CODORUS VALLEY BANCORP INC
Form 10-Q
August 11, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2010
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 þ 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 o 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 þ

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

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 August 4, 2010, 4,093,059 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 data)	June 30, 2010	December 31, 2009
Assets		
Interest bearing deposits with banks	$ 23,267	$ 14,545
Cash and due from banks	12,035	8,634
Federal funds sold	3,000	3,000
Total cash and cash equivalents	38,302	26,179
Securities, available-for-sale	186,914	174,177
Restricted investment in bank stocks, at cost	4,277	4,277
Loans held for sale	1,509	1,266
Loans (net of deferred fees of $677 2010 and $766 2009)	645,379	645,877
Less-allowance for loan losses	(6,366)	(7,175)
Net loans	639,013	638,702
Premises and equipment, net	10,946	11,223
Other assets	35,904	37,007
Total assets	$ 916,865	$ 892,831
Liabilities		
Deposits		
Noninterest bearing	$ 57,761	$ 55,583
Interest bearing	700,136	667,374
Total deposits	757,897	722,957
Short-term borrowings	10,390	8,466
Long-term debt	52,346	73,972
Junior subordinated debt	10,310	10,310
Other liabilities	9,448	5,114
Total liabilities	840,391	820,819
Shareholders equity		
Preferred stock, par value $2.50 per share; $1,000 liquidation preference, 1,000,000 shares authorized; 16,500 shares issued and outstanding 2010 and 2009	15,905	15,828
Common stock, par value $2.50 per share; 10,000,000 shares authorized; 4,093,193 shares issued and outstanding 2010 and 4,074,636 2009	10,233	10,187
Additional paid-in capital	37,136	37,004
Retained earnings	9,071	6,592
Accumulated other comprehensive income	4,129	2,401

Total shareholders equity	76,474	72,012
Total liabilities and shareholders equity	$ 916,865	$ 892,831

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands, except per share data)	2010	2009	2010	2009
Interest income				
Loans, including fees	$ 9,517	$ 8,568	$ 18,647	$ 16,633
Investment securities:				
Taxable	799	841	1,628	1,677
Tax-exempt	583	533	1,168	899
Dividends	1	2	4	9
Other	20	19	28	34
Total interest income	10,920	9,963	21,475	19,252
Interest expense				
Deposits	2,781	3,710	5,610	7,366
Federal funds purchased and other short-term borrowings	22	10	42	27
Long-term and junior subordinated debt	429	551	897	1,071
Total interest expense	3,232	4,271	6,549	8,464
Net interest income	7,688	5,692	14,926	10,788
Provision for loan losses	630	1,639	1,350	1,883
Net interest income after provision for loan losses	7,058	4,053	13,576	8,905
Noninterest income				
Trust and investment services fees	373	303	719	614
Income from mutual fund, annuity and insurance sales	443	358	762	704
Service charges on deposit accounts	649	581	1,211	1,106
Income from bank owned life insurance	161	155	319	318
Other income	132	154	286	302
Gains on sales of loans held for sale	217	403	361	570
Gains on sales of securities	108	128	108	291
Total noninterest income	2,083	2,082	3,766	3,905
Noninterest expense				
Personnel	3,213	3,157	6,419	6,503
Occupancy of premises, net	493	448	994	928
Furniture and equipment	419	401	859	836
Postage, stationery and supplies	162	139	277	249
Professional and legal	138	99	244	183

Marketing and advertising	223	115	350	240
FDIC insurance	316	646	624	876
Debit card processing	145	130	280	252
Charitable donations	27	31	356	207
Telephone	134	146	272	255
Foreclosed real estate including gains (losses) on sales	911	66	984	106
Impaired loan carrying costs	387	99	583	133
Other	674	642	1,084	1,159
Total noninterest expense	7,242	6,119	13,326	11,927
Income before income taxes (benefit)	1,899	16	4,016	883
Provision (benefit) for income taxes	274	(277)	680	(373)
Net income	1,625	293	3,336	1,256
Preferred stock dividends and discount accretion	245	244	490	467
Net income available to common shareholders	$ 1,380	$ 49	$ 2,846	$ 789
Net income per common share, basic and diluted	$ 0.34	$ 0.01	$ 0.70	$ 0.20

See accompanying notes.

