholders meeting;  
eliminate cumulative voting in the election of directors; and  
require advance notice of nominations for the election of directors and the presentation of shareholder proposals at meetings of shareholders.

**Item 1B: Unresolved Staff Comments**

Not applicable.

**Item 2: Properties**

Codorus Valley owns the Codorus Valley Corporate Center (“Corporate Center”), located at 105 Leader Heights Road, York, PA 17403, subject to a first lien held by ACNB Bank and a second lien held by its wholly owned subsidiary, PeoplesBank. The first lien held by ACNB Bank supports a \$3,000,000 line of credit. No draws have been made on the line and on December 31, 2016, the balance was zero. The second lien held by PeoplesBank totaled \$549,000 on December 31, 2016. 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 financial center and is approximately one half mile from PeoplesBank’s Administrative Services Center.

PeoplesBank owns and leases properties in York, Cumberland and Lancaster Counties, Pennsylvania and Baltimore, Carroll and Harford Counties and Baltimore City in Maryland as shown below.

	Owned	Leased	Total
Pennsylvania			
Financial Centers	11	8	19
Administrative Services Center	1	-	1
Other Property <sup>(1)</sup>	1	1	2
Maryland			
Financial Centers	3	4	7
Other Property <sup>(2)</sup>	-	1	1

<sup>(1)</sup> The other property located in Pennsylvania consists of a limited services facility located in Lancaster County and a maintenance facility for storage of maintenance equipment and other PeoplesBank items.

<sup>(2)</sup> The other property located in Maryland consists of a facility formerly used as an administrative office for Madison Federal Savings Bank, acquired as a result of the merger completed on January 16, 2015.

We believe that the above properties are adequate for the Corporation’s present levels of operation.

Item 3: Legal Proceedings

In the opinion of management, there are no legal proceedings pending against Codorus Valley 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 adverse proceedings known or contemplated by governmental authorities.

Item 4: Mine Safety Disclosures

Not applicable.



**PART II****Item 5: Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities****Market Information**

Codorus Valley Bancorp, Inc. common stock is listed on the NASDAQ Global Market under the symbol CVLY. Codorus Valley had approximately 2,232 holders of record as of March 1, 2017. The closing price per share of Codorus Valley's common stock on March 1, 2017, was \$26.41. 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. All amounts reflect the impact of the common stock dividends distributed by the Corporation.

Quarter	2016			2015		
	High	Low	Dividends Per Share	High	Low	Dividends Per Share
First	\$20.00	\$18.72	\$ 0.124	\$19.05	\$16.96	\$ 0.113
Second	20.79	18.82	\$ 0.124	19.79	17.43	\$ 0.113
Third	20.86	19.00	\$ 0.124	19.95	17.84	\$ 0.118
Fourth	29.34	19.99	\$ 0.124	20.10	18.37	\$ 0.118

**Dividend Policy**

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 9-Regulatory Matters in the notes to the consolidated financial statements.

On February 18, 2016, Codorus Valley redeemed the remaining \$12,000,000 of Series B preferred stock issued to the Treasury as reported on a Form 8-K filed February 19, 2016. Additional information about Series B preferred stock is disclosed in Note 10—Shareholders' Equity in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

The annualized dividend rate on the Series B preferred stock issued by Codorus Valley to the Treasury under the SBLF Program was 1 percent for the years ended December 31, 2015, 2014 and through the redemption date of February 18, 2016.

## 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 2000 Stock Incentive Plan, 2001 Employee Stock Bonus Plan, 2007 Long Term Incentive Plan and 2007 Employee Stock Purchase Plan, as adjusted for stock dividends distributed.

Plan Category	Equity Compensation Plan Information			
	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	217,369	\$ 14.52	255,626	(1)
Equity compensation plans not approved by security holders	0	0	18,241	(2)
Total	217,369	\$ 14.52	273,867	

(1) Includes 172,790 shares available for issuance under the 2007 Employee Stock Purchase Plan.

(2) Shares available for issuance under the 2001 Employee Stock Bonus Plan that provides for shares of common stock to employees as performance-based compensation. For a description of this plan, see Note 12 - Stock-Based Compensation, to the consolidated financial statements.

## Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The Corporation has a Share Repurchase Program (Program), which was authorized in 1995, and has been periodically amended, to permit the purchase of up to a maximum of 4.9 percent of the outstanding shares of the Corporation's common stock at a price per share no greater than 200 percent of the latest quarterly published book value. The U.S. Treasury's Small Business Lending Fund (SBLF) program imposed limits on the ability of the Corporation to repurchase shares of common stock if it failed to declare and pay quarterly dividends on the SBLF preferred stock. On February 18, 2016, Codorus Valley redeemed the remaining \$12,000,000 of Series B preferred stock issued to the Treasury as reported on a Form 8-K filed February 19, 2016; therefore, the limits previously imposed by the SBLF program are no longer applicable.

For the years ended December 31, 2016 and 2015, the Corporation did not acquire any of its common stock under the current repurchase program.

## Performance Graph

The following five-year performance graph compares the cumulative total shareholders return (including reinvestment of dividends) on Codorus Valley Bancorp, Inc.'s common stock to the S&P 500 Index and the ABA Community Bank NASDAQ Index. The stock performance graph assumes that \$100 was invested on December 31, 2011, and the cumulative return is measured as of each subsequent fiscal year end.

## Total Return Performance

Index	Period Ending					
	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Codorus Valley Bancorp, Inc.	\$100.00	\$196.01	\$274.18	\$296.68	\$329.95	\$499.25
S&P 500	100.00	116.00	153.57	174.60	177.01	198.18
ABA Community Bank Index(1)	100.00	115.33	160.59	165.10	177.40	241.24

(1) The ABA Community Bank Index is a market capitalization-weighted index, including banks and thrifts or their holding companies listed on The NASDAQ Stock Market as selected by the American Bankers Association (ABA).

## Item 6: Selected financial data

## Codorus Valley Bancorp, Inc.

	2016	2015	2014	2013	2012
<b>Summary of operations</b> (in thousands)					
Interest income	\$62,230	\$56,002	\$50,400	\$46,972	\$46,512
Interest expense	8,649	8,174	8,040	8,619	10,527
Net interest income	53,581	47,828	42,360	38,353	35,985
Provision for loan losses	3,000	3,500	1,600	1,470	1,750
Noninterest income	10,030	9,047	8,153	7,754	8,190
Noninterest expense	41,623	37,427	32,476	30,154	29,928
Income before income taxes	18,988	15,948	16,437	14,483	12,497
Provision for income taxes	5,886	4,813	4,668	3,917	3,103
Net income	13,102	11,135	11,769	10,566	9,394
Preferred stock dividends	16	120	174	250	384
Net income available to common shareholders	\$13,086	\$11,015	\$11,595	\$10,316	\$9,010
Per common share (adjusted for stock dividends)					
Net income, basic	\$1.56	\$1.68	\$1.88	\$1.88	\$1.67
Net income, diluted	\$1.55	\$1.67	\$1.84	\$1.84	\$1.65
Cash dividends paid	\$0.496	\$0.462	\$0.424	\$0.378	\$0.314
Stock dividends distributed	5	% 5	% 5	% 5	% 5
Book value	\$18.39	\$17.61	\$16.55	\$14.88	\$14.01
Tangible book value (1)	\$18.11	\$17.33	\$16.55	\$14.88	\$14.01
Cash dividend payout ratio	32.0	% 27.2	% 22.5	% 20.1	% 18.8
Weighted average shares outstanding	8,374,680	6,555,258	6,187,016	5,492,422	5,398,670
Weighted average diluted shares outstanding	8,446,361	6,625,865	6,295,404	5,602,141	5,472,396
Profitability ratios					
Return on average shareholders' equity (ROE)	8.47	% 8.94	% 10.22	% 10.08	% 9.55
Return on average assets (ROA)	0.88	% 0.82	% 0.98	% 0.96	% 0.90
Net interest margin	3.89	% 3.79	% 3.84	% 3.83	% 3.81
Efficiency ratio	64.09	% 64.60	% 62.83	% 63.01	% 65.65
Net overhead ratio	2.15	% 2.12	% 2.08	% 2.05	% 2.13
Capital ratios					
Common equity tier 1 ratio	11.88	% 12.56	n/a	n/a	n/a
Tier 1 risk-based capital	12.66	% 14.49	% 13.24	% 12.79	% 13.59
Total risk-based capital	13.81	% 15.60	% 14.42	% 13.89	% 14.79
Average shareholders' equity to average assets	10.44	% 9.15	% 9.62	% 9.57	% 9.45

**Summary of financial condition at year-end** *(in thousands)*

Investment securities	\$201,665	\$218,498	\$216,973	\$233,483	\$236,925
Loans	1,272,319	1,123,775	920,554	859,898	740,225
Assets	1,611,587	1,456,334	1,213,846	1,150,641	1,059,737
Deposits	1,264,177	1,094,149	954,973	925,303	901,307
Borrowings	181,947	194,820	132,590	110,856	50,171
Equity	154,957	159,141	118,440	107,649	101,331
Other data					
Full service financial centers	26	24	21	20	18
Number of employees <i>(full-time equivalents)</i>	306	282	238	229	219
Wealth Management assets, market value <i>(in thousands)</i>	\$562,865	\$514,728	\$307,000	\$261,044	\$329,626

(1) Book value less goodwill and core deposit intangibles

## **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 Form 10-K. 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 are used in this Form 10-K, management is making forward-looking statements.

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 Form 10-K. These factors include, but are not limited to, the following:

- Operating, legal and regulatory risks;
- Credit risk, including an increase in nonperforming assets requiring loss provisions and the incurrence of carrying costs related to nonperforming assets;
- Interest rate fluctuations which could increase our cost of funds or decrease our yield on earning assets and therefore reduce our net interest income;

- Declines in the market value of investment securities considered to be other-than-temporary;
- Unavailability of capital when needed or availability at less than favorable terms;
- Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of our computer systems or otherwise, may adversely affect the Corporation’s operations, net income or reputation;
- Inability to achieve merger-related synergies, and difficulties in integrating the business and operations of acquired institutions;
- A prolonged economic downturn;
- Political and competitive forces affecting banking, securities, asset management and credit services businesses;
- The effects of and changes in the rate of FDIC premiums, including special assessments;



Future legislative or administrative changes to U.S. governmental capital programs;

Enacted financial reform legislation, e.g., Dodd-Frank Wall Street Reform and Consumer Protection Act, may have a significant impact on the Corporation's business and results of operations; 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 in the notes to the consolidated financial statements included in this Form 10-K. 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 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. There is also the potential for adjustment to the allowance for loan losses as a result of regulatory examinations.

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 and impaired 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. 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 exists. 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 disclosures 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 37 and 55 of this report.

## **FINANCIAL HIGHLIGHTS**

### **Executive Summary**

The Corporation's net income available to common shareholders (earnings) was \$13,086,000 for the full year 2016, compared to \$11,015,000 of earnings in 2015, an increase of \$2,071,000 or 19 percent.

Net interest income for 2016 increased \$5,753,000 or 12 percent when compared to 2015, primarily due to an increase in the volume of commercial loans.

Net interest margin (tax-equivalent basis) for 2016 was 3.89 percent, compared to 3.79 percent for 2015. The Corporation continues to have success in growing low cost core deposits, while maintaining reasonable yields on new loan growth in a highly competitive, low interest rate environment. The average yield on earning assets increased to 4.51 percent in 2016 as compared to 4.43 percent in 2015 and the cost of interest-bearing liabilities increased slightly to 0.76 percent in 2016, as compared to 0.75 percent in 2015.

The loan loss provision for 2016 decreased \$500,000 compared to 2015, primary due to a reduction in net charge-offs in 2016 as compared to the prior year.

Noninterest income for 2016, excluding gains on sales of investment securities, increased \$1,281,000 or 15 percent when compared to 2015, primarily due to increases in trust fees, income from mutual fund, annuity and insurance sales, service fees on deposits, income from bank owned life insurance, other income and gains on sales of loans held for sale. Gains on sales of investment securities for 2016 decreased \$298,000 when compared to 2015.

Noninterest expense for 2016 increased \$4,196,000 or 11 percent above 2015. Personnel, costs associated with other real estate owned, external data processing, debit card processing and marketing expenses accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the expansion of our business and consumer banking services in our Maryland and Pennsylvania markets.

The provision for income taxes for 2016 increased \$1,073,000 above the income tax provision for 2015, primarily due to an increase in pre-tax net income and a slight decrease in the amount of tax-exempt income when compared to 2015.

Preferred stock dividends for 2016 compared to 2015 decreased \$104,000. In February 2016, the Corporation redeemed the remaining \$12,000,000 in outstanding shares of preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program (SBLF Program).

Earnings per share was \$1.56 basic and \$1.55 diluted for 2016 compared to \$1.68 basic and \$1.67 diluted for 2015. The decrease is primarily a result of the issuance of 1,746,850 of common shares in the \$34,500,000 public offering completed in December 2015.

On December 31, 2016, total assets were approximately \$1.61 billion, representing an 11 percent increase compared to December 31, 2015. The growth for 2016 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. In December 2015, the Corporation raised approximately \$32,500,000 in capital from the net proceeds of a public offering of common stock of 1,746,850 shares as previously reported on Form 8-Ks filed on December 15, 2015 and December 23, 2015.

The closing price for the Corporation's common stock (NASDAQ: CVLY) was \$28.60 per share on December 31, 2016, compared to \$19.37 per share on December 31, 2015, as adjusted. Cash dividends paid on common shares for the year 2016 totaled \$0.496 per share, as adjusted for stock dividends, representing an increase of \$0.034 or 7 percent above the cash dividends of \$0.462, as adjusted, paid in 2015. Also, the Corporation distributed a 5 percent common stock dividend on December 13, 2016. The **Selected Financial Data** schedule, located on page 29 of this report, provides a summary of operations and performance metrics for the past five years in a comparative format.

### **Year Ended December 31, 2016 vs. Year Ended December 31, 2015**

The full year 2016 net income available to common shareholders of \$13,086,000 represents an increase of \$2,071,000 compared to the full year 2015 earnings of \$11,015,000. Earnings per share was \$1.56 basic and \$1.55 diluted for 2016 compared to \$1.68 basic and \$1.67 diluted for 2015. The decrease is primarily a result of the issuance of 1,746,850 of common shares in the \$34,500,000 public offering completed in December 2015. The Corporation used the funds from the public offering to redeem the remaining \$12,000,000 of shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, as reported on a Form 8-K filed on February 19, 2016. In addition, approximately \$19,800,000 of the net proceeds were invested in the Corporation's Bank subsidiary PeoplesBank and the remaining proceeds were used for general corporate purposes.

Net interest income, which totaled \$53,581,000 for the year ended December 31, 2016, represented an increase of \$5,753,000 or 12 percent above net interest income of \$47,828,000 for 2015. The growth in net interest income reflects the increased volume of interest-earning assets, primarily commercial loans; however, the additional interest income from this new loan volume was partially offset by increased costs associated with the growth in core deposits and higher long-term borrowing costs.

The loan loss provision for 2016 totaled \$3,000,000 as compared to the loan loss provision of \$3,500,000 for 2015, a decrease of \$500,000. The decrease in the provision was primarily a result of a reduction in net charge-offs of \$1,246,000 in 2016 compared to 2015. The allowance for loan losses as a percentage of total period-end loans was 1.18 percent and 1.13 percent as of December 31, 2016 and 2015, respectively. The increased allowance for loan losses reflected both the overall commercial loan growth for 2016, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

Noninterest income, excluding gains on sales of investment securities, for the year ended December 31, 2016, totaled \$9,836,000 representing an increase of \$1,281,000 or 15 percent compared to noninterest income of \$8,555,000 for 2015. Specific noninterest income increases included trust fees, income from mutual fund, annuity and insurance sales, service fees on deposits, income from bank owned life insurance and gains on sales of loans held for sale. Gains on sales of investment securities for 2016 decreased \$298,000 when compared to 2015.

Noninterest expense for the year ended December 31, 2016, totaled \$41,623,000 representing an increase of \$4,196,000 or 11 percent compared to \$37,427,000 for 2015. Higher costs associated with: personnel, other real estate owned, external data processing, debit card processing and marketing expenses, accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the expansion of our business and consumer banking services in our Maryland and Pennsylvania markets.

The provision for income taxes for 2016 totaled \$5,886,000 which was \$1,073,000 or 22 percent above the provision for income taxes for 2015 of \$4,813,000. The increase was due to higher pre-tax net income and a slight decrease in the amount of tax-exempt income.

Preferred stock dividends for 2016 were \$16,000, a decrease of \$104,000, compared to \$120,000 in 2015. The preferred stock dividend rate for both years was 1 percent. On February 18, 2016, as reported on a Form 8-K filed on February 19, 2016, the Corporation redeemed the remaining \$12,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, resulting in the reduction in dividends expense for the year.

On December 31, 2016, total assets were \$1.61 billion, representing an 11 percent increase compared to total assets of \$1.46 billion as of December 31, 2015. Asset growth for 2016 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The growth in core deposits included a \$37,694,000 increase in the average balance of noninterest bearing deposits for 2016 as compared to 2015. Growing core deposits remains a particular focus of the Corporation because the rates paid for such deposits are low, transactional activity on these deposits are a source of fee income, and a core deposit relationship provides the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

Cash dividends paid on common shares for the year 2016 totaled \$0.496 per share, as adjusted for stock dividends, representing an increase of \$0.034 or 7 percent above the cash dividends of \$0.462, as adjusted, paid for the year 2015.

The Corporation distributed a 5 percent common stock dividend on December 13, 2016, the same common stock dividend percentage that was distributed in December 2015.

As a result of profitable operations and the public offering of common stock as previously reported on Form 8-Ks filed on December 15, 2015 and December 23, 2015, the Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Table 9 - Capital Ratios, following, shows that both the Corporation and PeoplesBank were well capitalized for all periods presented.

#### **Year Ended December 31, 2015 vs. Year Ended December 31, 2014**

The full year 2015 net income available to common shareholders of \$11,015,000 represents a decrease of \$580,000 compared to the full year 2014 earnings of \$11,595,000. Earnings per share was \$1.68 basic and \$1.67 diluted for 2015 compared to \$1.88 basic and \$1.84 diluted for 2014. The decrease is due to the reduction in the net income available to common shareholders, and to a lesser extent, the dilutive impact of the Corporation's issuance of 650,000



common shares in the private placement completed in the first quarter of 2014. The Corporation used the funds from the private placement to redeem \$13,000,000 of the \$25,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program.

Net interest income, which totaled \$47,828,000 for the year ended December 31, 2015, represented an increase of \$5,468,000 or 13 percent above net interest income of \$42,360,000 for 2014. The growth in net interest income reflects the increased volume of interest-earning assets, primarily commercial loans; however, the additional interest income from this new loan volume was partially offset by increased funding costs associated with the Corporation obtaining additional long-term borrowings, as loan growth outpaced deposit growth during the year.

The loan loss provision for 2015 totaled \$3,500,000 as compared to the loan loss provision of \$1,600,000 for 2014, contributing to an increase in allowance for loan losses from \$11,162,000 at December 31, 2014, to \$12,704,000 at December 31, 2015. The allowance for loan losses as a percentage of total period-end loans was 1.13 percent and 1.21 percent as of December 31, 2015 and 2014, respectively. The increased allowance for loan losses reflected both the overall commercial loan growth for 2015, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

Noninterest income for the year ended December 31, 2015, totaled \$9,047,000 representing an increase of \$894,000 or 11 percent compared to noninterest income of \$8,153,000 for 2014. Specific noninterest income increases included trust fees, income from mutual fund, annuity and insurance sales, service fees on deposits, and gains on sales of loans held for sale.

Noninterest expense for the year ended December 31, 2015, totaled \$37,427,000 representing an increase of \$4,951,000 or 15 percent compared to \$32,476,000 for 2014. Personnel and facility costs accounted for the majority of the increase, reflecting additional compensation, benefits, and occupancy expenses supporting expanded business banking and retail banking activities in the Maryland financial centers from the Madison acquisition, and the two financial centers in Shrewsbury, PA and Camp Hill, PA opened after the third quarter of 2014.

The provision for income taxes for 2015 totaled \$4,813,000 which was \$145,000 or 3 percent above the provision for income taxes for 2014 of \$4,668,000. While pre-tax income was lower in 2015, the increase is primarily due to a reduction in the amount of tax-exempt income.

Preferred stock dividends for 2015 were \$120,000, a decrease of \$54,000, compared to \$174,000 in 2014. The preferred stock dividend rate for both years was 1 percent. On May 30, 2014, as reported on a Form 8-K filed on the same date, the Corporation redeemed \$13,000,000 of \$25,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, resulting in the reduction in dividends expense for the year.

On December 31, 2015, total assets were \$1.46 billion, representing a 20 percent increase compared to total assets of \$1.21 billion as of December 31, 2014. Asset growth for 2015 occurred primarily in the commercial loan portfolio and was funded by increases in core deposits and low-rate advances from the Federal Home Loan Bank of Pittsburgh, as well as the loans added as a result of the acquisition of Madison Bancorp, Inc. in January 2015.

The growth in core deposits included a \$28,000,000 increase in the average balance of noninterest bearing deposits for 2015 as compared to 2014, including \$6,600,000 of core deposits from the Madison acquisition. Growing core deposits remains a particular focus of the Corporation because the rates paid for such deposits are low, transactional

activity on these deposits are a source of fee income, and a core deposit relationship provides the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

Cash dividends paid on common shares for the year 2015 totaled \$0.462 per share, as adjusted for stock dividends, representing an increase of \$0.038 or 9 percent above the cash dividends of \$0.424, as adjusted, paid for the year 2014.

The Corporation distributed a 5 percent common stock dividend on December 8, 2015, the same common stock dividend percentage that was distributed in December 2014.

As a result of profitable operations and the public offering of common stock as previously reported on Form 8-Ks filed on December 15, 2015 and December 23, 2015, the Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Table 9 - Capital Ratios, following, shows that both the Corporation and PeoplesBank were well capitalized for all periods presented.

## **INCOME STATEMENT ANALYSIS**

### **Net Interest Income**

The Corporation's principal source of revenue is net interest income, which is the difference between (i) interest income on earning assets, primarily loans and investment securities, and (ii) interest expense incurred on deposits and borrowed funds. Fluctuations in net interest income are caused by changes in both interest rates, and the volume and composition of interest rate sensitive assets and liabilities. Unless otherwise noted, this section discusses interest income and interest expense amounts as reported in the Consolidated Statements of Income, which are not presented on a tax equivalent basis.

