CODORUS VALLEY BANCORP INC
Form 10-Q
November 14, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2011
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from____________to______________

Commission file number: 0-15536

CODORUS VALLEY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania	**23-2428543**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

Not Applicable
(Former name, former address and former fiscal year, if changed since the last report.)

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

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 x No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company x

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. On November 1, 2011, 4,171,105 shares of common stock, par value $2.50, were outstanding.

Codorus Valley Bancorp, Inc.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Codorus Valley Bancorp, Inc.
Consolidated Balance Sheets
Unaudited

(dollars in thousands, except share and per share data)	**September 30, 2011**	**December 31, 2010**
Assets		
Interest bearing deposits with banks	$ 33,836	$ 32,219
Cash and due from banks	12,738	8,050
Federal funds sold	0	3,000
Total cash and cash equivalents	46,574	43,269
Securities, available-for-sale	229,439	222,536
Restricted investment in bank stocks, at cost	3,822	4,067
Loans held for sale	2,966	4,990
Loans (net of deferred fees of $758 - 2011 and $713 - 2010)	685,785	640,849
Less-allowance for loan losses	(8,617)	(7,626)
Net loans	677,168	633,223
Premises and equipment, net	10,755	10,766
Other assets	43,126	38,481
Total assets	$ 1,013,850	$ 957,332
Liabilities		
Deposits		
Noninterest bearing	$ 75,274	$ 65,642
Interest bearing	782,474	740,468
Total deposits	857,748	806,110
Short-term borrowings	11,979	6,763
Long-term debt	36,576	51,732
Junior subordinated debt	10,310	10,310
Other liabilities	6,071	5,878
Total liabilities	922,684	880,793
Shareholders equity		
Preferred stock, par value $2.50 per share; $1,000 liquidation preference, 1,000,000 shares authorized; 25,000 Series B shares issued and outstanding - 2011 and 16,500 Series A - 2010	25,000	15,983
Common stock, par value $2.50 per share; 10,000,000 shares authorized; 4,171,105 shares issued and outstanding - 2011 and 4,131,802 - 2010	10,428	10,330
Additional paid-in capital	37,183	37,290
Retained earnings	12,511	10,798
Accumulated other comprehensive income	6,044	2,138
Total shareholders equity	91,166	76,539
Total liabilities and shareholders equity	$ 1,013,850	$ 957,332

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands, except per share data)	**2011**	**2010**	**2011**	**2010**
Interest income				
Loans, including fees	$ 10,146	$ 9,748	$ 29,058	$ 28,395
Investment securities:				
Taxable	975	826	2,962	2,454
Tax-exempt	598	617	1,840	1,785
Dividends	2	2	6	6
Other	17	25	42	53
Total interest income	11,738	11,218	33,908	32,693
Interest expense				
Deposits	2,817	2,884	8,491	8,494
Federal funds purchased and other short-term borrowings	29	23	82	65
Long-term and junior subordinated debt	285	391	828	1,288
Total interest expense	3,131	3,298	9,401	9,847
Net interest income	8,607	7,920	24,507	22,846
Provision for loan losses	3,560	560	4,785	1,910
Net interest income after provision for loan losses	5,047	7,360	19,722	20,936
Noninterest income				
Trust and investment services fees	384	348	1,124	1,067
Income from mutual fund, annuity and insurance sales	308	329	891	1,091
Service charges on deposit accounts	657	632	1,934	1,843
Income from bank owned life insurance	164	161	489	480
Other income	153	147	453	433
Gains on sales of loans held for sale	126	177	422	538
Gain (loss) on sales of securities	0	0	(25)	108
Total noninterest income	1,792	1,794	5,288	5,560
Noninterest expense				
Personnel	3,218	3,393	10,182	9,812
Occupancy of premises, net	501	465	1,485	1,459
Furniture and equipment	434	405	1,305	1,264
Postage, stationery and supplies	128	112	397	389
Professional and legal	205	121	480	365
Marketing and advertising	278	179	661	529
FDIC insurance	223	331	785	955
Debit card processing	169	156	488	436
Charitable donations	37	43	272	399
Foreclosed real estate including (gains) losses on sales	214	765	1,305	1,749
Impaired loan carrying costs	95	199	521	782
Other	815	772	2,406	2,128
Total noninterest expense	6,317	6,941	20,287	20,267
Income before income taxes	522	2,213	4,723	6,229
Provision (benefit) for income taxes	(139)	433	679	1,113
Net income	661	1,780	4,044	5,116
Preferred stock dividends and discount accretion	657	245	1,148	735
Net income available to common shareholders	$ 4	$ 1,535	$ 2,896	$ 4,381
Net income per common share, basic	$ 0.00	$ 0.37	$ 0.70	$ 1.07
Net income per common share, diluted	$ 0.00	$ 0.37	$ 0.69	$ 1.07

