CODORUS VALLEY BANCORP INC
Form 10-Q
May 06, 2015

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2015
or
Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from____________to______________

Commission file number: 0-15536

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

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

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

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

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

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. On May 1, 2015, −−−−−−−5,848,726 shares of common stock, par value $2.50, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Codorus Valley Bancorp, Inc.
Consolidated Balance Sheets

(dollars in thousands, except share and per share data)	(Unaudited) March 31, 2015	December 31, 2014
Assets		
Interest bearing deposits with banks	$ 12,934	$ 17,420
Cash and due from banks	13,888	13,674
Total cash and cash equivalents	26,822	31,094
Securities, available-for-sale	218,895	213,174
Restricted investment in bank stocks, at cost	3,799	3,799
Loans held for sale	1,400	464
Loans (net of deferred fees of $2,445 - 2015 and $2,249 - 2014)	1,020,792	920,090
Less-allowance for loan losses	(11,435)	(11,162)
Net loans	1,009,357	908,928
Premises and equipment, net	21,501	18,471
Goodwill	2,421	0
Other assets	39,478	37,916
Total assets	$ 1,323,673	$ 1,213,846
Liabilities		
Deposits		
Noninterest bearing	$ 134,620	$ 121,673
Interest bearing	939,511	833,300
Total deposits	1,074,131	954,973
Short-term borrowings	29,161	42,184
Long-term debt	90,383	90,406
Other liabilities	9,320	7,843
Total liabilities	1,202,995	1,095,406
Shareholders' equity		
Preferred stock, par value $2.50 per share; $1,000 liquidation preference, 1,000,000 shares authorized; Series B shares issued and outstanding: 12,000 at March 31, 2015 and December 31, 2014	12,000	12,000
Common stock, par value $2.50 per share; 15,000,000 shares authorized; shares issued: 5,844,614 at March 31, 2015 and 5,830,913 at December 31, 2014; and shares outstanding: 5,842,238 at March 31, 2015 and 5,830,913 at December 31, 2014	14,611	14,577
Additional paid-in capital	62,957	62,713
Retained earnings	28,158	26,483
Accumulated other comprehensive income	2,958	2,667

Treasury stock, at cost; 2,376 shares at March 31, 2015	(6)	0
Total shareholders' equity	120,678	118,440
Total liabilities and shareholders' equity	$ 1,323,673	$ 1,213,846

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

(dollars in thousands, except per share data)	Three months ended March 31, 2015	2014
Interest income		
Loans, including fees	$12,307	$11,000
Investment securities:		
Taxable	780	839
Tax-exempt	422	541
Dividends	158	30
Other	19	3
Total interest income	13,686	12,413
Interest expense		
Deposits	1,640	1,671
Federal funds purchased and other short-term borrowings	41	36
Long-term debt	327	285
Total interest expense	2,008	1,992
Net interest income	11,678	10,421
Provision for loan losses	1,000	550
Net interest income after provision for loan losses	10,678	9,871
Noninterest income		
Trust and investment services fees	601	527
Income from mutual fund, annuity and insurance sales	156	133
Service charges on deposit accounts	757	678
Income from bank owned life insurance	171	173
Other income	150	139
Net gain on sales of loans held for sale	151	80
Gain on sales of securities	371	0
Total noninterest income	2,357	1,730
Noninterest expense		
Personnel	5,260	4,316
Occupancy of premises, net	800	566
Furniture and equipment	678	543
Postage, stationery and supplies	163	159
Professional and legal	174	183
Marketing	219	307
FDIC insurance	175	189
Debit card processing	202	200
Charitable donations	724	737

Telephone	161	146
External data processing	282	202
Merger related	425	0
Foreclosed real estate including (gains) losses on sales	117	80
Other	209	20
Total noninterest expense	9,589	7,648
Income before income taxes	3,446	3,953
Provision for income taxes	1,012	950
Net income	2,434	3,003
Preferred stock dividends	30	62
Net income available to common shareholders	$2,404	$2,941
Net income per common share, basic	$0.41	$0.58
Net income per common share, diluted	$0.41	$0.56

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Comprehensive Income
Unaudited

(dollars in thousands)	Three months ended March 31, 2015	2014
Net income	$2,434	$3,003
Other comprehensive income:		
Securities available for sale:		
Net unrealized holding gains arising during the period (net of tax expense of $24 and $198, respectively)	46	385
Reclassification adjustment for gains included in net income (net of tax expense of $126 and $0, respectively) (a) (b)	245	0
Net unrealized gains	291	385
Comprehensive income	$2,725	$3,388

(a) Amounts are included in net gain on sales of securities on the Consolidated Statements of Income within noninterest income.
(b) Income tax amounts are included in provision for income taxes on the Consolidated Statements of Income.