Net interest income for the year ended December 31, 2016, was \$53,581,000, an increase of \$5,753,000 or 12 percent above the full year 2015 net interest income. The increase was supported by a 9 percent increase in the average volume of interest-earning assets, primarily commercial loans. The additional interest income from the increased loan volume was partially offset by the costs associated with the growth in core deposits and higher long-term borrowing costs. The net interest margin, which reflects net interest income on a tax-equivalent basis as a percentage of average interest-earning assets, was 3.89 percent for 2016, compared to 3.79 percent for 2015.

Interest income for the full year 2016 totaled \$62,230,000, an increase of \$6,228,000 or 11 percent above 2015. The increase in total interest income was driven by a growth in the average volume of loans which was partially offset by a decrease in the average volume and yield on investment securities. Interest earning assets averaged \$1.40 billion and yielded 4.51 percent (tax equivalent basis) for 2016, compared to \$1.29 billion and a tax-equivalent yield of 4.43 percent, respectively, for 2015.

Interest expense for the full year 2016 totaled \$8,649,000, an increase of \$475,000 or 6 percent above 2015. The increase in total interest expense was primarily driven by an increase in volume and rate in core deposits (the Corporation defines core deposits as demand, savings, and money market deposits) and an increase in the rate paid on long-term borrowings. Interest expense on deposits increased \$372,000 or 6 percent for 2016 compared to 2015 and was primarily attributed to the increase in interest bearing core deposits. The average volume of interest bearing core deposits was \$581,565,000 for the full year 2016, a \$70,630,000 or 14 percent increase above the average volume for 2015. Interest expense on long-term debt increased \$136,000 or 8 percent for 2016. The average rate paid on

long-term borrowings in 2016 was 1.65 percent an increase from the average rate paid of 1.55 percent in 2015. Long-term debt is comprised of advances from the Federal Home Loan Bank of Pittsburgh, with intermediate term bullet maturities that supplement deposit funding and provide a partial funding hedge against rising market interest rates.

Tables 1 and 2, following, are presented on a tax-equivalent basis to make it easier to compare taxable and tax-exempt assets. Interest on tax-exempt assets (which include securities issued by, or loans made to, state and local governments) is adjusted based upon a 34 percent federal income tax rate.

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

(dollars in thousands)	2016			2015			2014		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
Assets									
Interest bearing deposits with banks	\$27,415	\$142	0.52 %	\$39,671	\$103	0.26 %	\$25,336	\$63	0.25 %
Investment securities:									
Taxable	129,353	2,759	2.13	146,356	3,337	2.28	150,232	3,611	2.40
Tax-exempt	70,497	2,355	3.34	66,936	2,482	3.71	74,579	2,913	3.91
Total investment securities	199,850	5,114	2.56	213,292	5,819	2.73	224,811	6,524	2.90
Loans:									
Taxable (1)	1,157,918	57,216	4.94	1,016,751	50,249	4.94	867,122	44,151	5.09
Tax-exempt	18,869	794	4.21	21,072	969	4.60	18,754	926	4.94
Total loans	1,176,787	58,010	4.93	1,037,823	51,218	4.94	885,876	45,077	5.09
Total earning assets	1,404,052	63,266	4.51	1,290,786	57,140	4.43	1,136,023	51,664	4.55
Other assets (2)	77,794			70,201			60,721		
Total assets	\$1,481,846			\$1,360,987			\$1,196,744		
Liabilities and Shareholders' Equity									
Deposits:									
Interest bearing demand	\$505,903	\$1,935	0.38 %	\$441,948	\$1,517	0.34 %	\$390,417	\$1,352	0.35 %
Savings	75,662	75	0.10	68,987	69	0.10	41,485	71	0.17
Time	413,876	4,657	1.13	424,885	4,709	1.11	410,917	5,245	1.28
Total interest bearing deposits	995,441	6,667	0.67	935,820	6,295	0.67	842,819	6,668	0.79
Short-term borrowings	31,129	162	0.52	39,649	195	0.49	33,744	170	0.50
Long-term debt	110,201	1,820	1.65	108,361	1,684	1.55	81,164	1,202	1.48
Total interest bearing liabilities	1,136,771	8,649	0.76	1,083,830	8,174	0.75	957,727	8,040	0.84
Noninterest bearing deposits	181,534			143,840			115,982		
Other liabilities	8,880			8,796			7,859		
Shareholders' equity	154,661			124,521			115,176		

Total liabilities and shareholders' equity	\$ 1,481,846	\$ 1,360,987	\$ 1,196,744
Net interest income (tax equivalent basis)	\$ 54,617	\$ 48,966	\$ 43,624
Net interest margin (3)	3.89 %	3.79 %	3.84 %
Tax equivalent adjustment	(1,036 )	(1,138 )	(1,264 )
Net interest income	\$ 53,581	\$ 47,828	\$ 42,360

(1) Average balance includes average nonaccrual loans of \$2,692,000 in 2016, \$7,145,000 in 2015, and \$10,615,000 in 2014. Interest includes net loan fees of \$3,370,000 in 2016, \$2,067,000 in 2015, and \$1,973,000 in 2014.

(2) Average balance includes average bank owned life insurance, foreclosed real estate and unrealized holding gains (losses) on investment securities.

(3) Net interest income (tax equivalent basis) annualized as a percent of average interest earning assets.

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

(dollars in thousands)	2016 vs. 2015			2015 vs. 2014		
	Increase (decrease) due to change in		Net	Increase (decrease) due to change in		Net
	Volume	Rate		Volume	Rate	
Interest Income						
Interest bearing deposits with banks	\$(32 )	\$71	\$39	\$36	\$4	\$40
Investment securities:						
Taxable	(414 )	(164 )	(578 )	(98 )	(176 )	(274 )
Tax-exempt	132	(259 )	(127 )	(298 )	(133 )	(431 )
Loans:						
Taxable	8,398	(1,431)	6,967	7,723	(1,625)	6,098
Tax-exempt	(102 )	(73 )	(175 )	115	(72 )	43
Total interest income	7,982	(1,856)	6,126	7,478	(2,002)	5,476
Interest Expense						
Deposits:						
Interest bearing demand	209	209	418	201	(36 )	165
Savings	7	(1 )	6	47	(49 )	(2 )
Time	(122 )	70	(52 )	178	(714 )	(536 )
Short-term borrowings	(47 )	14	(33 )	32	(7 )	25
Long-term debt	28	108	136	385	97	482
Total interest expense	75	400	475	843	(709 )	134
Net interest income	\$7,907	\$(2,256)	\$5,651	\$6,635	\$(1,293)	\$5,342

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 cover estimated losses attributable to uncollectable 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 Table 10 – Nonperforming Assets, Table 11 – Analysis of Allowance for Loan Losses, and Table 12 – Allocation of Allowance for Loan Losses, provides detailed information about the allowance for loan losses, the loan loss provision, and credit risk.

For the year 2016, the provision for loan losses was \$3,000,000, which was \$500,000 or 14 percent lower, compared to a provision of \$3,500,000 in 2015. The decreased provision for loan losses was impacted by a reduction in net charge-offs in 2016 of \$1,246,000. The provision for both periods supported adequate allowance for loan loss



coverage, including the Corporation's substantial growth in commercial loans, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

**Noninterest Income**

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

**Table 3 - Noninterest income**

(dollars in thousands)	2016	2015	2014
Trust and investment services fees	\$2,541	\$2,411	\$2,223
Income from mutual fund, annuity and insurance sales	870	810	648
Service charges on deposit accounts	3,696	3,406	2,968
Income from bank owned life insurance	861	694	714
Other income	898	567	630
Net gain on sales of loans held for sale	970	667	452
Gain on sales of securities	194	492	518
Total noninterest income	\$10,030	\$9,047	\$8,153

For the year 2016, the overall \$983,000 or 11 percent increase in total noninterest income, compared to the year 2015, was primarily the result of increases in trust fees, income from mutual fund, annuity and insurance sales, service fees on deposit, income from bank owned life insurance, and gains on sales of loans held for sale. The discussion that follows addresses changes in selected categories of noninterest income.

***Trust and investment services fees***—The upward trend in trust and investment services fee income over the three year period presented was due to growth in trust assets under management from both new accounts, and appreciation in the market value of managed accounts, upon which some fees are based.

***Income from mutual fund, annuity and insurance sales***—The upward trend in income from mutual fund, annuity and insurance sales over the three year period was due primarily to an increase in the assets under management from sales of non-deposit investment products, and the addition of a new large retirement plan client during the third quarter of 2015. The non-deposit investment products are sold by PeoplesBank's subsidiaries Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors.

***Service charges on deposit accounts***—For the year 2016, the \$290,000 or 9 percent increase in service charge income compared to the year 2015 was due to an increase in the volume of demand deposit accounts subject to fees and debit card transactions, as well as fee schedule increases implemented during the first quarter of 2015. For the year 2015, the \$438,000 or 15 percent increase in service charge income compared to the year 2014 was due to both (1) an increase in the volume of demand deposit accounts subject to fees, including deposit accounts assumed in the Madison

acquisition in January 2015, and (ii) planned increases on certain service charge categories which were implemented during the first quarter of 2015.

***Income from bank owned life insurance (BOLI)***—For the year 2016, the \$167,000 or 24 percent increase in income from BOLI compared to 2015 was primarily due to additional investments totaling \$6,987,000 during 2016. For the year 2015, the decrease of \$20,000 or 3 percent compared to 2014 was a result of downward trends in policy yields.

***Net gain on sales of loans held for sale***—The upward trend in net gains from the sale of loans held for sale is primarily due to a favorable trend of fixed-rate residential mortgage loan originations and sales.

**Net gain on sales of securities**—For the year 2016, the Corporation realized \$194,000 in gains on sales of securities compared to \$492,000 and \$518,000 for the full years 2015 and 2014, respectively. For the years 2016 and 2015, securities sold included those where market pricing for certain instruments provided a favorable total return upon the sales and reinvestment of proceeds, versus holding the respective securities to maturity. In addition, sales in 2016 provided cash to meet short-term liquidity needs. For the year 2014, securities sold included securities which had appreciated in value due to the low-yield interest rate environment. The gains on sales of securities in 2015 and 2014 substantially offset the impact of the non-recurring merger related noninterest expenses associated with the Corporation's acquisition of Madison Bancorp, Inc.

### 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)	2016	2015	2014
Personnel	\$24,187	\$21,317	\$18,025
Occupancy of premises, net	3,259	3,185	2,089
Furniture and equipment	2,801	2,685	2,251
Postage, stationery and supplies	676	683	741
Professional and legal	732	896	758
Marketing	1,518	1,286	1,295
FDIC insurance	606	712	663
Debit card processing	1,127	884	790
Charitable donations	1,079	986	1,134
Telephone	749	702	570
External data processing	1,455	1,154	878
Merger related	0	474	533
Foreclosed real estate including provision for (recovery of) losses	157	(422 )	425
Other	3,277	2,885	2,324
Total noninterest expense	\$41,623	\$37,427	\$32,476

Total noninterest expense for the year 2016 increased \$4,196,000 or 11 percent above the year 2015, reflecting the overall expansion of our business and consumer banking services in our Maryland and Pennsylvania markets. The discussion that follows addresses changes in selected noninterest expenses.

**Personnel**—The upward trend in personnel expense was due largely to an increase in wage and benefit costs resulting from planned staff additions to support our expanded business and consumer banking services in Maryland and

Pennsylvania. Also contributing to the increase is a higher cost of health insurance. Additionally, in 2015 personnel expense includes an accrual of \$250,000 for the employment agreement expense related to the separation of the Corporation's former Chief Operating Officer as reported on the Form 8-K filed on March 31, 2015.

**Occupancy of premises, net**— Occupancy of premises expense is comprised of rent, depreciation, maintenance, insurance, real estate taxes and utilities. The level of expense can vary annually based upon franchise expansion, repairs and maintenance, and normal business growth. The upward trend was due primarily to the addition of ten financial centers (eight full service and two limited service) to the Corporation since the third quarter of 2014, including four financial centers from the Madison acquisition and a new administrative services center near the Corporation's headquarters in York, PA.

**Furniture and equipment**—The upward trend in furniture and equipment expense was in alignment with the increased personnel expense, as additional furniture, computer hardware and software (and related depreciation and maintenance expenses) were incurred to support new staff from both business growth, the Madison acquisition in 2015, the addition of the new financial centers and administrative services center noted above. During 2014, expenditures were made for planned information system hardware and storage upgrades.

**Postage, stationary and supplies**—The level of postage, stationary and supplies can vary based on franchise expansion, postage rate changes, marketing promotions and in 2014, costs associated with new stationary reflecting the Corporation's updated branding and PeoplesBank's 150 year in business.

**Professional and legal**—The level of professional and legal expense can fluctuate annually based on the varying needs for legal, accounting and consulting services, which is driven in part by the level of routine lawsuits in the ordinary course of business and the number and complexity of corporate initiatives.

**Marketing**— The upward trend in marketing expense reflects an increased operating budget to support normal business growth, and corporate initiatives such as branding, product advertising and internal promotions. In 2016, marketing expense included initial costs associated with the acquisition of the naming rights to PeoplesBank Park, the facility that houses the York, Pennsylvania-based York Revolution independent league baseball team.

**FDIC insurance**—The \$106,000 or 15 percent decrease in FDIC insurance for 2016 as compared to 2015 was a result of a lower assessment rate due to PeoplesBank's improved financial performance and credit quality and a change in the assessment methodology effective with the third quarter 2016. For 2015 and 2014, the upward trend in FDIC insurance was primarily a result in growth in the average balance of assets less average tangible capital.

**Debit card processing**—The upward trend in debit card processing reflects a continual increase in higher debit card transaction volume, due primarily to the increased number of demand deposit accounts and debit cards, including those related to the Madison acquisition in 2015.

**Charitable donations**—The level of charitable donations can fluctuate annually due to the timing of payment and the availability of the state tax credits. Some donations to nonprofit organizations qualify for related state tax credits that typically range from 55 to 90 percent of the amount donated, effectively lowering the cost of the donation. PeoplesBank uses state tax credits from donations to reduce its Pennsylvania bank shares tax expense which is included in other expenses.

**Telecommunications**— The upward trend was due primarily to the addition of ten financial centers (eight full service and two limited service facilities) to the Corporation since the third quarter of 2014, including four financial centers from the Madison acquisition and a new administrative services center near the Corporation's headquarters in York, PA.

**External data processing**—The upward trend in external data processing reflects increased reliance on outsourcing transaction processing to specialized vendors, which is typically performed on their hosted and secure websites, thereby increasing the Corporation's data processing efficiency. Additional expenditures related to expansion in the electronic banking services offered to our client base, and charges for higher transaction volume from normal business growth and the Madison acquisition.

**Merger related**— The \$474,000 in 2015 and \$533,000 in 2014 of merger related expenses were associated with the Corporation's acquisition of Madison Bancorp, Inc. (the acquisition was completed on January 16, 2015, as disclosed on a Form 8-K filed on the same date). In 2015, acquisition-related expenses included external data processing conversion costs, severance payments, acquisition accounting services and legal expenses. In 2014, pre-acquisition expenses included investment banking fees, legal expenses, and external data processing conversion costs.

**Foreclosed real estate including (recovery of) provision for losses**—The \$579,000 or 369 percent increase in foreclosed real estate expenses compared to 2015 was primarily a result of 2015 including a partial recovery of a previous valuation allowance of \$746,000 on a large foreclosed real estate property. A downward trend in the volume of foreclosed assets held resulted in a reduction year-over-year holding costs including real estate taxes, property maintenance, appraisal fees, and provision for losses.

**Other expenses** —Other expense, comprised of many underlying expenses, increased \$392,000 or 14 percent in 2016 as compared to 2015 reflecting additional costs associated with the Pennsylvania Department of Banking and Securities' annual assessment, annual shareholder meeting, Pennsylvania bank shares tax and impaired loans. In 2015, other expenses increased \$561,000 or 24 percent reflecting the costs of several activities including the inception of corporate-wide seminars supporting expansion of revenue generation activities, as well as increased costs associated with franchise expansion, such as insurance, employee training and travel, and courier services.

### **Provision for Income Taxes**

The provision for income taxes for 2016 totaled \$5,886,000, which was \$1,073,000 or 22 percent above the provision for income taxes for 2015 of \$4,813,000. The increase was primarily due to higher pre-tax net income. For both years, the Corporation's incremental statutory federal income tax rate was 35 percent; however, the Corporation's effective income tax rate was approximately 31 percent for 2016, compared to 30 percent for 2015. The effective tax rate differs from the statutory tax rate due to the impact and volume of tax-exempt income, including income from bank owned life insurance and certain municipal securities and loans.

### **Preferred Stock Dividends**



Preferred stock dividends for 2016 were \$16,000, a decrease of \$104,000 compared to \$120,000 of preferred stock dividends in 2015. On February 18, 2016, as reported on a Form 8-K filed on February 19, 2016, the Corporation redeemed the remaining \$12,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, resulting in the reduction in dividends expense for the year. Information about the SBLF Program is provided in Note 10—Shareholders' Equity, to the consolidated financial statements. The preferred stock dividend rate for both 2016 and 2015 was 1 percent of the amount of the average preferred stock outstanding, paid quarterly to the U.S. Treasury.

**BALANCE SHEET REVIEW****Interest Bearing Deposits with Banks**

Interest bearing deposits with banks totaled \$54,966,000 on December 31, 2016, compared to \$44,496,000 on December 31, 2015. The increase was primarily a result of the strong growth in deposits which were used to fund new loans, principally commercial loans.

**Investment Securities (Available-for-Sale)**

The Corporation's entire investment securities portfolio is classified available-for-sale, and is comprised of interest-earning debt securities (see Table 5 below). Investment securities serve as an important source of liquidity, and provide stable interest income revenue supplementary to the larger loan portfolio. The securities also serve as collateral for public and trust deposits, securities sold under agreements to repurchase, and to support borrowing capacity. 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. Decisions to purchase or sell securities are based on an assessment of current economic and financial conditions, including the interest rate environment, the demand for loans, liquidity and income requirements.

The following table shows the amortized cost and fair value, by type of debt security, for three year-end periods:

**Table 5-Investment Securities**

	<b>December 31,</b>		<b>2015</b>		<b>2014</b>	
	<b>Amortized</b>	<b>Fair</b>	<b>Amortized</b>	<b>Fair</b>	<b>Amortized</b>	<b>Fair</b>
<i>(dollars in thousands)</i>	<b>Cost</b>	<b>Value</b>	<b>Cost</b>	<b>Value</b>	<b>Cost</b>	<b>Value</b>
Debt securities:						
U.S. Treasury notes	\$14,730	\$13,937	\$0	\$0	\$0	\$0
U.S. agency	26,045	25,086	17,554	17,414	17,811	17,907
U.S. agency mortgage-backed, residential	91,242	91,761	119,266	120,581	122,443	124,815
State and municipal	64,421	63,955	74,573	75,475	68,879	70,452
Total debt securities	\$196,438	\$194,739	\$211,393	\$213,470	\$209,133	\$213,174

At December 31, 2016, the fair value of securities, available-for-sale, totaled \$194,739,000, a decrease compared to the fair value of the investment securities portfolio balance of \$213,470,000 at December 31, 2015. For the year 2016,

cash inflows from maturities, repayments, and calls were reinvested in U.S. Treasury notes, U.S. agency, U.S. agency mortgage-backed, and tax-exempt municipal securities. Additionally, approximately \$12,903,000 of U.S. agency securities were sold during 2016 to realize \$194,000 of gains to meet short-term liquidity needs.

Securities available-for-sale are generally comprised of high quality debt instruments. On January 1, 2013, Section 939(a) of the Dodd-Frank Act became effective changing the definition of investment grade by removing reliance on credit ratings by national statistical rating organizations. Investment credit assessment, under the revised definition, requires an active review by the Corporation (i.e., pre-purchase and post-purchase credit risk analysis) of the underlying obligor to determine that the obligor has an adequate capacity to meet its financial commitments, and more specifically, that the risk of default is low, and that full and timely repayment of principal and interest is expected. Obligations of the U.S. government and U.S. government sponsored enterprises are not subject to the due diligence requirement. However, the Corporation's municipal securities, and any corporate securities that may be acquired in the future, are subject to the new requirement.

As shown in Table 5, above, the Corporation holds investments in the obligations of states and municipalities. Municipalities have many options for meeting their debt obligations, including decreasing costs and service levels, imposing taxes and fees and selling assets. In many cases, municipal debt issues are insured or, in the case of school districts of selected states, backed by specific reserves, which provide additional layers of protection to the investor. Access to the credit market and a good credit rating are high priorities enabling a municipality to meet its current and future funding needs at a reasonable interest cost. For these reasons, defaults on municipal bonds are unusual. The majority of municipal bonds in the Corporation's 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 such bonds are for critical services such as water and sewer. Many of the municipal holdings are also insured or backed by specific school district loss reserves. Based on the results of an independent credit review of the Bank's entire municipal bond portfolio as performed in 2016, and recent bond ratings by national statistical rating organizations, we believe that the municipal investments held by PeoplesBank are investment grade.

The table below shows that the available-for-sale securities portfolio had an overall yield of 2.51 percent on December 31, 2016:

**Table 6-Securities Maturity Schedule (amortized cost basis)**

	December 31, 2016 Maturity Distribution					Total Amount	Yield(1)
	One year or less	One through five years	Five through ten years	After ten years			
	<i>(dollars in thousands)</i>						
Debt securities:							
U.S. Treasury notes	\$0	\$0	\$14,730	\$0	\$14,730	1.68 %	
U.S. agency	9,009	2,036	15,000	0	26,045	1.44 %	
U.S. agency mortgage-backed, residential (2)	310	90,932	0	0	91,242	2.37 %	
State and municipal	13,566	21,319	25,167	4,369	64,421	3.33 %	
Total debt securities	\$22,885	\$114,287	\$54,897	\$4,369	\$196,438	2.51 %	
Yield (1)	2.19 %	2.52 %	2.46 %	4.42 %	2.51 %		

(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.