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

(dollars in thousands)	Six months ended June 30, 2010	2009
Cash flows from operating activities		
Net income	$ 3,336	$ 1,256
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	689	701
Provision for loan losses	1,350	1,883
Provision for losses on foreclosed real estate	722	
Amortization of investment in real estate partnership	281	271
Increase in cash surrender value of life insurance investment	(319)	(318)
Originations of loans held for sale	(21,036)	(50,766)
Proceeds from sales of loans held for sale	20,994	50,371
Gains on sales of loans held for sale	(361)	(570)
Gains on sales of securities available-for-sale	(108)	(291)
Gains on sales of held for sale assets	(35)	
Gains on sales of foreclosed real estate	(110)	
Stock-based compensation expense	67	100
Decrease (increase) in accrued interest receivable	165	(555)
Decrease (increase) in other assets	349	(1,159)
(Decrease) increase in accrued interest payable	(50)	132
Increase in other liabilities	4,387	1,118
Other, net	616	262
Net cash provided by operating activities	10,937	2,435
Cash flows from investing activities		
Securities, available-for-sale		
Purchases	(33,567)	(108,679)
Maturities, repayments and calls	18,246	12,565
Sales	4,845	8,947
Net increase in restricted investment in bank stock		(1,570)
Net increase in loans made to customers	(9,882)	(37,401)
Purchases of premises and equipment	(420)	(465)
Proceeds from sales of foreclosed real estate	7,395	
Net cash used in investing activities	(13,383)	(126,603)
Cash flows from financing activities		
Net increase in demand and savings deposits	29,985	39,197
Net increase in time deposits	4,955	48,186
Net increase (decrease) in short-term borrowings	1,924	(18,283)
Proceeds from issuance of long-term debt		66,000
Repayment of long-term debt	(21,626)	(15,601)
Cash dividends paid to preferred shareholders	(413)	(289)

Cash dividends paid to common shareholders	(367)	(804)
Net proceeds from issuance of preferred stock and common stock warrants		16,461
Issuance of common stock	111	189
Net cash provided by financing activities	14,569	135,056
Net increase in cash and cash equivalents	12,123	10,888
Cash and cash equivalents at beginning of year	26,179	14,875
Cash and cash equivalents at end of period	$ 38,302	$ 25,763

See accompanying notes.

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

(dollars in thousands, except share data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
For the six months ended June 30, 2010						
Balance, January 1, 2010	$ 15,828	$ 10,187	$ 37,004	$ 6,592	$ 2,401	$ 72,012
Comprehensive income:						
Net income				3,336		3,336
Other comprehensive income, net of tax:						
Unrealized gains on securities, net					1,728	1,728
Total comprehensive income						5,064
Preferred stock discount accretion	77			(77)		
Common stock cash dividends ($0.09 per share)				(367)		(367)
Preferred stock dividends				(413)		(413)
Stock-based compensation			67			67
Issuance of common stock:						
10,627 shares under dividend reinvestment and stock purchase plan		26	48			74
7,930 shares under employee stock purchase plan		20	17			37
Balance, June 30, 2010	$ 15,905	$ 10,233	$ 37,136	$ 9,071	$ 4,129	$ 76,474
For the six months ended June 30, 2009						
Balance, January 1, 2009	$	$ 10,043	$ 35,877	$ 5,057	$ 1,204	$ 52,181
Comprehensive income:						
Net income				1,256		1,256
Other comprehensive loss, net of tax:						
Unrealized losses on securities, net					(400)	(400)
Total comprehensive income						856
Preferred stock and common stock warrants issued, net of issuance costs of $39	15,678		783			16,461

Preferred stock discount accretion	73			(73)		
Common stock cash dividends ($0.20 per share)				(804)		(804)
Preferred stock dividends				(289)		(289)
Stock-based compensation			100			100
Issuance of common stock:						
18,557 shares under dividend reinvestment and stock purchase plan		46	102			148
7,581 shares under employee stock purchase plan		19	22			41
Balance, June 30, 2009	$ 15,751	$ 10,108	$ 36,884	$ 5,147	$ 804	$ 68,694

See accompanying notes.

Notes to Consolidated Financial Statements (Unaudited)

Note 1 Basis of Presentation

The accompanying consolidated balance sheet at December 31, 2009 has been derived from audited financial statements and the unaudited interim 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 footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the interim 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 statements should be read in conjunction with the notes to the audited financial statements contained in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2009.

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 five wholly owned subsidiaries, Codorus Valley Financial Advisors, Inc. and SYC Settlement Services, Inc. and three 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 six-month period ended June 30, 2010 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 June 30, 2010, but before the financial statements were issued for potential recognition or disclosure. In preparing these financial statements, the Corporation evaluated the events and transactions that occurred from June 30, 2010 through the date these financial statements were issued.

