

CODORUS VALLEY BANCORP INC  
Form 10-K  
March 15, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file Number 0-15536

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

**Pennsylvania 23-2428543**

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

**105 Leader Heights Road, P.O. Box 2887, York, Pennsylvania 17405**

(Address of principal executive offices) (Zip Code)

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

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

Title of each class	Name of each exchange on which registered
<b>Common Stock, \$2.50 par value</b>	<b>NASDAQ Global Market</b>

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes No

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller Reporting Company
Emerging Growth Company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of Codorus Valley Bancorp, Inc.'s voting stock held by non-affiliates was approximately \$228,753,924 as of June 30, 2018.

As of February 27, 2019, Codorus Valley Bancorp, Inc. had 9,457,820 shares of common stock outstanding, par value \$2.50 per share.

#### DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference to the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 21, 2019.



**Codorus Valley Bancorp, Inc.**

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## PART I

### Item 1: Business

Codorus Valley Bancorp, Inc. (“Codorus Valley” or the “Corporation”) is a Pennsylvania business corporation, incorporated on October 7, 1986. On March 2, 1987, Codorus Valley became a bank holding company under the Bank Holding Company Act of 1956, as amended. PeoplesBank, A Codorus Valley Company (“PeoplesBank”) is its wholly owned bank subsidiary. The Corporation’s business consists primarily of managing PeoplesBank, and its principal source of income is dividends received from PeoplesBank. The Corporation also wholly-owns one non-bank subsidiary, SYC Realty Co., Inc., a subsidiary for holding certain foreclosed assets pending liquidation. On December 31, 2018, Codorus Valley had total consolidated assets of \$1.81 billion, total deposits and other liabilities of \$1.63 billion, and total shareholders’ equity of \$178,746,000.

#### Bank Subsidiary

PeoplesBank, organized in 1934, is a Pennsylvania chartered bank that offers a full range of consumer, business, wealth management, and mortgage services at financial centers located in communities throughout South Central Pennsylvania and Central Maryland. In addition to the twenty-six full service financial centers there are eleven financial centers located primarily within retirement communities that provide a full suite of services on a limited basis. PeoplesBank, with origins dating back to 1864, is focused on acquiring and nurturing financial relationships with small and mid-sized businesses. The Federal Deposit Insurance Corporation insures the deposits of PeoplesBank to the maximum extent provided by law. On December 31, 2018, PeoplesBank had total gross loans of \$1.49 billion, excluding loans held for sale, and total deposits of \$1.50 billion. PeoplesBank had the second largest share of deposits in York County, Pennsylvania, with deposits totaling 15.5 percent of the market as of June 30, 2018, the latest available measurement date.

PeoplesBank is not dependent on deposits of, or exposed to a loan concentration to, a single client, or a small group of clients. Therefore, the loss of a single client, or a small client group, would not have a material adverse effect on the financial condition of PeoplesBank. At December 31, 2018, the largest indebtedness of a single PeoplesBank client was approximately \$23,550,000 or 1.6 percent of the total loan portfolio, which was within PeoplesBank’s regulatory lending limit of \$30,535,000.

Most of the Corporation's business is with clients in York County, Pennsylvania and northern Maryland. Although this market area may pose a concentration risk geographically, we believe that the diverse local economy and our detailed knowledge of the client base lessens this risk. At December 31, 2018, the Corporation had three industry

concentrations that exceeded 10 percent of the total loan portfolio: residential real estate investor represented 15.6 percent of the portfolio; commercial real estate investor represented 14.2 percent of the portfolio; and builder and developer represented 10.4 percent of the portfolio. At December 31, 2017, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor represented 16.5 percent of the portfolio; residential real estate investor represented 15.0 percent of the portfolio; and builder and developer represented 13.2 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

### **Nonbank Subsidiaries of PeoplesBank**

PeoplesBank had six wholly-owned nonbank subsidiaries as of December 31, 2018, that were consolidated for financial reporting purposes.

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

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

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

Periodically, PeoplesBank creates nonbank subsidiaries for the purpose of temporarily holding certain foreclosed assets pending liquidation. On December 31, 2018, one of three of these foreclosed asset subsidiaries was active.

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

In 2006, Codorus Valley formed CVB Statutory Trust No. 2, a wholly-owned special purpose subsidiary whose sole purpose was to facilitate a pooled trust preferred debt issuance of \$7,217,000. In 2004, Codorus Valley formed CVB Statutory Trust No. 1 to facilitate a pooled trust preferred debt issuance of \$3,093,000. The Corporation owns 100 percent of the common stock of these nonbank subsidiaries, which are not consolidated for financial reporting purposes. These obligations are reported as junior subordinated debt on the Corporation's balance sheet.

In 1991, SYC Realty Co., Inc. was incorporated as a wholly owned subsidiary of Codorus Valley, and originally commenced operations in October 1995. Codorus Valley created this nonbank subsidiary primarily for the purpose of holding certain foreclosed properties obtained by PeoplesBank pending liquidation of those properties. SYC Realty was inactive during the entire reporting period of 2018.



## **Employees**

At year-end 2018, PeoplesBank employed 327 full-time employees and 37 part-time employees, which equated to approximately 348 full-time equivalent employees. Employees are not covered by a collective bargaining agreement, and PeoplesBank considers its relations with employees to be satisfactory.

## **Segment Reporting**

Management has determined that it operates in only one segment, community banking. The Corporation's non-banking activities are not significant to the consolidated financial statements.

## Competition

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

## Supervision and Regulation

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

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

### *Bank Holding Company Regulations*

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

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

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

The Federal Reserve Act imposes restrictions on a subsidiary bank of a bank holding company, such as PeoplesBank. The restrictions affect extensions of credit to the bank holding company and its subsidiaries, investments in the stock or other securities of the bank holding company and its subsidiaries, and taking such stock or securities as collateral for loans.

The Federal Reserve Act and Federal Reserve regulations also place limitations and reporting requirements on extensions of credit by a bank to the principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulation may affect the terms upon which any person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

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

#### *Regulation of PeoplesBank*

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

State and federal banking laws and regulations govern such things as: the scope of a bank’s business; permissible investments; the reserves against deposits a bank must maintain; the types and terms of loans a bank may make and the collateral it may take; the activities of a bank with respect to mergers and consolidations; the establishment of

branches; and the sale of non-deposit investment products by the bank and its subsidiaries.

As the primary federal regulator of PeoplesBank, the FDIC regularly examines banks in such areas as capital, asset quality, management, earnings, liquidity and sensitivity to market risk and other aspects of operations and requires that PeoplesBank furnish annual and quarterly reports. Examinations by the FDIC are designed for the protection of PeoplesBank's depositors rather than Codorus Valley's shareholders. The FDIC provides deposit insurance to banks, which covers all deposit accounts. The standard maximum insurance amount is \$250,000 per depositor.

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

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

#### *Federal Deposit Insurance and Premiums*

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

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

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

#### *Dividend Restrictions*

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

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

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

*Other Laws and Regulations Affecting the Corporation and PeoplesBank*

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

Among other things, the Dodd-Frank Act:

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

Increases bank supervision by restructuring the supervision of holding companies and depository institutions; establishes the equivalent of a prompt corrective action program for large bank holding companies; requires that capital requirements for holding companies be at least as strict as capital requirements for depository institutions; disallows new issuances of trust preferred securities from qualifying for Tier 1 capital treatment; directs federal bank regulators to develop specific capital requirements for holding companies and depository institutions that address



activities that pose risk to the financial system, such as significant activities in higher risk areas, or concentrations in assets whose reported values are based on models;

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

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

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

**Sarbanes-Oxley Act of 2002** The Sarbanes-Oxley Act (“SOA”) was signed into law in July 2002 and applies to all companies, both U.S. and non-U.S, that file periodic reports under the Securities Exchange Act of 1934. The stated goals of the SOA were to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SEC is responsible for establishing rules to implement various provisions of the SOA. The SOA includes specific disclosure requirements and corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC. The SOA represents significant regulation of the accounting profession and corporate governance practices, such as the relationship between a board of directors and management and between a board of directors and its committees. Section 404 of the SOA requires publicly held companies to document, test and certify that their internal control systems over financial reporting are effective.

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

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

**May 2018 Banking Reform Legislation** On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the “Regulatory Relief Act”), amended certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as certain other statutes administered by the federal banking agencies. Some of the key provisions of the Regulatory Relief Act as it relates to community banks and bank holding companies include: (i) designating mortgages held in portfolio and “qualified mortgages” for banks with less than \$10 billion in assets, subject to certain documentation and product limitations; (ii) exempting banks with less than \$10 billion in assets (and total trading assets and trading liabilities of 5% or less of total assets) from Volcker Rule requirements

relating to proprietary trading; (iii) simplifying capital calculations for banks with less than \$10 billion in assets by requiring federal banking agencies to establish a community bank leverage ratio of tangible equity to average consolidated assets of not less than 8% or more than 10%, and provide that banks that maintain tangible equity in excess of such ratio will be deemed to be in compliance with risk-based capital and leverage requirements; (iv) assisting smaller banks with obtaining stable funding by providing an exception for reciprocal deposits from FDIC restrictions on acceptance of brokered deposits; (v) raising the eligibility for use of short-form Call Reports from \$1 billion to \$5 billion in assets; (vi) clarifying definitions pertaining to high volatility commercial real estate loans (HVCRE), which requires higher capital allocations, so that only loans with increased risk are subject to higher risk weightings; and (vii) changing the eligibility for use of the small bank holding company policy statement from institutions with under \$1 billion in assets to institutions with under \$3 billion in assets.

Section 201 of the Regulatory Relief Act directed the federal banking agencies to develop a community bank leverage ratio (“CBLR”) of not less than 8% and not more than 10% for qualifying community banks and bank holding companies with total consolidated assets of less than \$10 billion. Qualifying community banking organizations that exceed the CBLR level established by the agencies, and that elect to be covered by the CBLR framework, will be considered to have met: (i) the generally applicable leverage and risk-based capital requirements under the banking agencies’ capital rules; (ii) the capital ratio requirements necessary to be considered “well capitalized” under the banking agencies’ prompt corrective action framework in the case of insured depository institutions; and (iii) any other applicable capital or leverage requirements.

On February 8, 2019, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve Board, and the FDIC published for comment a proposed rule to implement the provisions of Section 201 of the Regulatory Relief Act. Under the proposal, a qualifying community banking organization would be defined as a deposit institution or depository institution holding company with less than \$10 billion in assets and specified limited amounts of off-balance sheet exposures, trading assets and liabilities, mortgage servicing assets, and certain temporary difference deferred tax assets. A qualifying community banking organization would be permitted to elect the CBLR framework if its CBLR is greater than 9%. The proposed rulemaking also addresses opting in and opting out of the CBLR framework by a community banking organization, the treatment of a community banking organization that falls below the CBLR requirements, and the effect of various CBLR levels for purposes of the prompt corrective action categories applicable to insured depository institutions. Advanced approaches banking organizations (generally, institutions with \$250 billion or more in consolidated assets) are not eligible to use the CBLR framework.

The Company continues to analyze the changes implemented by the Regulatory Relief Act, including the CBLR framework included in the recently proposed rulemaking. The Company does not believe, however, that such changes will materially impact the Company’s business, operations, or financial results.

#### *Future Laws and Regulations*

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

## Other Information

This Annual Report on Form 10-K is filed with the Securities and Exchange Commission (SEC). Copies of this document, the Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports and other filings by Codorus Valley with the SEC may be obtained electronically at PeoplesBank's website at [www.peoplesbanknet.com](http://www.peoplesbanknet.com) (select "Investor Relations", then select "Filings", then select "Documents"), or the SEC's website at [www.sec.gov](http://www.sec.gov). Copies can also be obtained without charge by writing to: Treasurer, Codorus Valley Bancorp, Inc., 105 Leader Heights Road, York, PA 17403.

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

## Item 1A: Risk Factors

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

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

### Risks Related to Our Business and Industry

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

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

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

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

increase loan delinquencies;

increase problem assets and foreclosures;

increase claims and lawsuits;

decrease the demand for our products and services; and

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

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

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

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

prolonged economic downturn or continued weakening in general economic conditions such as inflation, recession, unemployment or other factors beyond our control, could reduce our earnings.

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

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



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

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

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

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

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

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

***The planned phasing out of LIBOR as a financial benchmark presents risks to the financial instruments originated or held by the Corporation.***

The London Interbank Offered Rate ("LIBOR") is the reference rate used for many of the Corporation's transactions, including variable and adjustable rate loans and borrowings. However, a reduced volume of interbank unsecured term borrowing coupled with recent legal and regulatory proceedings related to rate manipulation by certain financial institutions has led to international reconsideration of LIBOR as a financial benchmark. The United Kingdom Financial Conduct Authority ("FCA"), which regulates the process for establishing LIBOR, announced in July 2017 that the sustainability of LIBOR cannot be guaranteed. Accordingly, the FCA intends to stop persuading, or compelling, banks to submit to LIBOR after 2021. Until such time, however, FCA panel banks have agreed to continue to support LIBOR. It is impossible to predict what benchmark rate(s) may replace LIBOR or how LIBOR will be determined for purposes of financial instruments that are currently referencing LIBOR if, and when, it ceases to exist. The uncertainty surrounding potential reforms, including the use of alternative reference rates and changes to the methods and processes used to calculate rates, may have an adverse effect on the trading market for LIBOR-based securities, loan yields, and the amounts received and paid on other financial instruments. In addition, the implementation of LIBOR reform proposals may result in increased compliance and operational costs.

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

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

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

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

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

The Dodd-Frank Act created the Consumer Financial Protection Bureau, or CFPB, as an independent bureau of the Federal Reserve with broad powers to supervise and enforce consumer protection laws. In addition, the CFPB has

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

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

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

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

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

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

the full amount of the loan or derivative exposure due us. Losses related to these credit risks could materially and adversely affect our results of operations or earnings.

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

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

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

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

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

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

We use various technology systems to manage our client relationships, general ledger, securities investments, deposits, and loans. We have established policies and procedures to prevent or limit the impact of system failures, interruptions, and security breaches (including privacy breaches and cyber-attacks), but such events may still occur or

may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter clients from using our products and services. Although we take protective measures, the security of our computer systems, software, and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious code and cyber-attacks that could have an impact on information security.



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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

## Risks Related to Our Common Stock

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

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

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

actual or anticipated variations in quarterly results of operations or quality of our assets;

recommendations by securities analysts;

operating and stock price performance of other companies that investors deem comparable to us;

any failure to pay dividends on our common stock or a reduction in cash dividends;

continued levels of loan quality and volume origination;

the adequacy of loan loss reserves;

the willingness of clients to substitute competitors' products and services for our products and services and vice versa, based on price, quality, relationship or otherwise;

interest rate, market and monetary fluctuations;

declines in the fair value of our available-for-sale securities that are deemed to be other-than-temporarily impaired;

the timely development of competitive new products and services by us and the acceptance of such products and services by clients;

changes in consumer spending and saving habits relative to the financial services we provide;

relationships with major clients;

our ability to continue to grow our business internally and through acquisition and successful integration of new or acquired entities while controlling costs;

news reports relating to trends, concerns and other issues in the financial services industry, including the failures of other financial institutions in the current economic downturn;

perceptions in the marketplace regarding us and/or our competitors;

rapidly changing technology, or new technology used, or services offered, by competitors;

deposit flows;

changes in accounting principles, policies and guidelines;

significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;

failure to integrate acquisitions or realize anticipated benefits from acquisitions;

changes in and compliance with laws and government regulations of federal, state and local agencies;

geopolitical conditions such as acts or threats of terrorism or military conflicts;

failure to retain or attract key personnel;

operating results that vary from the expectations of management, analysts and investors;

future sales of our equity or equity-related securities;

the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and developments with respect to financial institutions generally; and

the relatively low trading volume of our common stock.



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

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

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

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

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

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

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

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

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

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

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

We are currently authorized to issue up to 30,000,000 shares of common stock of which 9,451,547 shares were outstanding as of December 31, 2018, and up to 1,000,000 shares of preferred stock, none of which were outstanding as of December 31, 2018. Our board of directors has authority, without action or vote of the shareholders of common stock, to issue all or part of the authorized but unissued shares. Authorized but unissued shares of our common stock or preferred stock could be issued on terms or in circumstances that could dilute the interests of other shareholders.

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

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

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

and are continuing. These restrictions could have a negative effect on the value of our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, as and if declared by our board of directors.