The portfolio yield for 2016, reflected in the table above, is lower than the 2.74 percent securities portfolio yield as of December 31, 2015. Generally, lower yielding securities, as compared to the yields in maturing and called securities, were purchased in 2016. Purchases included the reinvestment of cash flows from maturities, calls and principal repayments on mortgage-backed bonds, during a year of persistently low market investment interest rates. More

information about investment securities is provided in Note 3-Securities, to the consolidated financial statements.

### **Restricted Investment in Bank Stocks**

At December 31, 2016, the Corporation held approximately \$6,926,000 in restricted common stock, compared to \$5,028,000 at year-end 2015. Investment in restricted stock is a condition of obtaining credit from the Federal Home Loan Bank of Pittsburgh (FHLBP) and the Atlantic Community Bankers Bank, which is a subsidiary of Atlantic Community Bancshares, Inc. (ACBI). Accordingly, changes in the level of restricted stock are the result of member capital requirements and borrowing levels from the FHLBP as described within the Long-term Debt section of this report. Of the total investment as of December 31, 2016, approximately \$6,851,000 consisted of stock issued by the FHLBP, with the remainder being restricted stock issued by ACBI. Information about restricted investment in bank stocks, including impairment considerations, is provided in Note 1—Summary of Significant Accounting Policies, to the consolidated financial statements.

### **Loans Held for Sale**

On December 31, 2016, loans held for sale were approximately \$1,548,000, compared to \$564,000 at year-end 2015. The \$1,548,000 consists of \$1,189,000 residential mortgage loans and \$359,000 of Small Business Administration (SBA) loans. For both years, PeoplesBank's mortgage banking production focused on originating and selling secondary-market qualifying residential mortgage loans. Beginning in January 2016, PeoplesBank retained mortgage servicing rights on residential mortgage loans sold on the secondary market. In addition, in 2016, PeoplesBank began originating loans partially guaranteed by the Small Business Administration with the intent to sell the guaranteed portion of secondary-market qualifying loans.

### **Loans**

On December 31, 2016, total loans, net of deferred fees, totaled approximately \$1.27 billion, compared to \$1.12 billion at year end 2015, an increase of \$147,560,000 or 13 percent above total loans as of year-end 2015. Most of the increase was due to a \$136,950,000 or 15 percent increase in commercial loans, which reflected continued strong commercial loan demand in our markets, and our continued ability to expand existing relationships with creditworthy borrowers, and acquire new loan business, based on our reputation for client service and competitive prices and terms.

The average yield (tax-equivalent basis) earned on total loans was 4.93 percent for the full year 2016, as compared to 4.94 percent for the year 2015. Persistent low market interest rates and strong competition in our markets resulted in continuing pricing pressures on new loan and refinancing activities. The composition of the Corporation's loan portfolio, by industry class, at December 31, 2016 and 2015 is provided in Note 4—Loans in the notes to the consolidated financial statements.



The following table presents the general composition of total loans for five year-end periods:

**Table 7-Loan Portfolio Composition**

<i>(dollars in thousands)</i>	<b>December 31,</b>		<b>2015</b>	<b>%</b>	<b>2014</b>	<b>%</b>	<b>2013</b>	<b>%</b>	<b>2012</b>	<b>%</b>
	<b>2016</b>	<b>%</b>								
Commercial, financial and agricultural	\$924,729	72.8	\$802,436	71.5	\$658,627	71.6	\$607,779	70.7	\$510,544	69.2
Real estate-construction and land development	148,635	11.7	133,978	11.9	114,695	12.5	106,436	12.4	96,936	13.2
Total commercial related loans	1,073,364	84.5	936,414	83.4	773,322	84.1	714,215	83.1	607,480	82.4
Real estate - residential mortgages	73,496	5.8	70,094	6.2	32,453	3.5	25,695	3.0	23,511	3.2
Consumer and home equity	123,911	9.7	116,703	10.4	114,315	12.4	119,474	13.9	106,143	14.4
Total consumer related loans	197,407	15.5	186,797	16.6	146,768	15.9	145,169	16.9	129,654	17.6
Total loans	\$1,270,771	100.0	\$1,123,211	100.0	\$920,090	100.0	\$859,384	100.0	\$737,134	100.0

The table below shows at December 31, 2016, the commercial loan portfolio was comprised of approximately \$768,149,000 or 72 percent in fixed rate loans, and \$305,215,000 or 28 percent in floating rate loans. This compares to \$670,150,000 or 72 percent in fixed rate loans, and \$266,264,000 or 28 percent in floating rate loans, for the year ended December 31, 2015. Floating rate loans reprice periodically with changes in the Wall Street Journal (WSJ) Prime Rate, or LIBOR.

**Table 8-Selected Loan Maturities and Interest Rate Sensitivity**

<i>(dollars in thousands)</i>	<b>December 31, 2016</b>			
	<b>Maturity Distribution</b>			
	<b>One year or less</b>	<b>One through five years</b>	<b>After five years</b>	<b>Total</b>
Commercial, financial and agricultural	\$113,545	\$215,997	\$595,187	\$924,729
Real estate-construction and land development	76,552	40,759	31,324	148,635
Total commercial related loans	\$190,097	\$256,756	\$626,511	\$1,073,364
Fixed interest rates	\$18,264	\$202,338	\$547,547	\$768,149
Floating interest rates	171,833	54,418	78,964	305,215
Total commercial related loans	\$190,097	\$256,756	\$626,511	\$1,073,364



During 2016, commercial borrowers continued to prefer fixed rate loans with maturities ranging from five to ten years. Although the commercial loan portfolio's increased fixed rate volume and longer maturities increase risk if interest rates rise, management has implemented interest rate risk mitigation strategies which include maintaining a shorter duration in the Corporation's investment portfolio, and lengthening fixed rate liabilities, principally borrowings from the Federal Home Loan Bank of Pittsburgh. In addition, commercial loans are generally structured whereby there is an initial fixed rate period, typically five years, and then adjust based upon a predetermined index. Approximately 40 percent of the loans identified as fixed interest rates above are set to adjust during the term of the loan. Additional loan information can be found in Note 4—Loans, in the notes to the consolidated financial statements, and within the Risk Management section of this report.

## **Premises and Equipment**

On December 31, 2016, premises and equipment, net of accumulated depreciation, totaled approximately \$24,573,000, compared to \$24,606,000 on December 31, 2015. The decrease was a result of depreciation and disposals on existing premises and equipment of \$2,347,000 exceeding new acquisitions of \$2,314,000.

## **Other Assets**

On December 31, 2016, other assets totaled approximately \$51,689,000, compared to \$42,373,000 of other assets as of December 31, 2015. Other assets were primarily comprised of investments in bank owned life insurance (BOLI), foreclosed real estate, accrued interest receivable, and deferred tax assets.

Investments in life insurance relates to a select group of employees and directors whereby PeoplesBank is the owner and beneficiary of the policies. These investments, carried at the cash surrender value of the underlying policies, totaled \$31,621,000 at year-end 2016, compared to \$23,980,000 at year-end 2015. PeoplesBank purchased \$6,987,000 of BOLI during 2016. The selection of the underlying BOLI insurers is based primarily on the respective insurers' high credit rating and reputation, and competitive tax-exempt yield. The Corporation also seeks to maintain a reasonable diversification among insurers supporting the BOLI portfolio. The level of the Corporation's BOLI investment was approximately 20 percent of PeoplesBank's Tier 1 capital, excluding net unrealized gains on available-for-sale securities, at December 31, 2016, which is well within the regulatory guideline of 25 percent of Tier 1 capital.

Other assets also includes foreclosed real estate, net of allowance, totaling \$2,705,000 at year-end 2016, compared to \$2,913,000 at year-end 2015. The \$208,000 decrease was a result of sales of smaller properties. Foreclosed real estate is discussed in the Nonperforming Assets section of this report.

Also included with other assets is \$4,448,000 of accrued interest receivable on loans and investment securities, and \$8,153,000 of net deferred tax assets. Additional information about these assets can be found in Note 1—Summary of Significant Accounting Policies in the notes to the consolidated financial statements under the appropriate subheadings.

## **Funding**

## Deposits

Deposits are the Corporation's principal source of funding for earning assets. The average rate paid on interest-bearing deposits was 0.67 percent for the years 2016 and 2015.

On December 31, 2016, deposits totaled \$1.26 billion, which represented a \$170,028,000 or 16 percent increase compared to the level at year-end 2015. The increase in all deposit categories, primarily money market and time deposits, reflects several rate promotions offered throughout the year. Core deposits, consisting of demand, money market and savings, in aggregate, increased \$140,938,000 or 20 percent and time deposits (i.e. CDs) increased \$29,090,000 or 7 percent. Of the total \$426,685,000 of time deposits as of December 31, 2016, the balance of certificates of deposit with a balance of less than \$100,000 totaled \$242,778,000, \$100,000 to \$250,000 totaled \$134,811,000 and \$250,000 or more totaled \$49,096,000. Time deposits totaling \$203,640,000 or 48 percent of the total at year-end 2016 will mature in 2017.

On December 31, 2016, the balance of certificates of deposit with a balance of \$100,000 and above was \$183,907,000. Of this total, \$25,103,000 mature within three months, \$17,485,000 mature after three months but within six months, \$47,564,000 mature after six months but within twelve months, and the remaining \$93,755,000 mature beyond twelve months.

The composition of the Corporation's deposit portfolio at December 31, 2016 is provided in Note 7-Deposits, in the notes to the consolidated financial statements.

### **Short-term Borrowings**

Short-term borrowings consist of securities sold under agreements to repurchase (repo agreements), federal funds purchased, and other borrowings as described more fully in Note 8-Short-term Borrowings and Long-term Debt, to the consolidated financial statements. On December 31, 2016, short-term borrowings totaled \$56,637,000, as compared to the \$74,510,000 as of December 31, 2015. The balance on December 31, 2016, consisted of \$23,637,000 of repurchase agreements and \$33,000,000 of other short-term borrowings as compared to the balance of \$74,510,000 at year-end 2015 consisting entirely of repurchase agreements. The increase in other short-term borrowings was to maintain adequate short-term liquidity and the decrease in the balance of repurchase agreements is primarily due to the loss of a significant account relationship.

### **Long-term Debt**

Long-term debt is a secondary funding source to deposits for asset growth. On December 31, 2016, long-term debt totaled \$125,310,000, compared to \$120,310,000 at year-end 2015. The increase was the result of \$40,000,000 in new advances from the Federal Home Loan Bank of Pittsburgh (FHLBP), which included refinances of \$35,000,000 of advances that matured during 2016. The 2016 advances have fixed rates of interest with maturities ranging between eighteen months to three-years.

Generally, funds for the payment of long-term debt come from operations. On December 31, 2016, total unused credit with the FHLBP was approximately \$291,924,000. Obligations to the FHLBP are secured by FHLBP stock and qualifying collateral, principally real estate secured loans. A listing of outstanding long-term debt obligations is provided in Note 8-Short-term Borrowings and Long-term Debt, in the notes to the consolidated financial statements.

### **Shareholders' Equity and Capital Adequacy**

Shareholders' equity, or capital, enables the Corporation to maintain asset growth and absorb losses. Capital adequacy can be affected by a multitude of factors, including profitability, new stock issuances, corporate expansion, balance sheet growth, dividend policy, and regulatory mandates.

Total shareholders' equity was \$154,957,000 on December 31, 2016, a decrease of approximately \$4,184,000 or 3 percent, compared to \$159,141,000 at year-end 2015. The decrease was primarily the result of the redemption of the remaining \$12,000,000 of the Corporation's Series B preferred stock issued in connection with the Small Business Lending Fund Program as discussed below. Information pertaining to preferred and common stock issued by the Corporation is disclosed in Note 10—Shareholders' Equity, in the notes to the consolidated financial statements.

*Redemption of Preferred Stock and Preferred Stock Dividends*

As previously disclosed, the Corporation participated in the U.S. Department of the Treasury's (Treasury) Small Business Lending Fund Program (SBLF Program). Information about the SBLF Program is provided in Note 10—Shareholders' Equity, to the consolidated financial statements. Under the SBLF program, the Corporation originally issued \$25,000,000, or 25,000 shares of non-cumulative, perpetual preferred stock, Series B, \$1,000 liquidation value, \$2.50 par value to the Treasury.

The SBLF preferred stock qualifies as Tier 1 regulatory capital and requires the payment of non-cumulative cash dividends quarterly on each January 1, April 1, July 1 and October 1. Preferred stock dividends for 2016 were \$16,000, a decrease of \$104,000 compared to \$120,000 of preferred stock dividends in 2015. On February 18, 2016, Codorus Valley redeemed the remaining \$12,000,000, or 12,000 shares of Series B preferred stock issued to the Treasury as reported on form 8-K filed on February 19, 2016.

The preferred stock annualized dividend rate for both years was 1 percent.

#### *Dividends on Common Stock*

The Corporation typically pays cash dividends on its common stock on a quarterly basis. The Board of Directors determines the dividend rate after considering the Corporation's capital requirements, current and projected net income, and other factors. Annual cash dividends per common share for the year 2016 totaled \$0.496 per share, as adjusted for stock dividends, representing an increase of \$0.034 or 7 percent above the cash dividends of \$0.462, as adjusted, paid for the year 2015.

Periodically, the Corporation distributes stock dividends on its common stock. On December 13, 2016, the Corporation distributed a 5 percent common stock dividend to shareholders of record at the close of business on October 25, 2016. A 5 percent common stock dividend was also distributed in December 2015.

#### *Compensation Plans*

As disclosed in this report, the Corporation maintains various employee and director benefit plans that could result in the issuance of its common stock or affect its earnings. Information regarding these plans can be found in Note 11-Benefit Plans and Note 12-Stock-Based Compensation, in the notes to the consolidated financial statements.

*Capital Ratios*

The Corporation and PeoplesBank are subject to various regulatory capital requirements administered by banking regulators that involve quantitative guidelines and qualitative judgments. Quantitative measures established by regulators pertain to minimum capital ratios, as set forth in Table 9 below. The table 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.

**Table 9-Capital Ratios**

	Ratios		Federal Minimum		Federal Well Capitalized	Capital (2)	
	at December 31, 2016	2015	Required (1) 2016	2015		at December 31, 2016	2015
<i>(dollars in thousands)</i>							
Common Equity Tier 1 Capital (as a percentage of risk weighted assets)							
Codorus Valley Bancorp, Inc. (consolidated)	11.88%	12.56%	5.125%	4.50%	n/a	%	\$ 153,762 \$ 143,456
PeoplesBank	12.38	13.10	5.125	4.50	6.50		159,832 149,073
Tier 1 risk-based capital (as a percentage of risk weighted assets)							
Codorus Valley Bancorp, Inc. (consolidated)	12.66%	14.49%	6.625%	6.00%	n/a	%	\$ 163,762 \$ 165,456
PeoplesBank	12.38	13.10	6.625	6.00	8.00		159,832 149,073
Total risk-based capital (as a percentage of risk weighted assets)							
Codorus Valley Bancorp, Inc. (consolidated)	13.81%	15.60%	8.625%	8.00%	n/a	%	\$ 178,754 \$ 178,160
PeoplesBank	13.54	14.21	8.625	8.00	10.00		174,824 161,777
Leverage (Tier 1 capital as a percentage of average total assets)							
Codorus Valley Bancorp, Inc. (consolidated)	10.76%	11.73%	4.00%	4.00%	n/a	%	\$ 163,762 \$ 165,456
PeoplesBank	10.53	10.60	4.00	4.00	5.00		159,832 149,073

(1) Minimum amounts and ratios as of December 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) Net unrealized gains and losses on securities available-for-sale, net of taxes, are disregarded for capital ratio computation purposes in accordance with federal regulatory banking guidelines.

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 will increase both the quantity and quality of capital held by banking organizations. Consistent with the Basel III framework, the rule includes 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 will apply to all supervised financial institutions. The rule also raises 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 increases 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 and PeoplesBank, became effective January 1, 2015.

The new rule provides that, in order to avoid restrictions on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold the 2.5 percent capital conservation buffer, 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 transition schedule for new ratios, including the capital conservation buffer, is as follows:

	<b>As of January 1:</b>				
	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
Minimum common equity Tier 1 capital ratio	4.5%	4.5%	4.5%	4.5%	4.5%
Common equity Tier 1 capital conservation buffer	N/A	0.625%	1.25%	1.875%	2.5%
Minimum common equity Tier 1 capital ratio plus capital conservation buffer	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of most deductions from common equity Tier 1 capital	40%	60%	80%	100%	100%
Minimum Tier 1 capital ratio	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Tier 1 capital ratio plus capital conservation buffer	N/A	6.625%	7.25%	7.875%	8.5%
Minimum total capital ratio	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum total capital ratio plus capital conservation buffer	N/A	8.625%	9.25%	9.875%	10.5%

As fully phased in, a banking organization with a buffer greater than 2.5 percent would not be subject to limits on dividend payments or discretionary bonus payments; however, a banking organization with a buffer less than 2.5 percent would be subject to increasingly stringent limitations as the buffer approaches zero. The new rule also prohibits a banking organization from making dividend payments or discretionary bonus payments if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5 percent as of the beginning of that quarter. Eligible net income is defined as net income for the 4 calendar quarters preceding the current calendar quarter, net of any distributions and associated tax effects not already reflected in net income. A summary of payout restrictions based on the capital conservation buffer is as follows:

<b>Capital Conservation Buffer</b>	<b>Maximum Payout</b>
<b>(as a % of risk-weighted assets)</b>	<b>(as a % of eligible retained income)</b>
Greater than 2.5%	No payout limitation applies
≤2.5% and >1.875%	60%
≤1.875% and >1.25%	40%
≤1.25% and >0.625%	20%
≤0.625%	0%

The Corporation's regulatory capital position at December 31, 2016 and 2015, as reflected in Table 9 above, reflects compliance with the new rule requirements that became effective January 1, 2015. The Corporation plans to manage its capital to ensure continued compliance.

### **Risk Management**

The Corporation's Enterprise Risk Management Committee ("Committee") meets at least quarterly and includes members of senior management and at least one independent director. The objective of the Committee is to identify

and manage risk inherent in the operations of the Corporation and its affiliates. While the Committee's risk review is broad in scope, its primary responsibility is to develop, implement and monitor compliance with formal risk management policies and procedures.

## Credit Risk Management

Credit risk represents the possibility that a loan client, counterparty or issuer may not perform in accordance with contractual terms, posing one of the most significant risks of loss to the Corporation. Accordingly, the Corporation emphasizes the management of credit risk. To support this objective, a lending policy framework has been established which management believes is sound given the nature and scope of our operations. This framework includes seven basic policy parameters that guide the lending process and minimize risk:

The Corporation follows detailed written lending policies and procedures.

Lending authority is granted commensurate with dollar amount, loan type, level of risk, and loan officer experience. Loan review committees function at both the senior lending officer level and the Board level to review and approve loans that exceed pre-established dollar thresholds and/or meet other criteria.

The Corporation lends mainly within its primary geographical market area, including York County, Cumberland County, and Lancaster County, Pennsylvania and Harford County, Baltimore County, Baltimore City and Carroll County, Maryland. Although this focus may pose a geographical concentration risk, the diverse local economies and employee knowledge of our clients lessens this risk.

The loan portfolio is diversified to prevent dependency upon a single client or small group of related clients. The Corporation does not participate in the subprime lending market, nor does it invest in securities backed by subprime mortgages.

The Corporation does not lend to foreign countries or persons residing therein.

The Corporation uses loan-to-value ratios (“LTV ratios”) for loan underwriting, establishing generally acceptable ratios of the loan amount to the value of the collateral securing the loan, to minimize the risk of future loss from the loan portfolio. At December 31, 2016, the LTV ratios listed below were in effect.

Loan type	LTV ratio %	
	Owner Occupied	Non-owner Occupied
Residential, owner occupied 1-4 units, tax assessment (PA)	85	80
Residential, owner occupied 1-4 units, tax assessment (MD)	90	90
Residential, owner occupied 1-4 units, certified appraisal	80	75
Residential construction - spec	N/A	70
Residential construction - presold	N/A	80
Agricultural	80	75
Residential (5 or more units)	75	75
Commercial	80	75
Raw Land	60	60
Approved, but unimproved land	65	65
Approved and improved land	70	70
Industrial	70	65
Special/Limited use properties	50	50



An acceptable valuation is required on all real estate secured loans. Generally, an appraisal performed by an independent licensed appraiser is required for real estate secured loans under any of the following conditions:

loan amount is above \$250,000;  
or if the LTV is above 75 percent for commercial non-owner occupied property;  
or if the LTV is above 80% for commercial owner occupied property;

or if the loan amount is greater than 85% of the tax assessed value for owner-occupied residential real estate in Pennsylvania;  
or if the loan amount is greater than 90% of the tax assessed value for owner-occupied residential real estate in Maryland;  
or if an existing appraisal is more than two years old (unless there was a material change in market conditions or the physical aspects of the property).

Exceptions to LTV ratios and the use of a licensed appraiser are sometimes made by management or the Board of Directors when there are compensating factors.

One component of the internal credit risk review is the identification and management of industry concentrations, defined as greater than 10 percent of the total loan portfolio. As of December 31, 2016, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor represented 19.2 percent of the portfolio; residential real estate investor represented 14.4 percent of the portfolio; and builder and developer represented 11.7 percent of the portfolio. As of December 31, 2015, the Corporation had the same three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor, which represented 17.1 percent of the portfolio; residential real estate investor, which represented 14.3 percent of the portfolio; and builder & developer, which represented 11.9 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

In addition to a comprehensive lending policy, numerous internal reviews of loan and foreclosed real estate portfolios occur throughout the year. These portfolios, or selected accounts therein, are also examined periodically by the Corporation's or PeoplesBank's regulators.

**Nonperforming Assets**

Table 10 – Nonperforming Assets, below, presents a five-year history of asset categories posing the greatest risk of loss and related ratios.