Note 2 Significant Accounting Policies

Per Share Computations

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

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except per share data)	2010	2009	2010	2009
Net income available to common shareholders	$ 1,380	$ 49	$ 2,846	$ 789
Weighted average shares outstanding (basic)	4,083	4,032	4,080	4,028
Effect of dilutive stock options	11	0	2	0
Weighted average shares outstanding (diluted)	4,094	4,032	4,082	4,028
Basic and diluted earnings per common share	$ 0.34	$ 0.01	$ 0.70	$ 0.20
Anti-dilutive stock options and common stock warrants excluded from the computation of earnings per share	421	435	421	423

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 (loss) and related tax effects are presented in the following table:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2010	2009	2010	2009
Unrealized holding gains (losses) arising during the period	$ 2,034	$ (3)	$ 2,726	$ (315)
Reclassification adjustment for gains included in income	(108)	(128)	(108)	(291)
Net unrealized gains (losses)	1,926	(131)	2,618	(606)
Tax effect	(655)	44	(890)	206
Net of tax amount	$ 1,271	$ (87)	$ 1,728	$ (400)

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. Noncash items for the six-month period ended June 30, 2010 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. Comparatively, for the six-month period ended June 30, 2009 noncash transfers included the transfer of loans to foreclosed real estate in the amount of $1,556,000 and the transfer of loans held for sale to investment in the amount of $3,585,000.

Supplemental Benefit Plans

In January 2009, the Corporation incurred a non-recurring cost of $242,000 to restructure employee benefit plans. Restructuring the benefit plans resulted in a federal income tax benefit so that the overall transaction had an insignificant impact on net income.

Income Taxes

The provision for income tax for the three and six month periods ending June 30, 2009 was a credit, or tax benefit, which reflected a low level of pretax income and significant increase in tax-exempt income. The tax benefit for the six month period ending June 30, 2009 included a federal income tax benefit of $242,000 associated with restructuring employee benefit plans in the first quarter of 2009.

Recent Accounting Pronouncements

The FASB issued ASU 2010-20, Receivables (Topic 310) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses . This ASU requires more information about the credit quality of financing receivables in the disclosures to financial statements, such as aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on how a company develops its allowance for credit losses and how it manages its credit exposure. The amendments in this Update apply to all public and

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nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. However, short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments. For public companies, the amendments that require disclosures as of the end of a reporting period are effective for periods *ending* on or after December 15, 2010. The amendments that require disclosures about activity that occurs during a reporting period are effective for periods beginning on or after December 15, 2010. The Corporation is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

The FASB issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements. The amendments in this Update require some new disclosures and clarify some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require:

- A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and
- In the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements.

In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures:

- For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and
- A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The Corporation adopted the update, except for disclosures about purchases, sales and issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010. The adoption of the Update did not have an effect on the Corporation s financial position or results of operations.

The FASB issued ASU 2009-16, Transfers and Servicing (Topic 860) Accounting for Transfers of Financial Assets an amendment of FASB Statement 140. The amendments in the Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The Corporation adopted the update, and it did not have an effect on its financial position or results of operations.

In November 2008, the 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.

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Note 3 Securities Available-for-Sale

A summary of available-for-sale securities at June 30, 2010 and December 31, 2009 is provided below:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2010				
Debt securities:				
U.S. treasury notes	$ 8,018	$ 109	$	$ 8,127
U.S. agency	12,046	181		12,227
U.S. agency mortgage-backed, residential	81,643	3,420		85,063
State and municipal	78,950	2,602	(55)	81,497
Total debt securities, available-for-sale	$ 180,657	$ 6,312	$ (55)	$ 186,914
December 31, 2009				
Debt securities:				
U.S. agency	$ 13,526	$ 120	$	$ 13,646
U.S. agency mortgage-backed, residential	82,579	1,715	(34)	84,260
State and municipal	73,446	2,059	(164)	75,341
Corporate trust preferred	987		(57)	930
Total debt securities, available-for-sale	$ 170,538	$ 3,894	$ (255)	$ 174,177

The amortized cost and estimated fair value of debt securities at June 30, 2010 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.

(dollars in thousands)	Available-for-sale Amortized Cost	Available-for-sale Fair Value
Due in one year or less	$ 5,776	$ 5,830
Due after one year through five years	122,880	127,571
Due after five years through ten years	47,287	48,779
Due after ten years	4,714	4,734
Total debt securities	$ 180,657	$ 186,914

Gross gains realized from the sale of available-for-sale securities were $108,000 and $291,000 for the six months and $108,000 and $128,000 for the three months ended June 30, 2010 and 2009, respectively. Realized gains and losses from the sale of available-for-sale securities are computed on the basis of specific identification of the adjusted cost of each security and are shown net as a separate line item in the income statement. Securities, issued by agencies of the federal government, with a carrying value of $92,987,000 and $84,460,000 on June 30, 2010 and December 31, 2009, respectively, were pledged to secure public and trust deposits, repurchase agreements, other short-term borrowings and Federal Home Loan Bank debt.

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The table below shows investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2010 and December 31, 2009.