See accompanying notes.

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

(dollars in thousands)	Three months ended March 31, 2015	2014
Cash flows from operating activities		
Net income	$2,434	$3,003
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation/amortization	557	436
Net amortization of premiums on securities	251	240
Amortization of deferred loan origination fees and costs	(197)	(166)
Provision for loan losses	1,000	550
Provision for losses on foreclosed real estate	59	0
Deferred income tax benefit	0	(145)
Amortization of investment in real estate partnership	0	89
Increase in bank owned life insurance	(171)	(173)
Originations of loans held for sale	(7,885)	(4,626)
Proceeds from sales of loans held for sale	7,100	3,894
Net gain on sales of loans held for sale	(151)	(80)
Net loss on disposal of premises and equipment	0	(4)
Gain on sales of securities, available-for-sale	(371)	0
Net loss on sales of foreclosed real estate	9	0
Stock-based compensation	71	77
Increase in interest receivable	(27)	(20)
Decrease (increase) in other assets	510	(465)
Increase in interest payable	10	19
(Decrease) increase in other liabilities	(168)	2,733
Net cash provided by operating activities	3,031	5,362
Cash flows from investing activities		
Purchases of securities, available-for-sale	(19,082)	(3,108)
Maturities, repayments and calls of securities, available-for-sale	8,148	8,687
Sales of securities, available-for-sale	7,170	0
Redemption of restricted investment in bank stock	0	232
Net proceeds from acquisition	21,091	0
Proceeds from acquired receivables of sold investment settlements	15,256	0
Net increase in loans made to customers	(24,004)	(12,846)
Purchases of premises and equipment	(1,004)	(296)
Proceeds from sale of fixed assets	18	0
Proceeds from sales of foreclosed real estate	95	685
Net cash provided by (used in) investing activities	7,688	(6,646)
Cash flows from financing activities		
Net increase in demand and savings deposits	16,571	21,397
Net (decrease) increase in time deposits	(17,958)	2,238

Net decrease in short-term borrowings	(13,023)	(17,549)
Proceeds from issuance of long-term debt	0	10,000
Repayment of long-term debt	(23)	(21)
Cash dividends paid to preferred shareholder	(30)	(62)
Cash dividends paid to common shareholders	(729)	(577)
Issuance of common stock	201	12,887
Net cash (used in) provided by financing activities	(14,991)	28,313
Net (decrease) increase in cash and cash equivalents	(4,272)	27,029
Cash and cash equivalents at beginning of year	31,094	15,062
Cash and cash equivalents at end of period	$26,822	$42,091

See accompanying notes.

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

(dollars in thousands, except per share data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance, January 1, 2015	$ 12,000	$ 14,577	$ 62,713	$ 26,483	$ 2,667	$ 0	$ 118,440
Net income				2,434			2,434
Other comprehensive income, net of tax					291		291
Common stock cash dividends ($0.125 per share)				(729)			(729)
Preferred stock cash dividends				(30)			(30)
Stock-based compensation including related tax benefit			71				71
Forfeiture of restricted stock			6			(6)	0
Issuance and reissuance of common stock including related tax benefit:							
5,133 shares under the dividend reinvestment and stock purchase plan		13	87				100
8,568 shares under the stock option plan		21	80				101
Balance, March 31, 2015	$ 12,000	$ 14,611	$ 62,957	$ 28,158	$ 2,958	$ (6)	$ 120,678
Balance, January 1, 2014	$ 25,000	$ 12,001	$ 45,399	$ 23,077	$ 2,172	$ 0	$ 107,649
Net income				3,003			3,003
Other comprehensive income, net of tax					385		385
Common stock cash dividends ($0.119 per share, adjusted)				(577)			(577)
Preferred stock cash dividends				(62)			(62)
Stock-based compensation including related tax benefit			77				77
Forfeiture of restricted stock			1			(1)	0
Issuance and reissuance of common stock including related tax benefit:							
		1,625	10,929				12,554

650,000 shares through private placement							
4,612 shares under the dividend reinvestment and stock purchase plan		11	81			1	93
16,292 shares under the stock option plan		40	200				240
Balance, March 31, 2014	$ 25,000	$ 13,677	$ 56,687	$ 25,441	$ 2,557	$ 0	$ 123,362

See accompanying notes.