Table 10-Nonperforming Assets

(dollars in thousands)	December 31,								
	2016	2015	2014	2013	2012				
Nonaccrual loans	\$3,114	\$3,045	\$6,384	\$13,231	\$6,232				
Nonaccrual loans, troubled debt restructurings	0	188	2,242	2,069	2,110				
Accruing loans that are contractually past due 90 days or more as to principal and interest	733	484	54	0	186				
Total nonperforming loans	3,847	3,717	8,680	15,300	8,528				
Foreclosed real estate, net of allowance	2,705	2,913	2,542	4,068	3,633				
Total nonperforming assets	\$6,552	\$6,630	\$11,222	\$19,368	\$12,161				
Accruing troubled debt restructurings	\$3,664	\$3,903	\$1,996	\$3,342	\$3,550				
Total period-end loans, net of deferred fees	\$1,270,771	\$1,123,211	\$920,090	\$859,384	\$737,134				
Allowance for loan losses (ALL)	\$14,992	\$12,704	\$11,162	\$9,975	\$9,302				
ALL as a % of total period-end loans	1.18	% 1.13	% 1.21	% 1.16	% 1.26	%			
Net charge-offs as a % of average total loans	0.06	% 0.19	% 0.05	% 0.10	% 0.16	%			
ALL as a % of nonperforming loans	389.69	% 341.78	% 128.59	% 65.20	% 109.08	%			
Nonperforming loans as a % of total period-end loans	0.30	% 0.33	% 0.94	% 1.78	% 1.16	%			
Nonperforming assets as a % of total period-end loans and net foreclosed real estate	0.51	% 0.59	% 1.22	% 2.24	% 1.64	%			
Nonperforming assets as a % of total period-end assets	0.41	% 0.46	% 0.92	% 1.68	% 1.15	%			
Nonperforming assets as a % of total period-end shareholders' equity	4.23	% 4.17	% 9.47	% 17.99	% 12.00	%			

While the Corporation's loan portfolio has experienced strong growth over the years, Table 10 above reflects notable progress in reducing or maintaining the level of nonperforming assets. This has been accomplished through continuous collection efforts coordinated by the Corporation's General Counsel, recoveries from borrower payments and foreclosed real estate sales, the establishment of valuation allowances for selective accounts, and if necessary, loan charge-offs. In monitoring and managing nonperforming assets, we remain concerned about the impact of changing economic conditions, and the potential for adverse real estate market value changes, and the corresponding effects on commercial borrowers.

Nonperforming assets are reviewed by management on a monthly basis. We generally rely on appraisals performed by independent licensed appraisers to determine the value of real estate collateral for impaired collateral-dependent loans. Generally, an appraisal is performed when: (i) an account reaches 90 days past due, unless a certified appraisal was

completed within the past twelve months; (ii) market values have changed significantly; (iii) the condition of the property has changed significantly; or (iv) the existing appraisal is outdated based upon regulatory or policy requirements. In instances where the value of the collateral is less than the net carrying amount of the loan, a specific loss allowance is established for the difference by recording a loss provision to the income statement. When it is probable that some portion or all of the loan balance will not be collected, that amount is charged off as loss against the allowance.

As of December 31, 2016, the nonperforming loan portfolio balance totaled \$3,847,000, compared to \$3,717,000 at year-end 2015. Nonperforming loans consist of nonaccrual loans and accruing loans 90 days or more past due. The Corporation generally places a loan on nonaccrual status and ceases accruing interest income (i.e., recognizes interest income on a cash basis as long as the loan is sufficiently collateralized) when loan payment performance is unsatisfactory and the loan is past due 90 days or more. Loans past due 90 days or more and still accruing interest represent loans that are contractually past due, but are well collateralized and in the process of collection. A loan is returned to interest accruing status when we determine that circumstances have improved to the extent that all of the principal and interest amounts contractually due are current for at least six consecutive payments and future payments are reasonably assured. As of December 31, 2016, the nonaccrual loan portfolio balance totaled \$3,114,000, compared to \$3,233,000 at year-end 2015. The slight decrease in nonaccrual loans resulted from reductions totaling \$2,135,000, primarily principal repayments and charge-offs, which was offset by loans totaling \$2,016,000 being placed on nonaccrual status. For both periods, the nonperforming loan portfolio balance was comprised primarily of collateralized commercial loans. For 2016, the gross interest income that would have been recorded if the nonaccrual loans had been current in accordance with their original terms and current throughout the period was approximately \$172,000. The amount of interest income on those nonaccrual loans that was included in net income for 2016 was approximately \$66,000. The interest income recognized on impaired loans in Note 4—Loans, in the notes to the consolidated financial statements, is a higher amount because it includes interest income on all impaired loans, which includes nonaccrual loans, from the time the loan was impaired.

Foreclosed real estate represents real estate acquired to satisfy debts owed to PeoplesBank and is included in the Other Assets category on the Corporation's balance sheet. The carrying amount of foreclosed real estate as of December 31, 2016, net of allowance, totaled \$2,705,000, a decrease of \$208,000 or 7 percent, compared to \$2,913,000 at year-end 2015. The decrease is attributable to the sales of seven properties which was partially offset by the transfer of four properties to foreclosed real estate during the year.

Troubled debt restructurings pertain to loans whose terms have been modified to include a concession that we would not ordinarily consider due to the debtor's financial difficulties. Concessions granted under a troubled debt restructuring typically involve a reduction of interest rate lower than the current market rate for new debt with similar risk, the deferral of payments or extension of the stated maturity date. Troubled debt restructurings are evaluated for impairment if they have been restructured during the most recent calendar year, or if they cease to perform in accordance with the modified terms. As of December 31, 2016, the accruing troubled debt restructuring portfolio balance totaled \$3,664,000, compared to \$3,903,000 at year-end 2015. The decrease was the result of principal payments made on loans within the troubled debt restructuring portfolio.

At December 31, 2016, there were \$11,979,000 in additional potential problem loans being closely monitored by management. These additional potential problem loans consist of loans classified as substandard, reflecting an increased risk of the borrowers' ability to comply with present repayment terms. These loans are not classified as nonperforming and are not disclosed in Table 10. Comparatively, we were monitoring \$12,416,000 of potential problem loans at December 31, 2015.





## Allowance for Loan Losses

Although the Corporation believes that it maintains sound credit policies, certain loans deteriorate and must be charged off as losses. The allowance for loan losses is maintained to absorb losses inherent in the portfolio. The allowance is increased by provisions charged to expense and is reduced by loan charge-offs, net of recoveries. The allowance is based upon management's continuous evaluation of the loan portfolio coupled with a formal review of adequacy on a quarterly basis, which is subject to review and approval by the Board. An overview of the methodology and key factors that we use in evaluating the adequacy of the allowance and loan impairment is provided in Note 1-Summary of Significant Accounting Policies, in the notes to the consolidated financial statements.

The allowance for loan losses consists primarily of three components: (i) specific allowances for individually impaired commercial loans; (ii) allowances calculated for pools of loans; and (iii) an unallocated component, which reflects the margin of imprecision inherent in the assumptions that underlie the evaluation of the adequacy of the allowance. The Corporation uses an internal risk rating system to evaluate individual loans. Loans are segmented into industry groups or pools with similar characteristics, and an allowance for loan losses is allocated to each segment based on quantitative factors such as recent loss history (two-year rolling average of net charge-offs) and qualitative factors, such as the results of internal and external credit reviews, changes in the size and composition of the loan portfolio, adequacy of collateral, and general economic conditions. Determining the level of the allowance for probable loan losses at any given period is subjective, particularly during deteriorating or uncertain economic periods, and requires that we make estimates using assumptions. There is also the potential for adjustment to the allowance as a result of regulatory examinations.

An analysis of the activity in the allowance for loan losses over a five-year period is presented in Table 11 - Analysis of Allowance for Loan Losses, below. A more detailed analysis of the allowance for the current year is provided in Note 5 - Allowance for Loan Losses in the notes to the consolidated financial statements.

The allowance for loan losses was \$14,992,000 or 1.18 percent of total loans, on December 31, 2016, compared to \$12,704,000 and 1.13 percent, respectively, on December 31, 2015. The \$2,288,000 or 18 percent increase in the allowance from December 31, 2015 to December 31, 2016, was generally consistent with the \$147,560,000 or 13 percent overall increase in loan growth (primarily commercial loans), net of deferred fees, over the same 12 month period.

Based on our comprehensive analysis of the loan portfolio, and recognizing other relevant considerations including expected continued loan growth, continued uncertainty on certain larger criticized assets as legal and collection efforts continue, and the unknown impact of future accounting and regulatory requirements related to the determination of the allowance for loan losses, we believe that the allowance for loan losses was adequate at December 31, 2016.



**Table 11 - Analysis of Allowance for Loan Losses**

(dollars in thousands)	2016	2015	2014	2013	2012
Balance - beginning of year	\$12,704	\$11,162	\$9,975	\$9,302	\$8,702
Provision charged to operating expense	3,000	3,500	1,600	1,470	1,750
Loans charged off:					
Commercial, financial and agricultural	771	1,151	326	591	607
Real estate - construction and land development	0	497	0	0	2
Real estate - residential mortgages	79	40	30	27	115
Consumer and home equity	116	337	396	380	501
Total loans charged off	966	2,025	752	998	1,225
Recoveries:					
Commercial, financial and agricultural	193	21	248	102	17
Real estate - residential mortgages	1	21	4	2	41
Consumer and home equity	60	25	87	97	17
Total recoveries	254	67	339	201	75
Net charge-offs	712	1,958	413	797	1,150
Balance - end of year	\$14,992	\$12,704	\$11,162	\$9,975	\$9,302
Ratios:					
Net charge-offs as a % of average total loans	0.06 %	0.19 %	0.05 %	0.10 %	0.16 %
Allowance for loan losses as a % of total period-end loans	1.18 %	1.13 %	1.21 %	1.16 %	1.26 %
Allowance for loan losses as a % of nonperforming loans	389.69%	341.78%	128.59%	65.20%	109.08%

Table 12 - Allocation of Allowance for Loan Losses, below, presents a comparison of the allocation of the allowance for loan losses by major loan category for five year-end periods. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

**Table 12-Allocation of Allowance for Loan Losses**

	December 31,		2015		2014		2013		2012	
	2016	%	2015	%	2014	%	2013	%	2012	%
(dollars in thousands)	Amount	Total Loans	Amount	Total Loans	Amount	Total Loans	Amount	Total Loans	Amount	Total Loans
Commercial, financial and agricultural	\$10,390	72.8	\$ 8,801	71.5	\$ 7,134	71.6	\$ 6,131	70.7	\$ 6,461	69.2
Real estate - construction and land development	2,384	11.7	1,934	11.9	2,236	12.5	2,073	12.4	1,571	13.2
Total commercial related	12,774	84.5	10,735	83.4	9,370	84.1	8,204	83.1	8,032	82.4

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Real estate - residential mortgages	85	5.8	67	6.2	64	3.5	65	3.0	124	3.2
Consumer and home equity	372	9.7	422	10.4	392	12.4	506	13.9	475	14.4
Total consumer related	457	15.5	489	16.6	456	15.9	571	16.9	599	17.6
Unallocated	1,761	n/a	1,480	n/a	1,336	n/a	1,200	n/a	671	n/a
Total	\$14,992	100.0	\$ 12,704	100.0	\$ 11,162	100.0	\$ 9,975	100.0	\$ 9,302	100.0

Affecting our estimation of the allowance for loan and lease losses are several considerations that are not specifically measurable through either specific loan impairment analyses, or portfolio-based historical losses. For example, we believe that we could face increasing credit risks and uncertainties, not yet reflected in current leading indicators, associated with prolonged low economic growth, or potential recessionary business conditions for certain industries or the broad economy, or the erosion of real estate values, any or all of which can adversely affect our borrowers' ability to service their loans.

Additionally, we have experienced continued strong commercial loan growth, including growth in newer markets where we have less of a loss history. Also, we recognize the inherent imprecision in any methodology for estimating specific and general loan losses, 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. Accordingly, as of December 31, 2016, we maintained a 12 percent unallocated portion of our allowance for loan losses, similar to 12 percent unallocated portion of the allowance as of December 31, 2015.

## **Liquidity**

Maintaining adequate liquidity provides the Corporation with the ability to meet financial obligations to depositors, loan clients, employees, and shareholders on a timely and cost effective basis in the normal course of business. Additionally, it provides funds for growth and business opportunities as they arise. Liquidity is generated from transactions relating to both the Corporation's assets and liabilities. The primary sources of asset liquidity are scheduled investment security maturities and cash inflows, funds received from client loan payments and, to a lesser degree, asset sales. The primary sources of liability liquidity are deposit growth, short-term borrowings and long-term debt. The Consolidated Statements of Cash Flows, included in this report, present the changes in cash from operating, investing and financing activities. At year-end 2016, we believe our liquidity was adequate based upon the potential liquidation of unpledged available-for-sale securities with a fair value totaling approximately \$34,022,000 and available credit from the Federal Home Loan Bank of Pittsburgh totaling approximately \$291,924,000. The Corporation's loan-to-deposit ratio was approximately 101 percent as of year-end 2016, compared to 103 percent as of year-end 2015. The decrease in the ratio was the result of deposit growth outpacing loan growth in 2016.

## **Off-Balance Sheet Arrangements**

The Corporation's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist primarily of commitments to grant new loans, unfunded commitments under existing loan facilities, and letters of credit issued under the same standards as on-balance sheet instruments. Financial instruments with off-balance sheet risk are disclosed in Note 14-Commitments to Extend Credit, to the consolidated financial statements, and totaled \$449,178,000 at December 31, 2016, compared to \$321,235,000 at December 31, 2015. Generally, these commitments have fixed expiration dates or termination clauses and are for specific purposes. Accordingly, many of the commitments are expected to expire without being drawn and, therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

## Contractual Obligations

The following table presents the amount and timing of payments due under long-term contractual obligations.

Table 13-Contractual Obligations

(dollars in thousands)	Total	December 31, 2016 Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	\$125,310	\$15,000	\$70,000	\$30,000	\$10,310
Operating leases	2,581	738	1,142	386	315
Time deposits	426,685	203,640	171,817	49,344	1,884
Supplemental retirement plans	8,207	185	370	756	6,896
Total	\$562,783	\$219,563	\$243,329	\$80,486	\$19,405

## Impact of Inflation and Changing Prices

The majority of assets and liabilities of a financial institution are monetary in nature and therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. However, inflation may impact the growth of total assets in the banking industry and the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity-to-assets ratio. Inflation may also significantly affect noninterest expenses, which tend to rise during periods of general inflation. The level of inflation can be measured by the change in the Consumer Price Index (CPI) for all urban consumers (December vs. December). The change in the CPI for 2016 was 2.1 percent, compared to 0.7 percent for 2015 and 0.8 percent for 2014.

Management believes that the most significant impact on financial results is the Corporation's ability to react to changes in market interest rates. Management strives to structure the balance sheet to increase net interest income by managing interest rate sensitive assets and liabilities to reprice in response to changes in market interest rates. Additionally, management is focused on increasing fee income, an income component that is less sensitive to changes in market interest rates.

## Item 7A: Quantitative and Qualitative Disclosures about Market Risk

The most significant market risk to which the Corporation is exposed is interest rate risk. The primary business of the Corporation and the composition of its balance sheet consist of investments in interest earning assets (primarily loans and securities) which are funded by interest bearing liabilities (deposits and borrowings), all of which have varying levels of sensitivity to changes in market interest rates. Changes in rates also have an impact on the Corporation's liquidity position and could affect its ability to meet obligations and continue to grow.

The Corporation employs various management techniques to minimize its exposure to interest rate risk. An Asset Liability Management Committee, consisting of key financial and senior management personnel, meets on a regular basis. The Committee is responsible for reviewing the interest rate sensitivity and liquidity positions of the Corporation, reviewing projected sources and uses of funds, approving asset and liability management policies, monitoring economic conditions, and overseeing the formulation and implementation of strategies regarding balance sheet positions.

Simulation of net interest income is performed for the next twelve-month period. A variety of interest rate scenarios are used to measure the effects of sudden and gradual movements upward and downward in the yield curve. These results are compared to the results obtained in a flat or unchanged interest rate scenario. Simulation of net interest income is used primarily to measure the Corporation's short-term earnings exposure to rate movements. A "shock" is an immediate upward or downward movement of interest rates. The shocks do not take into account changes in client behavior that could result in changes to mix and/or volumes in the balance sheet, nor do they account for competitive pricing over the forward 12-month period. The Corporation applies these interest rate "shocks" to its financial instruments up and down 100, 200, 300, and 400 basis points. A 300 and 400 basis point decrease in interest rates cannot be simulated at this time due to the historically low interest rate environment.

<b>Change in Interest Rates</b>	<b>Annual Change in Net</b>	<b>% Change in Net</b>	<b>% Change</b>		
<b>(basis points)</b>	<b>Interest Income (in thousands)</b>	<b>Interest Income</b>	<b>Policy Limit</b>		
+100	\$ 2,521	4.44	%	(5.00	)%
(100)	\$ (728 )	(1.28	)%	(5.00	)%
+200	\$ 4,947	8.72	%	(15.00	)%
(200)	\$ (2,083 )	(3.67	)%	(15.00	)%
+300	\$ 7,240	12.76	%	(25.00	)%
+400	\$ 9,685	17.07	%	(35.00	)%





## Management Report on Internal Controls Over Financial Reporting

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in SEC Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2016, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2016, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework (2013)*. Based on this assessment, management concluded that, as of December 31, 2016, the Corporation's internal control over financial reporting is effective based on those criteria.

The effectiveness of the Corporation's internal control over financial reporting has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in their report which is included herein.

/s/ Larry J. Miller	/s/ Charles T. Field
Larry J. Miller	Charles T. Field, CPA
(Principal Executive Officer) Chairman, President and Chief Executive Officer	(Principal Financial and Accounting Officer) Treasurer, and Assistant Secretary

March 15, 2017	March 15, 2017
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## **Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders

Codorus Valley Bancorp, Inc.

York, Pennsylvania

We have audited Codorus Valley Bancorp, Inc.'s (the "Corporation") internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Codorus Valley Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Codorus Valley Bancorp, Inc. as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the three years in the period ended December 31, 2016 and our report dated March 15, 2017 expressed an unqualified opinion thereon.

/s/BDO USA, LLP

Harrisburg, Pennsylvania

March 15, 2017

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders

Codorus Valley Bancorp, Inc.

York, Pennsylvania

We have audited the accompanying consolidated balance sheets of Codorus Valley Bancorp, Inc. (the “Corporation”) as of December 31, 2016 and 2015 and the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders’ equity for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Corporation’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Codorus Valley Bancorp, Inc. at December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Codorus Valley Bancorp, Inc.’s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 15, 2017 expressed an unqualified opinion thereon.

/s/BDO USA, LLP

Harrisburg, Pennsylvania

March 15, 2017

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## Item 8: Financial Statements and Supplementary Data

Codorus Valley Bancorp, Inc.

**Consolidated Balance Sheets**

	<b>December 31, 2016</b>	<b>December 31, 2015</b>
(dollars in thousands, except per share data)		
<b>Assets</b>		
Interest bearing deposits with banks	\$54,966	\$44,496
Cash and due from banks	19,066	12,989
Total cash and cash equivalents	74,032	57,485
Securities, available-for-sale	194,739	213,470
Restricted investment in bank stocks, at cost	6,926	5,028
Loans held for sale	1,548	564
Loans (net of deferred fees of \$3,685 - 2016 and \$2,701 - 2015)	1,270,771	1,123,211
Less-allowance for loan losses	(14,992 )	(12,704 )
Net loans	1,255,779	1,110,507
Premises and equipment, net	24,573	24,606
Goodwill	2,301	2,301
Other assets	51,689	42,373
Total assets	\$1,611,587	\$1,456,334
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest bearing	\$202,639	\$162,982
Interest bearing	1,061,538	931,167
Total deposits	1,264,177	1,094,149
Short-term borrowings	56,637	74,510
Long-term debt	125,310	120,310
Other liabilities	10,506	8,224
Total liabilities	1,456,630	1,297,193
<b>Shareholders' equity</b>		
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 December 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 and outstanding: 8,426,873 at December 31, 2016 and 7,957,145 at December 31, 2015	21,067	19,893
Additional paid-in capital	106,102	97,338
Retained earnings	28,909	28,539
Accumulated other comprehensive (loss) income	(1,121 )	1,371
Total shareholders' equity	154,957	159,141
Total liabilities and shareholders' equity	\$1,611,587	\$1,456,334



See accompanying notes.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Income**

(dollars in thousands, except per share data)	<b>Years ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Interest income			
Loans, including fees	\$57,747	\$50,897	\$44,770
Investment securities:			
Taxable	2,527	3,005	3,400
Tax-exempt	1,582	1,665	1,956
Dividends	232	332	211
Other	142	103	63
Total interest income	62,230	56,002	50,400
Interest expense			
Deposits	6,667	6,295	6,668
Federal funds purchased and other short-term borrowings	162	195	170
Long-term debt	1,820	1,684	1,202
Total interest expense	8,649	8,174	8,040
Net interest income	53,581	47,828	42,360
Provision for loan losses	3,000	3,500	1,600
Net interest income after provision for loan losses	50,581	44,328	40,760
Noninterest income			
Trust and investment services fees	2,541	2,411	2,223
Income from mutual fund, annuity and insurance sales	870	810	648
Service charges on deposit accounts	3,696	3,406	2,968
Income from bank owned life insurance	861	694	714
Other income	898	567	630
Net gain on sales of loans held for sale	970	667	452
Net gain on sales of securities	194	492	518
Total noninterest income	10,030	9,047	8,153
Noninterest expense			
Personnel	24,187	21,317	18,025
Occupancy of premises, net	3,259	3,185	2,089
Furniture and equipment	2,801	2,685	2,251
Postage, stationery and supplies	676	683	741
Professional and legal	732	896	758
Marketing	1,518	1,286	1,295
FDIC insurance	606	712	663
Debit card processing	1,127	884	790
Charitable donations	1,079	986	1,134
Telecommunications	749	702	570
External data processing	1,455	1,154	878
Merger related	0	474	533

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Foreclosed real estate including provision for (recovery of) losses	157	(422 )	425
Other	3,277	2,885	2,324
Total noninterest expense	41,623	37,427	32,476
Income before income taxes	18,988	15,948	16,437
Provision for income taxes	5,886	4,813	4,668
Net income	13,102	11,135	11,769
Preferred stock dividends	16	120	174
Net income available to common shareholders	\$13,086	\$11,015	\$11,595
Net income per common share, basic	\$1.56	\$1.68	\$1.88
Net income per common share, diluted	\$1.55	\$1.67	\$1.84

See accompanying notes.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Comprehensive Income**