	Less than 12 months		12 months or more		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2010						
Available-for-sale						
Debt securities:						
State and municipal	$ 3,419	$ 52	$ 461	$ 3	$ 3,880	$ 55
Total temporarily impaired debt securities	$ 3,419	$ 52	$ 461	$ 3	$ 3,880	$ 55
December 31, 2009						
Available-for-sale						
Debt securities:						
U.S. agency mortgage-backed, residential	$ 8,656	$ 34	$	$	$ 8,656	$ 34
State and municipal	10,607	164			10,607	164
Corporate trust preferred			930	57	930	57
Total temporarily impaired debt securities	$ 19,263	$ 198	$ 930	$ 57	$ 20,193	$ 255

At June 30, 2010, the unrealized losses within the less than 12 months category of $52,000 were attributable to eight different municipal securities, and $3,000 in the 12 months or more category was attributed to one municipal security.
In April 2009, the FASB issued FASB ASC Topic 320. This guidance clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, the Corporation must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required the Corporation to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

In instances when a determination is made that an other-than-temporary impairment exists but the Corporation does not intend to sell the debt security and it is unlikely that the Corporation will be required to sell the debt security prior to its anticipated recovery, FASB ASC Topic 320 changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income. FASB ASC Topic 320 was effective for the Corporation for interim and annual reporting periods ended after June 15, 2009.

Available-for-sale securities 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; and 8) current financial news.

We believe that unrealized losses at June 30, 2010 were primarily the result of changes in market interest rates and that we have 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. We believe that collection of the contractual principal and interest is probable and therefore, all impairment is considered to be temporary.

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Note 4 Restricted Investment in Bank Stocks

Restricted stock represents required investments in the common stock of correspondent banks. It consists primarily of the common stock of FHLB of Pittsburgh (FHLB) and to a lesser degree Atlantic Central Bankers Bank (ACBB) and is carried at cost as of June 30, 2010 and December 31, 2009. 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 obtaining loans from the FHLB. In December 2008, the FHLB notified member banks that it was suspending dividend payments and the repurchase of capital stock.

We evaluate the restricted stock for impairment in accordance with FASB ASC Topic 942. Our 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. 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 FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB. We believe that no impairment charge was necessary related to the restricted stock as of June 30, 2010.

Note 5 Loans

The composition of the loan portfolio was as follows:

(dollars in thousands)	June 30, 2010	December 31, 2009
Commercial, financial and agricultural	$ 419,666	$ 415,404
Real estate construction and land development	101,029	104,986
Total commercial related loans	520,695	520,390
Real estate residential and home equity	73,515	73,294
Consumer	51,169	52,193
Total consumer related loans	124,684	125,487
Total loans	$ 645,379	$ 645,877

Note 6 Impaired Commercial Loans

Information regarding impaired commercial loans, comprised of loans classified as nonaccrual, substandard or 90 days past due, at June 30, 2010 and December 31, 2009, is provided below. Commercial loans are predominately real estate collateral dependent. Accordingly, impairment is based on the net realizable value of the collateral relative to recorded investment in the loan.

(dollars in thousands)	June 30, 2010	December 31, 2009
Impaired loans without a related allowance	$ 22,531	$ 24,605
Impaired loans with a related allowance	1,091	7,828
Total impaired loans	$ 23,622	$ 32,433
Allowance for impaired loans	$ 340	$ 2,401

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Note 7 Deposits

The composition of deposits was as follows:

(dollars in thousands)	June 30, 2010	December 31, 2009
Noninterest bearing demand	$ 57,761	$ 55,583
NOW	62,393	55,010
Money market	203,063	186,873
Savings	27,742	23,508
Time deposits less than $100,000	241,371	238,594
Time deposits $100,000 or more	165,567	163,389
Total deposits	$ 757,897	$ 722,957

Note 8 Long-term Debt

PeoplesBank s obligations to the Federal Home Loan Bank of Pittsburgh (FHLBP) are primarily fixed rate instruments. A summary of long-term debt at June 30, 2010 and December 31, 2009, is provided below:

(dollars in thousands)	June 30, 2010	December 31, 2009
Obligations of PeoplesBank to FHLBP:		
Due February 2010, 1.55%	$	$ 15,000
Due June 2010, 4.32%		6,000
Due January 2011, 2.06%	14,000	14,000
Due January 2011, 4.30%, amortizing	3,527	3,676
Due August 2011, 2.42%	12,000	12,000
Due January 2012, 2.34%	10,000	10,000
Due June 2012, 4.25%, amortizing	760	948
Due December 2012, 1.91%	5,000	5,000
Due May 2013, 3.46%, amortizing	1,641	1,906
Due December 2013, 2.39%	5,000	5,000
	51,928	73,530
Capital lease obligation	418	442
Total long-term debt	$ 52,346	$ 73,972

Note 9 Regulatory Matters

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

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Quantitative measures established by regulators to ensure capital adequacy require Codorus Valley and PeoplesBank to maintain minimum ratios, as set forth below, to total and Tier 1 capital as a percentage of risk-weighted assets, and of Tier 1 capital to quarter-to-date average assets (leverage ratio). We believe that Codorus Valley and PeoplesBank were well capitalized on June 30, 2010, based on regulatory capital guidelines.