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Cash Flows
Unaudited

(dollars in thousands)	Nine months ended September 30, 2011	2010
Cash flows from operating activities		
Net income	$ 4,044	$ 5,116
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation/amortization	978	1,030
Net amortization of securities	1,060	761
Amortization of deferred loan origination fees and costs	(201)	(263)
Amortization of intangible assets	29	30
Provision for loan losses	4,785	1,910
Provision for losses on foreclosed real estate	388	722
Deferred income tax expense (benefit)	(198)	168
Amortization of investment in real estate partnership	436	421
Increase in cash surrender value of life insurance investment	(489)	(480)
Originations of loans held for sale	(25,184)	(33,456)
Proceeds from sales of loans held for sale	27,630	30,350
Net gain on sales of loans held for sale	(422)	(538)
Loss on disposal of premises and equipment	0	8
Net loss (gain) on sales of securities available-for-sale	25	(108)
Gain on sales of held for sale assets	0	(35)
Net gain on sales of foreclosed real estate	(154)	(110)
Stock-based compensation expense	188	87
(Increase) decrease in accrued interest receivable	322	(126)
(Increase) decrease in other assets	(1,592)	976
Decrease in accrued interest payable	(73)	(19)
Increase in other liabilities	273	3,525
Net cash provided by operating activities	11,845	9,969
Cash flows from investing activities		
Securities, available-for-sale		
Purchases	(34,296)	(89,850)
Maturities, repayments and calls	26,150	25,561
Sales	6,077	4,845
Redemption of restricted investment in bank stock	245	0
Net increase in loans made to customers	(50,414)	(5,890)
Purchases of premises and equipment	(967)	(713)
Investment in life insurance	(7)	(7)
Investment in foreclosed real estate	(4,243)	(8)
Proceeds from sales of foreclosed real estate	728	7,802
Net cash used in investing activities	(56,727)	(58,260)
Cash flows from financing activities		
Net increase in demand and savings deposits	54,435	49,081
Net (decrease) increase in time deposits	(2,797)	23,093
Net increase (decrease) in short-term borrowings	5,216	(1,403)
Proceeds from issuance of long-term debt	15,000	0
Repayment of long-term debt	(30,156)	(21,944)
Cash dividends paid to preferred shareholders	(775)	(619)
Cash dividends paid to common shareholders	(1,078)	(694)
Redemption of preferred stock and common stock warrant	(17,027)	0
Issuance of preferred stock	25,000	0
Issuance of common stock	369	173
Net cash provided by financing activities	48,187	47,687

Net increase (decrease) in cash and cash equivalents		3,305		(604)
Cash and cash equivalents at beginning of year		43,269		26,179
Cash and cash equivalents at end of period	$	46,574	$	25,575

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Changes in Shareholders Equity
Unaudited