(dollars in thousands)	<b>Years ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income	\$13,102	\$11,135	\$11,769
Other comprehensive income (loss):			
Securities available for sale:			
Net unrealized holding (losses) gains arising during the period (net of tax (benefit) expense of (\$1,218), (\$501), and \$431, respectively)	(2,364 )	(971 )	837
Reclassification adjustment for (gains) included in net income (net of tax expense of \$66, \$167, and \$176, respectively) (a) (b)	(128 )	(325 )	(342 )
Net unrealized (losses) gains	(2,492 )	(1,296 )	495
Comprehensive income	\$10,610	\$9,839	\$12,264

(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.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Cash Flows**

(dollars in thousands)	<b>Years ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cash flows from operating activities			
Net income	\$ 13,102	\$ 11,135	\$ 11,769
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation/amortization	2,343	2,266	1,772
Net amortization of premiums on securities	912	1,042	978
Amortization of deferred loan origination fees and costs	(1,049 )	(835 )	(774 )
Provision for loan losses	3,000	3,500	1,600
(Recovery of) provision for losses on foreclosed real estate	(31 )	(622 )	60
Deferred income tax (benefit) expense	(1,021 )	32	77
Amortization of investment in real estate partnership	0	0	208
Increase in bank owned life insurance	(861 )	(694 )	(714 )
Originations of loans held for sale	(43,660 )	(31,821 )	(21,894)
Proceeds from sales of loans held for sale	43,308	32,388	22,396
Net gain on sales of loans held for sale	(970 )	(667 )	(452 )
Loss on disposal of premises and equipment	4	105	5
Gain on sales of securities available-for-sale	(194 )	(492 )	(518 )
Net (gain) loss on sales of foreclosed real estate	(18 )	9	50
Stock-based compensation	525	358	288
Increase in interest receivable	(445 )	(301 )	(119 )
Decrease (increase) in other assets	1,203	(160 )	(442 )
(Decrease) increase in interest payable	(18 )	(9 )	86
Increase (decrease) in other liabilities	2,349	(1,232 )	969
Net cash provided by operating activities	18,479	14,002	15,345
Cash flows from investing activities			
Purchases of securities, available-for-sale	(47,665 )	(57,136 )	(37,736)
Maturities, repayments and calls of securities, available-for-sale	48,999	46,108	40,682
Sales of securities, available-for-sale	12,903	9,614	12,911
(Purchase) redemption of restricted investment in bank stock	(1,898 )	(1,229 )	943
Proceeds from acquisition, net	0	21,091	0
Proceeds from acquired receivables of sold investment settlements	0	15,256	0
Net increase in loans made to customers	(147,541)	(127,056)	(61,940)
Purchases of premises and equipment	(2,314 )	(5,957 )	(5,649 )
Investment in bank owned life insurance	(6,994 )	(7 )	(1,186 )
Proceeds from sales of fixed assets	0	51	0
Proceeds from bank owned life insurance	196	0	82
Proceeds from sales of foreclosed real estate	576	289	2,970
Net cash used in investing activities	(143,738)	(98,976 )	(48,923)
Cash flows from financing activities			
Net increase in demand and savings deposits	140,938	87,651	44,599

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Net increase (decrease) in time deposits	29,090	(69,020 )	(14,929)
Net (decrease) increase in short-term borrowings	(17,873 )	32,326	1,821
Proceeds from issuance of long-term debt	40,000	35,000	20,000
Repayment of long-term debt	(35,000 )	(5,096 )	(87 )
Tax benefit on vested restricted stock	0	13	52
Cash dividends paid to preferred shareholders	(46 )	(120 )	(207 )
Cash dividends paid to common shareholders	(4,144 )	(2,991 )	(2,611 )
Redemption of preferred stock	(12,000 )	0	(13,000)
Net issuance of common stock	853	33,614	13,982
Cash paid in lieu of fractional shares	(12 )	(12 )	(10 )
Net cash provided by financing activities	141,806	111,365	49,610
Net increase in cash and cash equivalents	16,547	26,391	16,032
Cash and cash equivalents at beginning of year	57,485	31,094	15,062
Cash and cash equivalents at end of period	\$74,032	\$57,485	\$31,094

See accompanying notes.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Changes in Shareholders' Equity**

(dollars in thousands, except per share data)	<b>Preferred Stock</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Treasury Stock</b>	<b>Total</b>
Balance, January 1, 2014	\$ 25,000	\$ 12,001	\$ 45,399	\$ 23,077	\$ 2,172	\$ 0	\$ 107,649
Net income				11,769			11,769
Other comprehensive income, net of tax					495		495
Common stock cash dividends (\$0.424 per share, adjusted)				(2,611 )			(2,611 )
5% common stock dividend, 275,900 shares at fair value		690	4,878	(5,578 )			(10 )
Preferred stock cash dividends				(174 )			(174 )
Redemption of preferred stock	(13,000 )						(13,000 )
Stock-based compensation including related tax benefit			340				340
Forfeiture and withheld shares of restricted stock			4			(39 )	(35 )
Issuance and reissuance of common stock including related tax benefit:							
650,000 shares through private placement		1,625	10,885				12,510
17,749 shares under the dividend reinvestment and stock purchase plan		42	333			2	377
72,585 shares under the employee stock option plan		181	819				1,000
7,710 shares under employee stock purchase plan		17	106			7	130
9,830 shares of stock-based compensation awards		21	(51 )			30	0
Balance, December 31, 2014	\$ 12,000	\$ 14,577	\$ 62,713	\$ 26,483	\$ 2,667	\$ 0	\$ 118,440
Net income				11,135			11,135
Other comprehensive loss, net of tax					(1,296 )		(1,296 )
Common stock cash dividends (\$0.462 per share, adjusted)				(2,991 )			(2,991 )
5% common stock dividend, 294,161 shares at fair value		735	5,221	(5,968 )			(12 )

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Preferred stock cash dividends				(120 )			(120 )
Stock-based compensation including related tax benefit			371				371
Forfeiture and withheld shares of restricted stock			8			(55 )	(47 )
Issuance and reissuance of common stock including related tax benefit:							
1,746,850 shares through public offering		4,367	28,135				32,502
19,585 shares under the dividend reinvestment and stock purchase plan		49	352				401
45,783 shares under the employee stock option plan		108	515			7	630
7,716 shares under employee stock purchase plan		17	90			21	128
17,450 shares of stock-based compensation awards		40	(67 )			27	0
Balance, December 31, 2015	\$ 12,000	\$ 19,893	\$ 97,338	\$ 28,539	\$ 1,371	\$ 0	\$ 159,141
Net income				13,102			13,102
Other comprehensive loss, net of tax					(2,492 )		(2,492 )
Common stock cash dividends (\$0.496 per share, adjusted)				(4,144 )			(4,144 )
5% common stock dividend, 398,541 shares at fair value		996	7,564	(8,572 )			(12 )
Preferred stock cash dividends				(16 )			(16 )
Redemption of preferred stock	(12,000 )						(12,000 )
Stock-based compensation			525				525
Forfeiture and withheld shares of restricted stock			8			(111 )	(103 )
Issuance and reissuance of common stock:							
20,592 shares under the dividend reinvestment and stock purchase plan		45	374			6	425
27,510 shares under the employee stock option plan		60	239			65	364
9,897 shares under employee stock purchase plan		21	106			40	167
20,716 shares of stock-based compensation awards		52	(52 )				0
Balance, December 31, 2016	\$ 0	\$ 21,067	\$ 106,102	\$ 28,909	\$ (1,121 )	\$ 0	\$ 154,957

See accompanying notes.





Codorus Valley Bancorp, Inc.

## Notes to Consolidated Financial Statements

### NOTE 1-Summary of Significant Accounting Policies

#### Nature of Operations and Basis of Presentation

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 three wholly-owned subsidiaries as of December 31, 2016. The subsidiaries consist of Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors, which sells non-deposit investment products in Pennsylvania, SYC Settlement Services, Inc., which provides real estate settlement services, and Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors, a subsidiary that sells non-deposit investment products in Maryland. 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 Subsidiary Corp. SYC Realty was inactive during the reportable period of 2016. CVLY Subsidiary Corp. was the surviving merged entity resulting from 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.

#### Investment Securities

The classification of securities is determined at the time of acquisition and is reevaluated at each reporting date. Securities classified as available-for-sale are debt securities that the Corporation intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in maturity mix of assets and liabilities, income or liquidity needs, regulatory considerations and other factors. Debt securities available-for-sale are carried at fair value, with unrealized gains and losses, net of taxes, reported as a component of accumulated other comprehensive income in shareholders’ equity. Premiums and discounts are recognized in interest income using the interest method over the estimated life of the security. Realized gains and losses from the sale of available-for-sale

securities 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 statement of income.

Declines in the fair value of available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management must first assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the cost basis of the investment will be recovered. The assessment of the probability of recovery would consider, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. More information about investment securities is provided in Note 3 – Securities.

### **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 December 31, 2016 and 2015 consisted primarily of the common stock of the Federal Home Loan Bank of Pittsburgh (FHLBP) and, to a lesser degree, Atlantic Community Bancshares, Inc. (ACBI), the parent company of Atlantic Community Bankers Bank (ACBB). Under the FHLBP's Capital Plan, PeoplesBank is required to maintain a minimum member stock investment, both 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 years ended December 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 December 31, 2016 and 2015.

### **Loans Held for Sale**

Loans held for sale are primarily comprised of residential mortgage loans originated by the Bank. During 2016, PeoplesBank began originating loans partially guaranteed by the Small Business Administration with the intent to sell the guaranteed portion of secondary-market qualified loans. Loans held for sale are reported at the lower of cost or fair value, as determined by the aggregate commitments from investors or current investor yield requirements. The amount

by which cost exceeds fair value, if any, is accounted for as a valuation allowance and is charged to expense in the period of the change. Gains or losses recognized on the sale of mortgage loans and loans guaranteed by the Small Business Administration loans are recognized based on the difference between the selling price and the carrying value of the related loan and are recorded in noninterest income.

## **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 is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or 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, 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.

The following is a summary of acquired impaired loans from the merger, as discussed in Note 20-Merger With Madison Bancorp, Inc.:

(dollars in thousands)	<b>January 16, 2015</b>
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 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.



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 4-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. 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 slightly

higher risk to the Corporation because economic and housing market conditions can adversely affect the underlying value of the collateral and the ability of some borrowers to service their debt.

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 a comprehensive analysis of the loan portfolio, the Corporation believes that the level of the allowance for loan losses at December 31, 2016 is adequate.



### Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is calculated principally on the straight-line method over the assets' estimated useful lives. Estimated useful lives are five to forty years for buildings and improvements, five to twenty years for furniture and equipment and two to seven years for computer equipment and software. Maintenance and repairs are charged to expense as incurred. The cost of significant improvements to existing assets is capitalized and amortized over the shorter of the asset's useful life or related lease term. When facilities are retired or otherwise disposed of, the depreciated cost is removed from the asset accounts, and any gain or loss is reflected in the statement of income.

### 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 charge-off. 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 December 31, 2016, foreclosed real estate, net of allowance, was \$2,705,000, compared to \$2,913,000 for December 31, 2015. Included within loans receivable as of December 31, 2016, was a recorded investment of \$230,000 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.

### Investments in Real Estate Partnerships

In March 2003, PeoplesBank acquired a 73.47 percent limited partner interest in a real estate joint venture known as Village Court, which was formed to develop, construct, own and operate a 60-unit affordable housing complex located in Dover Township, York County, Pennsylvania. Construction of the housing complex was completed in the fourth quarter of 2004 and the complex was fully leased by December 31, 2004. The investment balance included in other assets has been fully amortized as of December 31, 2016 and 2015.

Investment and related tax credits are accounted for under the effective yield method of accounting under which tax credits are recognized as they are allocated, and the cost of the investment is amortized to provide a constant yield over the period that tax credits are allocated, generally ten years.

### **Bank Owned Life Insurance**

PeoplesBank invests in bank owned life insurance (BOLI) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by PeoplesBank on a select group of employees and directors. PeoplesBank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies and is included in other assets in the amount of \$31,621,000 at December 31, 2016, compared to \$23,980,000 at December 31, 2015.

### **Mortgage Servicing Rights**

PeoplesBank retained servicing of sold mortgage loans beginning in 2016. The mortgage servicing rights (MSRs) associated with the sold loans are included in other assets on the consolidated balance sheets at an amount equal to the estimated fair value of the contractual rights to service the mortgage loans. The MSR asset is amortized as a reduction to servicing income. The MSR asset is evaluated periodically for impairment and carried at the lower of amortized cost or fair value. A third party calculates fair value by discounting the estimated cash flows from servicing income using a rate consistent with the risk associated with these assets and an expected life commensurate with the expected life of the underlying loans. In the event that the amortized cost of the MSR asset exceeds the fair value of the asset, a valuation allowance would be established through a charge against servicing income. Subsequent fair value evaluations may determine that impairment has been reduced or eliminated, in which case the valuation allowance would be reduced through a credit to earnings. At December 31, 2016, the MSR asset was \$324,000 and the balance of residential mortgage loans serviced for third parties was \$36,969,000. As December 31, 2015, there were no MSR assets.

### **Trust and Investment Services Assets**

Assets held by PeoplesBank in a fiduciary or agency capacity for its clients are not included in the consolidated balance sheets since these items are not assets of PeoplesBank.

### **Advertising**

Advertising costs are charged to expense when incurred.

### **Income Taxes**

Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted through the provision for income taxes for the effects of changes in tax laws and rates on the effective date.

The Corporation accounts for uncertain tax positions as required by FASB ASC Topic 740. FASB ASC Topic 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. Specifically, the accounting standard prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return as well as guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. No significant income tax uncertainties have been identified by the Corporation; therefore, the Corporation recognized no adjustment for unrecognized income tax benefits for the years ended December 31, 2016 and 2015. The Corporation's policy is to recognize interest and penalties on unrecognized tax benefits in income taxes expense in the Consolidated Statement of Income. The Corporation did not recognize any interest and penalties for the years ended December 31, 2016, 2015 and 2014. The tax years subject to examination by the taxing authorities are the years ended December 31, 2015, 2014, and 2013.



### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the evaluation of other-than-temporary impairment losses for investment securities and the evaluation of impairment losses for foreclosed real estate.

### **Fair Value of Financial Instruments**

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16 – Fair Value Measurements and Fair Values of Financial Instruments. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

### **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 1<sup>st</sup> of each year. Based upon the analysis, the Corporation concluded that the amount of recorded goodwill was not impaired as of October 1, 2016.

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

**Per Common Share Data**

Basic net income per common share is calculated as net income available to common shareholders divided by the weighted average number of common shares outstanding. Diluted net income per common share is calculated as net income available to common shareholders divided by the weighted average number of common shares outstanding plus common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding stock options and are determined using the treasury stock method. All share and per share amounts are adjusted for stock dividends that are declared prior to the issuance of the consolidated financial statements.

The computation of net income per common share for the years ended December 31, 2016, 2015 and 2014 is provided in the table below.

(in thousands, except per share data)	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income available to common shareholders	\$13,086	\$11,015	\$11,595
Weighted average shares outstanding (basic)	8,375	6,555	6,187
Effect of dilutive stock options	71	71	108
Weighted average shares outstanding (diluted)	8,446	6,626	6,295
Basic earnings per common share	\$1.56	\$1.68	\$1.88
Diluted earnings per common share	\$1.55	\$1.67	\$1.84
Anti-dilutive stock options excluded from the computation of earnings per share	78	112	62

### Stock-Based Compensation

The Corporation accounts for its stock-based compensation awards in accordance with FASB ASC Topic 718, which requires public companies to recognize compensation expense, related to stock-based compensation awards in their statements of operations. Compensation expense is equal to the fair value of the stock-based compensation awards on the grant date and is recognized over the vesting period of such awards. More information is provided in Note 12 – Stock-Based Compensation.

### 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.

(dollars in thousands)	<b>Years ended December</b>		
	<b>31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cash paid during the period for:			
Income taxes	\$4,973	\$6,050	\$3,511
Interest	\$8,667	\$8,183	\$7,954
Noncash investing activities:			
Transfer of loans to foreclosed real estate	\$318	\$41	\$1,597
Charitable donation of foreclosed real estate	\$0	\$0	\$43

#### Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Corporation enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. These financial instruments are recorded on the balance sheet when they become a receivable to the Corporation.

#### Comprehensive Income and Accumulated Other Comprehensive Income

Accounting principles generally accepted in the United States of America 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.

#### 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.

## Recent Accounting Pronouncements

### *Pronouncements Adopted in 2016*

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. In the fourth quarter of 2016, the Corporation elected early adoption of ASU 2016-09, effective January 1, 2016, and has applied the ASU using a modified retrospective approach. Adoption of this standard had the following impact on the Corporation's consolidated financial statements:

Excess tax benefits are recognized in the provision for income tax expense rather than additional paid in capital. An income tax benefit of approximately \$134,000 was recognized for the year ended December 31, 2016 as a result of the adoption of ASU 2016-09.

Excess tax benefits are presented as operating activities rather than as an inflow from financing activities and an outflow from operating activities in the consolidated statement of cash flows. The Corporation's early adoption of ASU 2016-09 resulted in the prospective presentation of \$134,000 of excess tax benefits included in the change in other liabilities in the consolidated statement of cash flows for the year ended December 31, 2016. No prior periods have been adjusted.

The Corporation has elected to continue the current process of recognizing forfeitures as a reversal of compensation expense in the period in which the forfeiture occurs.

### *Pronouncements Not Yet Effective*

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350). This standard simplifies the test for goodwill impairment by eliminating the requirement to calculate the implied fair value of goodwill, which currently is Step 2 of the goodwill impairment test. Instead, the goodwill impairment test will consist of a single quantitative step comparing the fair value of the reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The new standard is effective for annual and any interim goodwill impairment tests in reporting periods beginning after December 15, 2019. Early adoption is permitted. The Corporation intends to adopt this standard effective with its October 1, 2020 goodwill impairment test and the adoption of this standard is not expected to have a material impact on the its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. This standard clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash

flows to reduce diversity in practice. This standard contains guidance clarifying when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance. The new standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The Corporation intends to adopt this standard effective with its March 31, 2018 quarterly report on Form 10-Q and does not expect the adoption of the ASU to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326). This standard adds a new Topic 326 which requires companies to measure and record impairment on financial instruments at the time of origination using the expected credit loss (CECL) model. The CECL model calculates impairment based on historical experience, current conditions, and reasonable and supportable forecasts, and reflects the organization's current estimate of all expected credit losses over the contractual term of its financial assets. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements and is in the initial stages of assessing and gathering the necessary data to implement the new standard.

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 a 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 doesn't 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 and has determined that the provisions of ASU 2016-02 will result in an increase in assets to recognize the present value of the lease obligations (right-of-use assets) with a corresponding increase in liabilities. The initial measurement of the right-of-use asset and the corresponding liability will be affected by certain key assumptions such as expectations of renewals or extensions and the interest rate to be used to discount the future lease obligations. The Corporation is currently assessing its lease portfolio to determine the key assumptions; however, the total impact of the new standard will be affected by any new leases that are executed, leases that are terminated prior to the effective date, and any leases with changes to key assumptions or expectations such as renewals and extensions, and discount rates.

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. In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. This ASU amends the new revenue standard to make minor technical corrections that affect narrow aspects of the guidance, including contract cost accounting, disclosures, and other matters. ASU 2014-09 and ASU 2016-20 are effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is not permitted. The Corporation is evaluating the anticipated effects of these ASUs on its consolidated financial statements and related disclosures. The Corporation has determined that certain noninterest income financial statement line items, including trust and investment services fees, income from mutual fund, annuity and insurance sales, service charges on deposit accounts, and other noninterest income, contain revenue streams that are in scope of these updates. Preliminary findings indicate that there may be some changes in the presentation of certain revenues and expenses based on the principal versus agent guidance within these updates.

**NOTE 2-Restrictions on Cash and Due from Banks**

PeoplesBank is required to maintain average reserves, in the form of cash and balances with the Federal Reserve Bank, against its deposit liabilities. In 2016 and 2015, the reserves were met with vault cash. PeoplesBank is also required to maintain compensating balances with certain correspondent banks, which totaled \$50,000 at December 31, 2016 and 2015.

**NOTE 3-Securities**

A summary of securities, available-for-sale at December 31, 2016 and 2015, is provided below. The securities available-for-sale portfolio is generally comprised of high quality debt instruments, such as 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 December 31, 2016, the fair value of the municipal bond portfolio was concentrated in the state of Pennsylvania at 72 percent.

	<b>Amortized</b>	<b>Gross</b>		<b>Fair</b>
		<b>Unrealized</b>		
(dollars in thousands)	<b>Cost</b>	<b>Gains</b>	<b>Losses</b>	<b>Value</b>



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December 31, 2016

Debt securities:

U.S. Treasury notes	\$ 14,730	\$0	\$(793 )	\$ 13,937
U.S. agency	26,045	1	(960 )	25,086
U.S. agency mortgage-backed, residential	91,242	804	(285 )	91,761
State and municipal	64,421	272	(738 )	63,955
Total debt securities	\$ 196,438	\$ 1,077	\$(2,776)	\$ 194,739

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

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

(dollars in thousands)	Available-for-sale	
	Amortized Cost	Fair Value
Due in one year or less	\$22,885	\$22,933
Due after one year through five years	114,287	114,901
Due after five years through ten years	54,897	52,551
Due after ten years	4,369	4,354
Total debt securities	\$196,438	\$194,739

Gross realized gains and losses on sales of securities, available-for-sale is 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.

(dollars in thousands)	Years ended		
	December 31, 2016	2015	2014
Realized gains	\$194	\$492	\$518
Realized losses	0	0	0
Net gains	\$194	\$492	\$518

Securities, issued by agencies of the federal government, with a carrying value of \$160,357,000 and \$186,097,000 on December 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 December 31, 2016 and 2015.

(dollars in thousands)	Less than 12 months			12 months or more			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
December 31, 2016									
Debt securities:									
U.S. Treasury notes	3	\$13,937	\$(793)	0	\$0	\$0	3	\$13,937	\$(793)
U.S. agency	6	22,083	(960)	0	0	0	6	22,083	(960)
	15	36,473	(285)	0	0	0	15	36,473	(285)

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U.S. agency mortgage-backed, residential										
State and municipal	83	40,092	(734 )	1	501	(4 )	84	40,593	(738 )	
Total temporarily impaired debt securities, available-for-sale	107	\$112,585	\$(2,772 )	1	\$501	\$(4 )	108	\$113,086	\$(2,776 )	

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 )	

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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 any unrealized losses at December 31, 2016 were primarily the result of changes in market interest rates and that it has the ability to hold these investments for a time necessary to recover the amortized cost. Through December 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.