	Actual		Minimum for Capital Adequacy		Well Capitalized Minimum*	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Codorus Valley Bancorp, Inc. *(consolidated)*						
at June 30, 2010						
Capital ratios:						
Tier 1 risk based	$ 82,018	12.24%	$ 26,821	4.00%	n/a	n/a
Total risk based	88,384	13.18	53,643	8.00	n/a	n/a
Leverage	82,018	9.10	36,078	4.00	n/a	n/a
at December 31, 2009						
Capital ratios:						
Tier 1 risk based	$ 79,286	11.83%	$ 26,810	4.00%	n/a	n/a
Total risk based	86,461	12.90	53,620	8.00	n/a	n/a
Leverage	79,286	9.11	34,815	4.00	n/a	n/a
PeoplesBank, A Codorus Valley Company						
at June 30, 2010						
Capital ratios:						
Tier 1 risk based	$ 78,840	11.81%	$ 26,693	4.00%	$ 40,040	6.00%
Total risk based	85,206	12.77	53,386	8.00	66,733	10.00
Leverage	78,840	8.78	35,933	4.00	44,916	5.00
at December 31, 2009						
Capital ratios:						
Tier 1 risk based	$ 74,945	11.25%	$ 26,647	4.00%	$ 39,970	6.00%
Total risk based	82,120	12.33	53,293	8.00	66,616	10.00
Leverage	74,945	8.66	34,601	4.00	43,251	5.00

* To be well capitalized under prompt corrective action provisions.

Note 10 Shareholders Equity

Preferred Stock Issued to the United States Department of the Treasury

In connection with the Emergency Economic Stabilization Act of 2008 (EESA), the U.S. Treasury Department (Treasury) initiated a Capital Purchase Program (CPP) which allowed for qualifying financial institutions to issue preferred stock to the Treasury, subject to certain limitations and terms. The EESA was developed to attract broad participation by strong financial institutions, to stabilize the financial system and increase lending to benefit the national economy and citizens of the United States.

On January 9, 2009, the Corporation entered into a Securities Purchase Agreement with the Treasury pursuant to which the Corporation sold to the Treasury, for an aggregate purchase price of $16.5 million, 16,500 shares of non-voting cumulative perpetual preferred stock, $1,000 liquidation value, $2.50 par value, and warrants to purchase up to 263,859 shares of common stock, par value $2.50 per share, with an exercise price of $9.38 per share. As a condition under the CPP, without the consent of the Treasury, the Corporation s share repurchases are limited to purchases in connection with the administration of any employee benefit plan, including purchases to offset share dilution in connection with any such plans. This restriction is effective until January 9, 2012 or until the Treasury no longer owns any of the Corporation s preferred shares issued under the CPP. The Corporation s preferred stock is included as a component of Tier 1 capital in accordance with regulatory capital requirements. See Note 9, Regulatory Matters for details of the Corporation s regulatory capital.

The preferred stock ranks senior to the Corporation s common shares and pays a compounded cumulative dividend at a rate of 5 percent per year for the first five years, and 9 percent per year thereafter. Dividends are payable quarterly on February 15th, May 15th, August 15th and November 15th. The Corporation is prohibited from paying any dividend with respect to shares of common stock or repurchasing or redeeming any shares of the Corporation s common shares in any quarter unless all accrued and unpaid dividends are paid on the preferred stock for all past dividend periods (including the latest completed dividend period), subject to certain limited exceptions. In addition, without the prior consent of the Treasury, the Corporation is prohibited from declaring or paying any cash dividends on common shares in excess of $0.12 per share, which was the last quarterly cash dividend per share declared prior to October 14, 2008. The CPP also places restrictions on incentive compensation to senior executives. The preferred stock is non-voting, other than class voting rights on matters that could adversely affect the preferred stock, and is generally redeemable at the liquidation value at any time in whole or in part (i.e., a minimum of 25 percent of the issue price) with regulatory permission.