(dollars in thousands, except per share data)	**Preferred Stock**	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income**	**Total**
Balance, January 1, 2011	$ 15,983	$ 10,330	$ 37,290	$ 10,798	$ 2,138	$ 76,539
Comprehensive income:						
Net income				4,044		4,044
Other comprehensive gain, net of tax:						
Unrealized gains on securities, net					3,906	3,906
Total comprehensive income						7,950
Preferred stock discount accretion	478			(478)		0
Common stock cash dividends ($0.26 per share)				(1,078)		(1,078)
Preferred stock dividends				(775)		(775)
Redemption of preferred stock and repurchase of common stock warrant	(16,461)		(566)			(17,027)
Issuance of preferred stock	25,000					25,000
Stock-based compensation			188			188
Issuance of common stock:						
19,291 shares under dividend reinvestment and stock purchase plan		48	153			201
14,682 shares under stock option plan		37	89			126
5,330 shares under employee stock purchase plan		13	29			42
Balance, September 30, 2011	$ 25,000	$ 10,428	$ 37,183	$ 12,511	$ 6,044	$ 91,166
Balance, January 1, 2010	$ 15,828	$ 10,187	$ 37,004	$ 6,592	$ 2,401	$ 72,012
Comprehensive income:						
Net income				5,116		5,116
Other comprehensive gain, net of tax:						
Unrealized gains on securities, net					2,360	2,360
Total comprehensive income						7,476
Preferred stock discount accretion	116			(116)		0
Common stock cash dividends ($0.17 per share)				(694)		(694)
Preferred stock dividends				(619)		(619)
Stock-based compensation			87			87
Issuance of common stock:						
17,759 shares under dividend reinvestment and stock purchase plan		44	92			136
7,932 shares under employee stock purchase plan		20	17			37
Balance, September 30, 2010	$ 15,944	$ 10,251	$ 37,200	$ 10,279	$ 4,761	$ 78,435

See accompanying notes.

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Notes to Consolidated Financial Statements (Unaudited)

Note 1 Basis of Presentation

The accompanying consolidated balance sheet at December 31, 2010 has been derived from audited financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, the instructions to Form 10-Q, and FASB Accounting Standards Codification (ASC) 270. Accordingly, the interim financial statements do not include all of the financial information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the interim consolidated financial statements include all adjustments necessary to present fairly the financial condition and results of operations for the reported periods, and are of a normal and recurring nature.

These consolidated statements should be read in conjunction with the notes to the audited consolidated financial statements contained in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2010.

The consolidated financial statements include the accounts of Codorus Valley Bancorp, Inc. and its wholly owned bank subsidiary, PeoplesBank, A Codorus Valley Company (PeoplesBank), and its wholly owned nonbank subsidiary, SYC Realty Company, Inc. (collectively referred to as Codorus Valley or the Corporation). PeoplesBank has four wholly-owned subsidiaries, Codorus Valley Financial Advisors, Inc., SYC Settlement Services, Inc. and two subsidiaries whose purpose is to temporarily hold foreclosed properties pending eventual liquidation. All significant intercompany account balances and transactions have been eliminated in consolidation. The combined results of operations of the nonbank subsidiaries are not material to the consolidated financial statements.

The results of operations for the nine-month period ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year.

In accordance with FASB ASC 855, the Corporation evaluated the events and transactions that occurred after the balance sheet date of September 30, 2011, and through the date these financial statements were issued for items of potential recognition or disclosure.

Note 2 Significant Accounting Policies

Loans

Loans 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 loan 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, 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 adequately 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 is determined based on contractual due dates for loan payments.

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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 uncollectible 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 are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is unlikely. 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.

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 and general allocations and an unallocated component. The specific allocation 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 allocation 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 include:

- 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

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. An unallocated component is maintained to cover uncertainties that could affect the Corporation s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the loan portfolio.

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As disclosed in Note 5-Loans, the Corporation engages in commercial and consumer lending. Loans are made within the Corporation s primary market area and surrounding areas, and include the purchase of whole loans or participation interests in loans from other financial institutions. Commercial related 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 increased 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.