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

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

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

As of December 31, 2018, we had \$10,310,000 outstanding aggregate principal amount of junior subordinated debt securities issued in connection with the sale of trust preferred securities by certain of our subsidiaries that are statutory business trusts. We have also guaranteed those trust preferred securities. There are currently two separate series of these junior subordinated debt securities outstanding, each series having been issued under a separate indenture and with a separate guarantee. Each of these indentures, together with the related guarantee, prohibits us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock at any time when (i) there shall have occurred and be continuing an event of default under the indenture or any event, act or condition that with notice or lapse of time or both would constitute an event of default under the indenture; or (ii) we are in default with respect to payment of any obligations under the related guarantee; or (iii) we have deferred payment of interest on the junior subordinated debt securities outstanding under that indenture. In that regard, we are entitled, at our option but subject to certain conditions, to defer payments of interest on the junior subordinated debt securities of each series from time to time for up to five years.

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



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

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

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

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

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

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

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

divide our board of directors into three classes serving staggered three year terms;

authorize our board of directors to oppose a tender or other offer for the Company's securities if the board determines that such an offer should be rejected;

require the affirmative vote of holders of at least 75 percent of the outstanding shares of our common stock to approve merger, consolidation, liquidation or dissolution of the Company, or any sale or other disposition of all or substantially all of the assets of the Company, excepting transactions described above that are approved by at least 80 percent of the members of the Board of Directors, where such transactions shall only require shareholder approval by a majority of the votes cast at the shareholders meeting;

eliminate cumulative voting in the election of directors; and

require advance notice of nominations for the election of directors and the presentation of shareholder proposals at meetings of shareholders.



**Item 1B: Unresolved Staff Comments**

Not applicable.

**Item 2: Properties**

Codorus Valley owns the Codorus Valley Corporate Center (“Corporate Center”), located at 105 Leader Heights Road, York, PA 17403, subject to a first lien held by ACNB Bank and a second lien held by its wholly owned subsidiary, PeoplesBank. The first lien held by ACNB Bank supports a \$3,000,000 line of credit. No draws have been made on the line and on December 31, 2018, the balance was zero. The second lien held by PeoplesBank totaled \$169,000 on December 31, 2018. This facility serves as the corporate headquarters and is approximately 40,000 square feet, a portion of which is leased to third-parties. The Corporate Center is adjacent to PeoplesBank’s Data Operations Center and the Leader Heights financial center and is approximately one half mile from PeoplesBank’s Administrative Services Centers.

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

	<b>Owned</b>	<b>Leased</b>	<b>Total</b>
<b>Pennsylvania</b>			
Financial Centers	11	9	20
Limited Service Facilities	-	11	11
Administrative Services Centers	1	1	2
Other Property <sup>(1)</sup>	1	-	1
<b>Maryland</b>			
Financial Centers	4	2	6
Other Properties <sup>(2)</sup>	-	2	2

<sup>(1)</sup> The other property located in Pennsylvania consists of a maintenance facility for storage of maintenance equipment.

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

In January 2019 a 3-building complex was purchased in Pennsylvania for future back office operations expansion.

Item 3: Legal Proceedings

In the opinion of management, there are no legal proceedings pending against Codorus Valley or any of its subsidiaries which are expected to have a material impact upon the financial position and/or operating results of the Corporation. Management is not aware of any adverse proceedings known or contemplated by governmental authorities.

Item 4: Mine Safety Disclosures

Not applicable.

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

Codorus Valley Bancorp, Inc. common stock is listed on the NASDAQ Global Market under the symbol CVLY. Codorus Valley had approximately 2,450 holders of record as of February 27, 2019. The closing price per share of Codorus Valley's common stock on February 27, 2019, was \$22.95. The following table sets forth high and low sales prices and dividends paid per common share for Codorus Valley as reported by NASDAQ during the periods indicated. All amounts reflect the impact of the common stock dividends distributed by the Corporation.

	2018			2017		
	Quarter High	Low	Dividends Per Share	High	Low	Dividends Per Share
First	\$ 28.31	\$ 23.65	\$ 0.148	\$ 26.17	\$ 22.70	\$ 0.123
Second	29.51	26.21	\$ 0.148	26.81	22.88	\$ 0.123
Third	31.86	28.19	\$ 0.148	28.90	21.73	\$ 0.123
Fourth	30.48	20.27	\$ 0.148	31.87	26.01	\$ 0.123

**Dividend Policy**

Codorus Valley has a long history of paying quarterly cash dividends on its common stock. Codorus Valley presently expects to pay future cash dividends; however, the payment of such dividends will depend primarily upon the earnings of its subsidiary, PeoplesBank. Management anticipates that substantially all of the funds available for the payment of cash dividends by Codorus Valley will be derived from dividends paid to it by PeoplesBank. The payment of cash dividends is also subject to restrictions on dividends and capital requirements as reported in Note 9-Regulatory Matters in the notes to the consolidated financial statements.

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

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

### Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information about options outstanding and securities available for future issuance under the Corporation's 2001 Employee Stock Bonus Plan, 2007 Long Term Incentive Plan, 2007 Employee Stock Purchase Plan and 2017 Long Term Incentive Plan, as adjusted for stock dividends distributed.

Plan Category	Equity Compensation Plan Information		Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)	
	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted-average exercise price of outstanding options, warrants and rights		
Equity compensation plans approved by security holders	204,418	\$ 15.62	480,648	(1)
Equity compensation plans not approved by security holders	0	0	20,111	(2)
Total	204,418	\$ 15.62	500,759	

(1) Includes 168,171 shares available for issuance under the 2007 Employee Stock Purchase Plan.

Shares available for issuance under the 2001 Employee Stock Bonus Plan that provides for shares of common

(2) stock to employees as performance-based compensation. For a description of this plan, see Note 12 - Stock-Based Compensation, to the consolidated financial statements.

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

The Corporation has a Share Repurchase Program (Program), which was authorized in 1995, and has been periodically amended, to permit the purchase of up to a maximum of 4.9 percent of the outstanding shares of the Corporation's common stock at a price per share no greater than 200 percent of the latest quarterly published book value. No shares were repurchased in 2017 under the 1995 Program. On February 13, 2018 the Corporation cancelled the prior Program and authorized a new Share Repurchase Program, to permit the purchase of up to a maximum of 4.9 percent of the outstanding shares of the Corporation's common stock at a price per share no greater than 150 percent of the latest quarterly published book value. The U.S. Treasury's Small Business Lending Fund (SBLF) program imposed limits on the ability of the Corporation to repurchase shares of common stock if it failed to declare and pay quarterly dividends on the SBLF preferred stock. On February 18, 2016, Codorus Valley redeemed the remaining \$12,000,000 of Series B preferred stock issued to the Treasury as reported on a Form 8-K filed February 19, 2016; therefore, the limits previously imposed by the SBLF program are no longer applicable.

For the years ended December 31, 2018 and 2017, the Corporation did not acquire any of its common stock under the current repurchase program.

**Performance Graph**

The following five-year performance graph compares the cumulative total shareholders return (including reinvestment of dividends) on Codorus Valley Bancorp, Inc.'s common stock to the S&P 500 Index and the ABA Community Bank NASDAQ Index. The stock performance graph assumes that \$100 was invested on December 31, 2013, and the cumulative return is measured as of each subsequent fiscal year end.

Index	Period Ending					
	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
Codorus Valley Bancorp, Inc.	\$100.00	\$108.21	\$120.34	\$182.09	\$187.61	\$155.35
S&P 500	100.00	113.69	115.26	129.05	157.22	150.33
ABA Community Bank Index(1)	100.00	102.81	110.47	150.22	151.32	126.17

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

**Item 6: Selected financial data**

Codorus Valley Bancorp, Inc.

	2018	2017	2016	2015	2014	
<b>Summary of operations</b> (in thousands)						
Interest income	\$80,321	\$70,415	\$62,230	\$56,002	\$50,400	
Interest expense	16,401	10,868	8,649	8,174	8,040	
Net interest income	63,920	59,547	53,581	47,828	42,360	
Provision for loan losses	2,700	4,175	3,000	3,500	1,600	
Noninterest income	13,314	11,522	10,030	9,047	8,153	
Noninterest expense	49,810	44,986	41,623	37,427	32,476	
Income before income taxes	24,724	21,908	18,988	15,948	16,437	
Provision for income taxes	5,182	9,904	5,886	4,813	4,668	
Net income	19,542	12,004	13,102	11,135	11,769	
Preferred stock dividends	0	0	16	120	174	
Net income available to common shareholders	\$19,542	\$12,004	\$13,086	\$11,015	\$11,595	
Per common share (adjusted for stock dividends)						
Net income, basic	\$2.08	\$1.29	\$1.42	\$1.52	\$1.70	
Net income, diluted	\$2.06	\$1.27	\$1.41	\$1.51	\$1.67	
Cash dividends paid	\$0.592	\$0.492	\$0.448	\$0.420	\$0.384	
Stock dividends distributed	5	% 5	% 5	% 5	% 5	%
Book value	\$18.91	\$17.56	\$16.68	\$15.97	\$15.01	
Tangible book value (1)	\$18.67	\$17.31	\$16.43	\$15.72	\$15.01	
Cash dividend payout ratio	28.3	% 38.0	% 32.0	% 27.2	% 22.5	%
Weighted average shares outstanding	9,388,151	9,314,110	9,233,085	7,227,172	6,821,185	
Weighted average diluted shares outstanding	9,479,266	9,423,455	9,312,113	7,305,017	6,940,683	
Profitability ratios						
Return on average shareholders' equity (ROE)	11.42	% 7.40	% 8.47	% 8.94	% 10.22	%
Return on average assets (ROA)	1.11	% 0.72	% 0.88	% 0.82	% 0.98	%
Net interest margin (tax equivalent basis)	3.84	% 3.84	% 3.89	% 3.79	% 3.84	%
Efficiency ratio	63.95	% 62.07	% 64.09	% 64.60	% 62.83	%
Net overhead ratio	2.08	% 2.03	% 2.15	% 2.12	% 2.08	%
Capital ratios (consolidated)						
Common equity tier 1 ratio	12.15	% 11.58	% 11.88	% 12.56	% n/a	
Tier 1 risk-based capital	12.83	% 12.29	% 12.66	% 14.49	% 13.24	%



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Total risk-based capital	14.09	%	13.48	%	13.81	%	15.60	%	14.42	%
Average shareholders' equity to average assets	9.75	%	9.79	%	10.44	%	9.15	%	9.62	%

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

Investment securities (including restricted bank stock)	\$ 155,515	\$ 164,902	\$ 201,665	\$ 218,498	\$ 216,973
Loans (including loans held for sale)	1,489,807	1,401,479	1,272,319	1,123,775	920,554
Assets	1,807,480	1,709,205	1,611,587	1,456,334	1,213,846
Deposits	1,495,280	1,384,507	1,264,177	1,094,149	954,973
Borrowings	122,332	150,805	181,947	194,820	132,590
Equity	178,746	164,219	154,957	159,141	118,440
Other data					
Full service financial centers	26	26	26	24	21
Number of employees <i>(full-time equivalents)</i>	348	326	306	282	238
Wealth Management assets, market value <i>(in thousands)</i>	\$ 725,087	\$ 711,161	\$ 562,865	\$ 514,728	\$ 307,000

(1) The following table provides the reconciliation of tangible book value, which is a non-GAAP Financial Measure, for the dates indicated:

(dollars in thousands)	2018	2017	2016	2015	2014
Total Shareholders' Equity	\$178,746	\$164,219	\$154,957	\$159,141	\$118,440
Less: Preferred Stock	0	0	0	(12,000)	(12,000)
Less: Goodwill and Other Intangible Assets	(2,316)	(2,321)	(2,327)	(2,333)	0
Tangible Shareholders' Equity	\$176,430	\$161,898	\$152,630	\$144,808	\$106,440
Common Shares Outstanding	9,452	9,351	9,290	9,211	7,087
Book Value	\$18.91	\$17.56	\$16.68	\$15.97	\$15.01
Book Value	\$18.91	\$17.56	\$16.68	\$15.97	\$15.01
Effect of Intangible Assets	(0.25)	(0.25)	(0.25)	(0.25)	0.00
Tangible Book Value	\$18.67	\$17.31	\$16.43	\$15.72	\$15.01

This report contains certain financial information determined by methods other than in accordance with GAAP. This non-GAAP disclosure has limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of the Corporation's results as reported under GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies. Our management uses this non-GAAP measure in its analysis of our performance because it believes this measure is material and will be used as a measure of our performance by investors.

## Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations

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

### Forward-looking Statements

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

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

Operating, legal and regulatory risks;

Credit risk, including an increase in nonperforming assets requiring loss provisions and the incurrence of carrying costs related to nonperforming assets;

Interest rate fluctuations which could increase our cost of funds or decrease our yield on earning assets and therefore reduce our net interest income;

Declines in the market value of investment securities considered to be other-than-temporary;

Unavailability of capital when needed or availability at less than favorable terms;

Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of our computer systems or otherwise, may adversely affect the Corporation's operations, net income or reputation;

Inability to achieve merger-related synergies, and difficulties in integrating the business and operations of acquired institutions;

A prolonged economic downturn or excessive inflation;

Political and competitive forces affecting banking, securities, asset management and credit services businesses;

The effects of and changes in the rate of FDIC premiums, including special assessments;

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

Future changes in federal or state tax laws or tax rates;

Enacted financial reform legislation, e.g., Dodd-Frank Wall Street Reform and Consumer Protection Act, may have a significant impact on the Corporation's business and results of operations; and

The risk that management's analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

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

### **Critical Accounting Estimates**

Disclosure of Codorus Valley's significant accounting policies is included in Note 1 in the notes to the consolidated financial statements included in this Form 10-K. Some of these policies require management to make significant judgments, estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities. Management makes significant estimates in determining the allowance for loan losses, valuation of foreclosed real estate, and evaluation of other-than-temporary impairment losses of securities.

Management considers a variety of factors in establishing allowance for loan losses such as current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strength of borrowers, adequacy of collateral, (if collateral dependent, or present value of future cash flows) and other relevant factors. There is also the potential for adjustment to the allowance for loan losses as a result of regulatory examinations.

Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Appraisals are generally used to determine fair value. After foreclosure, management reviews valuations at least quarterly and adjusts the asset to the lower of cost or fair value minus estimated costs to

sell. Estimates related to the value of collateral can have a significant impact on whether or not management continues to accrue income on delinquent and impaired loans and on the amounts at which foreclosed real estate is recorded on the statement of financial condition.

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

Management discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosures with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report. Additional information is contained in Management's Discussion and Analysis regarding critical accounting estimates, including the provision and allowance for loan losses located on pages 38 and 56 of this report.

## **FINANCIAL HIGHLIGHTS**

### **Executive Summary**

The Corporation's net income available to common shareholders (earnings) was \$19,542,000 for the full year 2018, compared to \$12,004,000 of earnings in 2017, an increase of \$7,538,000 or 63 percent. The increase in net income for the year was partially the result of a \$2,755,000 reduction in the net deferred tax asset value at December 31, 2017 due to the new corporate tax rate of 21 percent enacted on December 22, 2017 as part of the Tax Cuts and Jobs Act that became effective January 1, 2018.

Net interest income for 2018 increased \$4,373,000 or 7 percent when compared to 2017, primarily due to an increase in the volume of commercial loans, which was partially offset by an increase in interest-bearing deposits.

Net interest margin (tax-equivalent basis) for 2018 was 3.84 percent, compared to 3.84 percent for 2017. The Corporation continues to have success in growing lower cost core deposits, while maintaining reasonable yields on new loan growth in a highly competitive environment. The average yield on earning assets increased to 4.82 percent in 2018 as compared to 4.53 percent in 2017 and the cost of interest-bearing liabilities increased to 1.24 percent in 2018, as compared to 0.86 percent in 2017.

The loan loss provision for 2018 was \$2,700,000, a decrease of \$1,475,000 compared to a provision of \$4,175,000 for 2017. The change in provision for 2018 was primarily due to specific loan loss reserves assigned during 2018 as compared to a larger amount of aggregate net charge-offs and specific loan loss reserves in the prior year. The provision for both periods supported adequate allowance for loan loss coverage considering several factors, including the Corporation's growth in commercial loans. The allowance as a percentage of total loans was 1.29 percent at December 31, 2018, and 1.19 percent at December 31, 2017.

Noninterest income, excluding gains on sales of investment securities, for the year ended December 31, 2018, totaled \$13,314,000 representing an increase of \$1,871,000 or 16 percent compared to noninterest income of \$11,443,000 for 2017. Specific noninterest income increases included trust and investment services fees, income from mutual fund, annuity and insurance sales, service charges on deposits, gain on sale of loans held for sale, and other income. There

were no gains on sales of investment securities for 2018 compared to \$79,000 in 2017.

Noninterest expense for the year ended 2018, totaled \$49,810,000 representing an increase of \$4,824,000 or 11 percent compared to \$44,986,000 for 2017. Higher costs associated with personnel, professional and legal, debit card processing, external data processing, and charitable donations, accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the continued expansion of our business and consumer banking in and support services for our Maryland and Pennsylvania markets. The higher costs were partially offset by a reduction in telecommunications expense due to a contract re-negotiation.