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Note 1—Summary of Significant Accounting Policies

Nature of Operations and Basis of Presentation
The accompanying consolidated balance sheet at December 31, 2014 has been derived from audited financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, the instructions to Form 10-Q, and FASB Accounting Standards Codification (ASC) 270. Accordingly, the interim financial statements do not include all of the financial information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the interim consolidated financial statements include all adjustments necessary to present fairly the financial condition and results of operations for the reported periods, and all such adjustments are of a normal and recurring nature.

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

The consolidated financial statements include the accounts of Codorus Valley and its wholly-owned bank subsidiary, PeoplesBank, and two wholly-owned nonbank subsidiaries, SYC Realty Company, Inc. and CVLY Corp. SYC Realty is primarily used to hold foreclosed properties obtained by PeoplesBank and was inactive during the period ended March 31, 2015. CVLY Corp. was formed in connection with the acquisition of Madison Bancorp, Inc. The accounts of CVB Statutory Trust No. 1 and No. 2 are not included in the consolidated financial statements as discussed in Note 8—Short-Term Borrowings and Long-Term Debt. All significant intercompany account balances and transactions have been eliminated in consolidation. The accounting and reporting policies of Codorus Valley and subsidiaries conform to accounting principles generally accepted in the United States of America and have been followed on a consistent basis.

These consolidated statements should be read in conjunction with the notes to the audited consolidated financial statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2014.

The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for the full year.

In accordance with FASB ASC 855, the Corporation evaluated the events and transactions that occurred after the balance sheet date of March 31, 2015 and through the date these consolidated financial statements were issued, for items of potential recognition or disclosure.

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Loans

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

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A loan may remain on accrual status if it is in the process of collection and well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to the Corporation’s judgment as to the collectability of principal. Generally, 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.

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Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company 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 Company 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 Company 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 2-Merger With Madison Bancorp, Inc.:

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

Allowance for Loan Losses

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

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

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

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

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

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

Banking regulatory agencies, as an integral part of their examination process, periodically review the Corporation’s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to the Corporation. Based on an analysis of the loan portfolio, the Corporation believes that the level of the allowance for loan losses at March 31, 2015 is adequate.

Foreclosed Real Estate
Foreclosed real estate, included in other assets, is comprised of property acquired through a foreclosure proceeding or property that is acquired through in-substance foreclosure. Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Any difference between the carrying value and the new cost basis is charged against the allowance for loan losses. Appraisals, based upon 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 March 31, 2015, foreclosed real estate, net of allowance, was $2,385,000, compared to $2,542,000 as of December 31, 2014. Included within loans receivable as of March 31, 2015 was a recorded investment of $507,000 of consumer mortgage loans secured by residential real estate properties, for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdiction.

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Goodwill and Core Deposit Intangible Assets
Goodwill arising from acquisitions is not amortized, but is subject to an annual impairment test to determine if an impairment loss has occurred. 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. At March 31, 2015, the Corporation does not have any indicators of potential impairment of goodwill.

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 10 years.

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

	Three months ended March 31,	
(in thousands, except per share data)	2015	2014
Net income available to common shareholders	$2,404	$2,941
Weighted average shares outstanding (basic)	5,836	5,098
Effect of dilutive stock options	76	110
Weighted average shares outstanding (diluted)	5,912	5,208
Basic earnings per common share	$0.41	$0.58
Diluted earnings per common share	$0.41	$0.56
Anti-dilutive stock options excluded from the computation of earnings per share	35	24

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

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

Supplemental cash flow information is provided in the table below.

	Three months ended March 31,	
(dollars in thousands)	2015	2014
Cash paid during the period for:		
Income taxes	$ 350	$ 1
Interest	$ 1,998	$ 1,973
Noncash investing activities:		
Transfer of loans to foreclosed real estate	$ 0	$ 252

Recent Accounting Pronouncements
In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606).
This standards update provides a framework that replaces most existing revenue recognition guidance. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

Note 2-Merger With Madison Bancorp, Inc.