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. Commercial loans that are collateral dependent and deemed impaired are generally evaluated for impairment loss based on the fair value of the collateral. For commercial loans that are not collateral dependent, the Corporation relies on the present value of expected future cash flows, discounted at the loan s effective interest rate, to determine any impairment loss. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual residential mortgage loans, home equity loans and other consumer loans for impairment disclosures, unless such loans are classified as troubled debt restructurings.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value less estimated selling costs (i.e., net realizable value). For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. 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. Appraised values 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.

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 a reduction of the debt, accrued interest or interest rate, or extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk. 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. Loans classified as troubled debt restructurings are designated as impaired.

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Federal 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 September 30, 2011 is adequate.

Foreclosed Real Estate

Foreclosed real estate, included in other assets, is comprised of property acquired through a foreclosure proceeding, property that is acquired through acceptance of a deed-in-lieu of foreclosure and property that has not yet been acquired but which is classified as an insubstance 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. 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 through a valuation allowance. Costs related to the improvement of foreclosed real estate are generally capitalized until the real estate reaches a saleable condition. Revenue and expense from operations and changes in the valuation allowance are included in 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 September 30, 2011, foreclosed real estate, net of allowance, was $15,739,000, compared to $10,572,000 for December 31, 2010.

Per Common Share Computations

The weighted average number of shares of common stock outstanding used for basic and diluted calculations are provided below:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands, except per share data)	**2011**	**2010**	**2011**	**2010**
Net income available to common shareholders	$ 4	$ 1,535	$ 2,896	$ 4,381
Weighted average shares outstanding (basic)	4,167	4,097	4,152	4,086
Effect of dilutive stock options	39	9	45	4
Weighted average shares outstanding (diluted)	4,206	4,106	4,197	4,090
Basic earnings per common share	$ 0.00	$ 0.37	$ 0.70	$ 1.07
Diluted earnings per common share	$ 0.00	$ 0.37	$ 0.69	$ 1.07
Anti-dilutive stock options and common stock warrants excluded from the computation of earnings per share	88	421	88	427

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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 equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income and related tax effects are presented in the following table:

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	2011	2010	2011	2010
Unrealized holding gains arising during the period	$ 2,461	$ 958	$ 5,893	$ 3,684
Reclassification adjustment for (gains) losses included in income	0	0	25	(108)
Net unrealized gains	2,461	958	5,918	3,576
Tax effect	(837)	(326)	(2,012)	(1,216)
Net of tax amount	$ 1,624	$ 632	$ 3,906	$ 2,360

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. Non-cash items for the nine-month period ended September 30, 2011 consisted of the transfer of loans to foreclosed real estate in the amount of $1,885,000. The increase in other liabilities includes accounts payable for investment in foreclosed real estate of $476,000. Comparatively, for the nine-month period ended September 30, 2010, non-cash items consisted of the transfer of loans to foreclosed real estate in the amount of $8,291,000 and the transfer of loans held for sale to investment in the amount of $160,000.

Recent Accounting Pronouncements

The FASB issued ASU No. 2011-05, Presentation of Comprehensive Income . The provisions of this Update amend FASB ASC Topic 220, *Comprehensive Income*, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The Update prohibits the presentation of the components of comprehensive income in the statement of shareholders equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all 3 presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this Update are effective for fiscal years and interim periods beginning after December 31, 2011 for public entities. As the two remaining options for presentation existed prior to the issuance of this Update, early adoption is permitted. The Corporation is evaluating the impact of the Update on its consolidated financial statements.

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The FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S GAAP and IFRSs. This Update amends FASB ASC Topic 820, Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The Update clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity s stockholder s equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The Update also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The Update also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. This Update is effective for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The Corporation is evaluating the impact of this Update on its consolidated financial statements.

In November 2008, the Securities and Exchange Commission (SEC) released a proposed roadmap regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards (IFRS). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board (IASB). Under the proposed roadmap, the Corporation may be required to prepare financial statements in accordance with IFRS as early as 2015. The SEC has indicated it will make a determination in 2011 regarding the mandatory adoption of IFRS. The Corporation is currently assessing the impact that this potential change would have on its consolidated financial statements, and it will continue to monitor the development of the potential implementation of IFRS.