The provision for income taxes for 2018 totaled \$5,182,000 which was \$4,772,000 or 48 percent below the provision for income taxes for 2017 of \$9,904,000. The decrease was due to a \$2,755,000 reduction in the net deferred tax asset value at December 31, 2017 due to the new corporate tax rate of 21 percent enacted on December 22, 2017 as part of the Tax Cuts and Jobs Act that became effective January 1, 2018 and an overall higher tax rate in 2017, offset by a \$2,816,000 increase in 2018 pre-tax net income.

Earnings per share were \$2.08 basic and \$2.06 diluted for 2018 compared to \$1.29 basic and \$1.27 diluted for 2017. The increase in earnings per share for the year was primarily the result of the aforementioned reduction in the net deferred tax asset value in 2017.

On December 31, 2018, total assets were approximately \$1.81 billion, representing a 6 percent increase compared to December 31, 2017. The growth for 2018 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions.

The closing price for the Corporation's common stock (NASDAQ: CVLY) was \$21.25 per share on December 31, 2018, compared to \$26.22 per share on December 31, 2017, as adjusted. Cash dividends paid on common shares for the year 2018 totaled \$0.592 per share, as adjusted for stock dividends, representing an increase of \$0.100 or 20 percent above the cash dividends of \$0.492, as adjusted, paid for the year 2017. Also, the Corporation distributed a 5 percent common stock dividend on December 11, 2018. The **Selected Financial Data** schedule, located on page 29 of this report, provides a summary of operations and performance metrics for the past five years in a comparative format.

### **Year Ended December 31, 2018 vs. Year Ended December 31, 2017**

The full year 2018 net income available to common shareholders of \$19,542,000 represents an increase of \$7,538,000 compared to the full year 2017 earnings of \$12,004,000. Earnings per share were \$2.08 basic and \$2.06 diluted for 2018 compared to \$1.29 basic and \$1.27 diluted for 2017. The increase in net income and earnings per share for the year was partially the result of a \$2,755,000 reduction in the net deferred tax asset value at December 31, 2017 due to the new corporate tax rate of 21 percent enacted on December 22, 2017 as part of the Tax Cuts and Jobs Act that became effective January 1, 2018.

Net interest income, which totaled \$63,920,000 for the year ended December 31, 2018, represented an increase of \$4,373,000 or 7 percent above net interest income of \$59,547,000 for 2017. The growth in net interest income reflects



the increased volume of interest-earning assets, primarily commercial loans; however, the additional interest income from this new loan volume was partially offset by increased costs associated with the growth in core deposits and an increase in volume and rates paid for time deposits and an increase in rates paid for long-term borrowings.

The loan loss provision for 2018 was \$2,700,000, a decrease of \$1,475,000 compared to a provision of \$4,175,000 for 2017. The change in provision for 2018 was primarily due to specific loan loss reserves assigned during 2018 as compared to a larger amount of aggregate net charge-offs and specific loan loss reserves in the prior year. The allowance for loan losses as a percentage of total period-end loans was 1.29 percent and 1.19 percent as of December 31, 2018 and 2017, respectively. The provision for loan losses for both periods supported adequate allowance for loan loss coverage considering several factors, including the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

Noninterest income, excluding gains on sales of investment securities, for the year ended December 31, 2018, totaled \$13,314,000 representing an increase of \$1,871,000 or 16 percent compared to noninterest income of \$11,443,000 for 2017. Specific noninterest income increases included trust and investment services fees, income from mutual fund, annuity and insurance sales, service charges on deposits, gains on sales of loans held for sale, and other income. There were no gains on sales of investment securities for 2018 compared to \$79,000 in 2017.

Noninterest expense for the year ended December 31, 2018, totaled \$49,810,000 representing an increase of \$4,824,000 or 11 percent compared to \$44,986,000 for 2017. Higher costs associated with personnel, professional and legal, debit card processing, external data processing, charitable donations and foreclosed real estate, accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the expansion of our business and consumer banking in and support services for our Maryland and Pennsylvania markets. The increase was partially offset by a decrease in telecommunications expense.

The provision for income taxes for 2018 totaled \$5,182,000 which was \$4,772,000 or 48 percent below the provision for income taxes for 2017 of \$9,904,000. The decrease was due to a \$2,755,000 reduction in the net deferred tax asset value at December 31, 2017 due to the new corporate tax rate of 21 percent enacted on December 22, 2017 as part of the Tax Cuts and Jobs Act that became effective January 1, 2018 and an overall higher tax rate in 2017, offset by a \$2,816,000 increase in 2018 pre-tax net income.

On December 31, 2018, total assets were \$1.81 billion, representing a 6 percent increase compared to total assets of \$1.71 billion as of December 31, 2017. Asset growth for 2018 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The growth in core deposits included a \$31,419,000 increase in the average balance of noninterest bearing deposits for 2018 as compared to 2017. Growing core deposits remains a particular focus of the Corporation because the rates paid for such deposits are low, transactional activity on these deposits are a source of fee income, and a core deposit relationship provides the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

Cash dividends paid on common shares for the year 2018 totaled \$0.592 per share, as adjusted for stock dividends, representing an increase of \$0.100 or 20 percent above the cash dividends of \$0.492, as adjusted, paid for the year 2017.

The Corporation distributed a 5 percent common stock dividend on December 11, 2018, the same common stock dividend percentage that was distributed in December 2017.

The Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Table 9 - Capital Ratios, following, shows that both the Corporation and PeoplesBank were well capitalized for all periods presented.

**Year Ended December 31, 2017 vs. Year Ended December 31, 2016**

The full year 2017 net income available to common shareholders of \$12,004,000 represents a decrease of \$1,082,000 compared to the full year 2016 earnings of \$13,086,000. Earnings per share were \$1.29 basic and \$1.27 diluted for 2017 compared to \$1.42 basic and \$1.41 diluted for 2016. The decrease in net income and earnings per share for the year was primarily the result of a \$2,755,000 reduction in the net deferred tax asset value due to the new corporate tax rate of 21 percent enacted as part of the Tax Cuts and Jobs Act.

Net interest income, which totaled \$59,547,000 for the year ended December 31, 2017, represented an increase of \$5,966,000 or 11 percent above net interest income of \$53,581,000 for 2016. The growth in net interest income reflects the increased volume of interest-earning assets, primarily commercial loans; however, the additional interest income from this new loan volume was partially offset by increased costs associated with the growth in core deposits and an increase in volume and rates paid for both time deposits and long-term borrowings.

The loan loss provision for 2017 totaled \$4,175,000 as compared to the loan loss provision of \$3,000,000 for 2016, an increase of \$1,175,000. The increase in the provision was primarily a result of an increase in net charge-offs of \$1,766,000 in 2017 compared to 2016 and commercial loan portfolio growth. The allowance for loan losses as a percentage of total period-end loans was 1.19 percent and 1.18 percent as of December 31, 2017 and 2016, respectively. The increased allowance for loan losses reflected both the overall commercial loan growth for 2017, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

Noninterest income, excluding gains on sales of investment securities, for the year ended December 31, 2017, totaled \$11,443,000 representing an increase of \$1,607,000 or 16 percent compared to noninterest income of \$9,836,000 for 2016. Specific noninterest income increases included trust fees, service charges on deposits, income from bank owned life insurance and gains on sales of loans held for sale. Gains on sales of investment securities for 2017 decreased \$115,000 when compared to 2016.

Noninterest expense for the year ended December 31, 2017, totaled \$44,986,000 representing an increase of \$3,363,000 or 8 percent compared to \$41,623,000 for 2016. Higher costs associated with: personnel, external data processing, charitable contributions and other expenses, accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the expansion of our business and consumer banking in and support services for our Maryland and Pennsylvania markets.

The provision for income taxes for 2017 totaled \$9,904,000 which was \$4,018,000 or 68 percent above the provision for income taxes for 2016 of \$5,886,000. The increase was due to a \$2,755,000 reduction in the net deferred tax asset value due to the new corporate tax rate of 21 percent enacted as part of the Tax Cuts and Jobs Act and a \$2,920,000 increase in pre-tax net income.

On December 31, 2017, total assets were \$1.71 billion, representing a 6 percent increase compared to total assets of \$1.61 billion as December 31, 2016. Asset growth for 2017 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The growth in core deposits included a \$35,740,000 increase in the average balance of noninterest bearing deposits for 2017 as compared to 2016. Growing core deposits remains a particular focus of the Corporation because the rates paid for such deposits are low, transactional activity on these deposits are a source of fee income, and a core deposit relationship provides the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

Cash dividends paid on common shares for the year 2017 totaled \$0.492 per share, as adjusted for stock dividends, representing an increase of \$0.044 or 10 percent above the cash dividends of \$0.448, as adjusted, paid for the year 2016.

The Corporation distributed a 5 percent common stock dividend on December 12, 2017, the same common stock dividend percentage that was distributed in December 2016.

The Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Table 9 - Capital Ratios, following, shows that both the Corporation and PeoplesBank were well capitalized for all periods presented.

## **INCOME STATEMENT ANALYSIS**

### **Net Interest Income**

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

Net interest income for the year ended December 31, 2018, was \$63,920,000, an increase of \$4,373,000 or 7 percent above the full year 2017 net interest income. The increase was supported by a 6 percent increase in the average volume of interest-earning assets, primarily commercial loans. The additional interest income from the increased loan volume was partially offset by the costs associated with the growth in core deposits and an increase in volume and rates paid for interest bearing demand deposits, time deposits and long-term borrowings. The net interest margin, which reflects net interest income on a tax-equivalent basis as a percentage of average interest-earning assets, was 3.84 percent for 2018, compared to 3.84 percent for 2017.

Interest income for the full year 2018 totaled \$80,321,000, an increase of \$9,906,000 or 14 percent above 2017. The increase in total interest income was driven by a growth in the average volume and rate of loans which was partially offset by a decrease in the average volume and rate of tax-exempt investment securities and tax-exempt loans. Interest earning assets averaged \$1.67 billion and yielded 4.82 percent (tax equivalent basis) for 2018, compared to \$1.57 billion and a tax-equivalent yield of 4.53 percent, respectively, for 2017.

Interest expense for the full year 2018 totaled \$16,401,000, an increase of \$5,533,000 or 51 percent above 2017. The increase in total interest expense was primarily driven by an increase in rate in core deposits (the Corporation defines core deposits as demand, savings, and money market deposits), time deposits and long-term borrowings. Interest expense on deposits increased \$5,415,000 or 67 percent for 2018 compared to 2017 and was primarily attributed to the increases in rates paid on interest bearing core deposits and time deposits. The average volume of interest bearing core deposits was \$728,283,000 for the full year 2018, a \$59,969,000 or 9 percent increase above the average volume for 2017. Interest expense on long-term debt increased \$375,000 or 16 percent for 2018. The average rate paid on long-term borrowings in 2018 of 2.14 percent, reflected a 17 percent increase from the average rate paid of 1.83 percent in 2017. Long-term debt is primarily comprised of advances from the Federal Home Loan Bank of Pittsburgh, with intermediate term bullet maturities that supplement deposit funding and provide a partial funding hedge against rising market interest rates.

Tables 1 and 2, following, are presented on a tax-equivalent basis to make it easier to compare taxable and tax-exempt assets. Interest on tax-exempt assets (which include securities issued by, or loans made to, state and local governments) is adjusted based upon a 21 percent federal income tax rate in 2018 compared to a 35 percent rate for 2017 and 2016.

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

	2018			2017			2016		
(dollars in thousands)	Average Balance	Yield/ Interest Rate	Average Balance	Yield/ Interest Rate	Average Balance	Yield/ Interest Rate	Average Balance	Yield/ Interest Rate	
<b>Assets</b>									
Interest bearing deposits with banks	\$ 53,522	\$ 1,053	1.97 %	\$ 34,050	\$ 379	1.11 %	\$ 27,415	\$ 142	0.52 %
Investment securities:									
Taxable	113,703	2,745	2.41	131,999	2,809	2.13	129,353	2,759	2.13
Tax-exempt	46,376	1,309	2.82	55,565	1,855	3.34	70,497	2,355	3.34
Total investment securities	160,079	4,054	2.53	187,564	4,664	2.49	199,850	5,114	2.56
<b>Loans:</b>									
Taxable (1)	1,445,572	75,024	5.19	1,335,264	65,501	4.91	1,157,918	57,216	4.94
Tax-exempt	15,264	558	3.66	17,611	750	4.26	18,869	794	4.21
Total loans	1,460,836	75,582	5.17	1,352,875	66,251	4.90	1,176,787	58,010	4.93
Total earning assets	1,674,437	80,689	4.82	1,574,489	71,294	4.53	1,404,052	63,266	4.51
Other assets (2)	80,769			81,534			77,794		
Total assets	\$ 1,755,206			\$ 1,656,023			\$ 1,481,846		
<b>Liabilities and Shareholders' Equity</b>									
<b>Deposits:</b>									
Interest bearing demand	\$ 640,813	\$ 6,366	0.99 %	\$ 582,389	\$ 2,841	0.49 %	\$ 505,903	\$ 1,935	0.38 %
Savings	87,470	87	0.10	85,925	86	0.10	75,662	75	0.10
Time	454,608	7,100	1.56	426,189	5,211	1.22	413,876	4,657	1.13
Total interest bearing deposits	1,182,891	13,553	1.15	1,094,503	8,138	0.74	995,441	6,667	0.67
Short-term borrowings	10,104	59	0.58	38,988	316	0.81	31,129	162	0.52
Long-term debt	130,611	2,789	2.14	132,200	2,414	1.83	110,201	1,820	1.65
Total interest bearing liabilities	1,323,606	16,401	1.24	1,265,691	10,868	0.86	1,136,771	8,649	0.76
Noninterest bearing deposits	248,693			217,274			181,534		
Other liabilities	11,795			10,837			8,880		
Shareholders' equity	171,112			162,221			154,661		
Total liabilities and shareholders' equity	\$ 1,755,206			\$ 1,656,023			\$ 1,481,846		
Net interest income (tax equivalent basis)		\$ 64,288			\$ 60,426			\$ 54,617	
Net interest margin (3)			3.84 %			3.84 %			3.89 %



Tax equivalent adjustment	(368 )	(879 )	(1,036 )
Net interest income	\$ 63,920	\$ 59,547	\$ 53,581

(1) Average balance includes average nonaccrual loans of \$6,414,000 in 2018, \$5,095,000 in 2017, and \$2,692,000 in 2016. Interest includes net loan fees of \$3,209,000 in 2018, \$2,995,000 in 2017, and \$3,370,000 in 2016.

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

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

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

(dollars in thousands)	2018 vs. 2017			2017 vs. 2016		
	Increase (decrease) due to change in		Net	Increase (decrease) due to change in		Net
	Volume	Rate		Volume	Rate	
Interest Income						
Interest bearing deposits with banks	\$217	\$457	\$674	\$34	\$203	\$237
Investment securities:						
Taxable	(384 )	320	(64 )	41	9	50
Tax-exempt	(306 )	(240 )	(546 )	(499 )	(1 )	(500 )
Loans:						
Taxable	5,430	4,093	9,523	7,784	501	8,285
Tax-exempt	(100 )	(92 )	(192 )	(53 )	9	(44 )
Total interest income	4,857	4,538	9,395	7,307	721	8,028
Interest Expense						
Deposits:						
Interest bearing demand	291	3,234	3,525	313	593	906
Savings	1	0	1	10	1	11
Time	348	1,541	1,889	138	416	554
Short-term borrowings	(259 )	2	(257 )	62	92	154
Long-term debt	(27 )	402	375	346	248	594
Total interest expense	354	5,179	5,533	869	1,350	2,219
Net interest income	\$4,503	\$(641 )	\$3,862	\$6,438	\$(629 )	\$5,809

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

### Provision for Loan Losses

The provision for loan losses is an expense charged to earnings to cover estimated losses attributable to uncollectable loans. The provision reflects management's judgment of an appropriate level for the allowance for loan losses. The Risk Management section of this report, including Table 10 – Nonperforming Assets, Table 11 – Analysis of Allowance for Loan Losses, and Table 12 – Allocation of Allowance for Loan Losses, provides detailed information about the allowance for loan losses, the loan loss provision, and credit risk.