#### NOTE 4-Loans

##### *Loan Portfolio Composition*

The table below provides the composition of the loan portfolio at December 31, 2016 and 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.

	<b>December 31, 2016</b>	<b>% Total Loans</b>	<b>December 31, 2015</b>	<b>% Total Loans</b>
(dollars in thousands)				
Builder & developer	\$ 148,635	11.7	\$ 133,978	11.9
Commercial real estate investor	243,623	19.2	191,994	17.1
Residential real estate investor	183,623	14.4	161,144	14.3
Hotel/Motel	82,085	6.5	84,171	7.5
Wholesale & retail	88,062	6.9	77,694	6.9
Manufacturing	32,616	2.6	30,325	2.7
Agriculture	51,848	4.1	41,217	3.7
Other	242,872	19.1	215,891	19.2
Total commercial related loans	1,073,364	84.5	936,414	83.4
Residential mortgages	73,496	5.8	70,094	6.2
Home equity	94,222	7.4	86,408	7.7

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Other	29,689	2.3	30,295	2.7
Total consumer related loans	197,407	15.5	186,797	16.6
Total loans	\$1,270,771	100.0	\$1,123,211	100.0

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### *Concentrations of Credit Risk*

Concentrations of credit risk arise when a number of clients are engaged in similar business activities in the same geographic region or have similar economic features that could cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Most of the Corporation's business is with clients in York County, Pennsylvania and northern-central Maryland, specifically Baltimore, Harford and Carroll counties. Although this focus may pose a concentration risk geographically, the Corporation believes that the diverse local economy and our detailed knowledge of the client base lessens this risk. At December 31, 2016, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor, which represented 19.2 percent of the portfolio; residential real estate investor, which represented 14.4 percent of the portfolio; and builder & developer, which represented 11.7 percent of the portfolio. At December 31, 2015, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor, which represented 17.1 percent of the portfolio; residential real estate investor, which represented 14.3 percent of the portfolio; and builder & developer, which represented 11.9 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

The principal balance of outstanding loans to directors, executive officers, principal shareholders and any affiliates of such persons was \$162,000 at December 31, 2016 and \$129,000 at December 31, 2015. During 2016, total additions were \$170,000 and total repayments and reductions were \$137,000. As of year-end 2016, all loans to this group were current and performing in accordance with contractual terms.

### *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 \$500,000, 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 typically 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.

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. 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,” nor does it include the regulatory classification of “loss”, because the Corporation promptly charges off loan losses.

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

(dollars in thousands)	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Nonaccrual</b>	<b>Total</b>
December 31, 2016					
Builder & developer	\$138,653	\$6,090	\$ 3,508	\$ 384	\$148,635
Commercial real estate investor	236,240	1,490	5,893	0	243,623
Residential real estate investor	177,763	4,157	866	837	183,623
Hotel/Motel	81,724	0	0	361	82,085
Wholesale & retail	79,884	8,178	0	0	88,062
Manufacturing	27,564	4,439	613	0	32,616
Agriculture	50,123	796	0	929	51,848
Other	235,515	6,213	885	259	242,872
Total commercial related loans	1,027,466	31,363	11,765	2,770	1,073,364
Residential mortgage	73,340	14	85	57	73,496
Home equity	93,908	70	0	244	94,222
Other	29,420	97	129	43	29,689
Total consumer related loans	196,668	181	214	344	197,407
Total loans	\$1,224,134	\$31,544	\$ 11,979	\$ 3,114	\$1,270,771
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



*Impaired Loans*

The table below presents a summary of impaired loans at December 31, 2016 and 2015. Generally, impaired loans are loans risk rated substandard and nonaccrual or classified as troubled debt restructurings. An allowance is established for those individual loans that are commercial related where the Corporation has doubt as to full recovery of the outstanding principal balance. Typically, impaired consumer related loans are partially or fully charged-off eliminating the need for a specific allowance. The recorded investment represents outstanding unpaid principal loan balances adjusted for charge-offs.

	<b>With No Allowance</b>		<b>With A Related Allowance</b>			<b>Total</b>	
	<b>Recorded Investment</b>	<b>Unpaid Principal</b>	<b>Recorded Investment</b>	<b>Unpaid Principal</b>	<b>Related Allowance</b>	<b>Recorded Investment</b>	<b>Unpaid Principal</b>
(dollars in thousands)							
December 31, 2016							
Builder & developer	\$3,508	\$3,644	\$384	\$384	\$200	\$3,892	\$4,028
Commercial real estate investor	5,893	5,908	0	0	0	5,893	5,908
Residential real estate investor	1,404	1,404	299	299	136	1,703	1,703
Hotel/Motel	361	361	0	0	0	361	361
Wholesale & retail	260	260	0	0	0	260	260
Manufacturing	613	613	0	0	0	613	613
Agriculture	568	568	361	361	263	929	929
Other commercial	961	961	183	298	82	1,144	1,259
Total impaired commercial related loans	13,568	13,719	1,227	1,342	681	14,795	15,061
Residential mortgage	142	222	0	0	0	142	222
Home equity	244	244	0	0	0	244	244
Other consumer	172	172	0	0	0	172	172
Total impaired consumer related loans	558	638	0	0	0	558	638
Total impaired loans	\$14,126	\$14,357	\$1,227	\$1,342	\$681	\$15,353	\$15,699
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



The table below presents a summary of average impaired loans and related interest income that was included in net income for the years ended December 31, 2016, 2015 and 2014.

	With No Related Allowance			With A Related Allowance			Total		
	Average	Total	Cash Basis	Average	Total	Cash Basis	Average	Total	Cash Basis
(dollars in thousands)	Recorded Investment	Interest Income	Interest Income	Recorded Investment	Interest Income	Interest Income	Recorded Investment	Interest Income	Interest Income
December 31, 2016									
Builder & developer	\$3,835	\$230	\$0	\$153	\$0	\$0	\$3,988	\$230	\$0
Commercial real estate investor	5,880	301	0	0	0	0	5,880	301	0
Residential real estate investor	937	29	2	489	0	0	1,426	29	2
Hotel/Motel	386	2	2	0	0	0	386	2	2
Wholesale & retail	280	11	0	0	0	0	280	11	0
Manufacturing	622	39	0	0	0	0	622	39	0
Agriculture	368	26	26	385	0	0	753	26	26
Other commercial	1,258	76	20	110	0	0	1,368	76	20
Total impaired commercial related loans	13,566	714	50	1,137	0	0	14,703	714	50
Residential mortgage	225	2	1	0	0	0	225	2	1
Home equity	285	2	2	0	0	0	285	2	2
Other consumer	216	11	4	0	0	0	216	11	4
Total impaired consumer related loans	726	15	7	0	0	0	726	15	7
Total impaired loans	\$14,292	\$729	\$57	\$1,137	\$0	\$0	\$15,429	\$729	\$57
December 31, 2015									
Builder & developer	\$4,086	\$275	\$33	\$1,396	\$0	\$0	\$5,482	\$275	\$33
Commercial real estate investor	4,959	644	416	1,193	0	0	6,152	644	416
Residential real estate investor	871	24	1	882	27	0	1,753	51	1
Hotel/Motel	478	14	14	0	0	0	478	14	14
Wholesale & retail	373	18	2	0	0	0	373	18	2
Manufacturing	642	40	0	0	0	0	642	40	0
Agriculture	0	0	0	424	13	13	424	13	13
Other commercial	1,651	95	31	95	0	0	1,746	95	31
Total impaired commercial related loans	13,060	1,110	497	3,990	40	13	17,050	1,150	510
Residential mortgage	166	4	0	0	0	0	166	4	0
Home equity	159	2	2	0	0	0	159	2	2
Other consumer	343	22	13	0	0	0	343	22	13
Total impaired consumer related loans	668	28	15	0	0	0	668	28	15
Total impaired loans	\$13,728	\$1,138	\$512	\$3,990	\$40	\$13	\$17,718	\$1,178	\$525
December 31, 2014									
Builder & developer	\$4,154	\$290	\$20	\$3,958	\$18	\$0	\$8,112	\$308	\$20

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Commercial real estate investor	6,794	213	102	299	87	0	7,093	300	102
Residential real estate investor	527	35	26	1,409	7	0	1,936	42	26
Hotel/Motel	463	19	0	0	0	0	463	19	0
Wholesale & retail	764	90	78	0	0	0	764	90	78
Manufacturing	665	42	0	0	0	0	665	42	0
Agriculture	0	0	0	442	31	0	442	31	0
Other commercial	1,156	148	128	390	22	0	1,546	170	128
Total impaired commercial related loans	14,523	837	354	6,498	165	0	21,021	1,002	354
Residential mortgage	147	4	3	0	0	0	147	4	3
Home equity	208	4	3	0	0	0	208	4	3
Other consumer	482	32	32	0	0	0	482	32	32
Total impaired consumer related loans	837	40	38	0	0	0	837	40	38
Total impaired loans	\$15,360	\$877	\$392	\$6,498	\$165	\$0	\$21,858	\$1,042	\$392

*Past Due and Nonaccrual*

The performance and credit quality of the loan portfolio is also monitored by using an aging schedule which 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 December 31, 2016 and 2015.

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	≥ 90 Days		Total Past Due and		Total Loans
			Past Due and Accruing	Nonaccrual	Nonaccrual	Current	
December 31, 2016							
Builder & developer	\$1,456	\$0	\$ 0	\$ 384	\$ 1,840	\$146,795	\$148,635
Commercial real estate investor	392	209	0	0	601	243,022	243,623
Residential real estate investor	171	0	0	837	1,008	182,615	183,623
Hotel/Motel	0	0	0	361	361	81,724	82,085
Wholesale & retail	0	0	0	0	0	88,062	88,062
Manufacturing	0	0	0	0	0	32,616	32,616
Agriculture	0	0	0	929	929	50,919	51,848
Other	238	102	498	259	1,097	241,775	242,872
Total commercial related loans	2,257	311	498	2,770	5,836	1,067,528	1,073,364
Residential mortgage	55	0	68	57	180	73,316	73,496
Home equity	203	176	0	244	623	93,599	94,222
Other	131	127	167	43	468	29,221	29,689
Total consumer related loans	389	303	235	344	1,271	196,136	197,407
Total loans	\$2,646	\$614	\$ 733	\$ 3,114	\$ 7,107	\$1,263,664	\$1,270,771
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

*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 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 with respect to which 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 years ended December 31, 2016 and 2015. There were no defaults during the year ended December 31, 2016 for TDRs entered into during the previous 12 month period.

**NOTE 5-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 years ended December 31, 2016, 2015 and 2014.

	<b>Allowance for Loan Losses</b>					<b>December 31, 2016</b>
	<b>January 1, 2016</b>					
(dollars in thousands)	<b>Balance</b>	<b>Charge-offs</b>	<b>Recoveries</b>	<b>Provision</b>		<b>Balance</b>
Builder & developer	\$1,934	\$ (85 )	\$ 3	\$ 532		\$ 2,384
Commercial real estate investor	2,337	0	0	533		2,870
Residential real estate investor	2,101	(487 )	187	716		2,517
Hotel/Motel	837	0	0	(30 )		807
Wholesale & retail	701	0	3	99		803
Manufacturing	223	(140 )	0	224		307
Agriculture	548	0	0	71		619
Other commercial	2,054	(59 )	0	472		2,467
Total commercial related loans	10,735	(771 )	193	2,617		12,774
Residential mortgage	67	(79 )	1	96		85
Home equity	161	0	0	18		179
Other consumer	261	(116 )	60	(12 )		193
Total consumer related loans	489	(195 )	61	102		457
Unallocated	1,480	0	0	281		1,761
Total	\$12,704	\$ (966 )	\$ 254	\$ 3,000		\$ 14,992

	<b>Allowance for Loan Losses</b>					<b>December 31, 2015</b>
	<b>January 1, 2015</b>					
(dollars in thousands)	<b>Balance</b>	<b>Charge-offs</b>	<b>Recoveries</b>	<b>Provision</b>		<b>Balance</b>
Builder & developer	\$2,236	\$ (497)	\$ 0	\$ 195		\$ 1,934
Commercial real estate investor	2,204	0	0	133		2,337
Residential real estate investor	1,484	(709 )	2	1,324		2,101
Hotel/Motel	671	0	0	166		837
Wholesale & retail	691	0	19	(9 )		701
Manufacturing	201	0	0	22		223
Agriculture	329	0	0	219		548
Other commercial	1,554	(442 )	0	942		2,054
Total commercial related loans	9,370	(1,648 )	21	2,992		10,735
Residential mortgage	64	(40 )	21	22		67
Home equity	176	(40 )	0	25		161
Other consumer	216	(297 )	25	317		261
Total consumer related loans	456	(377 )	46	364		489
Unallocated	1,336	0	0	144		1,480
Total	\$11,162	\$ (2,025 )	\$ 67	\$ 3,500		\$ 12,704

	<b>Allowance for Loan Losses</b>				
	<b>January 1, 2014</b>				<b>December 31, 2014</b>
(dollars in thousands)	<b>Balance</b>	<b>Charge-offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Balance</b>
Builder & developer	\$2,073	\$ 0	\$ 3	\$ 160	\$ 2,236
Commercial real estate investor	1,500	(200 )	0	904	2,204
Residential real estate investor	1,482	(91 )	215	(122 )	1,484
Hotel/Motel	595	0	0	76	671
Wholesale & retail	637	(35 )	30	59	691
Manufacturing	217	0	0	(16 )	201
Agriculture	307	0	0	22	329
Other commercial	1,393	0	0	161	1,554
Total commercial related loans	8,204	(326 )	248	1,244	9,370
Residential mortgage	65	(30 )	4	25	64
Home equity	237	(116 )	40	15	176
Other consumer	269	(280 )	47	180	216
Total consumer related loans	571	(426 )	91	220	456
Unallocated	1,200	0	0	136	1,336
Total	\$9,975	\$ (752 )	\$ 339	\$ 1,600	\$ 11,162



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 December 31, 2016, 2015 and 2014 along with the related loan balances for those years.

(dollars in thousands)	Allowance for Loan Losses			Loans		
	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance
December 31, 2016						
Builder & developer	\$200	\$ 2,184	\$2,384	\$3,892	\$ 144,743	\$ 148,635
Commercial real estate investor	0	2,870	2,870	5,893	237,730	243,623
Residential real estate investor	136	2,381	2,517	1,703	181,920	183,623
Hotel/Motel	0	807	807	361	81,724	82,085
Wholesale & retail	0	803	803	260	87,802	88,062
Manufacturing	0	307	307	613	32,003	32,616
Agriculture	263	356	619	929	50,919	51,848
Other commercial	82	2,385	2,467	1,144	241,728	242,872
Total commercial related	681	12,093	12,774	14,795	1,058,569	1,073,364
Residential mortgage	0	85	85	142	73,354	73,496
Home equity	0	179	179	244	93,978	94,222
Other consumer	0	193	193	172	29,517	29,689
Total consumer related	0	457	457	558	196,849	197,407
Unallocated	0	1,761	1,761	-	-	-
Total	\$681	\$ 14,311	\$14,992	\$15,353	\$ 1,255,418	\$1,270,771
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
December 31, 2014						
Builder & developer	\$953	\$ 1,283	\$2,236	\$5,973	\$ 108,722	\$ 114,695
Commercial real estate investor	600	1,604	2,204	6,550	137,656	144,206
Residential real estate investor	559	925	1,484	1,738	95,824	97,562

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Hotel/Motel	0	671	671	520	78,892	79,412
Wholesale & retail	0	691	691	394	74,669	75,063
Manufacturing	0	201	201	655	33,507	34,162
Agriculture	100	229	329	432	41,704	42,136
Other commercial	300	1,254	1,554	1,447	184,639	186,086
Total commercial related	2,512	6,858	9,370	17,709	755,613	773,322
Residential mortgage	0	64	64	146	32,307	32,453
Home equity	0	176	176	109	82,147	82,256
Other consumer	0	216	216	393	31,666	32,059
Total consumer related	0	456	456	648	146,120	146,768
Unallocated	0	1,336	1,336	-	-	-
Total	\$2,512	\$ 8,650	\$11,162	\$18,357	\$ 901,733	\$920,090

**NOTE 6-Premises and Equipment**

The following table presents a summary of premises and equipment as of December 31, 2016 and 2015.

(dollars in thousands)	2016	2015
Land	\$4,521	\$4,467
Buildings and improvements	24,560	23,726
Equipment	18,796	17,458
	47,877	45,651
Less accumulated depreciation/amortization	(23,304)	(21,045)
Premises and equipment, net	\$24,573	\$24,606

PeoplesBank leases certain banking branches under noncancellable operating leases. The terms include various renewal options and provide for rental increases based upon predetermined factors. Total lease expenses under operating leases amounted to \$762,000 in 2016, \$788,000 in 2015, and \$367,000 in 2014.

At December 31, 2016, future minimum lease payments for these leases are payable as follows:

(dollars in thousands)	<b>Operating Leases</b>
2017	\$ 738
2018	692
2019	450
2020	256
2021	130
Thereafter	315
Total future minimum lease payments	\$ 2,581

**NOTE 7-Deposits**

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

(dollars in thousands)	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Noninterest bearing demand	\$202,639	\$162,982
NOW	130,394	102,943
Money market	425,874	360,983
Savings	78,585	69,646
Time deposits less than \$100,000	242,778	238,392
Time deposits \$100,000 to \$250,000	134,811	122,730
Time deposits \$250,000 or more	49,096	36,473
Total deposits	\$1,264,177	\$1,094,149

The deposits from directors, executive officers, principal shareholders and any affiliates of such persons were \$1,440,000 at December 31, 2016 and \$1,094,000 at December 31, 2015.

The following table presents scheduled maturities of time deposits by year as of December 31, 2016.

(dollars in thousands)	2016
2017	\$203,640
2018	112,893
2019	58,924
2020	22,191
2021	27,153
Thereafter	1,884
Total time deposits	\$426,685

#### **NOTE 8-Short-term Borrowings and Long-term Debt**

The schedule below provides a summary of short-term borrowings that consist of securities sold under agreements to repurchase, federal funds purchased and other borrowings. Securities sold under agreements to repurchase are overnight borrowings between PeoplesBank and its commercial depositors and are subject to daily repricing. Federal Funds purchased from correspondent banks mature in one business day and reprice daily based on the Federal Funds rate. As of December 31, 2016, PeoplesBank's total availability under Federal Funds lines was \$13,000,000. Other short-term borrowings consist of credit available through the Federal Home Loan Bank of Pittsburgh (FHLBP) and the Federal Reserve Discount Window. PeoplesBank maintains a line-of credit (Open Repo Plus) with the FHLBP which is a revolving term commitment used on an overnight basis. The term of this commitment may not exceed 364 days and it reprices daily at market rates. Under terms of a blanket collateral agreement with the FHLBP, the line-of-credit and long term advances are secured by FHLBP stock and qualifying real estate secured loans. As of December 31, 2016, PeoplesBank's total availability was \$291,924,000 with the FHLBP.

The Corporation maintains a \$3,000,000 line of credit with ACNB Bank to provide a source of liquidity. The line, renewable annually, is secured by a first lien on the Codorus Valley Corporate Center. The interest rate on the ACNB Bank line is Wall Street Journal Prime. No draws have been made on the line and on December 31, 2016 and 2015, the balance was zero.

The following table presents a summary of aggregate short-term borrowings as of and for the years ended December 31, 2016, 2015 and 2014.

<b>2016</b>		<b>2015</b>		<b>2014</b>	
	<b>Other</b>		<b>Other</b>		<b>Other</b>

(dollars in thousands)	<b>Repurchase agreements</b>		<b>Short-term borrowings</b>		<b>Repurchase agreements</b>		<b>Short-term borrowings</b>		<b>Repurchase agreements</b>		<b>Short-term borrowings</b>	
Amount outstanding at end of year	\$23,637	\$33,000	\$74,510	\$0	\$42,184	\$0						
Weighted average interest rate at end of year	0.47	%	0.94	%	0.48	%	0	%	0.46	%	0	%
Maximum amount outstanding at any month-end	\$36,231	\$33,000	\$74,510	\$9,459	\$51,218	\$11,825						
Daily average amount outstanding	\$27,677	\$3,452	\$39,449	\$200	\$32,688	\$1,056						
Approximate weighted average interest rate for the year	0.50	%	0.66	%	0.49	%	0.33	%	0.51	%	0.21	%

Securities that serve as collateral for securities sold under agreements to repurchase and pledged to provide access to the Federal Reserve Bank Discount Window and other short-term borrowing remain in available-for-sale securities. The fair value of these securities was \$33,795,000 and \$85,201,000 on December 31, 2016 and 2015, respectively.

The following table presents a summary of long-term debt as of December 31, 2016 and 2015:

(dollars in thousands)	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
PeoplesBank's obligations:		
FHLBP		
Due July 2016, 2.35%	0	5,000
Due September 2016, 1.18%	0	10,000
Due October 2016, 1.06%	0	10,000
Due October 2016, 1.10%	0	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 June 2018, 1.41%	10,000	0
Due November 2018, 1.62%	5,000	5,000
Due December 2018, 1.60%	15,000	0
Due June 2019, 1.64%	5,000	5,000
Due June 2019, 2.10%	5,000	5,000
Due December 2019, 1.89%	15,000	0
Due June 2020, 1.87%	15,000	15,000
Due June 2021, 2.14%	15,000	15,000
Total FHLBP	115,000	110,000
Codorus Valley Bancorp, Inc. obligations:		
Junior subordinated debt		
Due 2034, 2.98%, floating rate based on 3 month LIBOR plus 2.02%, callable quarterly	3,093	3,093
Due 2036, 2.42% floating rate based on 3 month LIBOR plus 1.54%, callable quarterly	7,217	7,217
Total long-term debt	\$125,310	\$120,310

PeoplesBank's long-term debt obligations to FHLBP are fixed rate instruments.

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.





The following table presents long-term debt maturities by year as of December 31, 2016.