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

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The merger is being 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 fair value estimates are subject to change for up to one year after the closing date of the transaction if additional information relative to the closing date fair values becomes available. As the Corporation continues to analyze the acquired assets and liabilities, there may be adjustments to the recorded carrying values. 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 January 16, 2015.

(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	17,447	
Total assets acquired		134,188
Liabilities Assumed:		
Deposits	120,545	
Other liabilities	1,639	
Total liabilities assumed		122,184
Net goodwill resulting from merger		$2,421

The fair value of total assets acquired as a result of the merger totaled $134,188,000, which included $1,396,000 of securities which were subsequently sold in the first quarter of 2015. Additionally, other assets of $17,447,000 included $15,256,000 of receivables related to investment securities sold prior to the merger, pending receipt of sales proceeds. The transaction also resulted in a core deposit intangible of $39,000 and goodwill of $2,421,000. 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.

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The following table presents unaudited pro forma information as if the merger between PeoplesBank and MSFSB had been completed on January 1, 2014. Nonrecurring merger related expenses of $1,423,000 related to the acquisition of MSFSB are reflected in the unaudited pro forma amounts. The pro forma information does not necessarily reflect the results of operations that would have occurred had MSFSB merged with PeoplesBank at the beginning of 2014. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, cost savings, or other factors.

(in thousands, except per share data)	Pro forma for the year ended December 31, 2014	
Net interest income	$	44,598
Noninterest income		8,246
Net income available to common shareholders		10,972
Pro forma earnings per share:		
Basic	$	1.96
Diluted	$	1.92

Note 3-Securities

A summary of securities available-for-sale at March 31, 2015 and December 31, 2014 is provided below. The securities available-for-sale portfolio is generally comprised of high quality debt instruments, principally obligations of the United States government or agencies thereof and investments in the obligations of states and municipalities. The majority of municipal bonds in the portfolio are general obligation bonds, which can draw upon multiple sources of revenue, including taxes, for payment. Only a few bonds are revenue bonds, which are dependent upon a single revenue stream for payment, but they are for critical services such as water and sewer. In many cases, municipal debt issues are insured or, in the case of school districts of selected states, backed by specific loss reserves. At March 31, 2015, the fair value of the municipal bond portfolio was concentrated in the states of Pennsylvania at 46 percent and Texas at 16 percent.

	Amortized	Gross Unrealized		Fair
(dollars in thousands)	Cost	Gains	Losses	Value
March 31, 2015				
Debt securities:				
U.S. agency	$19,229	$23	$(28)	$19,224
U.S. agency mortgage-backed, residential	126,043	3,048	(8)	129,083
State and municipal	69,141	1,469	(22)	70,588
Total debt securities	$214,413	$4,540	$(58)	$218,895
December 31, 2014				
Debt securities:				
U.S. agency	$17,811	$193	$(97)	$17,907
U.S. agency mortgage-backed, residential	122,443	2,373	(1)	124,815
State and municipal	68,879	1,610	(37)	70,452
Total debt securities	$209,133	$4,176	$(135)	$213,174

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The amortized cost and estimated fair value of debt securities at March 31, 2015 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	$ 14,561	$ 14,684
Due after one year through five years	140,903	144,234
Due after five years through ten years	53,327	54,208
Due after ten years	5,622	5,769
Total debt securities	$ 214,413	$ 218,895

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

	Three months ended March 31,	
(dollars in thousands)	2015	2014
Realized gains	$ 371	$ 0
Realized losses	0	0
Net gains	$ 371	$ 0

Securities, issued by agencies of the federal government, with a carrying value of $150,595,000 and $174,834,000 on March 31, 2015 and December 31, 2014, respectively, were pledged to secure public and trust deposits, repurchase agreements and other short-term borrowings.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time, for securities that have been in a continuous unrealized loss position, at March 31, 2015 and December 31, 2014.