For the year 2018, the provision for loan losses was \$2,700,000, which was \$1,475,000 or 35 percent lower, compared to a provision of \$4,175,000 in 2017. The decreased provision for loan losses was the result of a \$2,233,000 decrease

in net loan charge-offs offset partially by modest net loan growth. Additionally, the increase in classified and past due loans resulted in increases to applicable qualitative factors and the amounts recorded to the provision in 2018. Higher provision for loan losses in 2017 was impacted by an increase in net charge-offs of \$1,766,000. One loan in the construction and land development portfolio was the primary contributor to the higher net charge-offs in 2017. The provision for both periods supported adequate allowance for loan loss coverage, including the Corporation's growth in commercial loans, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

**Noninterest Income**

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

**Table 3 - Noninterest income**

<i>(dollars in thousands)</i>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Trust and investment services fees	\$ 3,218	\$ 2,889	\$ 2,541
Income from mutual fund, annuity and insurance sales	1,031	821	870
Service charges on deposit accounts	4,732	4,164	3,696
Income from bank owned life insurance	972	1,028	861
Other income	1,650	1,107	898
Net gain on sales of loans held for sale	1,711	1,434	970
Gain on sales of securities	0	79	194
Total noninterest income	\$ 13,314	\$ 11,522	\$ 10,030

For the year 2018, the overall \$1,792,000 or 16 percent increase in total noninterest income, compared to the year 2017, was primarily the result of increases in trust and investment services fees, income from mutual fund, annuity and insurance sales, service charges on deposit, gains on sales of loans held for sale and other income. The discussion that follows addresses changes in selected categories of noninterest income.

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

**Income from mutual fund, annuity and insurance sales**— Income from mutual fund, annuity and insurance sales increased during the current year due to higher volume of business. Despite a decline in fees in 2017 as compared to 2016, assets under management have shown a steady increase over the last three year period. The non-deposit investment products are sold by PeoplesBank's subsidiaries Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors.

**Service charges on deposit accounts**—For the year 2018, the \$568,000 or 14 percent increase in service charge income compared to the year 2017 was due to an increase in the volume of demand deposit accounts subject to fees and debit card transactions. For the year 2017, service charge income increased \$468,000 or 13 percent as compared to the year 2016.

***Income from bank owned life insurance (BOLI)***—For the year 2018, the \$56,000 or 5 percent decrease in income from BOLI compared to 2017 was primarily due to a lower return on investments. For the year 2017, the \$167,000 or 19 percent increase in income from BOLI compared to 2016 was primarily due to additional investments totaling \$4,007,000 during 2017.

***Other income***—For the year 2018, the \$543,000 or 49 percent increase in other income compared to the year 2017 was primarily due to an increase in credit card merchant fees, loan servicing fees and letter of credit fees.

***Net gain on sales of loans held for sale***—The upward trend in net gains from the sale of loans held for sale is primarily due to a favorable trend in sales of fixed-rate residential mortgage loans and selling the guaranteed portion of secondary-market qualified loans originated through programs with the Small Business Administration.

**Net gain on sales of securities**—There were no gains on sales of securities in 2018. For the year 2017, the Corporation realized \$79,000 in gains on sales of securities compared to \$194,000 for the full year 2016. Securities sold included those where market pricing for certain instruments provided a favorable total return upon the sales and reinvestment of proceeds, versus holding the respective securities to maturity. In addition, sales provided cash to meet short-term liquidity needs.

## Noninterest Expense

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

**Table 4 - Noninterest expense**

<i>(dollars in thousands)</i>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Personnel	\$ 29,410	\$ 26,045	\$ 24,187
Occupancy of premises, net	3,457	3,305	3,259
Furniture and equipment	3,044	2,851	2,801
Postage, stationery and supplies	734	765	676
Professional and legal	922	823	732
Marketing	1,589	1,572	1,518
FDIC insurance	702	723	606
Debit card processing	1,302	1,071	1,127
Charitable donations	2,131	1,368	1,079
Telecommunications	627	813	749
External data processing	2,144	1,690	1,455
Foreclosed real estate including provision for (recovery of) losses	66	(21 )	157
Other	3,682	3,981	3,277
Total noninterest expense	\$ 49,810	\$ 44,986	\$ 41,623

Total noninterest expense for the year 2018 increased \$4,824,000 or 11 percent above the year 2017, reflecting the overall expansion of our business and consumer banking and support services for our Maryland and Pennsylvania markets. The discussion that follows addresses changes in selected noninterest expenses.

**Personnel**—The upward trend in personnel expense was due largely to an increase in wage and benefit costs resulting from planned staff additions to support our expanded business and consumer banking services in Maryland and Pennsylvania. Also contributing to the increase were higher incentive payments due to target financial metrics being achieved, along with increased costs associated with health insurance.



**Occupancy of premises, net**— Occupancy of premises expense is comprised of rent, depreciation, maintenance, insurance, real estate taxes and utilities. The level of expense can vary annually based upon franchise expansion, repairs and maintenance, and normal business growth.

**Furniture and equipment**—The upward trend in furniture and equipment expense was in alignment with the increased personnel expense, as additional furniture, computer hardware and software (and related depreciation and maintenance expenses) were incurred to support staff growth. During 2017, overall maintenance and repair expenses declined compared to 2016, offsetting some of the aforementioned increases in expenses.

**Postage, stationary and supplies**—The level of postage, stationary and supplies can vary based on growth in loan and deposit customers, franchise expansion, postage rate changes, and marketing promotions.

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

**Marketing**— The upward trend in marketing expense reflects an increased operating budget to support normal business growth, and corporate initiatives such as branding, product advertising and internal promotions.

**FDIC insurance**—FDIC insurance fluctuations are a result of growth in assets and changes in financial ratios and other factors which are used to calculate the assessment multiplier. There was a change of assessment methodology effective with the third quarter 2016, resulting in a lower assessment rate for 2016 as compared to subsequent years.

**Debit card processing**—The upward trend in debit card processing reflects a continual increase in debit card transaction volume, due primarily to the increased number of demand deposit accounts and debit cards offset by a new contract in 2017 which reduced the costs per transaction.

**Charitable donations**—The level of charitable donations can fluctuate annually due to the timing of payment and the availability of the state tax credits. Some donations to nonprofit organizations qualify for related state tax credits that typically range from 50 to 90 percent of the amount donated, effectively lowering the cost of the donation. PeoplesBank uses state tax credits from donations to reduce its Pennsylvania bank shares tax expense which is included in other expenses as well as Maryland corporate income tax. In 2018 the Corporation established a charitable foundation, accounting for \$560,000 of the increase as compared to 2017.



**Telecommunications**— Although network capacity, the number of facilities, and personnel continue to increase, telecommunication decreased 23 percent in 2018, as compared to 2017 and decreased 16 percent, as compared to 2016, as the result of a contract re-negotiation.

**External data processing**—The upward trend in external data processing from 2016 to 2018 reflects increased reliance on outsourcing transaction processing to specialized vendors, which is typically performed on their hosted and secure websites, thereby increasing the Corporation's data processing efficiency. Additional expenditures related to expansion in the electronic banking services offered to our client base, and charges for higher transaction volume from normal business growth.

**Foreclosed real estate including provision for (recovery of) losses**— An upward trend in the volume of foreclosed assets held resulted in an increase in year-over-year holding costs including real estate taxes, property maintenance, appraisal fees, and provision for losses. In addition, during 2017, there was a recovery of a prior provision in 2016.

**Other expenses** —Other expense, comprised of many underlying expenses, decreased \$299,000 or 8 percent in 2018 as compared to 2017 reflecting reduced costs associated with miscellaneous loan expenses and impaired loans. In 2017, other expenses increased \$704,000 or 21 percent as compared to 2016 reflecting additional costs associated with director and committee fees, miscellaneous loan expenses, memberships, Pennsylvania bank shares tax, deposit charge-offs and impaired loans.

### **Provision for Income Taxes**

The provision for income taxes for 2018 totaled \$5,182,000, which was \$4,722,000 or 48 percent below the provision for income taxes for 2017 of \$9,904,000. The decrease was due to a \$2,755,000 reduction in the net deferred tax asset value at December 31, 2017 due to the new corporate tax rate of 21 percent enacted as part of the Tax Cuts and Jobs Act. For 2017 and 2016, the Corporation's incremental statutory federal income tax rate was 35 percent; however, the Corporation's effective income tax rate was approximately 45 percent for 2017, compared to 31 percent for 2016. The effective tax rate differs from the statutory tax rate due to the impact and volume of tax-exempt income, including income from bank owned life insurance and certain municipal securities and loans and the new corporate tax rate.

### **Preferred Stock Dividends**

No preferred stock dividends were paid in 2018 or 2017 as compared to \$16,000 for 2016. On February 18, 2016, as reported on a Form 8-K filed on February 19, 2016, the Corporation redeemed the remaining \$12,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, resulting in the reduction in dividends expense for the year. Information about the SBLF Program is provided in Note 10—Shareholders' Equity, to the consolidated financial statements. The preferred stock dividend rate for both 2016 was 1 percent of the amount of the average preferred stock outstanding, paid quarterly to the U.S. Treasury.



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

Interest bearing deposits with banks totaled \$69,103,000 on December 31, 2018, compared to \$55,566,000 on December 31, 2017. The balance increased as a result of the strong growth in deposits and cash flow from the investment portfolio offset by loan growth, principally commercial loans and a reduction in short-term borrowings and long-term debt.

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

The Corporation's entire investment securities portfolio is classified available-for-sale, and is comprised of interest-earning debt securities (see Table 5 below). Investment securities serve as an important source of liquidity, and provide stable interest income revenue supplementary to the larger loan portfolio. The securities also serve as collateral for public and trust deposits, securities sold under agreements to repurchase, and to support borrowing capacity. The investment securities portfolio is managed to comply with the Corporation's Investment Securities Policy, and accounted for in accordance with FASB ASC Topic 320. Decisions to purchase or sell securities are based on an assessment of current economic and financial conditions, including the interest rate environment, the demand for loans, liquidity and income requirements.

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

**Table 5-Investment Securities**

	<b>December 31,</b>		<b>2017</b>		<b>2016</b>	
	<b>2018</b>		<b>Amortized Fair</b>	<b>Amortized Fair</b>	<b>Amortized Fair</b>	<b>Amortized Fair</b>
<i>(dollars in thousands)</i>	<b>Cost</b>	<b>Value</b>	<b>Cost</b>	<b>Value</b>	<b>Cost</b>	<b>Value</b>
Debt securities:						
U.S. Treasury notes	\$19,780	\$19,003	\$14,758	\$14,071	\$14,730	\$13,937
U.S. agency	16,000	15,063	18,015	17,303	26,045	25,086
U.S. agency mortgage-backed, residential	75,446	74,555	75,204	75,175	91,242	91,761
State and municipal	41,184	40,972	51,827	52,042	64,421	63,955
Total debt securities	\$152,410	\$149,593	\$159,804	\$158,591	\$196,438	\$194,739

At December 31, 2018, the fair value of securities, available-for-sale, totaled \$149,593,000, a decrease compared to the fair value of the investment securities portfolio balance of \$158,591,000 at December 31, 2017. For the year

2018, cash inflows from maturities, repayments, and calls were reinvested in commercial loans and paid off short-term borrowings and long-term debt, while increasing on-Balance Sheet liquidity.

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

As shown in Table 5, above, the Corporation holds investments in the obligations of states and municipalities. Municipalities have many options for meeting their debt obligations, including decreasing costs and service levels, imposing taxes and fees and selling assets. In many cases, municipal debt issues are insured or, in the case of school districts of selected states, backed by specific reserves, which provide additional layers of protection to the investor. Access to the credit market and a good credit rating are high priorities enabling a municipality to meet its current and future funding needs at a reasonable interest cost. For these reasons, defaults on municipal bonds are unusual. The majority of municipal bonds in the Corporation's portfolio are general obligation bonds, which can draw upon multiple sources of revenue, including taxes, for payment. Only a few bonds are revenue bonds, which are dependent upon a single revenue stream for payment, but such bonds are for critical services such as water and sewer. Many of the municipal holdings are also insured or backed by specific school district loss reserves. Based on the results of an independent credit review of the Bank's entire municipal bond portfolio as performed in 2018, and recent bond ratings by national statistical rating organizations, we believe that the municipal investments held by PeoplesBank are investment grade.

The table below shows that the available-for-sale securities portfolio had an overall yield of 2.58 percent on December 31, 2018:

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

	December 31, 2018 Maturity Distribution				Total Amount	Yield(1)
	One year or less	One through five years	Five through ten years	After ten years		
<i>(dollars in thousands)</i>						
Debt securities:						
U.S. Treasury notes	\$0	\$9,966	\$9,814	\$0	\$19,780	1.96 %
U.S. agency	0	5,000	11,000	0	16,000	1.95 %
U.S. agency mortgage-backed, residential (2)	418	61,501	5,464	8,063	75,446	2.69 %
State and municipal	4,285	13,734	20,157	3,008	41,184	2.92 %
Total debt securities	\$4,703	\$90,201	\$46,435	\$11,071	\$152,410	2.58 %
Yield (1)	3.28 %	2.41 %	2.60 %	3.62 %	2.58 %	

(1) Weighted average yields (tax equivalent basis) were calculated on the amortized cost basis.

(2) U.S. agency mortgage-backed securities are included in the maturity categories based on average expected life.

The portfolio yield as of December 31, 2018, reflected in the table above, is higher than the 2.44 percent securities portfolio yield as of December 31, 2017. Generally, higher yielding securities, as compared to the yields in maturing and called securities, were purchased in 2018. Purchases included the reinvestment of cash flows from maturities, calls and principal repayments on mortgage-backed bonds, during a year of increasing market investment interest rates. More information about investment securities is provided in Note 3-Securities, to the consolidated financial statements.

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

At December 31, 2018, the Corporation held approximately \$5,922,000 in restricted common stock, compared to \$6,311,000 at year-end 2017. Investment in restricted stock is a condition of obtaining credit from the Federal Home Loan Bank of Pittsburgh (FHLBP) and the Atlantic Community Bankers Bank, which is a subsidiary of Atlantic Community Bancshares, Inc. (ACBI). Accordingly, changes in the level of restricted stock are the result of member capital requirements and borrowing levels from the FHLBP as described within the Long-term Debt section of this report. Of the total investment as of December 31, 2018, approximately \$5,847,000 consisted of stock issued by the FHLBP, with the remainder being restricted stock issued by ACBI. Information about restricted investment in bank stocks, including impairment considerations, is provided in Note 1—Summary of Significant Accounting Policies, to the consolidated financial statements.

### **Loans Held for Sale**

On December 31, 2018, loans held for sale were approximately \$4,127,000, compared to \$1,715,000 at year-end 2017. The \$4,127,000 consists of \$516,000 residential mortgage loans and \$3,611,000 of Small Business Administration (SBA) loans. For both years, PeoplesBank's mortgage banking production focused on originating and selling secondary-market qualifying residential mortgage loans.

### **Loans**

On December 31, 2018, total loans, net of deferred fees, totaled approximately \$1.49 billion, compared to \$1.40 billion at year end 2017, an increase of \$85,916,000 or 6 percent above total loans as of year-end 2017. Most of the increase was due to an \$81,980,000 or 7 percent increase in commercial loans, which reflected continued strong commercial loan demand in our markets, and our continued ability to expand existing relationships with creditworthy borrowers, and acquire new loan business, based on our reputation for client service and competitive prices and terms.

The average yield (tax-equivalent basis) earned on total loans was 5.17 percent for the full year 2018, as compared to 4.90 percent for the year 2017. Slowly rising market interest rates and strong competition in our markets resulted in continuing pricing pressures on new loan and refinancing activities. The composition of the Corporation's loan portfolio, by industry class, at December 31, 2018 and 2017 is provided in Note 4—Loans in the notes to the consolidated financial statements.

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



**Table 7-Loan Portfolio Composition**

Table 7-Loan Portfolio Composition

(dollars in thousands)	December 31,									
	2018	%	2017	%	2016	%	2015	%	2014	%
Commercial, financial and agricultural	\$1,124,833	75.7	\$1,013,428	72.4	\$924,729	72.8	\$802,436	71.5	\$658,627	71.6
Real estate-construction and land development	154,977	10.4	184,402	13.2	148,635	11.7	133,978	11.9	114,695	12.5
Total commercial related loans	1,279,810	86.1	1,197,830	85.6	1,073,364	84.5	936,414	83.4	773,322	84.1
Real estate - residential mortgages	83,977	5.7	79,325	5.6	73,496	5.8	70,094	6.2	32,453	3.5
Consumer and home equity	121,893	8.2	122,609	8.8	123,911	9.7	116,703	10.4	114,315	12.4
Total consumer related loans	205,870	13.9	201,934	14.4	197,407	15.5	186,797	16.6	146,768	15.9
Total loans	\$1,485,680	100.0	\$1,399,764	100.0	\$1,270,771	100.0	\$1,123,211	100.0	\$920,090	100.0

The table below shows at December 31, 2018, the commercial loan portfolio was comprised of approximately \$832,146,000 or 65 percent in fixed rate loans, and \$447,664,000 or 35 percent in floating rate loans. This compares to \$822,285,000 or 69 percent in fixed rate loans, and \$375,545,000 or 31 percent in floating rate loans, for the year ended December 31, 2017. Floating rate loans reprice periodically with changes in the Wall Street Journal (WSJ) Prime Rate, or LIBOR.