Note 3-Securities

A summary of securities, available-for-sale at September 30, 2011 and December 31, 2010 is provided below:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
September 30, 2011				
Debt securities:				
U.S. Treasury notes	$ 10,005	$ 149	$ 0	$ 10,154
U.S. agency	29,612	1,140	0	30,752
U.S. agency mortgage-backed, residential	100,137	3,927	0	104,064
State and municipal	80,527	3,946	(4)	84,469
Total debt securities	$ 220,281	$ 9,162	$ (4)	$ 229,439
December 31, 2010				
Debt securities:				
U.S. Treasury notes	$ 8,014	$ 126	$ 0	$ 8,140
U.S. agency	13,519	155	(31)	13,643
U.S. agency mortgage-backed, residential	108,967	2,213	(827)	110,353
State and municipal	88,796	2,079	(475)	90,400
Total debt securities	$ 219,296	$ 4,573	$ (1,333)	$ 222,536

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The amortized cost and estimated fair value of debt securities at September 30, 2011 by contractual maturity are shown below. Actual maturities may differ from contractual maturities if call options on select debt issues are exercised in the future. Mortgage-backed securities are included in the maturity categories based on average expected life.

	Available-for-sale	
(dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 12,228	$ 12,331
Due after one year through five years	144,051	150,112
Due after five years through ten years	60,179	63,033
Due after ten years	3,823	3,963
Total debt securities	$ 220,281	$ 229,439

Gross realized gains and losses on sales of securities are shown below.

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	2011	2010	2011	2010
Realized gains	$ 0	$ 0	$ 79	$ 108
Realized losses	0	0	(104)	0
Net gains (losses)	$ 0	$ 0	$ (25)	$ 108

Realized gains and losses from the sale of securities, available-for-sale 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.

Securities, issued by agencies of the federal government, with a carrying value of $140,819,000 and $125,785,000 on September 30, 2011 and December 31, 2010, respectively, were pledged to secure public and trust deposits, repurchase agreements, other short-term borrowings and Federal Home Loan Bank debt.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time, for securities, available-for-sale that have been in a continuous unrealized loss position, at September 30, 2011 and December 31, 2010.

	Less than 12 months		12 months or more		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2011						
Debt securities:						
State and municipal	$ 899	$ 4	$ 0	$ 0	$ 899	$ 4
Total temporarily impaired debt securities	$ 899	$ 4	$ 0	$ 0	$ 899	$ 4
December 31, 2010						
Debt securities:						
U.S. agencies	$ 4,969	$ 31	$ 0	$ 0	$ 4,969	$ 31
U.S. agency mortgage-backed, residential	50,982	827	0	0	50,982	827
State and municipal	20,382	429	350	46	20,732	475
Total temporarily impaired debt securities	$ 76,333	$ 1,287	$ 350	$ 46	$ 76,683	$ 1,333

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At September 30, 2011, the unrealized losses of $4,000 within the less than 12 months category were attributable to two different municipal issues with one rated AA+ by Standard & Poor s rating service and the other rated Aa2 by the Moody s rating service.

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

The Corporation believes that unrealized losses at September 30, 2011 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. To date, 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 Restricted Investment in Bank Stocks

Restricted stock represents required investments in the common stock of correspondent banks, consisting primarily of the common stock of Federal Home Loan Bank of Pittsburgh (FHLB) and, to a lesser degree, Atlantic Central Bankers Bank (ACBB) and is carried at cost as of September 30, 2011 and December 31, 2010. Under the FHLB 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 borrowing from the FHLB. In December 2008, the FHLB notified member banks that it was suspending dividend payments and the repurchase of capital stock as strategies to preserve its capital. During 2010, the FHLB partially lifted its restriction on capital stock repurchases.