Common Stock Warrants

The 263,859 shares of common stock warrants issued to the Treasury have a term of 10 years (expiring January 9, 2019) and are exercisable at any time, in whole or in part, at an exercise price of $9.38 per share (subject to certain anti-dilution adjustments). The $16.5 million of proceeds was allocated to the preferred stock and the warrants based on their relative fair values at issuance ($15.7 million was allocated to the preferred stock and $783,000 to the warrants). The fair value of the preferred stock was based on a 10 percent assumed market discount rate. The fair value of the stock warrants was calculated by a third-party software model based on many financial assumptions, including market price of the stock, stock price volatility and risk free interest rate. The difference between the initial value allocated to the preferred stock of approximately $15.7 million and the liquidation value of $16.5 million, i.e., the preferred stock discount, will be charged to retained earnings over the first five years of the life of the preferred stock as an adjustment to the dividend yield using the effective yield method.

Note 11 Contingent Liabilities

We are not aware of any material contingent liabilities as of June 30, 2010.

Note 12 Guarantees

Codorus Valley does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by PeoplesBank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $6,718,000 of standby letters of credit outstanding on June 30, 2010, compared to $5,651,000 on December 31, 2009. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required under the corresponding letters of credit. The amount of the liability as of June 30, 2010 and December 31, 2009, for guarantees under standby letters of credit issued, was not material. Many of the commitments are expected to expire without being drawn and therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

Note 13 Fair Value Measurements and Fair Values of Financial Instruments

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

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Fair value measurement guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Additional guidance is provided on determining when the volume and level of activity for the asset or liability has significantly decreased and on identifying circumstances when a transaction may not be considered orderly.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed, and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance further clarifies that, when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value and disclosure guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset s or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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For financial assets measured at fair value, the fair value measurements by level within the fair value hierarchy are as follows:

(dollars in thousands)	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
June 30, 2010				
Measured at fair value on a recurring basis:				
Securities, available-for-sale:				
U.S. treasury notes	$ 8,127	$ 8,127	$	$
Other	178,787		178,787	
Measured at fair value on a nonrecurring basis:				
Impaired loans	751			751
Other real estate owned	2,576			2,576
December 31, 2009				
Measured at fair value on a recurring basis:				
Securities, available-for-sale	$ 174,177	$	$ 174,177	$
Measured at fair value on a nonrecurring basis:				
Impaired loans	5,427			5,427
Other real estate owned	668			668

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation s financial instruments and certain nonfinancial assets at June 30, 2010 and December 31, 2009:

Cash and cash equivalents (carried at cost)

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets fair values.

Securities, available-for-sale (carried at fair value)

The fair values of securities available-for-sale are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted prices.

Restricted investment in bank stocks (carried at cost)

The carrying amount of restricted investment in bank stocks approximates fair value, and considers the limited marketability of such securities.

Loans held for sale (carried at lower of cost or fair value)

The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan. At June 30, 2010, the fair value of loans held for sale exceeded the cost basis.

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Loans (carried at cost)
Generally, for variable and adjustable rate loans that reprice frequently and with no significant change in credit risk, fair value is based on carrying value. Fair values for other loans in the portfolio are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal.
Impaired loans (generally carried at fair value)
Impaired loans are those that are accounted for under FASB ASC Topic 310, in which the Corporation has measured impairment generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. A portion of the allowance for loan losses is allocated to impaired loans if the value of the collateral supporting such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when we believe that the uncollectability of a loan is confirmed. These loans are included as Level 3 fair values, based on the lowest level of input that is significant to the fair value measurements. At June 30, 2010, the fair value of loans with a specific reserve allowance was $1,091,000, net of a valuation allowance of $340,000, compared to $7,828,000, net of a valuation allowance of $2,401,000 at December 31, 2009.
Other Real Estate Owned (carried at lower of cost or fair value)
Other real estate property acquired through foreclosure is initially recorded at fair value of the property at the transfer date less estimated selling cost. Subsequently, other real estate owned is carried at the lower of its carrying value or the fair value less estimated selling cost. Fair value is usually determined based upon an independent third-party appraisal of the property or occasionally upon a recent sales offer. The carrying value of other real estate at June 30, 2010 with a valuation allowance was $2,576,000 ($3,298,000 less $722,000 allowance), which pertained to a single property. At December 31, 2009, the carrying value of other real estate with a valuation allowance was $668,000 ($857,000 less $189,000 allowance), which pertained to a single property that was sold in the first quarter of 2010.
Interest receivable and payable (carried at cost)
The carrying amount of interest receivable and interest payable approximates its fair value.
Deposit liabilities (carried at cost)
The fair values disclosed for demand deposits (e.g., noninterest and interest bearing checking, money market and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for variable rate time deposits that reprice frequently are based on carrying value. Fair values for fixed rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities of time deposits.
Short-term borrowings (carried at cost)
The carrying amount of short-term borrowings approximates its fair value.
Long-term debt (carried at cost)
Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices are obtained from this active market and represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

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Junior subordinated debt (carried at cost)
The fair value of junior subordinated debt is estimated using discounted cash flow analysis, based on market rates and spread characteristics currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

Off-balance sheet financial instruments (disclosed at cost)
Fair values for the Corporation s off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. These amounts were not considered to be material at June 30, 2010 and December 31, 2009.