(dollars in thousands)	2016
2017	\$ 15,000
2018	45,000
2019	25,000
2020	15,000
2021	15,000
Thereafter	10,310
Total long-term debt	\$ 125,310

#### **NOTE 9-Regulatory Matters**

The Corporation is subject to restrictions on the payment of dividends to its shareholders pursuant to the Pennsylvania Business Corporation Law of 1988, as amended (“BCL”). The BCL prohibits dividend payments if such payment would render the Corporation insolvent or result in negative net worth. Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by PeoplesBank to the Corporation. The amount of total dividends, which may be paid at any date, is generally limited to the retained earnings of PeoplesBank. Furthermore, dividend payments would be prohibited if the effect thereof would cause PeoplesBank’s capital to be reduced below applicable minimum capital requirements as discussed below. Loans and advances by PeoplesBank to affiliates, including the Corporation, are limited to 10 percent of PeoplesBank’s capital stock and contributed capital on a secured basis.

The Corporation and PeoplesBank are subject to various regulatory capital requirements. Failure to meet minimum capital requirements can result in certain mandatory and possible additional discretionary actions by regulators that, if imposed, could have a material effect on the Corporation’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation 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 classification 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.

Quantitative measures established by regulators to ensure capital adequacy require the Corporation and PeoplesBank to maintain minimum ratios, as set forth below, to total and Tier 1 capital as a percentage of risk-weighted assets, and of Tier 1 capital to quarter-to-date average assets (leverage ratio). In December 2016, PeoplesBank received the most recent notification from the Federal Deposit Insurance Corporation, which categorized PeoplesBank as “well capitalized”, as of September 30, 2016, under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes would change PeoplesBank’s well capitalized category. As of December 31, 2015, PeoplesBank was also categorized as “well capitalized”.

	Actual		Minimum for Capital Adequacy (1)		Well Capitalized Minimum (2)		
	Amount	Ratio	Amount	Ratio	Amount	Ratio	
<i>(dollars in thousands)</i>							
<b>Codorus Valley Bancorp, Inc. (consolidated)</b>							
at December 31, 2016							
Capital ratios:							
Common Equity Tier 1	\$153,762	11.88%	\$66,320	5.125%	\$n/a	n/a	%
Tier 1 risk based	163,762	12.66	85,731	6.625	n/a	n/a	
Total risk based	178,754	13.81	111,611	8.625	n/a	n/a	
Leverage	163,762	10.76	60,870	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 December 31, 2016							
Capital ratios:							
Common Equity Tier 1	\$159,832	12.38%	\$66,151	5.125%	\$83,899	6.50%	
Tier 1 risk based	159,832	12.38	85,513	6.625	103,260	8.00	
Total risk based	174,824	13.54	111,328	8.625	129,076	10.00	
Leverage	159,832	10.53	60,723	4.00	75,903	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	

Minimum amounts and ratios as of December 31, 2016 include the first year phase in of the capital conservation (1)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.

## **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 option of \$34,500,000, less related underwriting discounts, commissions and offering expenses 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.

### *Private Placement of Common Stock*

On March 26, 2014, the Corporation completed a private placement of 650,000 shares of its common stock at a price of \$20.00 per share, par value \$2.50 per share, pursuant to the terms of a Securities Purchase Agreement ("Purchase Agreement") dated March 26, 2014, by and among the Corporation and seven accredited investors. Pursuant to the terms of the Purchase Agreement, the accredited investors also entered into a Registration Rights Agreement with the Corporation, under which the Corporation agreed to file with the Securities and Exchange Commission (the "SEC") a registration statement covering the resale of the common stock issued pursuant to the Purchase Agreement. This registration statement was filed with the SEC on April 25, 2014. The full text and form of both the Purchase Agreement and the Registration Rights Agreement are attached to the Corporation's related Form 8-K filed on March 27, 2014.

The Corporation raised net proceeds of approximately \$12,500,000 resulting from the gross amount of the private placement transaction of \$13,000,000, less related issuance costs of approximately \$500,000. The Corporation used the net proceeds from the private placement, and additional cash, to redeem \$13,000,000 of the \$25,000,000 in outstanding shares of the Corporation's preferred stock held by the United States Department of the Treasury.

*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 periods ended December 31, 2015 and 2014, and through the redemption date of February 18, 2016.

### *Common Stock Dividend*

Periodically, the Corporation distributes stock dividends on its common stock. The Corporation distributed 5 percent common stock dividends on December 13, 2016 and December 8, 2015 which resulted in the issuance of 398,541 and 294,161 additional common shares, respectively.

## **NOTE 11- Benefit Plans**

### **Defined Contribution Plan**

PeoplesBank maintains a 401(k) savings and investment plan covering substantially all employees. Under the plan, employees can contribute a percentage of their compensation subject to certain limits based on federal tax law. In 2016, 2015, and 2014, PeoplesBank made 100 percent matching contributions up to the first 4 percent of each employee's compensation contributed to the plan, and both the employee and employer contributions vest immediately. PeoplesBank's expense for the 401(k) savings and investment plan was \$522,000 for 2016, \$461,000 for 2015 and \$398,000 for 2014.

### **Supplemental Benefit Plans**

PeoplesBank maintains supplemental retirement plans for selected executives. The expense associated with these plans was approximately \$255,000 for 2016, \$170,000 for 2015 and \$242,000 for 2014. The accrued liability for the supplemental retirement plans was \$3,993,000 at December 31, 2016 and \$3,923,000 at December 31, 2015. Income earned from bank owned life insurance policies was used to finance the cost of supplemental benefit plans, and provide a tax-exempt return to PeoplesBank.

### **Director's Post Retirement Split-dollar Life Insurance Benefit**

PeoplesBank recorded net expense of \$104,000 in 2016, \$3,000 in 2015 and \$15,000 in 2014, on bank owned life insurance policies with a post retirement split-dollar life insurance benefit. The accrued liability for the post retirement split-dollar benefit was \$363,000 at December 31, 2016 and \$259,000 at December 31, 2015.

**NOTE 12-Stock-Based Compensation**

FASB ASC Topic 718 requires that the fair value of equity awards granted to employees be recognized as compensation expense over the period during which an employee is required to provide service in exchange for such awards.

The Corporation early adopted ASU 2016-09 in 2016, which provides improvements to the accounting for employee share-based payments. See Note 1 – Summary of Significant Accounting Policies for additional information.

The following table presents information about the Corporation's stock plans, adjusted for stock dividends distributed, as of December 31, 2016.

<b>Plan</b>	<b>Types of grants</b>	<b>Number of shares reserved (2)</b>	<b>Number of options (2)</b>	<b>Number of shares outstanding available for future issuance (2)</b>
	Stock options			
2000 Stock Incentive Plan (2000 Plan) (1)	Stock appreciation rights			
	Restricted stock	9,520	9,520	0
	Stock options			
	Stock appreciation rights			
2007 Long Term Incentive Plan (LTIP)	Restricted stock			
	Stock awards	290,685	207,849 (3)	82,836
2007 Employee Stock Purchase Plan (ESPP)	Stock option	172,790	0	172,790
Employee Stock Bonus Plan (ESBP)	Stock awards	18,241	0	18,241

(1) All options available for grant under the 2000 Plan have been granted.

(2) Shares/options are subject to adjustment in the event of specified changes in the Corporation's capital structure.

(3) Amount includes 46,614 of unvested options.

**2000 Stock Incentive Plan and 2007 Long-Term Incentive Plan (LTIP)**

Options awarded under these plans to date have been granted with an exercise price equal to the fair value of the stock on the grant date, a minimum vesting period of six months and an expiration period of ten years. Restricted awards are granted at fair value. All of the restricted shares granted in 2016 and 15,290 of the restricted shares granted in 2015 vest as follows: 1/3<sup>rd</sup> at the end of the first year from the date of grant; 1/3<sup>rd</sup> at the end of the second year from the date



of grant; and 1/3<sup>rd</sup> at the end of the third year from the date of grant. The remaining 2,268 restricted shares granted in 2015 and all restricted shares granted during 2014 vest as follows: 0% at the end of the first year from the date of grant; 50% at the end of the second year from the date of grant; and 50% at the end of the third year from the date of grant. Upon exercise and/or award, the Corporation has historically issued authorized, but unissued, common stock to satisfy the options/awards.

The following table presents compensation expense and related tax benefits for stock option and restricted stock awards recognized on the consolidated statement of income.

(dollars in thousands)	2016	2015	2014
Compensation expense	\$491	\$325	\$256
Tax benefit	(164)	(78)	(61)
Net income effect	\$327	\$247	\$195

The tax benefit shown in the preceding table is less than the benefit that would be calculated using the Corporation's 35% statutory Federal tax rate. Under FASB ASC Topic 718, tax benefits are only recognized over the vesting period for options that ordinarily will generate a tax deduction when exercised (non-qualified stock options) and restricted stock awards.

The Corporation granted the following stock options and restricted stock awards during the years ended December 31, 2016, 2015 and 2014.

	2016	2015	2014
Nonqualified stock options	21,723	70,184	11,846
Incentive stock options	0	5,185	22,645
Restricted stock	20,837	17,558	9,840

The weighted average grant-date fair value and weighted average assumptions used to determine the fair value using the Black-Scholes valuation model for the stock options granted are presented below.

	2016	2015	2014
Fair value	\$3.64	\$4.22	\$5.42
Expected life (in years)	4.5	5.2	5.5
Risk-free interest rate	1.57 %	1.64 %	1.56 %
Expected volatility	24.31 %	28.22 %	36.01 %
Expected dividend yield	2.42 %	2.59 %	2.33 %

The expected life of the options was estimated based on historical behavior and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is the U.S. Treasury rate commensurate with the expected life of the options on the grant date. Volatility of the Corporation's stock price was based on historical volatility for the period commensurate with the expected life of the options. Dividend yield was based on dividends for the most current year divided by the average market price for the most current year.

A summary of stock options activity from the option and stock incentive plans, adjusted for stock dividends distributed, is shown below.

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$ 000)
Outstanding at January 1, 2016	233,826	\$ 13.94	7.5 years	\$ 1,306

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Granted	21,723	21.50		
Exercised	(27,790 )	13.06		
Cancelled	(10,390 )	19.90		
Outstanding at December 31, 2016	217,369	\$ 14.52	6.8 years	\$ 3,061
Vested and exercisable at December 31, 2016	170,755	\$ 12.85	6.1 years	\$ 2,690
Vested and non-vested, expected to vest at December 31, 2016	217,369	\$ 14.52	6.8 years	\$ 3,061

The following table presents information about stock options exercised for the years ended December 31, 2016, 2015 and 2014.

(dollars in thousands)	2016	2015	2014
Total intrinsic value of options exercised	\$338	\$481	\$777
Cash received from options exercised	\$364	\$475	\$737
Tax deduction realized from options exercised	\$113	\$154	\$264

The following table presents information about non-vested options and restricted stock, adjusted for stock dividends distributed, for the year ended December 31, 2016.

	<b>Stock Options</b>		<b>Restricted Stock</b>	
	<b>Options</b>	<b>Weighted Average Exercise Price Per Share</b>	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Non-vested at January 1, 2016	79,138	\$19.68	31,239	\$18.81
Vested	(43,857 )	19.50	(11,979)	18.34
Cancelled	(10,390 )	19.90	(3,373 )	18.97
Granted	21,723	21.50	20,837	21.28
Non-vested at December 31, 2016	46,614	\$20.64	36,724	\$20.35

As of December 31, 2016, total unrecognized compensation cost related to non-vested options and restricted stock was \$662,000, of which \$437,000 will be recognized in 2017, \$177,000 will be recognized in 2018, and \$48,000 in 2019, with a weighted average recognition period of 1.0 year. The unrecognized compensation expense does not include an estimate for forfeiture of stock awards. The Corporation recognizes forfeitures in the period in which the forfeiture occurs.

### **Employee Stock Purchase Plan (ESPP)**

Under the ESPP, eligible employees can purchase common stock of the Corporation at 85% of the fair market value of the stock at the beginning or end of the six-month offering period, whichever is lower. The ESPP is considered to be a compensatory plan. The following table presents information about the ESPP for the years ended December 31, 2016, 2015 and 2014.

	2016	2015	2014
ESPP shares purchased	9,897	7,716	7,710
Average purchase price per share (85% of market value)	\$16.860	\$16.530	\$16.776
Compensation expense recognized (in thousands)	\$34	\$33	\$32
Shares issued from treasury stock to satisfy the purchase of ESPP shares	1,416	990	940
Shares issued from authorized but unissued common stock to satisfy the purchase of ESPP shares	8,481	6,726	6,770

### **Employee Stock Bonus Plan (ESBP)**

The ESBP is administered by the Compensation Committee which is comprised of non-employee members of the Corporation's Board of Directors. Under the ESBP the Corporation may issue shares of its common stock to employees as performance based compensation. There were no shares of common stock issued under the ESBP in 2016, 2015 and 2014.

**NOTE 13-Income Taxes**

The following table presents the provision for income taxes for the years ended December 31, 2016, 2015 and 2014.

(dollars in thousands)	2016	2015	2014
Current tax provision			
Federal	\$6,221	\$4,827	\$4,204
State	686	417	387
Total current tax provision	6,907	5,244	4,591
Deferred tax (benefit) expense			
Federal	(838 )	(376 )	141
State	(183 )	(55 )	(64 )
Total deferred tax (benefit) expense	(1,021)	(431 )	77
Total tax provision	\$5,886	\$4,813	\$4,668

The differences between the effective income tax rate and the Federal statutory income tax rate for the years ended December 31, 2016, 2015 and 2014 are shown below.

	2016	2015	2014
Statutory tax rate	35.0%	35.0%	35.0%
Increase (decrease) resulting from:			
Low-income housing credits	0.0	0.0	(0.5 )
Tax-exempt interest income	(3.6 )	(4.7 )	(5.1 )
Bank owned life insurance income	(1.6 )	(1.5 )	(1.5 )
State income taxes, net of federal tax benefit	1.7	1.5	1.3
Other, net	(0.5 )	(0.1 )	(0.8 )
Effective income tax rate	31.0%	30.2%	28.4%

Significant components of the Corporation's net deferred tax asset, included in other assets as of December 31, 2016 and 2015 are shown below.

(dollars in thousands)	2016	2015
Deferred tax assets		
Allowance for loan losses	\$5,672	\$4,740
Deferred compensation	1,755	1,623
Low-income housing partnerships	312	404
Foreclosed real estate	334	366
Acquisition accounting adjustments	218	266
Net unrealized losses on available-for-sale securities	578	0
Acquired net operating loss carryforwards	347	487

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Other	421	145
Total deferred tax assets	\$9,637	\$8,031
Deferred tax liabilities		
Deferred loan fees	\$528	\$539
Depreciation	565	620
Net unrealized gains on available-for-sale securities	0	706
Other	391	318
Total deferred tax liabilities	\$1,484	\$2,183
Net deferred tax assets	\$8,153	\$5,848

Based on the level of historical income projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes that, as of December 31, 2016, it is more likely than not that the Corporation will realize the benefits of its deferred tax assets.

**NOTE 14-Commitments to Extend Credit**

In the normal course of business, the Corporation is a party to various financial transactions that are not funded as of the balance sheet date. Off-balance sheet financial instruments, which enable PeoplesBank clients to meet their financing needs, are comprised mainly of commitments to extend credit and standby letters of credit. Standby letters of credit are written conditional commitments issued by PeoplesBank to guarantee the performance of a client to a third party. The credit and market risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. To manage these risks, the Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments and requires collateral to support these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability as of December 31, 2016 and 2015, for guarantees under standby letters of credit issued was considered not material by management. Normally, commitments to extend credit and letters of credit have fixed expiration dates or termination clauses, have specific rates and are for specific purposes. Many of the commitments are expected to expire without being extended; therefore, total commitment amounts do not necessarily represent future cash requirements.

A summary of outstanding commitments at December 31, 2016 and 2015 is shown below.

(dollars in thousands)	2016	2015
Commitments to grant loans		
Fixed rate	\$ 104,274	\$ 35,706
Variable rate	27,369	34,791
Unfunded commitments of existing loans		
Fixed rate	\$ 68,571	\$ 49,818
Variable rate	229,459	181,883
Standby letters of credit	\$ 19,505	\$ 19,037

**NOTE 15-Contingent Liabilities**

Periodically, the Corporation and its subsidiary, PeoplesBank, may be defendants in legal proceedings relating to the conduct of their banking business. Most of such legal proceedings are normal parts of the banking business and, in management's opinion, do not materially affect the financial position or results of operations of the Corporation.

**Note 16-Fair Value Measurements and Fair Values of Financial Instruments**



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.

### **Assets Measured at Fair Value on a Recurring Basis**

#### **Securities Available for Sale**

The fair values of investment securities were measured using information from a third-party pricing service. The pricing service uses quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique, used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. At least annually, the Corporation reviews a random sample of the pricing information received from the third-party pricing service by comparing it to price quotes from third-party brokers. Historically,

price deviations have been immaterial.

	<b>Total</b>	<b>Fair Value Measurements</b>		
		<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>
		<b>Quoted Prices in</b>	<b>Significant</b>	<b>Significant Other</b>
		<b>Active Markets</b>	<b>Other</b>	
		<b>for</b>	<b>Observable</b>	<b>Unobservable</b>
		<b>Identical Assets</b>	<b>Inputs</b>	<b>Inputs</b>
(dollars in thousands)				
December 31, 2016				
Securities available-for-sale:				
U.S. Treasury notes	\$ 13,937	\$ 13,937	\$ 0	\$ 0
U.S. agency	25,086	0	25,086	0
U.S. agency mortgage-backed, residential	91,761	0	91,761	0
State and municipal	63,955	0	63,955	0
December 31, 2015				
Securities available-for-sale:				
U.S. agency	\$ 17,414	\$ 0	\$ 17,414	\$ 0
U.S. agency mortgage-backed, residential	120,581	0	120,581	0
State and municipal	75,475	0	75,475	0

## Assets Measured at Fair Value on a Nonrecurring Basis

### Impaired Loans

Impaired loans are those that are accounted for under FASB ASC Topic 310, in which the Corporation has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These loans are included as Level 3 fair values, based on the lowest level of input that is significant to the fair value measurements. At December 31, 2016, the fair value consists of impaired loan balances of \$604,000, net of valuation allowances of \$681,000 and charge-offs of \$170,000, compared to impaired loan balances of \$1,846,000, net of valuation allowances of \$405,000 and charge-offs of \$1,262,000, at December 31, 2015.

### Foreclosed Real Estate

Other real estate property acquired through foreclosure is initially recorded at fair value of the property at the transfer date less estimated selling cost. Subsequently, other real estate owned is carried at the lower of its carrying value or the fair value less estimated selling cost. Fair value is usually determined based upon an independent third-party appraisal of the property or occasionally upon a recent sales offer. At December 31, 2016, the fair value of foreclosed real estate with a valuation allowance or write-down was \$1,594,000, which is net of valuation allowances of \$881,000 and no write-downs. At December 31, 2015, the fair value of foreclosed real estate with a valuation allowance or write-down was \$1,846,000, which is net of valuation allowances of \$405,000 and write-downs of \$1,262,000.

### Mortgage Servicing Rights

Mortgage servicing rights are initially recorded at fair value upon the sale of residential mortgage loans to secondary market investors. The fair value of servicing rights is based on the present value of estimated future cash flows on pools of mortgages stratified by rate and original time to maturity. Mortgage servicing rights are subsequently evaluated for impairment on a quarterly basis. Significant inputs to the valuation include expected cash flow, expected net servicing income, a cash flow discount rate and the expected life of the underlying loans. At December 31, 2016, the fair value of the mortgage servicing rights asset was \$367,000. There were no mortgage servicing assets as of December 31, 2015.

(dollars in thousands)	Total	Fair Value Measurements		
		(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
December 31, 2016				
Impaired loans	\$604	\$0	\$0	\$604
Foreclosed real estate	1,594	0	0	1,594

Mortgage servicing rights	367	0	0	367
December 31, 2015				
Impaired loans	\$1,846	\$0	\$0	\$1,846
Foreclosed real estate	2,003	0	0	2,003

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Corporation has utilized Level 3 inputs to determine fair value:

(dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements				Weighted Average
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range	
December 31, 2016					
Impaired loans	\$604	Appraisal (1)	Appraisal adjustments (2)	15% - 25%	19%
Foreclosed real estate	1,594	Appraisal (1)	Appraisal adjustments (2)	9% - 9%	9%
Mortgage servicing rights	367	Multiple of annual service fee	Estimated prepayment speed based on rate and term	247% - 490%	446%
December 31, 2015					
Impaired loans	\$1,846	Appraisal (1)	Appraisal adjustments (2)	15% - 25%	16%
Foreclosed real estate	2,003	Appraisal (1)	Appraisal adjustments (2)	7% - 38%	34%

(1) Fair value is generally determined through independent appraisals, which generally include various level 3 inputs that are not identifiable.

(2) Appraisals may be adjusted downward by the Corporation's management for qualitative factors such as economic conditions, and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

### Disclosures about Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair values of the Corporation's financial instruments as of December 31, 2016 and 2015.

#### Cash and Cash Equivalents

The carrying amount is a reasonable estimate of fair value.

#### Securities Available for Sale

The fair value of securities available for sale is determined in accordance with the methods described under FASB ASC Topic 820 as described above.

### **Restricted Investment in Bank Stocks**

The carrying amount of restricted investment in bank stocks is a reasonable estimate of fair value. The Corporation is required to maintain minimum investment balances in these stocks. These stocks are not actively traded and, therefore, have no readily determinable market value.

### **Loans Held for Sale**

The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan.

### **Loans, net**

The fair value of loans, excluding all impaired loans, is estimated using discounted cash flow analyses using the current interest rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans were first segregated by type such as commercial, real estate, and consumer, and were then further segmented into fixed and variable rate. Projected future cash flows are calculated based upon contractual maturity or call dates. For variable rate loans that reprice frequently and have no significant change in credit risk, fair value is based on carrying value.

### **Interest Receivable**

The carrying value of interest receivable is a reasonable estimate of fair value.

### **Deposits**

The fair value of demand deposits, savings accounts and money market deposits is the amount payable on demand at the reporting date. The fair values of time deposits are estimated using a discounted cash flow analyses. The discount rates used are based on rates currently offered for deposits with similar remaining maturities. The fair values of variable rate time deposits that reprice frequently are based on carrying value. The fair values of time deposit liabilities do not take into consideration the value of the Corporation's long-term relationships with depositors, which may have significant value.