The Corporation evaluates the restricted stock for impairment in accordance with FASB ASC Topic 942. The determination of whether these investments are impaired is based on an assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as: (1) the significance of the decline in net assets of the issuer as compared to the capital stock amount for the issuer and the length of time this situation has persisted, (2) commitments by the issuer to make payments required by law or regulation and the level of such payments in relation to the operating performance of the issuer, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuer. The Corporation believes that no impairment charge was necessary related to the restricted stock during the periods ended September 30, 2011 and 2010.

Note 5 Loans

The table below provides the composition of the loan portfolio at September 30, 2011 and December 31, 2010. The portfolio is comprised of two segments, commercial and consumer loans. The commercial loan segment is disaggregated by industry class which allows us 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 a multitude of industries, including: health services, professional services, public administration, restaurant, service, transportation, finance, natural resources, recreation and religious organizations. The consumer related segment is comprised of residential mortgages, home equity and other consumer loans. The Corporation does not engage in sub-prime residential mortgage originations.

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(dollars in thousands)		September 30, 2011		December 31, 2010
Builder & developer	$	102,605	$	95,735
Commercial real estate investor		110,672		95,281
Residential real estate investor		60,559		55,930
Hotel/Motel		51,034		48,041
Wholesale & retail		56,750		44,963
Manufacturing		25,857		24,989
Agriculture		17,221		14,247
Other		129,741		136,198
Total commercial related loans		554,439		515,384
Residential mortgages		22,472		20,357
Home equity		58,366		56,294
Other		50,508		48,814
Total consumer related loans		131,346		125,465
Total loans	$	685,785	$	640,849

Note 6 Loan Quality

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

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. Accordingly, 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.

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The table below presents a summary of loan risk ratings by loan class at September 30, 2011 and December 31, 2010.

(dollars in thousands)	Pass	Special Mention	Substandard	Nonaccrual	Total
September 30, 2011					
Builder & developer	$ 94,206	$ 6,152	$ 460	$ 1,787	$ 102,605
Commercial real estate investor	98,326	10,105	0	2,241	110,672
Residential real estate investor	58,362	1,623	0	574	60,559
Hotel/Motel	51,034	0	0	0	51,034
Wholesale & retail	50,580	2,198	1,405	2,567	56,750
Manufacturing	25,132	725	0	0	25,857
Agriculture	16,727	0	494	0	17,221
Other	115,296	8,385	2,088	3,972	129,741
Total commercial related loans	509,663	29,188	4,447	11,141	554,439
Residential mortgage	22,244	0	41	187	22,472
Home equity	58,068	90	188	20	58,366
Other	49,613	285	344	266	50,508
Total consumer related loans	129,925	375	573	473	131,346
Total loans	$ 639,588	$ 29,563	$ 5,020	$ 11,614	$ 685,785
December 31, 2010					
Builder & developer	$ 84,409	$ 2,647	$ 453	$ 8,226	$ 95,735
Commercial real estate investor	85,420	9,534	148	179	95,281
Residential real estate investor	55,346	94	0	490	55,930
Hotel/Motel	48,041	0	0	0	48,041
Wholesale & retail	37,252	1,850	1,019	4,842	44,963
Manufacturing	24,989	0	0	0	24,989
Agriculture	13,747	0	500	0	14,247
Other	123,965	6,300	1,913	4,020	136,198
Total commercial related loans	473,169	20,425	4,033	17,757	515,384
Residential mortgage	20,109	0	43	205	20,357
Home equity	56,183	12	0	99	56,294
Other	47,933	418	0	463	48,814
Total consumer related loans	124,225	430	43	767	125,465
Total loans	$ 597,394	$ 20,855	$ 4,076	$ 18,524	$ 640,849

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The table below presents a summary of impaired loans at September 30, 2011 and December 31, 2010. Generally, impaired loans are loans risk rated substandard and nonaccrual. An allowance is established for those individual loans that are commercial related and only those consumer related loans classified as troubled debt restructurings where the Corporation has doubt as to full recovery of the outstanding principal balance. The recorded investment represents outstanding unpaid principal loan balances adjusted for charge-offs.