The estimated fair values of the Corporation s financial instruments were as follows at June 30, 2010 and December 31, 2009.

	June 30, 2010		December 31, 2009	
(dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 38,302	$ 38,302	$ 26,179	$ 26,179
Securities, available-for-sale	186,914	186,914	174,177	174,177
Restricted investment in bank stocks	4,277	4,277	4,277	4,277
Loans held for sale	1,509	1,546	1,266	1,293
Loans, net	639,013	643,300	638,702	641,250
Interest receivable	3,262	3,262	3,427	3,427
Financial liabilities				
Noninterest bearing demand, NOW, money market and savings deposits	$ 350,959	$ 350,959	$ 320,974	$ 320,974
Time deposits	406,938	415,029	401,983	406,203
Short-term borrowings	10,390	10,390	8,466	8,466
Long-term debt	52,346	53,357	73,972	74,681
Junior subordinated debt	10,310	4,194	10,310	4,331
Interest payable	702	702	752	752
Off-balance sheet instruments				

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

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

Forward-looking statements:

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

Note that many factors, some of which are discussed elsewhere in this report and in the documents that are incorporated by reference, could affect the future financial results of the Corporation and its subsidiaries, both individually and collectively, and could cause those results to differ materially from those expressed in the forward-looking statements contained or incorporated by reference in this Form 10-Q. These factors include, but are not limited to, the following:

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

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

Critical accounting estimates:

Disclosure of Codorus Valley s significant accounting policies is included in Note 1 to the consolidated financial statements included in the 2009 Annual Report on Form 10-K for the period ended December 31, 2009. Some of these policies require management to make significant judgments, estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities.

We make significant estimates in determining the allowance for loan losses, valuation of foreclosed real estate, and evaluation of other-than-temporary impairment losses of securities. We consider a variety of factors in establishing allowance for loan losses such as current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strength of borrowers, adequacy of collateral, if collateral dependent, and present value of future cash flows and other relevant factors. Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Appraisals are generally used to determine fair value. After foreclosure, we review valuations at least quarterly and adjust the asset to the lower of carrying value or fair value minus estimated costs to sell. Estimates related to the value of collateral also have a significant impact on whether or not we continue to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded on the balance sheet.

We record the available-for-sale securities portfolio at fair value. Fair values for these securities are determined based on methodologies in accordance with FASB ASC 820, and as clarified by several FASB accounting standard updates. Fair values for debt securities are volatile and may be influenced by any number of factors, including market interest rates, prepayment trends, discount rates, credit ratings and yield curves. Fair values for debt securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security. When the fair value of a debt security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exits. Available-for-sale debt securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers whether the Corporation has the intent to sell its debt securities prior to market recovery or maturity and whether it is more likely than not that the Corporation will be required to sell its debt securities prior to market recovery or maturity. Often, information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the debt security may be different than previously estimated, which could have a material effect on the Corporation s results of operations and financial condition.

We discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosure with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report. Additional information is contained in Management s Discussion and Analysis regarding critical accounting estimates, including the provision and allowance for loan losses, located on pages 26 and 33 of this report.

Three months ended June 30, 2010,
compared to three months ended June 30, 2009

FINANCIAL HIGHLIGHTS

The Corporation earned net income available to common shareholders of $1,380,000 or $0.34 per share ($0.34 diluted) for the three-month period ended June 30, 2010, compared to $49,000 or $0.01 per share ($0.01 diluted), for the same period of 2009. The $1,331,000 increase in net income available to common shareholders was the result of an increase in net interest income and a decrease in the provision for loan losses, which more than offset increases in noninterest expense and income tax expense.

The $1,996,000 or 35 percent increase in net interest income for the second quarter reflected a larger volume of interest earning assets, principally business loans and investment securities, compared to 2009. Net interest income was also favorably impacted by lower rates paid on deposit products, which reflected record lows for short-term market interest rates. The net interest margin was 3.76 percent for the current quarter, compared to 3.04 percent for the same period in 2009. The provision for loan losses for the current period decreased $1,009,000 or 62 percent, compared to 2009. The provision in the second quarter of 2009 included the impact of a large provision for an impaired commercial real estate loan that was later transferred to the foreclosed real estate portfolio. Loan charge-offs, which were reserved for in 2009, increased during the current quarter. As a result, the Corporation s allowance for loan losses ratio decreased and the annualized net loan charge-offs ratio increased. The $1,123,000 or 18 percent increase in noninterest expense was primarily the result of increased carrying costs and loss provisions for foreclosed real estate, and increased carrying costs for impaired loans. The $551,000 or 199 percent increase in income tax expense for the current quarter was primarily the result of a significant increase in pretax income, compared to the second quarter of 2009.