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

	December 31, 2018			Total
	Maturity Distribution			
	One year or less	One through five years	After five years	
<i>(dollars in thousands)</i>				
Commercial, financial and agricultural	\$ 241,736	\$ 248,806	\$ 634,291	\$ 1,124,833
Real estate-construction and land development	94,910	30,970	29,097	154,977
Total commercial related loans	\$ 336,646	\$ 279,776	\$ 663,388	\$ 1,279,810
Fixed interest rates	\$ 54,001	\$ 213,910	\$ 564,235	\$ 832,146
Floating interest rates	282,645	65,866	99,153	447,664
Total commercial related loans	\$ 336,646	\$ 279,776	\$ 663,388	\$ 1,279,810

During 2018, in terms of dollars and percentages more floating rate commercial loans were originated although a majority of the commercial portfolio is fixed rate loans with maturities ranging from five to ten years. Although the commercial loan portfolio's fixed rate volume and longer maturities increase risk if interest rates rise, management has implemented interest rate risk mitigation strategies which include maintaining a shorter duration in the Corporation's investment portfolio, and lengthening fixed rate liabilities, principally borrowings from the Federal Home Loan Bank of Pittsburgh. In addition, commercial loans are generally structured whereby there is an initial fixed rate period, typically five years, and then adjust based upon a predetermined index if a new fixed rate is not renegotiated. Approximately 52 percent of the loans identified as fixed interest rates above are set to adjust during the term of the loan. Additional loan information can be found in Note 4—Loans, in the notes to the consolidated financial statements, and within the Risk Management section of this report.

### Premises and Equipment

On December 31, 2018, premises and equipment, net of accumulated depreciation, totaled approximately \$24,724,000, as compared to \$24,382,000 on December 31, 2017. The increase was a result of new acquisitions of \$2,754,000, offset by depreciation and disposals on existing premises and equipment of \$2,412,000.

## Other Assets

On December 31, 2018, other assets totaled approximately \$57,495,000, compared to \$53,306,000 of other assets as of December 31, 2017. Other assets were primarily comprised of investments in bank owned life insurance (BOLI), foreclosed real estate, accrued interest receivable, and deferred tax assets.

Investments in life insurance relates to a select group of employees and directors whereby PeoplesBank is the owner and beneficiary of the policies. These investments, carried at the cash surrender value of the underlying policies, totaled \$37,585,000 at year-end 2018, compared to \$36,632,000 at year-end 2017. PeoplesBank purchased \$4,007,000 of BOLI during 2017. The selection of the underlying BOLI insurers is based primarily on the respective insurers' high credit rating and reputation, and competitive tax-exempt yield. The Corporation also seeks to maintain a reasonable diversification among insurers supporting the BOLI portfolio. The level of the Corporation's BOLI investment was approximately 21 percent of PeoplesBank's Tier 1 capital, excluding net unrealized gains on available-for-sale securities, at December 31, 2018, which is within the regulatory guideline of 25 percent of Tier 1 capital.

Other assets also include foreclosed real estate, net of allowance, totaling \$1,755,000 at year-end 2018, compared to \$216,000 at year-end 2017. The \$1,539,000 increase was primarily the result of the addition of one property. Foreclosed real estate is discussed in the Nonperforming Assets section of this report.

Also included with other assets is \$5,552,000 of accrued interest receivable on loans and investment securities, and \$5,018,000 of net deferred tax assets. Additional information about these assets can be found in Note 1—Summary of Significant Accounting Policies in the notes to the consolidated financial statements under the appropriate subheadings.

## **Funding**

### **Deposits**

Deposits are the Corporation's principal source of funding for earning assets. The average rate paid on interest-bearing deposits was 1.15 percent for the year 2018 as compared to 0.74 percent for the year 2017.

On December 31, 2018, deposits totaled \$1.50 billion, which represented a \$110,773,000 or 8 percent increase compared to the level at year-end 2017. The increase, primarily associated with noninterest bearing demand, money market and time deposits less than \$250,000, reflects several rate promotions offered throughout the year. Core deposits, consisting of demand, money market and savings, in aggregate, increased \$92,018,000 or 10 percent and time deposits (i.e. CDs) increased \$18,755,000 or 4 percent. Of the total \$464,776,000 of time deposits as of December 31, 2018, the balance of certificates of deposit with a balance of less than \$100,000 totaled \$271,794,000, \$100,000 to \$250,000 totaled \$144,866,000 and \$250,000 or more totaled \$48,116,000. Time deposits totaling \$187,087,000 or 40 percent of the total at year-end 2018 will mature in 2019.

On December 31, 2018, the balance of certificates of deposit with a balance of \$100,000 and above was \$192,982,000. Of this total, \$16,827,000 mature within three months, \$21,241,000 mature after three months but within six months, \$41,540,000 mature after six months but within twelve months, and the remaining \$113,374,000 mature beyond twelve months. The composition of the Corporation's deposit portfolio at December 31, 2018 is provided in Note 7-Deposits, in the notes to the consolidated financial statements.

### **Short-term Borrowings**

Short-term borrowings consist of securities sold under agreements to repurchase (repo agreements), federal funds purchased, and other borrowings as described more fully in Note 8-Short-term Borrowings and Long-term Debt, to the consolidated financial statements. On December 31, 2018, short-term borrowings totaled \$7,022,000, as compared to the \$20,495,000 as of December 31, 2017. The balance on December 31, 2018, consisted of \$7,022,000 of repurchase agreements and no other short-term borrowings as compared to the balance of \$20,495,000 at year-end 2017 consisting of \$10,295,000 of repurchase agreements and \$10,200,000 of short-term borrowings. The decrease in the balance of repurchase agreements was a result of a shifting in balances into deposit products while other short-term borrowings declined as cash flow from investments and deposits were ample to fund loan growth and maintain adequate liquidity.

## **Long-term Debt**

Long-term debt is a secondary funding source to deposits for asset growth. On December 31, 2018, long-term debt totaled \$115,310,000, compared to \$130,310,000 at year-end 2017. The decrease was the result of the repayment of matured advances from the Federal Home Loan Bank of Pittsburgh (FHLBP).

Generally, funds for the payment of long-term debt come from operations. On December 31, 2018, total unused credit with the FHLBP was approximately \$409,978,000. Obligations to the FHLBP are secured by FHLBP stock and qualifying collateral, principally real estate secured loans. A listing of outstanding long-term debt obligations is provided in Note 8-Short-term Borrowings and Long-term Debt, in the notes to the consolidated financial statements.

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

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

Total shareholders' equity was \$178,746,000 on December 31, 2018, an increase of approximately \$14,527,000 or 9 percent, compared to \$164,219,000 at year-end 2017. The increase was primarily the result the Corporation's \$19,542,000 in net income available for common shareholders less \$5,539,000 of dividends paid to common shareholders for 2018. Information pertaining to preferred and common stock of the Corporation is disclosed in Note 10—Shareholders' Equity, in the notes to the consolidated financial statements.

### *Redemption of Preferred Stock and Preferred Stock Dividends*

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

The SBLF preferred stock qualifies as Tier 1 regulatory capital and requires the payment of non-cumulative cash dividends quarterly on each January 1, April 1, July 1 and October 1. Preferred stock dividends for 2016 were

\$16,000. On February 18, 2016, Codorus Valley redeemed the remaining \$12,000,000, or 12,000 shares of Series B preferred stock issued to the Treasury as reported on form 8-K filed on February 19, 2016. The annualized dividend rate on the preferred stock issued under the SBLF Program was 1 percent through the redemption date of February 18, 2016.

*Dividends on Common Stock*

The Corporation typically pays cash dividends on its common stock on a quarterly basis. The Board of Directors determines the dividend rate after considering the Corporation's capital requirements, current and projected net income, and other factors. Annual cash dividends per common share for the year 2018 totaled \$0.592 per share, as adjusted for stock dividends, representing an increase of \$0.100 or 20 percent above the cash dividends of \$0.492, as adjusted, paid for the year 2017.

Periodically, the Corporation distributes stock dividends on its common stock. On December 11, 2018, the Corporation distributed a 5 percent common stock dividend to shareholders of record at the close of business on October 23, 2018. A 5 percent common stock dividend was also distributed in December 2017.

*Compensation Plans*

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

*Capital Ratios*

The Corporation and PeoplesBank are subject to various regulatory capital requirements administered by banking regulators that involve quantitative guidelines and qualitative judgments. Quantitative measures established by regulators pertain to minimum capital ratios, as set forth in Table 9 below. The table provides a comparison of the Corporation's and PeoplesBank's risk-based capital ratios and leverage ratios to the minimum regulatory requirement for the periods indicated.

**Table 9-Capital Ratios**

	<b>Ratios at December 31,</b>		<b>Federal Minimum Required (1)</b>		<b>Federal Well Capitalized</b>	<b>Capital (2) at December 31,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>		<b>2018</b>	<b>2017</b>
<i>(dollars in thousands)</i>							
Common Equity Tier 1 Capital (as a percentage of risk weighted assets)							
Codorus Valley Bancorp, Inc. (consolidated)	12.15 %	11.58 %	6.375 %	5.750 %	n/a	% \$ 178,656	\$ 162,860
PeoplesBank	12.58	12.04	6.375	5.750	6.50	184,420	168,879
Tier 1 risk-based capital (as a percentage of risk weighted assets)							
Codorus Valley Bancorp, Inc. (consolidated)	12.83 %	12.29 %	7.875 %	7.250 %	n/a	% \$ 188,656	\$ 172,860
PeoplesBank	12.58	12.04	7.875	7.250	8.00	184,420	168,879
Total risk-based capital (as a percentage of risk weighted assets)							
Codorus Valley Bancorp, Inc. (consolidated)	14.09 %	13.48 %	9.875 %	9.250 %	n/a	% \$ 207,040	\$ 189,549
PeoplesBank	13.83	13.23	9.875	9.250	10.00	202,757	185,568



## Leverage

(Tier 1 capital as a percentage of average total assets)

Codorus Valley Bancorp, Inc. (consolidated)	10.46%	10.26%	4.00 %	4.00 %	n/a	%	\$ 188,656	\$ 172,860
PeoplesBank	10.25	10.05	4.00	4.00	5.00		184,420	168,879

(1) Minimum amounts and ratios as of December 31, 2018 include the third year phase in of the capital conservation buffer of 0.625 percent required by the Basel III framework. The conservation buffer is to be phased in over a four year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019.

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

On July 2, 2013, the Board of Governors of the Federal Reserve System finalized its rule implementing the Basel III regulatory capital framework, which the FDIC adopted on July 9, 2013. Under the rule, minimum requirements will increase both the quantity and quality of capital held by banking organizations. Consistent with the Basel III framework, the rule includes a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5 percent, and a common equity Tier 1 conservation buffer of 2.5 percent of risk-weighted assets, that will apply to all supervised financial institutions. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4 percent to 6 percent, and includes a minimum leverage ratio of 4 percent for all banking organizations. The new rule also increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors. The rule for smaller, less complex institutions, including the Corporation and PeoplesBank, became effective January 1, 2015.

The new rule provides that, in order to avoid restrictions on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold the 2.5 percent capital conservation buffer, which is to be phased in over a four year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019.

The transition schedule for new ratios, including the capital conservation buffer, is as follows:

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

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

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

The Corporation's regulatory capital position at December 31, 2018 and 2017, as reflected in Table 9 above, reflects compliance with the new rule requirements that became effective January 1, 2015. The Corporation plans to manage its capital to ensure continued compliance.

**Risk Management**

The Corporation's Enterprise Risk Management Committee ("Committee") meets at least quarterly and includes members of senior management and at least one independent director. The objective of the Committee is to identify and manage risk inherent in the operations of the Corporation and its affiliates. While the Committee's risk review is broad in scope, its primary responsibility is to develop, implement and monitor compliance with formal risk management policies and procedures.

## Credit Risk Management

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

The Corporation follows detailed written lending policies and procedures.

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

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

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

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

The Corporation uses loan-to-value ratios (“LTV ratios”) for loan underwriting, establishing generally acceptable ratios of the loan amount to the value of the collateral securing the loan, to minimize the risk of future loss from the loan portfolio. At December 31, 2018, the LTV ratios listed below were in effect.

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

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Hotels/motels and mobile home parks	N/A	65
Special/Limited use properties	50	50

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

- loan amount is above \$250,000;
- or if the LTV is above 75 percent for commercial non-owner occupied property;
- or if the LTV is above 80 percent for commercial owner occupied property;
- or if the loan amount is greater than 90 percent of the tax assessed value for owner-occupied residential real estate in Pennsylvania;
- or if the loan amount is greater than 90 percent of the tax assessed value for owner-occupied residential real estate in Maryland;
- or if an existing appraisal is more than two years old (unless there was a material change in market conditions or the physical aspects of the property).

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

One component of the internal credit risk review is the identification and management of industry concentrations, defined as greater than 10 percent of the total loan portfolio. As of December 31, 2018, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: residential real estate investor represented 15.6 percent of the portfolio; commercial real estate investor represented 14.2 percent of the portfolio; and builder and developer represented 10.4 percent of the portfolio. As of December 31, 2017, the Corporation had the same three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor, which represented 16.5 percent of the portfolio; residential real estate investor, which represented 15.0 percent of the portfolio; and builder & developer, which represented 13.2 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

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

**Nonperforming Assets**

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

**Table 10-Nonperforming Assets**

<i>(dollars in thousands)</i>	<b>December 31,</b>				
	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Nonaccrual loans	\$ 20,058	\$ 5,052	\$ 3,114	\$ 3,045	\$ 6,384
Nonaccrual loans, troubled debt restructurings	930	0	0	188	2,242
Accruing loans that are contractually past due 90 days or more as to principal and interest	2,128	76	733	484	54
Total nonperforming loans	23,116	5,128	3,847	3,717	8,680
Foreclosed real estate, net of allowance	1,755	216	2,705	2,913	2,542
Total nonperforming assets	\$ 24,871	\$ 5,344	\$ 6,552	\$ 6,630	\$ 11,222
Accruing troubled debt restructurings	\$ 3,098	\$ 3,344	\$ 3,664	\$ 3,903	\$ 1,996
Total period-end loans, net of deferred fees	\$ 1,485,680	\$ 1,399,764	\$ 1,270,771	\$ 1,123,211	\$ 920,090
Allowance for loan losses (ALL)	\$ 19,144	\$ 16,689	\$ 14,992	\$ 12,704	\$ 11,162
ALL as a % of total period-end loans	1.29	% 1.19	% 1.18	% 1.13	% 1.21
Net charge-offs as a % of average total loans	0.02	% 0.18	% 0.06	% 0.19	% 0.05
ALL as a % of nonperforming loans	82.81	% 325.48	% 389.69	% 341.78	% 128.59
Nonperforming loans as a % of total period-end loans	1.56	% 0.37	% 0.30	% 0.33	% 0.94
Nonperforming assets as a % of total period-end loans and net foreclosed real estate	1.67	% 0.38	% 0.51	% 0.59	% 1.22
Nonperforming assets as a % of total period-end assets	1.38	% 0.31	% 0.41	% 0.46	% 0.92
Nonperforming assets as a % of total period-end shareholders' equity	13.91	% 3.25	% 4.23	% 4.17	% 9.47

While the Corporation's loan portfolio has experienced strong growth over the years, Table 10 above reflects notable progress prior to 2018 in reducing or maintaining the level of nonperforming assets. This was accomplished through continuous collection efforts coordinated by the Corporation's General Counsel, recoveries from borrower payments and foreclosed real estate sales, the establishment of valuation allowances for selective accounts, and if necessary, loan charge-offs. During 2018 there was a \$17.9 million increase in nonperforming loans, primarily related to the identification of a likely deterioration within eight credit relationships that had a loan balance of \$16.9 million, of

which one relationship represents \$9.4 million of the \$13.8 million. Loan balances of \$2.1 million are still accruing interest due to sufficient collateral coverage. Management believes that specific reserves assigned within the allowance for loan losses for each credit is sufficient at December 31, 2018 and the bank is not experiencing a change in the portfolio's credit quality. In monitoring and managing nonperforming assets, we remain concerned about the impact of changing economic conditions, and the potential for adverse real estate market value changes, and the corresponding effects on commercial borrowers.

Nonperforming assets are reviewed by management on a monthly basis. We generally rely on appraisals performed by independent licensed appraisers to determine the value of real estate collateral for impaired collateral-dependent loans. Generally, an appraisal is performed when: (i) an account reaches 90 days past due, unless a certified appraisal was completed within the past twelve months; (ii) market values have changed significantly; (iii) the condition of the property has changed significantly; or (iv) the existing appraisal is outdated based upon regulatory or policy requirements. In instances where the value of the collateral is less than the net carrying amount of the loan, a specific loss allowance is established for the difference by recording a loss provision to the income statement. When it is probable that some portion or all of the loan balance will not be collected, that amount is charged off as loss against the allowance.