	September 30, 2011			December 31, 2010		
(dollars in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
Impaired loans with no related allowance:						
Builder & developer	$ 1,983	$ 2,883	$ 0	$ 8,260	$ 8,260	$ 0
Commercial real estate investor	2,078	2,078	0	0	0	0
Residential real estate investor	482	482	0	394	394	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	3,972	6,247	0	1,019	1,019	0
Manufacturing	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Other commercial	5,180	5,180	0	5,219	5,219	0
Residential mortgage	228	384	0	248	294	0
Home equity	208	208	0	99	99	0
Other consumer	610	610	0	463	463	0
Total impaired loans with no related allowance	$ 14,741	$ 18,072	$ 0	$ 15,702	$ 15,748	$ 0
Impaired loans with a related allowance:						
Builder & developer	$ 264	$ 264	$ 147	$ 419	$ 419	$ 25
Commercial real estate investor	163	263	25	327	427	185
Residential real estate investor	92	92	30	96	96	10
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	0	0	0	4,842	4,842	675
Manufacturing	0	0	0	0	0	0
Agriculture	494	494	100	500	500	100
Other commercial	880	880	120	714	714	200
Residential mortgage	0	0	0	0	0	0
Home equity	0	0	0	0	0	0
Other consumer	0	0	0	0	0	0
Total impaired loans with a related allowance	$ 1,893	$ 1,993	$ 422	$ 6,898	$ 6,998	$ 1,195
Total impaired loans:						
Builder & developer	$ 2,247	$ 3,147	$ 147	$ 8,679	$ 8,679	$ 25
Commercial real estate investor	2,241	2,341	25	327	427	185
Residential real estate investor	574	574	30	490	490	10
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	3,972	6,247	0	5,861	5,861	675
Manufacturing	0	0	0	0	0	0
Agriculture	494	494	100	500	500	100
Other commercial	6,060	6,060	120	5,933	5,933	200
Residential mortgage	228	384	0	248	294	0
Home equity	208	208	0	99	99	0
Other consumer	610	610	0	463	463	0
Total impaired loans	$ 16,634	$ 20,065	$ 422	$ 22,600	$ 22,746	$ 1,195

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The table below presents a summary of average impaired loans and related interest income for three and nine months ended September 30, 2011.

	Three months ended September 30, 2011			Nine months ended September 30, 2011		
(dollars in thousands)	Average Recorded Investment	Interest Income	Cash Basis	Average Recorded Investment	Interest Income	Cash Basis
Impaired loans with no related allowance:						
Builder & developer	$ 3,852	$ 172	$ 165	$ 5,601	$ 392	$ 374
Commercial real estate investor	2,049	20	14	1,025	36	26
Residential real estate investor	483	1	0	438	2	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,695	25	0	1,857	65	0
Manufacturing	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Other commercial	5,627	86	65	5,428	332	264
Residential mortgage	272	2	1	277	12	11
Home equity	208	1	0	134	2	0
Other consumer	664	10	5	576	29	14
Total impaired loans with no related allowance	$ 15,850	$ 317	$ 250	$ 15,336	$ 870	$ 689
Impaired loans with a related allowance:						
Builder & developer	$ 1,366	$ 0	$ 0	$ 929	$ 0	$ 0
Commercial real estate investor	166	0	0	208	0	0
Residential real estate investor	92	0	0	94	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,421	0	0	3,632	0	0
Manufacturing	0	0	0	0	0	0
Agriculture	496	9	0	498	26	0
Other commercial	791	18	0	751	22	0
Residential mortgage	0	0	0	0	0	0
Home equity	0	0	0	0	0	0
Other consumer	0	0	0	0	0	0
Total impaired loans with a related allowance	$ 5,332	$ 27	$ 0	$ 6,112	$ 48	$ 0
Total impaired loans:						
Builder & developer	$ 5,218	$ 172	$ 165	$ 6,530	$ 392	$ 374
Commercial real estate investor	2,215	20	14	1,233	36	26
Residential real estate investor	575	1	0	532	2	0
Hotel/Motel	0	0	0	0		