Both commercial and consumer loan demand were weak for the current quarter, a reflection of prolonged economic weakness, declining consumer confidence and high unemployment. Overall deposit growth has remained steady, which is being driven in part by the growth of money market deposits.

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

INCOME STATEMENT ANALYSIS

Net interest income

Net interest income for the three-month period ended June 30, 2010, was $7,688,000, an increase of $1,996,000 or 35 percent above the second quarter of 2009 as a result of an increase in earning assets and a decrease in the average rates paid on deposit products, which reflected record low short-term market interest rates. These factors improved the net interest margin, which was 3.76 percent for the second quarter of this year, compared to 3.04 percent for the second quarter of 2009.

For the second quarter of 2010, total interest income increased $957,000 or 10 percent above 2009 due primarily to an increase in the average volume of earning assets. Earning assets averaged $856 million and yielded 5.28 percent (tax equivalent basis) for the current quarter, compared to $791 million and 5.20 percent, respectively, for the second quarter of 2009. The $65 million or 8 percent increase in average earning assets was primarily the result of growth in the business loan and investment securities portfolios.

For the second quarter of 2010, total interest expense decreased $1,039,000 or 24 percent below the second quarter of 2009 due to a decrease in the average rates paid on deposits. Total interest bearing liabilities averaged $766 million at an average rate of 1.69 percent for the current quarter, compared to $706 million and 2.43 percent, respectively, for the second quarter of 2009. The $60 million or 8 percent increase in average interest bearing liabilities was primarily attributable to an increase in the average volume of money market deposits.

Provision for loan losses

For the quarter ended June 30, 2010, the provision for loan losses was $630,000, compared to $1,639,000 for the second quarter of 2009. The prior period provision included the impact of a large provision for an impaired commercial real estate loan that was later transferred to the foreclosed real estate portfolio. The current period provision reflected current economic conditions, including depressed real estate values and the high level of unemployment, which could adversely affect our borrower s ability to service their loans. Information about loan quality is provided in the Nonperforming Asset section of this report on page 31.

Noninterest income

The following table presents the components of total noninterest income for the second quarter of 2010, compared to the second quarter of 2009. Total noninterest income for the current quarter was $2,083,000, basically the same amount as the second quarter of 2009. The lack of growth in total noninterest income primarily reflected a decline in income (gains) from the sale of mortgage loans held for sale.

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Table 1 Noninterest income

(dollars in thousands)	Three months ended June 30, 2010	Three months ended June 30, 2009	Change Increase (Decrease) $	Change Increase (Decrease) %
Trust and investment services fees	$ 373	$ 303	$ 70	23%
Income from mutual fund, annuity and insurance sales	443	358	85	24
Service charges on deposit accounts	649	581	68	12
Income from bank owned life insurance	161	155	6	4
Other income	132	154	(22)	(14)
Gains on sales of loans held for sale	217	403	(186)	(46)
Gains on sales of securities	108	128	(20)	(16)
Total noninterest income	$ 2,083	$ 2,082	$ 1	0%

The discussion that follows addresses changes in selected categories of noninterest income.

Trust and investment services fees The increase reflected appreciation in market value, upon which fees are based, and an increase in income from the sale of settlement advisory services.

Income from mutual fund, annuity and insurance sales The increase in income from the sale of mutual funds, annuities and insurance products by Codorus Valley Financial Advisors, a subsidiary of PeoplesBank, was a result of market appreciation, upon which some fees are based, and increased sales.

Service charges on deposit accounts The increase was due primarily to an increase in debit card revenue, which reflected an increase in the volume of transactions.

Gains on sales of loans held for sale The decrease was due to a decrease in the volume of mortgage loan sales. Economic concerns, including employment instability, coupled with the expiration in April 2010 of a federal home-buyer tax credit program, reduced the demand for mortgage loans.

Gains on sales of securities Gains were realized from the sale of U.S. agency mortgage-backed bonds from the available-for-sale securities portfolio in both periods to take advantage of the low interest rate environment.

Noninterest expense

The following table presents the components of total noninterest expense for the second quarter of 2010, compared to the second quarter of 2009. Total noninterest expense for the current quarter was $7,242,000, an increase of $1,123,000 or 18 percent above 2009 due primarily to an increase in carrying costs and loss provisions for foreclosed real estate, and increased carrying costs for impaired loans.

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Table 2 Noninterest expense

	Three months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	2010	2009	$	%