As of December 31, 2018, the nonperforming loan portfolio balance totaled \$23,116,000, compared to \$5,128,000 at year-end 2017. Nonperforming loans consist of nonaccrual loans and accruing loans 90 days or more past due. The Corporation generally places a loan on nonaccrual status and ceases accruing interest income (i.e., recognizes interest income on a cash basis as long as the loan is sufficiently collateralized) when loan payment performance is unsatisfactory and the loan is past due 90 days or more. Loans past due 90 days or more and still accruing interest represent loans that are contractually past due, but are well collateralized and in the process of collection. A loan is returned to interest accruing status when we determine that circumstances have improved to the extent that all of the principal and interest amounts contractually due are current for at least six consecutive payments and future payments are reasonably assured. As of December 31, 2018, the nonaccrual loan portfolio balance totaled \$20,988,000, compared to \$5,052,000 at year-end 2017. The increase in nonaccrual loans resulted from loans totaling \$19,576,000 being placed on nonaccrual status, which was offset by reductions totaling \$3,640,000 primarily the result of principal repayments and charge-offs. For both periods, the nonperforming loan portfolio balance was comprised primarily of collateralized commercial loans. For 2018, the gross interest income that would have been recorded if the nonaccrual loans had been current in accordance with their original terms and current throughout the period was approximately \$1,271,000. The amount of interest income on those nonaccrual loans that was included in net income for 2018 was approximately \$357,000. The interest income recognized on impaired loans in Note 4—Loans, in the notes to the consolidated financial statements, is a higher amount because it includes interest income on all impaired loans, which includes nonaccrual loans, from the time the loan was impaired.

Foreclosed real estate represents real estate acquired to satisfy debts owed to PeoplesBank and is included in the Other Assets category on the Corporation's balance sheet. The carrying amount of foreclosed real estate as of December 31, 2018, net of allowance, totaled \$1,755,000, an increase of \$1,539,000 or 713 percent, compared to \$216,000 at year-end 2017. The increase is primarily attributable to the addition of one property.

Troubled debt restructurings pertain to loans whose terms have been modified to include a concession that we would not ordinarily consider due to the debtor's financial difficulties. Concessions granted under a troubled debt restructuring typically involve a reduction of interest rate lower than the current market rate for new debt with similar risk, the deferral of payments or extension of the stated maturity date. Troubled debt restructurings are evaluated for impairment if they have been restructured during the most recent calendar year, or if they cease to perform in accordance with the modified terms. As of December 31, 2018, the accruing troubled debt restructuring portfolio balance totaled \$3,098,000, compared to \$3,344,000 at year-end 2017. The decrease was the result of principal payments made on loans within the troubled debt restructuring portfolio.

At December 31, 2018, there were \$23,997,000 in additional potential problem loans being closely monitored by management. These additional potential problem loans consist of loans classified as substandard, reflecting an increased risk of the borrowers' ability to comply with present repayment terms. These loans are not classified as nonperforming and are not disclosed in Table 10. Comparatively, we were monitoring \$18,141,000 of potential problem loans at December 31, 2017.

## Allowance for Loan Losses

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

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

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

The allowance for loan losses was \$19,144,000 or 1.29 percent of total loans, on December 31, 2018, compared to \$16,689,000 and 1.19 percent, respectively, on December 31, 2017. While the \$2,455,000 or 15 percent increase in the allowance from December 31, 2017 to December 31, 2018 was generally consistent with the additional \$3,436,000 related allowance established for impaired loans over the same 12 month period, the bank analyzed the increase of loan designated as impaired, including those identified as nonaccrual or contractually past due, and made adjustments to applicable qualitative factors in the calculation of the reserve. The increase is considered credit specific and not believed to be an indication of a larger deterioration trend within overall credit quality.

Based on our comprehensive analysis of the loan portfolio, and recognizing other relevant considerations including expected continued loan growth, continued uncertainty on certain larger criticized assets as legal and collection efforts continue, and the unknown impact of future accounting and regulatory requirements related to the determination of the allowance for loan losses, we believe that the allowance for loan losses was adequate at December 31, 2018.



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

<i>(dollars in thousands)</i>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Balance - beginning of year	\$ 16,689	\$ 14,992	\$ 12,704	\$ 11,162	\$ 9,975
Provision charged to operating expense	2,700	4,175	3,000	3,500	1,600
Loans charged off:					
Commercial, financial and agricultural	146	858	771	1,151	326
Real estate - construction and land development	0	1,474	0	497	0
Real estate - residential mortgages	10	0	79	40	30
Consumer and home equity	326	305	116	337	396
Total loans charged off	482	2,637	966	2,025	752
Recoveries:					
Commercial, financial and agricultural	168	101	193	21	248
Real estate - construction and land development	18	30	0	0	0
Real estate - residential mortgages	10	5	1	21	4
Consumer and home equity	41	23	60	25	87
Total recoveries	237	159	254	67	339
Net charge-offs	245	2,478	712	1,958	413
Balance - end of year	\$ 19,144	\$ 16,689	\$ 14,992	\$ 12,704	\$ 11,162

**Ratios:**

Net charge-offs as a % of average total loans	0.02	%	0.18	%	0.06	%	0.19	%	0.05	%
Allowance for loan losses as a % of total period-end loans	1.29	%	1.19	%	1.18	%	1.13	%	1.21	%
Allowance for loan losses as a % of nonperforming loans	82.81	%	325.48	%	389.69	%	341.78	%	128.59	%

Table 12 - Allocation of Allowance for Loan Losses, below, presents a comparison of the allocation of the allowance for loan losses by major loan category for five year-end periods. 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.

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

	<b>December 31,</b>		<b>2017</b>	<b>%</b>	<b>2016</b>	<b>%</b>	<b>2015</b>	<b>%</b>	<b>2014</b>	<b>%</b>
	<b>2018</b>	<b>Total</b>								
<i>(dollars in thousands)</i>	<b>Amount</b>	<b>Loans</b>	<b>Amount</b>	<b>Loans</b>	<b>Amount</b>	<b>Loans</b>	<b>Amount</b>	<b>Loans</b>	<b>Amount</b>	<b>Loans</b>
Commercial, financial and agricultural	\$ 15,055	75.7	\$ 10,730	72.4	\$ 10,390	72.8	\$ 8,801	71.5	\$ 7,134	71.6
	2,835	10.4	3,388	13.2	2,384	11.7	1,934	11.9	2,236	12.5

Real estate - construction and land development										
Total commercial related	17,890	86.1	14,118	85.6	12,774	84.5	10,735	83.4	9,370	84.1
Real estate - residential mortgages	126	5.7	108	5.6	85	5.8	67	6.2	64	3.5
Consumer and home equity	409	8.2	283	8.8	372	9.7	422	10.4	392	12.4
Total consumer related	535	13.9	391	14.4	457	15.5	489	16.6	456	15.9
Unallocated	719	n/a	2,180	n/a	1,761	n/a	1,480	n/a	1,336	n/a
Total	\$ 19,144	100.0	\$ 16,689	100.0	\$ 14,992	100.0	\$ 12,704	100.0	\$ 11,162	100.0

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

Additionally, we have experienced continued strong commercial loan growth, including growth in newer markets where we have less of a loss history. Also, we recognize the inherent imprecision in any methodology for estimating specific and general loan losses, including the unpredictable timing and amounts of charge-offs and related historical loss averages, and specific-credit or broader portfolio future cash flow value and collateral valuation uncertainties which could negatively impact unimpaired portfolio loss factors. Accordingly, as of December 31, 2018, we maintained a 4 percent unallocated portion of the allowance for loan losses, a decrease from a 13 percent unallocated portion of the allowance as of December 31, 2017.

## **Liquidity**

Maintaining adequate liquidity provides the Corporation with the ability to meet financial obligations to depositors, loan clients, employees, and shareholders on a timely and cost effective basis in the normal course of business. Additionally, it provides funds for growth and business opportunities as they arise. Liquidity is generated from transactions relating to both the Corporation's assets and liabilities. The primary sources of asset liquidity are scheduled investment security maturities and cash inflows, funds received from client loan payments and, to a lesser degree, asset sales. The primary sources of liability liquidity are deposit growth, short-term borrowings and long-term debt. The Consolidated Statements of Cash Flows, included in this report, present the changes in cash from operating, investing and financing activities. At year-end 2018, we believe our liquidity was adequate based upon the potential liquidation of unpledged available-for-sale securities with a fair value totaling approximately \$26,505,000 and available credit from the Federal Home Loan Bank of Pittsburgh totaling approximately \$409,978,000. The Corporation's loan-to-deposit ratio was approximately 99 and 101 percent as of year-end 2018 and 2017, respectively. The ratio was relatively flat with period end deposit growth slightly higher than loan growth in 2018.

## **Off-Balance Sheet Arrangements**

The Corporation's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist primarily of commitments to grant new loans, unfunded commitments under existing loan facilities, and letters of credit issued under the same standards as on-balance sheet instruments. Financial instruments with off-balance sheet risk are disclosed in Note 14-Commitments to Extend Credit, to the consolidated financial statements, and totaled \$442,269,000 at December 31, 2018, compared to \$508,575,000 at December 31, 2017. Generally, these commitments have fixed expiration dates or termination clauses and are for specific purposes. Accordingly, many of the commitments are expected to expire without being drawn and, therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

## Contractual Obligations

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

**Table 13-Contractual Obligations**

<i>(dollars in thousands)</i>	<b>Total</b>	<b>December 31, 2018</b>			
		<b>Payments due by period</b>			
		<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Long-term debt	\$ 115,310	\$ 35,000	\$ 60,000	\$ 10,000	\$ 10,310
Operating leases	2,823	814	1,052	674	283
Time deposits	464,776	187,087	238,149	38,986	554
Supplemental retirement plans	7,837	185	718	884	6,050
Purchase obligations	8,155	2,352	2,799	2,601	403
Naming rights	1,180	295	590	295	0
Total	\$ 600,081	\$ 225,733	\$ 303,308	\$ 53,440	\$ 17,600

## Impact of Inflation and Changing Prices

The majority of assets and liabilities of a financial institution are monetary in nature and therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. However, inflation may impact the growth of total assets in the banking industry and the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity-to-assets ratio. Inflation may also significantly affect noninterest expenses, which tend to rise during periods of general inflation. The level of inflation can be measured by the change in the Consumer Price Index (CPI) for all urban consumers (December vs. December). The change in the CPI for 2018 and 2017 was 1.9 percent, compared to 2.1 percent for 2016.

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





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

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

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

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

The following table summarizes the expected impact of interest rate shocks on net interest income as well as the Corporation's policy limits at each level. All scenarios were within policy limits at December 31, 2018.

<b>Change in Interest Rates (basis points)</b>	<b>Annual Change in Net Interest Income (in thousands)</b>	<b>% Change in Net Interest Income</b>	<b>% Change Policy Limit</b>
+100	\$ 2,089	3.22 %	(5.00 )%
(100)	\$ (2,175 )	(3.36 )%	(5.00 )%
+200	\$ 4,010	6.19 %	(15.00 )%
(200)	\$ (3,459 )	(5.34 )%	(15.00 )%

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+300	\$ 6,017	9.29	%	(25.00 )%
(300)	\$ (5,946 )	(9.18	)%	(25.00 )%
+400	\$ 8,085	12.48	%	(35.00 )%

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## Management Report on Internal Controls Over Financial Reporting

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in SEC Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2018, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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

Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2018, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework (2013)*. Based on this assessment, management concluded that, as of December 31, 2018, the Corporation's internal control over financial reporting is effective based on those criteria.

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

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

March 15, 2019

March 15, 2019

## **Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders

Codorus Valley Bancorp, Inc.

York, Pennsylvania

## **Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of Codorus Valley Bancorp, Inc. (the “Corporation”) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders’ equity, for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Corporation and subsidiaries at December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Corporation's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 15, 2019, expressed an unqualified opinion thereon.

## **Basis for Opinion**

These consolidated financial statements are the responsibility of the Corporation’s management. Our responsibility is to express an opinion on the Corporation’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Corporation in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Corporation's auditor since 2013.

Harrisburg, Pennsylvania

March 15, 2019

## **Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders

Codorus Valley Bancorp, Inc.

York, Pennsylvania

## **Opinion on Internal Control over Financial Reporting**

We have audited Codorus Valley Bancorp, Inc.'s (the "Corporation's") internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Corporation as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the three years in the period ended December 31, 2018, and the related notes and our report dated March 15, 2019, expressed an unqualified opinion thereon.

## **Basis for Opinion**

The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management Report on Internal Controls over Financial Reporting. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Corporation in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective

internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control over Financial Reporting**

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

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

/s/BDO USA, LLP

Harrisburg, Pennsylvania

March 15, 2019

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## Item 8: Financial Statements and Supplementary Data

Codorus Valley Bancorp, Inc.

**Consolidated Balance Sheets**

	<b>December 31, 2018</b>	<b>December 31, 2017</b>
(dollars in thousands, except per share data)		
<b>Assets</b>		
Interest bearing deposits with banks	\$69,103	\$55,566
Cash and due from banks	27,679	23,958
Total cash and cash equivalents	96,782	79,524
Securities, available-for-sale	149,593	158,591
Restricted investment in bank stocks, at cost	5,922	6,311
Loans held for sale	4,127	1,715
Loans (net of deferred fees of \$3,722 - 2018 and \$4,039 - 2017)	1,485,680	1,399,764
Less-allowance for loan losses	(19,144 )	(16,689 )
Net loans	1,466,536	1,383,075
Premises and equipment, net	24,724	24,382
Goodwill	2,301	2,301
Other assets	57,495	53,306
Total assets	\$1,807,480	\$1,709,205
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest bearing	\$252,777	\$246,866
Interest bearing	1,242,503	1,137,641
Total deposits	1,495,280	1,384,507
Short-term borrowings	7,022	20,495
Long-term debt	115,310	130,310
Other liabilities	11,122	9,674
Total liabilities	1,628,734	1,544,986
<b>Shareholders' equity</b>		
Preferred stock, par value \$2.50 per share; 1,000,000 shares authorized; shares issued and outstanding: 0 at December 31, 2018 and 0 at December 31, 2017	0	0
Common stock, par value \$2.50 per share; 30,000,000 shares authorized at December 31, 2018 and 15,000,000 at December 31, 2017; shares issued and outstanding: 9,451,547 at December 31, 2018 and 8,906,052 at December 31, 2017	23,629	22,265
Additional paid-in capital	134,506	120,052
Retained earnings	22,837	22,860
Accumulated other comprehensive loss	(2,226 )	(958 )
Total shareholders' equity	178,746	164,219
Total liabilities and shareholders' equity	\$1,807,480	\$1,709,205

See accompanying notes.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Income**

(dollars in thousands, except per share data)	<b>Years ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Interest income			
Loans, including fees	\$75,471	\$65,996	\$57,747
Investment securities:			
Taxable	2,330	2,496	2,527
Tax-exempt	1,051	1,231	1,582
Dividends	416	313	232
Other	1,053	379	142
Total interest income	80,321	70,415	62,230
Interest expense			
Deposits	13,553	8,138	6,667
Federal funds purchased and other short-term borrowings	59	316	162
Long-term debt	2,789	2,414	1,820
Total interest expense	16,401	10,868	8,649
Net interest income	63,920	59,547	53,581
Provision for loan losses	2,700	4,175	3,000
Net interest income after provision for loan losses	61,220	55,372	50,581
Noninterest income			
Trust and investment services fees	3,218	2,889	2,541
Income from mutual fund, annuity and insurance sales	1,031	821	870
Service charges on deposit accounts	4,732	4,164	3,696
Income from bank owned life insurance	972	1,028	861
Other income	1,650	1,107	898
Net gain on sales of loans held for sale	1,711	1,434	970
Gain on sales of securities	0	79	194
Total noninterest income	13,314	11,522	10,030
Noninterest expense			
Personnel	29,410	26,045	24,187
Occupancy of premises, net	3,457	3,305	3,259
Furniture and equipment	3,044	2,851	2,801
Postage, stationery and supplies	734	765	676
Professional and legal	922	823	732
Marketing	1,589	1,572	1,518
FDIC insurance	702	723	606
Debit card processing	1,302	1,071	1,127
Charitable donations	2,131	1,368	1,079
Telecommunications	627	813	749
External data processing	2,144	1,690	1,455

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Foreclosed real estate including provision for (recovery of) losses	66	(21 )	157
Other	3,682	3,981	3,277
Total noninterest expense	49,810	44,986	41,623
Income before income taxes	24,724	21,908	18,988
Provision for income taxes	5,182	9,904	5,886
Net income	19,542	12,004	13,102
Preferred stock dividends	0	0	16
Net income available to common shareholders	\$19,542	\$12,004	\$13,086
Net income per common share, basic	\$2.08	\$1.29	\$1.42
Net income per common share, diluted	\$2.06	\$1.27	\$1.41

See accompanying notes.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Comprehensive Income**

(dollars in thousands)	Years ended December 31,		
	2018	2017	2016
Net income	\$ 19,542	\$ 12,004	\$ 13,102
Other comprehensive income (loss):			
Securities available for sale:			
Net unrealized holding (losses) gains arising during the period (net of tax (benefit) expense of (\$336), \$181, and (\$1,218), respectively)	(1,268 )	384	(2,364 )
Reclassification adjustment for (gains) included in net income (net of tax expense of \$0, \$28, and \$66, respectively) (a) (b)	0	(51 )	(128 )
Net unrealized (losses) gains	(1,268 )	333	(2,492 )
Comprehensive income	\$ 18,274	\$ 12,337	\$ 10,610

(a) Amounts are included in net gain on sales of securities on the Consolidated Statements of Income within noninterest income.