	Less than 12 months		12 months or more		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2015						
Debt securities:						
U.S. agency	$ 3,467	$ (4)	$ 5,059	$ (24)	$ 8,526	$ (28)
U.S. agency mortgage-backed, residential	3,292	(8)	0	0	3,292	(8)
State and municipal	5,318	(7)	1,686	(15)	7,004	(22)
Total temporarily impaired debt securities, available-for-sale	$ 12,077	$ (19)	$ 6,745	$ (39)	$ 18,822	$ (58)
December 31, 2014						

Debt securities:						
U.S. agency	$ 5,999	$ (27)	$ 5,019	$ (70)	$ 11,018	$ (97)
U.S. agency mortgage-backed, residential	2,054	(1)	0	0	2,054	(1)
State and municipal	6,379	(18)	1,686	(19)	8,065	(37)
Total temporarily impaired debt securities, available-for-sale	$ 14,432	$ (46)	$ 6,705	$ (89)	$ 21,137	$ (135)

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The unrealized losses of $19,000 at March 31, 2015 within the less than 12 months category were attributable to one U.S. agency security, one U.S. agency mortgage-backed security, and eight state and municipal securities. The unrealized losses of $39,000 within the 12 months or more category were attributable to two U.S. agency securities and four state and municipal securities. All of the securities with unrealized losses have been evaluated and determined to be investment grade.

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

The Corporation believes that unrealized losses at March 31, 2015 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 March 31, 2015 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, which represents required investments in the common stock of correspondent banks, is carried at cost and, as of March 31, 2015 and December 31, 2014, consisted primarily of the common stock of the Federal Home Loan Bank of Pittsburgh (FHLBP) and, to a lesser degree, Atlantic Community Bankers Bank (ACBB). Under the FHLBP's Capital Plan, PeoplesBank is required to maintain a minimum member stock investment, as a condition of becoming and remaining a member and as a condition of obtaining borrowings from the FHLBP. The FHLBP uses a formula to determine the minimum stock investment, which is based on the volume of loans outstanding, unused borrowing capacity and other factors.

The FHLBP paid dividends during the periods ended March 31, 2015 and 2014. The FHLBP restricts the repurchase of the excess capital stock of member banks. The amount of excess capital stock that can be repurchased from any member is currently the lesser of five percent of the member's total capital stock outstanding or its excess capital stock outstanding.

Management evaluates the restricted stock for impairment in accordance with FASB ASC Topic 942. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. Using the FHLBP as an example, the determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLBP as compared to the capital stock amount for the FHLBP and the length of time this situation has persisted; (2) commitments by the FHLBP to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLBP; and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLBP. Management believes no impairment charge was necessary related to the restricted stock during the periods ended March 31, 2015 and 2014.

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Note 5—Loans

Loan Portfolio Composition

The table below provides the composition of the loan portfolio at March 31, 2015 and December 31, 2014. The portfolio is comprised of two segments, commercial and consumer loans. The commercial loan segment is disaggregated by industry class which allows the Corporation to monitor risk and performance. Those industries representing the largest dollar investment and most risk are listed separately. The “Other” commercial loans category is comprised of various industries. The consumer related segment is comprised of residential mortgages, home equity and other consumer loans. The Corporation has not engaged in sub-prime residential mortgage originations.

(dollars in thousands)	March 31, 2015	% Total Loans	December 31, 2014	% Total Loans
Builder & developer	$126,637	12.4	$114,695	12.5
Commercial real estate investor	161,635	15.8	144,206	15.7
Residential real estate investor	111,497	10.9	97,562	10.6
Hotel/Motel	81,441	8.0	79,412	8.6
Wholesale & retail	77,455	7.6	75,063	8.2
Manufacturing	33,095	3.2	34,162	3.7
Agriculture	43,849	4.3	42,136	4.6
Other	193,577	19.0	186,086	20.2
Total commercial related loans	829,186	81.2	773,322	84.1
Residential mortgages	74,665	7.3	32,453	3.5
Home equity	83,629	8.2	82,256	8.9
Other	33,312	3.3	32,059	3.5
Total consumer related loans	191,606	18.8	146,768	15.9
Total loans	$1,020,792	100.0	$920,090	100.0

Loan Risk Ratings

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

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

The table below presents a summary of loan risk ratings by loan class at March 31, 2015 and December 31, 2014.