### **Short-term Borrowings**

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

### **Long-term Debt**

Long-term debt includes FHLBP advances (Level 2) and junior subordinated debt (Level 3). The fair value of FHLBP advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLBP advances with similar credit risk characteristics, terms and remaining maturity. These prices are obtained from this active market and represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party. The fair value of junior subordinated debt is estimated using discounted cash flow analysis, based on market rates and spread characteristics of similar debt with similar credit risk characteristics, terms and remaining maturity.

### **Interest Payable**

The carrying value of interest payable is a reasonable estimate of fair value.

### **Off-Balance Sheet Instruments**

Off-balance sheet instruments consist of lending commitments and letters of credit are based on fees currently charged in the market to enter into similar arrangements, taking into account the remaining terms of the agreements and counterparties' credit standing. These amounts were not considered material.



The following presents the carrying amount and estimated fair value of the Corporation's financial instruments as of December 31, 2016 and 2015.

(dollars in thousands)	Carrying Amount	Estimated Fair Value	Fair Value Estimates		
			(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
December 31, 2016					
Financial assets					
Cash and cash equivalents	\$74,032	\$74,032	\$74,032	\$0	\$0
Securities available-for-sale	194,739	194,739	13,937	180,802	0
Restricted investment in bank stocks	6,926	6,926	0	6,926	0
Loans held for sale	1,548	1,603	0	1,603	0
Loans, net	1,255,779	1,251,031	0	0	1,251,031
Interest receivable	4,448	4,448	0	4,448	0
Mortgage servicing rights	324	367	0	0	367
Financial liabilities					
Deposits	\$1,264,177	\$1,262,529	\$0	\$1,262,529	\$0
Short-term borrowings	56,637	56,637	0	56,637	0
Long-term debt	125,310	123,353	0	115,195	8,158
Interest payable	450	450	0	450	0
Off-balance sheet instruments	0	0	0	0	0
December 31, 2015					
Financial assets					
Cash and cash equivalents	\$57,485	\$57,485	\$57,485	\$0	\$0
Securities available-for-sale	213,470	213,470	0	213,470	0
Restricted investment in bank stocks	5,028	5,028	0	5,028	0
Loans held for sale	564	574	0	574	0
Loans, net	1,110,507	1,119,758	0	0	1,119,758
Interest receivable	4,003	4,003	0	4,003	0
Financial liabilities					
Deposits	\$1,094,149	\$1,092,819	\$0	\$1,092,819	\$0
Short-term borrowings	74,510	74,510	0	74,510	0
Long-term debt	120,310	117,041	0	110,195	6,846
Interest payable	468	468	0	468	0

Off-balance sheet instruments	0	0	0	0	0
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**Note 17—Assets and Liabilities Subject to Offsetting***Securities Sold Under Agreements to Repurchase*

PeoplesBank enters into agreements with clients in which it sells securities subject to an obligation to repurchase the same securities (“repurchase agreements”). The contractual maturity of the repurchase agreement is overnight and continues until either party terminates the agreement. These repurchase agreements are accounted for as a collateralized financing arrangement (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability (short-term borrowings) in the Corporation’s consolidated financial statements of condition, while the securities underlying the repurchase agreements are appropriately segregated for safekeeping purposes and remain in the respective securities asset accounts. Thus, there is no offsetting or netting of the securities with the repurchase agreement liabilities.

	<b>Gross</b>	<b>Gross</b>	<b>Net</b>	<b>Gross amounts Not Offset in</b>			
	<b>Amounts of</b>	<b>Amounts</b>	<b>Amounts</b>	<b>the Statements of Condition</b>			
	<b>Recognized</b>	<b>Offset in</b>	<b>of</b>	<b>Financial</b>		<b>Cash</b>	
	<b>Liabilities</b>	<b>the</b>	<b>Liabilities</b>	<b>Instruments</b>	<b>U.S</b>	<b>Collateral</b>	<b>Net</b>
		<b>Statements</b>	<b>Presented</b>	<b>Agency</b>	<b>mortgage-backed,</b>	<b>Pledged</b>	<b>Amount</b>
		<b>of</b>	<b>in</b>		<b>U.S.</b>		
		<b>the</b>	<b>the</b>	<b>residential</b>	<b>agency</b>		
		<b>Statements</b>	<b>Statements</b>				
		<b>of</b>	<b>of</b>				
		<b>Condition</b>	<b>Condition</b>				
<i>(dollars in thousands)</i>							
<b>December 31, 2016</b>							
Repurchase Agreements (1)	\$ 23,637	\$ 0	\$ 23,637	\$ (23,529)	\$(108)	\$ 0	\$0
<b>December 31, 2015</b>							
Repurchase Agreements (1)	\$ 74,510	\$ 0	\$ 74,510	\$ (63,162)	\$(11,348)	\$ 0	\$0

(1) As of December 31, 2016 and 2015, the fair value of securities pledged in connection with repurchase agreements was \$32,535,000 and \$75,094,000, respectively.

**Note 18-Condensed Financial Information-Parent Company Only**

## Condensed Balance Sheets

(dollars in thousands)	December 31,	
	2016	2015
Assets		
Cash and due from banks	\$467	\$13,023
Investment in bank subsidiary	161,027	152,759
Investment in other subsidiaries	317	317
Premises and equipment, net	3,451	3,647
Other assets	612	587
Total assets	\$165,874	\$170,333
Liabilities		
Long-term debt	\$10,310	\$10,310
Long-term debt with bank subsidiary	549	728
Other liabilities	58	154
Total liabilities	10,917	11,192
Shareholders' equity	154,957	159,141
Total liabilities and shareholders' equity	\$165,874	\$170,333

## Condensed Statements of Income and Comprehensive Income

(dollars in thousands)	Years ended December 31,		
	2016	2015	2014
Income			
Interest from investment securities	\$7	\$6	\$6
Dividends from bank subsidiary	2,801	16,116	2,336
Total income	2,808	16,122	2,342
Expense			
Interest expense on long-term debt	275	239	272
Occupancy of premises, net	174	153	154
Other	463	422	316
Total expense	912	814	742
Income before applicable income tax benefit and undistributed earnings (losses) of subsidiaries	1,896	15,308	1,600
Applicable income tax benefit	445	273	249
Income before undistributed earnings (losses) of subsidiaries	2,341	15,581	1,849
Equity in undistributed earnings (losses) of bank subsidiary	10,761	(4,446)	9,920
Net income	\$13,102	\$11,135	\$11,769
Preferred stock dividends	16	120	174
Net income available to common shareholders	\$13,086	\$11,015	\$11,595
Comprehensive income	\$10,610	\$9,839	\$12,264



**Note 18-Condensed Financial Information-Parent Company Only (continued)**

## Condensed Statements of Cash Flows

(dollars in thousands)	Years ended December 31,		
	2016	2015	2014
Cash flows from operating activities			
Net income	\$13,102	\$11,135	\$11,769
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation	208	207	196
Equity in undistributed (earnings) losses of subsidiaries, net	(10,761)	4,446	(9,920 )
Other, net	435	555	216
Net cash provided by operating activities	2,984	16,343	2,261
Cash flows from investing activities			
Additional investment in bank subsidiary	0	(19,775)	0
Outlay for business acquisition	0	(14,425)	0
Return of investment in other subsidiary	0	0	476
Investment in other subsidiary	0	0	(3 )
Purchases of premises and equipment	(12 )	(130 )	(350 )
Net cash (used in) provided by investing activities	(12 )	(34,330)	123
Cash flows from financing activities			
Repayments of long-term debt	(179 )	(172 )	(151 )
Tax benefit on vested restricted stock	0	13	52
Cash dividends paid to preferred shareholders	(46 )	(120 )	(207 )
Cash dividends paid to common shareholders	(4,144 )	(2,991 )	(2,611 )
Redemption of preferred stock	(12,000)	0	(13,000)
Net issuance of common stock	853	33,614	13,982
Cash paid in lieu of fractional shares	(12 )	(12 )	(10 )
Net cash (used in) provided by financing activities	(15,528)	30,332	(1,945 )
Net (decrease) increase in cash and cash equivalents	(12,556)	12,345	439
Cash and cash equivalents at beginning of year	13,023	678	239
Cash and cash equivalents at end of year	\$467	\$13,023	\$678

**Note 19-Quarterly Results of Operations (Unaudited)**

A summary of the quarterly results of operations for the years ended December 31, 2016 and 2015 is shown below.

(dollars in thousands, except per share data)	2016				2015			
	Quarter Fourth	Third	Second	First	Quarter Fourth	Third	Second	First
Interest income	\$16,233	\$15,660	\$15,323	\$15,014	\$14,393	\$14,117	\$13,806	\$13,686
Interest expense	2,231	2,245	2,124	2,049	2,094	2,095	1,977	2,008
Net interest income	14,002	13,415	13,199	12,965	12,299	12,022	11,829	11,678
Provision for loan losses	600	800	800	800	1,200	500	800	1,000
Noninterest income	2,271	2,308	2,211	2,076	2,036	2,040	1,977	1,835
Net gain on sales of loans held for sale	358	262	235	115	178	181	157	151
Noninterest expense	10,530	10,222	10,413	10,458	9,360	9,510	8,968	9,589
Income before taxes and securities gain	5,501	4,963	4,432	3,898	3,953	4,233	4,195	3,075
Net gain on sales of securities	0	0	0	194	0	121	0	371
Income before income taxes	5,501	4,963	4,432	4,092	3,953	4,354	4,195	3,446
Provision for income taxes	1,659	1,560	1,392	1,275	1,183	1,343	1,275	1,012
Net income	3,842	3,403	3,040	2,817	2,770	3,011	2,920	2,434
Preferred stock dividends	0	0	0	16	30	30	30	30
Net income available to common shareholders	\$3,842	\$3,403	\$3,040	\$2,801	\$2,740	\$2,981	\$2,890	\$2,404
Net income per common share, basic (1)	\$0.46	\$0.41	\$0.36	\$0.33	\$0.40	\$0.46	\$0.45	\$0.37
Net income per common share, diluted (1)	\$0.46	\$0.40	\$0.36	\$0.33	\$0.40	\$0.45	\$0.45	\$0.37

(1) adjusted for common stock dividends distributed.

**Note 20-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

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; adjusted:

Basic	\$	1.78
Diluted	\$	1.74

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**Item 9: Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A: Controls and Procedures**

The Corporation maintains controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based upon their evaluation of those controls and procedures required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Exchange Act performed as of December 31, 2016, the Chief Executive and Chief Financial Officers of the Corporation concluded that the Corporation's disclosure controls and procedures were effective. There was no change in the Corporation's internal control over financial reporting that occurred during the quarter ended December 31, 2016 that materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting. A Report of Management's Assessment of Internal Control Over Financial Reporting is located on page 60 of this Annual Report, and incorporated herein by reference.

The Chief Executive and Chief Financial Officers are not aware of any changes in internal controls over financial reporting or in other factors that has materially affected these controls subsequent to December 31, 2016, the date of their evaluation.

**Item 9B: Other information**

None.

## **PART III**

### **Item 10: Directors, executive officers and corporate governance**

Information appearing in the Proxy Statement relating to the 2017 Annual Meeting of Shareholders to be held May 16, 2017 (“Proxy Statement”), under the heading, “Proposal 1-Election of Directors” and the caption “Information about Nominees and Continuing Directors,” under the heading “Information Concerning Security Ownership” and the caption “Executive Officers,” and under the heading “Governance of the Corporation” is incorporated by reference in response to this item.

The Corporation has adopted a Code of Business Conduct and Ethics (“Code of Ethics”) as defined in Item 406 of Regulation S-K. The Code of Ethics was filed as Exhibit 14 to a Form 10-Q filed with the SEC on November 13, 2012, and is incorporated by reference in response to this item. The Code of Ethics is also accessible on PeoplesBank’s website at [www.peoplesbanknet.com](http://www.peoplesbanknet.com). Select “Investor Relations”, then select “Corporate Information” and then select “Governance Documents”.

Information appearing in the Proxy Statement, under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” is incorporated by reference in response to this item.

### **Item 11: Executive compensation**

Information appearing in the Proxy Statement, under the captions “Executive Compensation”, “Director Compensation” and “Compensation Committee Interlocks and Insider Participation” is incorporated by reference in response to this item.

### **Item 12: Security ownership of certain beneficial owners and management and related shareholder matters**

Information appearing on page 26 of this report under the caption “Securities Authorized for Issuance under Equity Compensation Plans” and in the Proxy Statement, under the caption “Information Concerning Security Ownership” is incorporated by reference in response to this item.

Item 13: Certain relationships and related transactions, and director independence

Information appearing in the Proxy Statement, under the captions “Related Person Transactions and Policies” and “Governance of the Corporation” is incorporated by reference in response to this item.

**Item 14: Principal accounting fees and services**

Information appearing in the Proxy Statement, under the caption “Independent Registered Public Accounting Firm,” is incorporated by reference in response to this item.

PART IV

Item 15: Exhibits and financial statement schedules

(a) Documents filed as part of this Form 10-K report.

1. Financial Statements

The following consolidated statements of Codorus Valley Bancorp, Inc. are incorporated by reference to Part II, Item 8 hereof:

Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income

Consolidated Statements of Cash Flows

Consolidated Statements of Changes in Shareholders' Equity

Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Required financial statement schedules are omitted. This information is either not applicable, not required or is shown in the respective financial statements or in the notes thereto.

3. Exhibits filed as part of 10-K pursuant to Item 601 of Regulation S-K.

See Exhibit Index.



## Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Codorus Valley Bancorp, Inc. (Registrant)

/s/ Larry J. Miller  
Larry J. Miller,      Date: March 15, 2017  
Chairman,  
President and  
Chief Executive  
Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

### Signature and Capacity

/s/ Larry J. Miller Larry J. Miller (Principal Executive Officer)	President, Chief Executive Officer, Chairman of the Board of Directors and Director	3/15/17
/s/ D. Reed Anderson D. Reed Anderson, Esq.	Vice-Chairman of the Board of Directors and Lead Director	3/15/17
Brian D. Brunner	Director	3/15/17
/s/ Cynthia A. Dotzel Cynthia A. Dotzel, CPA	Director	3/15/17
/s/ Jeffrey R. Hines Jeffrey R. Hines, P.E.	Director	3/15/17
/s/ MacGregor S. Jones MacGregor S. Jones	Director	3/15/17



/s/ Dallas L. Smith                      Director                      3/15/17  
Dallas L. Smith

/s/ Harry R. Swift                      Director                      3/15/17  
Harry R. Swift, Esq.

/s/ Charles T. Field                      Treasurer and Assistant Secretary                      3/15/17  
Charles T. Field, CPA  
(Principal Financial and Accounting Officer)

**Exhibit Index**

Exhibit Number	Description of Exhibit
3.1	Amended Articles of Incorporation (Incorporated by reference to Exhibit 3.1 of the Quarterly Report on Form 10-Q for June 30, 2016, filed with the Commission on August 8, 2016)
3.2	Amended By-laws (Incorporated by reference to Exhibit 3(ii) to the Registrant’s Current Report on Form 8-K, filed with the Commission on January 12, 2016)
10.1	Employment Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Larry J. Miller, dated December 27, 2005 and amendment dated August 9, 2011(Incorporated by reference to Exhibit 10.1 of the Registrant’s Annual Report on Form 10-K for December 31, 2015, filed with the Commission on March 8, 2016) and second amendment dated

March 8, 2016  
(Incorporated by  
reference to Exhibit  
10.1 to the Registrant's  
Current Report on  
Form 8-K, filed with  
the Commission on  
March 8, 2016) \*

10.2 2000 Stock Incentive  
Plan (Incorporated by  
reference to Exhibit 4.3  
of Registration  
Statement No.  
333-40532 on Form  
S-8, filed with the  
Commission on June  
30, 2000) \*

10.3 2001 Employee Stock  
Bonus Plan  
(Incorporated by  
reference to Exhibit  
99.1 of Registration  
Statement No.  
333-68410 on Form  
S-8, filed with the  
Commission on August  
27, 2001) \*

10.4 Dividend Reinvestment  
and Stock Purchase  
Plan (Incorporated by  
reference to Exhibit  
10.1 of Registration  
Statement No.  
333-179179 on Form  
S-3D, filed with the  
Commission on  
January 26, 2012)

10.5 Salary Continuation  
Agreement between  
PeoplesBank, A  
Codus Valley  
Company and Larry J.  
Miller dated October 1,  
1998 (Incorporated by  
reference to Exhibit  
10.6 of the Registrant's  
Annual Report on

Form 10-K for  
December 31, 2014,  
filed with the  
Commission on March  
10, 2015) \*

10.6 Salary Continuation  
Agreement between  
PeoplesBank, A  
Codus Valley  
Company and Harry R.  
Swift dated October 1,  
1998 (Incorporated by  
reference to Exhibit  
10.7 of the Registrant's  
Annual Report on  
Form 10-K for  
December 31, 2014,  
filed with the  
Commission on March  
10, 2015) \*

10.7 Salary Continuation  
Agreement between  
PeoplesBank, A  
Codus Valley  
Company and Jann  
Allen Weaver dated  
October 1, 1998  
(Incorporated by  
reference to Exhibit  
10.8 of the Registrant's  
Annual Report on  
Form 10-K for  
December 31, 2014,  
filed with the  
Commission on March  
10, 2015) \*

10.8 Amendment to Salary  
Continuation  
Agreement between  
PeoplesBank, A  
Codus Valley  
Company and Larry J.  
Miller dated December  
27, 2005 (Incorporated  
by reference to Exhibit  
10.9 of the Registrant's  
Annual Report on  
Form 10-K for

December 31, 2014,  
filed with the  
Commission on March  
10, 2015) \*

- 10.9 Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Harry R. Swift dated December 27, 2005 (Incorporated by reference to Exhibit 10.10 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.10 Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Jann Allen Weaver dated December 27, 2005 (Incorporated by reference to Exhibit 10.11 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.11 Second Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Larry J. Miller dated December 23, 2008 – (Incorporated by reference to Exhibit 10.12 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.12 Second Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Harry R. Swift dated December 23, 2008 (Incorporated by reference to Exhibit 10.13 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.13 Second Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Jann Allen Weaver dated December 23, 2008 (Incorporated by reference to Exhibit 10.14 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.14 Third Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Larry J. Miller dated May 10, 2016 – (Incorporated by reference to Exhibit 10.1 of the Registrant's Annual Report on Form 8-K filed with the Commission on May 16, 2016) \*
- 10.15 Form of Group Term Replacement Plan, dated January 1, 2009 pertaining to senior officers of the Corporation's subsidiary, PeoplesBank, A Codorus Valley Company (Incorporated by reference to Exhibit 10.16 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.16 Form of Director Group Term Replacement Plan, dated December 1, 1998, including Split Dollar Policy Endorsements pertaining to non-employee directors of the Corporation's subsidiary, PeoplesBank, A Codorus Valley Company (Incorporated by reference to Exhibit 10.16 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015) \*
- 10.17 Long-Term Nursing Care Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Larry J. Miller, dated December 27, 2005 (Incorporated by reference to Exhibit 10.16 of the Registrant's Annual Report on Form 10-K for December 31, 2015, filed with the Commission on March 8, 2016) \*
- 10.18 Codorus Valley Bancorp, Inc. Change in Control and Supplemental Benefit Trust Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Hershey Trust Company, dated January 25, 2006 and Resignation and Appointment of Trustee (Incorporated by reference to Exhibit 10.17 of the Registrant's Annual Report on Form 10-K for December 31, 2015, filed with the Commission on March 8, 2016) \*

- 10.19 Amended and Restated Declaration of Trust of CVB Statutory Trust No. 2, dated as of June 28, 2006, among Codorus Valley Bancorp, Inc., as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on June 30, 2006)
- 10.20 Indenture, dated as of June 28, 2006, between Codorus Valley Bancorp, Inc., as issuer, and the trustee named therein, relating to the Junior Subordinated Debt Securities due 2036. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the Commission on June 30, 2006)
- 10.21 Guarantee Agreement, dated as of June 28, 2006, between Codorus Valley Bancorp, Inc. and guarantee trustee named therein. (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the Commission on June 30, 2006)
- 10.22 2007 Long-Term Incentive Plan of Codorus Valley Bancorp, Inc. (Incorporated by reference to Exhibit A of the Registrant's definitive proxy statement, dated April 6, 2012) \*
- 10.23 2007 Employee Stock Purchase Plan (Incorporated by reference to Exhibit B of the Registrant's definitive proxy statement, dated April 6, 2012) \*
- 10.24 Executive Incentive Plan – filed herewith \*
- 10.25 Form of Change of Control Agreement dated June 23, 2016 by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and each of Diane E. Baker and Amy L. Doll (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 28, 2016)
- 10.26 Employment Agreement of A. Dwight Utz dated September 17, 2015 (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 22, 2015) \*
- 10.27 First Amendment to Employment Agreement of A. Dwight Utz dated April 14, 2016 (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on April 15, 2016) \*
- 10.28 Change of Control Agreement by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Charles T. Field, dated November 9, 2016. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on November 15, 2016) \*
- 10.29

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Change of Control Agreement by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Matthew A. Clemens, dated July 14, 2016 – filed herewith \*

10.30 Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Matthew A. Clemens, dated October 1, 2002 – filed herewith \*

10.31 Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Matthew A. Clemens, dated December 27, 2005 – filed herewith \*

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- 10.32 Second Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Matthew A. Clemens, dated December 23, 2008 – filed herewith \*
  - 10.33 Third Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Matthew A. Clemens, dated March 11, 2014 – filed herewith \*
  - 12 Statements Regarding Computation of Ratios – filed herewith
  - 14 Code of Ethics (Incorporated by reference to Exhibit 14 to the Registrant’s Quarterly Report on Form 10-Q for September 30, 2012 filed with the Commission on November 13, 2012)
  - 21 List of subsidiaries of Codorus Valley Bancorp, Inc.
  - 23 Consents of Independent Registered Public Accounting Firm
  - 24 Power of Attorney
  - 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 32 Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Interactive data file containing the following financial statements of Codorus Valley Bancorp, Inc. formatted in XBRL: (i) Consolidated Balance Sheets at December 31, 2016 and 2015, (ii) Consolidated Statements of Income for the years ended December 31, 2016, 2015, and 2014, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015, and 2014, (iv) Consolidated Statements of Cash Flow for the years ended December 31, 2016, 2015, and 2014, (v) Consolidated Statements of Changes in Shareholders’ Equity for the years ended December 31, 2016, 2015, and 2014 and (vi) Notes to Consolidated Financial Statements – filed herewith.

\* Management contract or compensation plan or arrangement required to be filed or incorporated as an exhibit.