(b) Income tax amounts are included in provision for income taxes on the Consolidated Statements of Income.

See accompanying notes.

Codorus Valley Bancorp, Inc.

**Consolidated Statements of Cash Flows**

<b>(dollars in thousands)</b>	<b>Years ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Cash flows from operating activities			
Net income	\$19,542	\$12,004	\$13,102
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation/amortization	2,423	2,357	2,343
Net amortization of premiums on securities	422	667	912
Amortization of deferred loan origination fees and costs	(1,554 )	(1,640 )	(1,049 )
Provision for loan losses	2,700	4,175	3,000
Recovery of foreclosed real estate	0	(47 )	(31 )
Deferred income tax (benefit) expense	(34 )	3,287	(1,021 )
Increase in bank owned life insurance	(972 )	(1,028 )	(861 )
Originations of mortgage loans held for sale	(35,537)	(39,687 )	(42,260 )
Originations of SBA loans held for sale	(13,932)	(5,316 )	(1,400 )
Proceeds from sales of mortgage loans held for sale	36,602	40,203	42,191
Proceeds from sales of SBA loans held for sale	11,781	5,416	1,117
Gain on sales of mortgage loans held for sale	(905 )	(1,039 )	(894 )
Gain on sales of SBA loans held for sale	(806 )	(395 )	(76 )
(Gain) loss on disposal of premises and equipment	(11 )	(9 )	4
Gain on sales of securities available-for-sale	0	(79 )	(194 )
Net loss (gain) on sales of foreclosed real estate	2	(11 )	(18 )
Stock-based compensation	697	752	525
Increase in interest receivable	(584 )	(520 )	(445 )
(Increase) decrease in other assets	(423 )	(1,593 )	1,203
Increase (decrease) in interest payable	210	176	(18 )
Increase (decrease) in other liabilities	1,329	(984 )	2,349
Net cash provided by operating activities	20,950	16,689	18,479
Cash flows from investing activities			
Purchases of securities, available-for-sale	(22,663)	(13,546 )	(47,665 )
Maturities, repayments and calls of securities, available-for-sale	29,635	43,900	48,999
Sales of securities, available-for-sale	0	5,692	12,903
Redemption (purchase) of restricted investment in bank stock	389	615	(1,898 )
Net increase in loans made to customers	(86,316)	(127,509)	(147,541)
Purchases of premises and equipment	(2,754 )	(2,157 )	(2,314 )
Investment in bank owned life insurance	(7 )	(4,007 )	(6,994 )
Proceeds from bank owned life insurance	0	0	196
Proceeds from sales of foreclosed real estate	168	454	576
Net cash used in investing activities	(81,548)	(96,558 )	(143,738)
Cash flows from financing activities			
Net increase in demand and savings deposits	92,018	100,994	140,938

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Net increase in time deposits	18,755	19,336	29,090
Net decrease in short-term borrowings	(13,473)	(36,142 )	(17,873 )
Proceeds from issuance of long-term debt	30,000	20,000	40,000
Repayment of long-term debt	(45,000)	(15,000 )	(35,000 )
Cash dividends paid to preferred shareholders	0	0	(46 )
Cash dividends paid to common shareholders	(5,539 )	(4,559 )	(4,144 )
Redemption of preferred stock	0	0	(12,000 )
Net issuance of common stock	1,114	751	853
Cash paid in lieu of fractional shares	(19 )	(19 )	(12 )
Net cash provided by financing activities	77,856	85,361	141,806
Net increase in cash and cash equivalents	17,258	5,492	16,547
Cash and cash equivalents at beginning of year	79,524	74,032	57,485
Cash and cash equivalents at end of period	\$96,782	\$79,524	\$74,032

See accompanying notes.

Codorus Valley Bancorp, Inc.

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

(dollars in thousands, except per share data)	<b>Preferred Stock</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Treasury Stock</b>	<b>Total</b>
Balance, January 1, 2016	\$ 12,000	\$ 19,893	\$ 97,338	\$ 28,539	\$ 1,371	\$ 0	\$ 159,141
Net income				13,102			13,102
Other comprehensive loss, net of tax					(2,492 )		(2,492 )
Common stock cash dividends (\$0.448 per share, adjusted)				(4,144 )			(4,144 )
5% common stock dividend, 398,541 shares at fair value		996	7,564	(8,572 )			(12 )
Preferred stock cash dividends				(16 )			(16 )
Redemption of preferred stock	(12,000)						(12,000 )
Stock-based compensation including related tax benefit			525				525
Forfeiture and withheld shares of restricted stock			8			(111 )	(103 )
Issuance and reissuance of common stock including related tax benefit:							
20,592 shares under the dividend reinvestment and stock purchase plan		45	374			6	425
27,510 shares under the employee stock option plan		60	239			65	364
9,897 shares under employee stock purchase plan		21	106			40	167
20,716 shares of stock-based compensation awards		52	(52 )				0
Balance, December 31, 2016	\$ 0	\$ 21,067	\$ 106,102	\$ 28,909	\$ (1,121 )	\$ 0	\$ 154,957
Net income				12,004			12,004
Impact of change in enacted tax rate				170	(170 )		0
Other comprehensive income, net of tax					333		333
Common stock cash dividends (\$0.488 per share, adjusted)				(4,559 )			(4,559 )
		1,049	12,510	(13,664)		86	(19 )



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5% common stock dividend, 422,439 shares at fair value							
Stock-based compensation		752					752
Forfeiture and withheld shares of restricted stock		4				(163 )	(159 )
Issuance and reissuance of common stock:							
16,553 shares under the dividend reinvestment and stock purchase plan	40	403				22	465
11,857 shares under the employee stock option plan	28	153				14	195
10,732 shares under employee stock purchase plan	20	189				41	250
24,431 shares of stock-based compensation awards	61	(61 )					0
Balance, December 31, 2017	\$0	\$22,265	\$120,052	\$22,860	\$ (958 )	\$0	\$164,219
Net income				19,542			19,542
Other comprehensive loss, net of tax					(1,268 )		(1,268 )
Common stock cash dividends (\$0.592 per share, adjusted)				(5,539 )			(5,539 )
5% common stock dividend, 447,092 shares at fair value	1,118	12,889		(14,026)			(19 )
Stock-based compensation		697					697
Forfeiture and withheld shares of restricted stock		5				(158 )	(153 )
Issuance and reissuance of common stock:							
19,614 shares under the dividend reinvestment and stock purchase plan	44	445				57	546
47,164 shares under the employee stock option plan	110	319				76	505
10,607 shares under employee stock purchase plan	20	171				25	216
29,062 shares of stock-based compensation awards	72	(72 )					0
Balance, December 31, 2018	\$0	\$23,629	\$134,506	\$22,837	\$ (2,226 )	\$0	\$178,746

See accompanying notes.

## **Codorus Valley Bancorp, Inc.**

### **Notes to Consolidated Financial Statements**

#### **NOTE 1-Summary of Significant Accounting Policies**

##### **Nature of Operations and Basis of Presentation**

Codorus Valley Bancorp, Inc. (“Corporation” or “Codorus Valley”) is a one-bank holding company headquartered in York, Pennsylvania that provides a full range of banking services through its subsidiary, PeoplesBank, A Codorus Valley Company (“PeoplesBank” or “Bank”). PeoplesBank operates three wholly-owned subsidiaries as of December 31, 2018. The subsidiaries consist of Codorus Valley Financial Advisors, Inc. d/b/a Peoples Wealth Advisors, which sells non-deposit investment products in Pennsylvania, SYC Settlement Services, Inc., which provides real estate settlement services, and Codorus Valley Financial Advisors, Inc. d/b/a Peoples Wealth Advisors, a subsidiary that sells non-deposit investment products in Maryland. In addition, PeoplesBank may periodically create nonbank subsidiaries for the purpose of temporarily holding foreclosed properties pending the liquidation of these properties. PeoplesBank operates under a state charter and is subject to regulation by the Pennsylvania Department of Banking and Securities, and the Federal Deposit Insurance Corporation. The Corporation is subject to regulation by the Federal Reserve Board and the Pennsylvania Department of Banking and Securities.

The consolidated financial statements include the accounts of Codorus Valley and its wholly-owned bank subsidiary, PeoplesBank, and a wholly-owned nonbank subsidiary, SYC Realty Company, Inc. SYC Realty was inactive during the reportable period of 2018. 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.

##### **Reclassifications**

Certain amounts in the 2017 and 2016 consolidated financial statements and notes have been reclassified to conform to the 2018 presentation.

##### **Investment Securities**

The classification of securities is determined at the time of acquisition and is reevaluated at each reporting date. Securities classified as available-for-sale are debt securities that the Corporation intends to hold for an indefinite

period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in maturity mix of assets and liabilities, income or liquidity needs, regulatory considerations and other factors. Debt securities available-for-sale are carried at fair value, with unrealized gains and losses, net of taxes, reported as a component of accumulated other comprehensive income in shareholders' equity. Premiums and discounts are recognized in interest income using the interest method over the estimated life of the security. Realized gains and losses from the sale of available-for-sale securities are computed on the basis of specific identification of the adjusted cost of each security and are shown net as a separate line item in the statement of income.

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

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

Restricted stock, which represents required investments in the common stock of correspondent banks, is carried at cost and, as of December 31, 2018 and 2017 consisted primarily of the common stock of the Federal Home Loan Bank of Pittsburgh (FHLBP) and, to a lesser degree, Atlantic Community Bancshares, Inc. (ACBI), the parent company of Atlantic Community Bankers Bank (ACBB). Under the FHLBP's Capital Plan, PeoplesBank is required to maintain a minimum member stock investment, both as a condition of becoming and remaining a member and as a condition of obtaining borrowings from the FHLBP. The FHLBP uses a formula to determine the minimum stock investment, which is based on the volume of loans outstanding, unused borrowing capacity and other factors.

The FHLBP paid dividends during the years ended December 31, 2018 and 2017. The FHLBP restricts the repurchase of the excess capital stock of member banks. The amount of excess capital stock that can be repurchased from any member is currently the lesser of five percent of the member's total capital stock outstanding or its excess capital stock outstanding.

Management evaluates the restricted stock for impairment in accordance with FASB ASC Topic 942. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. Using the FHLBP as an example, the determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLBP as compared to the capital stock amount for the FHLBP and the length of time this situation has persisted; (2) commitments by the FHLBP to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLBP; and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLBP. Management believes no impairment charge was necessary related to the restricted stock during the periods ended December 31, 2018 and 2017.

### **Loans Held for Sale**

Loans held for sale are comprised of residential mortgage loans and the guaranteed portion of secondary-market qualified Small Business Administration loans. Loans held for sale are reported at the lower of cost or fair value, as determined by the aggregate commitments from investors or current investor yield requirements. The amount by which cost exceeds fair value, if any, is accounted for as a valuation allowance and is charged to expense in the period of the change. The Company generally sells the guaranteed portion of its SBA loans to a third party and retains the

servicing, holding the nonguaranteed portion in its portfolio. Gains or losses recognized on the sale of mortgage loans and loans guaranteed by the Small Business Administration loans are recognized based on the difference between the selling price and the carrying value of the related loan and are recorded in noninterest income.

## **Loans**

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

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to the Corporation's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

## **Allowance for Loan Losses**

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

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



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

- Changes in national and local economies and business conditions
- Changes in the value of collateral for collateral dependent loans
- Changes in the level of concentrations of credit
- Changes in the volume and severity of classified and past due loans
- Changes in the nature and volume of the portfolio
- Changes in collection, charge-off, and recovery procedures
- Changes in underwriting standards and loan terms
- Changes in the quality of the loan review system
- Changes in the experience/ability of lending management and key lending staff
- Regulatory and legal regulations that could affect the level of credit losses
- Other pertinent environmental factors

The unallocated component is maintained to cover uncertainties that could affect the Corporation's estimate of probable losses. For example, increasing credit risks and uncertainties, not yet reflected in current leading indicators, associated with prolonged low economic growth, or recessionary business conditions for certain industries or the broad economy, or the erosion of real estate values, represent risk factors, the occurrence of any or all of which can adversely affect a borrowers' ability to service their loans. The unallocated component of the allowance also reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the loan portfolio, including the unpredictable timing and amounts of charge-offs and related historical loss averages, and specific-credit or broader portfolio future cash flow value and collateral valuation uncertainties which could negatively impact unimpaired portfolio loss factors.

As disclosed in Note 4-Loans, the Corporation engages in commercial and consumer lending. Loans are made within the Corporation's primary market area and surrounding areas, and include the purchase of whole loan or participation interests in loans from other financial institutions. Commercial loans, which pose the greatest risk of loss to the Corporation, whether originated or purchased, are generally secured by real estate. Within the broad commercial loan segment, the builder & developer and commercial real estate investor loan classes generally present a higher level of risk than other commercial loan classifications. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties, unstable real estate prices and the dependency upon successful construction and sale or operation of the real estate project. Within the consumer loan segment, junior (i.e., second) liens present a slightly higher risk to the Corporation because economic and housing market conditions can adversely affect the underlying



value of the collateral and the ability of some borrowers to service their debt.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. The Corporation determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Loans that are deemed impaired are evaluated for impairment loss based on the net realizable value of the collateral, as applicable. Loans that are not collateral dependent will rely on the present value of expected future cash flows discounted at the loan's effective interest rate to determine impairment loss. Large groups of smaller balance homogeneous loans such as residential mortgage loans, home equity loans and other consumer loans are collectively evaluated for impairment, unless they are classified as impaired.

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

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

Banking regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to the Corporation. Based on a comprehensive analysis of the loan portfolio, the Corporation believes that the level of the allowance for loan losses at December 31, 2018 is adequate.



### Transfers of Financial Assets

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

### Premises and Equipment

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

### Foreclosed Real Estate

Foreclosed real estate, included in other assets, is comprised of property acquired through a foreclosure proceeding or property that is acquired through in substance foreclosure. Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Any difference between the carrying value and the new cost basis is charged against the allowance for loan losses. Appraisals, obtained from an independent third party, are generally used to determine fair value. After foreclosure, management reviews valuations at least quarterly and adjusts the asset to the lower of cost or fair value minus estimated costs to sell through a valuation allowance or a charge-off. Costs related to the improvement of foreclosed real estate are generally capitalized until the real estate reaches a saleable condition subject to fair value limitations. Revenue and expense from operations and changes in the valuation allowance are included in noninterest expense. When a foreclosed real estate asset is ultimately sold, any gain or loss on the sale is included in the income statement as a component of noninterest expense. At December 31, 2018, foreclosed real estate was \$1,755,000, which included \$18,000 of residential real estate, compared to \$216,000 in foreclosed real estate, which included \$96,000 of residential real estate, at December 31, 2017. Included within loans receivable as of December 31, 2018, was a recorded investment of \$138,000 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.

### Bank Owned Life Insurance

PeoplesBank invests in bank owned life insurance (BOLI) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by PeoplesBank on a select group of employees and members of the board of directors. PeoplesBank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies and is included in other assets in the amount of \$37,585,000 at December 31, 2018, compared to \$36,632,000 at December 31, 2017.

### **Mortgage Servicing Rights**

PeoplesBank retained servicing of sold mortgage loans beginning in 2016. The mortgage servicing rights (MSRs) associated with the sold loans are included in other assets on the consolidated balance sheets at an amount equal to the estimated fair value of the contractual rights to service the mortgage loans. The MSR asset is amortized as a reduction to servicing income which was \$213,000, \$128,000, and \$37,000 in 2018, 2017 and 2016, respectively. Mortgage servicing income is included in other income on the consolidated statements of income. The MSR asset is evaluated periodically for impairment and carried at the lower of amortized cost or fair value. A third party calculates fair value by discounting the estimated cash flows from servicing income using a rate consistent with the risk associated with these assets and an expected life commensurate with the expected life of the underlying loans. In the event that the amortized cost of the MSR asset exceeds the fair value of the asset, a valuation allowance would be established through a charge against servicing income. Subsequent fair value evaluations may determine that impairment has been reduced or eliminated, in which case the valuation allowance would be reduced through a credit to earnings. At December 31, 2018, the balance of residential mortgage loans serviced for third parties was \$98,852,000 compared to \$70,780,000 at December 31, 2017.

The following table summarizes the changes in MSRs, which are included in other assets on the consolidated balance sheets.