(dollars in thousands)	Pass	Special Mention	Substandard	Nonaccrual	Total
March 31, 2015					
Builder & developer	$114,216	$6,412	$3,902	$2,107	$126,637
Commercial real estate investor	151,384	4,102	3,866	2,283	161,635
Residential real estate investor	105,067	4,424	894	1,112	111,497
Hotel/Motel	80,932	0	0	509	81,441
Wholesale & retail	68,854	8,481	0	120	77,455
Manufacturing	28,438	4,008	649	0	33,095
Agriculture	40,581	2,844	424	0	43,849
Other	190,679	1,273	846	779	193,577
Total commercial related loans	780,151	31,544	10,581	6,910	829,186
Residential mortgage	74,461	0	0	204	74,665
Home equity	82,923	565	0	141	83,629
Other	32,802	122	120	268	33,312
Total consumer related loans	190,186	687	120	613	191,606
Total loans	$970,337	$32,231	$10,701	$7,523	$1,020,792
December 31, 2014					
Builder & developer	$102,109	$6,613	$3,861	$2,112	$114,695
Commercial real estate investor	133,923	3,733	3,377	3,173	144,206
Residential real estate investor	91,765	4,059	266	1,472	97,562
Hotel/Motel	78,892	0	0	520	79,412
Wholesale & retail	66,415	8,526	0	122	75,063
Manufacturing	29,528	3,979	655	0	34,162
Agriculture	39,025	2,679	432	0	42,136
Other	183,556	1,083	840	607	186,086
Total commercial related loans	725,213	30,672	9,431	8,006	773,322

Residential mortgage	32,307	0	28	118	32,453
Home equity	81,581	566	0	109	82,256
Other	31,586	80	0	393	32,059
Total consumer related loans	145,474	646	28	620	146,768
Total loans	$870,687	$31,318	$9,459	$8,626	$920,090

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Impaired Loans

The table below presents a summary of impaired loans at March 31, 2015 and December 31, 2014. Generally, impaired loans are loans risk rated substandard and nonaccrual or classified as troubled debt restructurings. An allowance is established for individual commercial loans where the Corporation has doubt as to full recovery of the outstanding principal balance. Typically, impaired consumer loans are partially or fully charged off obviating the need for a specific allowance. The recorded investment represents outstanding unpaid principal loan balances adjusted for charge-offs.

	With No Allowance		With A Related Allowance			Total	
(dollars in thousands)	Recorded Investment	Unpaid Principal	Recorded Investment	Unpaid Principal	Related Allowance	Recorded Investment	Unpaid Principal
March 31, 2015							
Builder & developer	$ 3,964	$ 4,100	$ 2,045	$ 2,045	$ 703	$ 6,009	$ 6,145
Commercial real estate investor	3,892	3,907	2,257	2,257	800	6,149	6,164
Residential real estate investor	1,369	1,740	637	637	113	2,006	2,377
Hotel/Motel	509	509	0	0	0	509	509
Wholesale & retail	390	390	0	0	0	390	390
Manufacturing	649	649	0	0	0	649	649
Agriculture	0	0	424	424	100	424	424
Other commercial	1,625	2,441	0	0	0	1,625	2,441
Total impaired commercial related loans	12,398	13,736	5,363	5,363	1,716	17,761	19,099
Residential mortgage	204	254	0	0	0	204	254
Home equity	141	181	0	0	0	141	181
Other consumer	388	407	0	0	0	388	407
Total impaired consumer related loans	733	842	0	0	0	733	842
Total impaired loans	$ 13,131	$ 14,578	$ 5,363	$ 5,363	$ 1,716	$ 18,494	$ 19,941
December 31, 2014							
Builder & developer	$ 3,928	$ 3,928	$ 2,045	$ 2,045	$ 953	$ 5,973	$ 5,973
Commercial real estate investor	5,055	5,055	1,495	1,495	600	6,550	6,550
Residential real estate investor	785	785	953	953	559	1,738	1,738
Hotel/Motel	520	520	0	0	0	520	520

Wholesale & retail	394	394	0	0	0	394	394
Manufacturing	655	655	0	0	0	655	655
Agriculture	0	0	432	432	100	432	432
Other commercial	973	973	474	474	300	1,447	1,447
Total impaired commercial related loans	12,310	12,310	5,399	5,399	2,512	17,709	17,709
Residential mortgage	146	172	0	0	0	146	172
Home equity	109	109	0	0	0	109	109
Other consumer	393	393	0	0	0		