(dollars in thousands)	<b>Years ended</b>	
	<b>December 31,</b>	
	<b>2018</b>	<b>2017</b>
Amortized cost:		
Balance at beginning of year	\$672	\$324
Originations of mortgage servicing rights	386	422
Amortization expense	(133)	(74)
Balance at end of year	\$925	\$672

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

Assets held by PeoplesBank in a fiduciary or agency capacity for its clients are not included in the consolidated balance sheets since these items are not assets of PeoplesBank. At December 31, 2018, the market value of assets was \$725,087,000 compared to \$711,161,000 at December 31, 2017.

### **Advertising**

Advertising costs are charged to expense when incurred.

### **Income Taxes**

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

The Corporation accounts for uncertain tax positions as required by FASB ASC Topic 740. FASB ASC Topic 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. Specifically, the accounting standard prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return as well as guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. No significant income tax uncertainties have been identified by the Corporation; therefore, the Corporation recognized no adjustment for unrecognized income tax benefits for the years ended December 31, 2018 2017. The Corporation's policy is to recognize interest and penalties on unrecognized tax benefits in income taxes expense in the Consolidated

Statement of Income. The Corporation did not recognize any interest and penalties for the years ended December 31, 2018, 2017 and 2016. The tax years subject to examination by the taxing authorities are the years ended December 31, 2017, 2016, and 2015.

### **Use of Estimates**

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

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

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

### **Goodwill and Core Deposit Intangible Assets**

Goodwill arising from acquisitions is not amortized, but is subject to an annual impairment test. This test consists of a qualitative analysis. If the Corporation determines events or circumstances indicate that it is more likely than not that goodwill is impaired, a quantitative analysis must be completed. Analyses may also be performed between annual tests. Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting an appropriate control premium. The Corporation completes its annual goodwill impairment test on October 1<sup>st</sup> of each year. Based upon the analysis, the Corporation concluded that the amount of recorded goodwill was not impaired as of October 1, 2018.

Core deposit intangibles represent the value assigned to demand, interest checking, money market, and savings accounts acquired as part of an acquisition. The core deposit intangible value represents the future economic benefit of potential cost savings from acquiring core deposits as part of an acquisition compared to the cost of alternative funding sources and the alternative cost to grow a similar core deposit base. The core deposit intangible asset resulting from the merger with Madison Bancorp, Inc. was determined to have a definite life and is being amortized using the sum of the years' digits method over ten years. All intangible assets must be evaluated for impairment if certain events or changes in circumstances occur. Any impairment write-downs would be recognized as expense on the consolidated statements of income.

At December 31, 2018, the Corporation does not have any indicators of potential impairment of either goodwill or core deposit intangibles.



### **Revenue from Contracts with Customers**

Revenue from contracts with customers that are required to be recognized under FASB ASC Topic 606 - Revenue from Contracts with Customers (ASC 606) is measured based on consideration specified in a contract with a customer, and excludes any sales incentives and amounts collected on behalf of third parties. The Corporation recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the previous accounting guidance under ASC 605.

The majority of the Corporation's revenue-generating transactions are not within the scope of ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, derivatives and investment securities, as well as revenue related to our mortgage servicing activities, as these activities are subject to other U.S. Generally Accepted Accounting Principles (GAAP) discussed elsewhere within our disclosures. Descriptions of our revenue-generating activities that are within the scope of ASC 606, which are presented in our consolidated statements of income as components of non-interest income are as follows:

Trust and investment service fees – The Corporation provides trust, investment management custody and irrevocable life insurance trust services to customers. Such services are rendered in accordance with the underlying contracts for which fees are earned. The Corporation's performance obligations are generally satisfied, and the related revenue recognized, over the period in which the service is provided. Payment for services rendered is primarily received in the following month.

Income from mutual fund, annuity and insurance sales – The Corporation sells mutual funds, annuity and insurance products to its customers. The Corporation's performance obligation is met upon the signing of the product agreement and, in certain cases, a time component may exist when the customer has the right to rescind the agreement with or without penalty. The Corporation recognizes revenues upon delivery of the product or service unless there is a time component in which case revenues are recognized utilizing the expected value method. Payment for services rendered is primarily received in the following month.

Service charges on deposits accounts – These represent general service fees for monthly account maintenance and activity- or transaction based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Other service charges include revenue from processing wire transfers, cashier's checks and other services. Revenue is recognized when the performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to the customers' accounts.

Other noninterest income – The Corporation evaluated individual components of other noninterest income, such as credit card merchant fees, credit and gift card fees and ATM fees. Debit card income is primarily comprised of interchange fees earned whenever the Corporation's debit cards are processed through payment networks, such as Visa. Credit and gift card income is realized through a third party provider who issues credits as private label in the Corporation's name. ATM fees are primarily generated when a non-Corporation cardholder uses a Corporation ATM. The income is primarily comprised as a percentage of interchange fees earned whenever the issuer's card is processed through card payment networks, such as Visa or Pulse. Merchant services income is realized through a third party service provider who is contracted by the Corporation under a referral arrangement. Such fees represent fees charged to merchants to process their debit card transactions. The Corporation's performance obligation these fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received within a 1 to 3 day lag or in the following month.

### **Per Common Share Data**

Basic net income per common share is calculated as net income available to common shareholders divided by the weighted average number of common shares outstanding. Diluted net income per common share is calculated as net income available to common shareholders divided by the weighted average number of common shares outstanding plus common shares that would have been outstanding if dilutive potential common shares had been issued, as well as

any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding stock options and are determined using the treasury stock method. All share and per share amounts are adjusted for stock dividends that are declared prior to the issuance of the consolidated financial statements.

The computation of net income per common share for the years ended December 31, 2018, 2017 and 2016 is provided in the table below.

(in thousands, except per share data)	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net income available to common shareholders	\$19,542	\$12,004	\$13,086
Weighted average shares outstanding (basic)	9,388	9,314	9,233
Effect of dilutive stock options	91	109	79
Weighted average shares outstanding (diluted)	9,479	9,423	9,312
Basic earnings per common share	\$2.08	\$1.29	\$1.42
Diluted earnings per common share	\$2.06	\$1.27	\$1.41
Anti-dilutive stock options excluded from the computation of earnings per share	33	17	86

### Stock-Based Compensation

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

### Cash Flow Information

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

Supplemental cash flow information is provided in the table below.

(dollars in thousands)	<b>Years ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Cash paid during the period for:			
Income taxes	\$4,605	\$7,926	\$4,973
Interest	\$16,191	\$10,692	\$8,667
Noncash investing activities:			
Transfer of loans to foreclosed real estate	\$1,709	\$216	\$318
Loans to facilitate sales of foreclosed real estate	\$0	\$2,310	\$0

Transfer of loans held for sale to held-to-maturity portfolio	\$0	\$228	\$251
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#### Off-Balance Sheet Financial Instruments

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

#### Comprehensive Income and Accumulated Other Comprehensive Income

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

## Segment Reporting

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

## Recent Accounting Pronouncements

### *Pronouncements Adopted in 2018*

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. This standard clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows to reduce diversity in practice. This standard contains guidance clarifying when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance. The new standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Corporation adopted this standard effective with its March 31, 2018 quarterly report on Form 10-Q. The adoption of the new standard did not have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606).

This standards update provides a framework that replaces most existing revenue recognition guidance. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. This ASU amends the new revenue standard to make minor technical corrections that affect narrow aspects of the guidance, including contract cost accounting, disclosures, and other matters. ASU 2014-09 and ASU 2016-20 are effective for interim and annual reporting periods beginning after December 15, 2017. The Corporation has determined that certain noninterest income financial statement line items, including trust and investment services fees, income from mutual fund, annuity and insurance sales, service charges on deposit accounts, and other noninterest income, contain revenue streams that are in scope of these updates. The Corporation adopted this standard on January 1, 2018 utilizing the modified retrospective method and the adoption of the new standard did not have a material impact on the recognition of revenue.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied by means of a cumulative effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. In February 2018, the FASB issued ASU No. 2018-03 which includes technical corrections and improvements to clarify the guidance in ASU No. 2016-01. The Corporation adopted ASU 2016-01 on January 1, 2018 and it did not have a material effect on its accounting for fair value disclosures and other disclosure requirements.

*Pronouncements Not Yet Effective*

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

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326). This standard adds a new Topic 326 which requires companies to measure and record impairment on financial instruments at the time of origination using the expected credit loss (CECL) model. The CECL model calculates impairment based on historical experience, current conditions, and reasonable and supportable forecasts, and reflects the organization's current estimate of all expected credit losses over the contractual term of its financial assets. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018. The Corporation is planning to adopt the standard in the first quarter of 2020 and is continuing its implementation, having established a Corporation-wide implementation team. This team is assigning roles and responsibilities, key tasks and a general timeline. The team meets periodically to discuss the latest developments and ensure progress is being made. The team is in the final stages of a vendor partner selection and each finalist has established that they can meet the general timeline. We are evaluating the need to join with an advisory consultant and to identify the methodologies that will be utilized, which will be followed by developing and documenting processes, controls, policies and disclosure requirements in preparation for performing a full parallel run. The Corporation expects the provisions of ASU No. 2016-13 to impact the Corporation's consolidated financial statements, in particular, the level of the reserve for credit losses. The Corporation is continuing to evaluate the extent of the potential impact and expects that portfolio composition and economic conditions at the time of adoption will be a factor.

In February 2016, the FASB issued ASU 2016-02, Leases and in July 2018 issued ASU 2018-10 and ASU 2018-11, Codification Improvements to Topic 842, Leases. From the lessee's perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing lease. If the lessor doesn't convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Corporation elected the transition option provided in ASU No. 2018-11 and the modified retrospective approach was applied on January 1, 2019 (as opposed to January 1,



2017). The Corporation adopted certain practical expedients available under the new guidance, which will not require it to (1) reassess whether any expired or existing contracts contain leases, (2) reassess initial direct costs for any existing leases and (3) the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset. Upon adoption of ASU 2016-02 on its required effective date of January 1, 2019, the Corporation recorded a right of use asset of approximately \$4,200,000 and a lease liability of approximately \$4,500,000. The Corporation expects its regulatory capital ratios to remain above the thresholds necessary to be classified as a “well capitalized” institution. The new guidance did not have a material impact on the consolidated statements of income. The Corporation is completing its evaluation of the ASU’s expanded disclosure requirements effective for the March 31, 2019 Form 10-Q.

In July 2018, the FASB issued ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting. This standard expands the scope of Topic 718, Compensation – Stock Compensation to include share-based payment transactions for acquiring goods and services from nonemployees. This standard requires application of Topic 718 to nonemployee awards for specific guidance on inputs to an option pricing model and the attribution of costs (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period). The amendments in the Update are effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. The adoption of this standard is not expected to have a material impact on the Corporation's consolidated financial statements based on current circumstances.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement. The amendments in this update modify the disclosure requirements in Topic 820, Fair Value Measurement. The following disclosure requirements were removed: the amount of and reasons for transfers between Level 1 and Level 2, the policy for timing of transfers between levels, and the valuation processes for Level 3 fair value measurements. The following disclosure requirements were modified: for investments in certain entities that calculate net asset value, and entity is required to disclose the timing of liquidation of investee's assets and the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The following disclosure requirements were added: the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The update is effective for fiscal years beginning after December 15, 2019. The Corporation is currently evaluating the impact of the adoption of this update on its disclosures.

In August 2018, the FASB issued ASU 2018-14, Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20). The amendments in this update remove disclosures that are no longer considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. The update is effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The Corporation is currently evaluating the impact of the adoption of this update on its disclosures.

In August 2018, the FASB issued ASU 2018-15, Intangibles-Goodwill and Other-Internal-Use Software. This standard aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with those incurred to develop or obtain internal-use software. This standard requires application of Subtopic 350-40 to determine which costs to implement the service contract would be capitalized as an asset and which costs would be expensed. The amendments in the Update are effective for the years beginning after December 15, 2019. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

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

PeoplesBank is required to maintain average reserves, in the form of cash and balances with the Federal Reserve Bank, against its deposit liabilities. In 2018 and 2017, the reserves were met with vault cash. PeoplesBank is also required to maintain compensating balances with certain correspondent banks, which totaled \$65,000 at December 31, 2018 and \$50,000 at December 31, 2017.

**NOTE 3-Securities**

A summary of securities, available-for-sale at December 31, 2018 and 2017 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 December 31, 2018, 86 percent of the fair value of the municipal bond portfolio was concentrated in the Commonwealth of Pennsylvania.

<i>(dollars in thousands)</i>	<b>Amortized Cost</b>	<b>Gross Unrealized</b>		<b>Fair Value</b>
		<b>Gains</b>	<b>Losses</b>	
<b>December 31, 2018</b>				
Debt securities:				
U.S. Treasury notes	\$ 19,780	\$ 29	\$ (806 )	\$ 19,003
U.S. agency	16,000	0	(937 )	15,063
U.S. agency mortgage-backed, residential	75,446	102	(993 )	74,555
State and municipal	41,184	85	(297 )	40,972
Total debt securities	\$ 152,410	\$ 216	\$ (3,033)	\$ 149,593
<b>December 31, 2017</b>				
Debt securities:				
U.S. Treasury notes	\$ 14,758	\$ 0	\$ (687 )	\$ 14,071
U.S. agency	18,015	0	(712 )	17,303
U.S. agency mortgage-backed, residential	75,204	327	(356 )	75,175
State and municipal	51,827	304	(89 )	52,042
Total debt securities	\$ 159,804	\$ 631	\$ (1,844)	\$ 158,591

The amortized cost and estimated fair value of debt securities at December 31, 2018 by contractual maturity are shown below. Actual maturities may differ from contractual maturities if call options on selected debt issues are exercised in the future. Mortgage-backed securities are included in the maturity categories based on average expected life.

<i>(dollars in thousands)</i>	<b>Available-for-sale</b>	
	<b>Amortized</b>	<b>Fair</b>
	<b>Cost</b>	<b>Value</b>
Due in one year or less	\$ 4,703	\$ 4,714
Due after one year through five years	90,202	88,756
Due after five years through ten years	46,435	45,006
Due after ten years	11,070	11,117
Total debt securities	\$ 152,410	\$ 149,593

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

	Years ended December 31,		
(dollars in thousands)	2018	2017	2016
Realized gains	\$ 0	\$ 79	\$ 194
Realized losses	0	0	0
Net gains	\$ 0	\$ 79	\$ 194

Investment securities having a carrying value of \$123,088,000 and \$105,603,000 on December 31, 2018 and December 31, 2017, respectively, were pledged to secure public and trust deposits, repurchase agreements and other short-term borrowings.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time, for securities that have been in a continuous unrealized loss position, at December 31, 2018 and 2017.

(dollars in thousands)	Less than 12 months			12 months or more			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
<b>December 31, 2018</b>									
Debt securities:									
U.S. Treasury notes	0	\$ 0	\$ 0	3	\$ 13,980	\$ (806 )	3	\$ 13,980	\$ (806 )
U.S. agency	0	0	0	4	15,063	(937 )	4	15,063	(937 )
U.S. agency mortgage-backed, residential	8	4,878	(14 )	39	51,137	(979 )	47	56,015	(993 )
State and municipal	15	6,707	(11 )	36	20,287	(286 )	51	26,994	(297 )
Total temporarily impaired debt securities, available-for-sale	23	\$ 11,585	\$ (25 )	82	\$ 100,467	\$ (3,008 )	105	\$ 112,052	\$ (3,033 )
<b>December 31, 2017</b>									
Debt securities:									
U.S. Treasury notes	0	\$ 0	\$ 0	3	\$ 14,071	\$ (687 )	3	\$ 14,071	\$ (687 )
U.S. agency	1	989	(12 )	4	16,314	(700 )	5	17,303	(712 )
U.S. agency mortgage-backed, residential	25	43,329	(261 )	2	5,051	(95 )	27	48,380	(356 )
State and municipal	27	12,171	(60 )	5	3,277	(29 )	32	15,448	(89 )
Total temporarily impaired debt securities, available-for-sale	53	\$ 56,489	\$ (333 )	14	\$ 38,713	\$ (1,511 )	67	\$ 95,202	\$ (1,844 )

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

The Corporation believes that any unrealized losses at December 31, 2018 were primarily the result of changes in market interest rates and that it has the ability to hold these investments for a time necessary to recover the amortized cost. Through December 31, 2018, the Corporation has collected all interest and principal on its investment securities as scheduled. The Corporation believes that collection of the contractual principal and interest is probable and, therefore, all impairment is considered to be temporary.

**NOTE 4-Loans***Loan Portfolio Composition*

The table below provides the composition of the loan portfolio at December 31, 2018 and 2017. The portfolio is comprised of two segments, commercial and consumer loans. The commercial loan segment is disaggregated by industry class which allows the Corporation to monitor risk and performance.

Those industries representing the largest dollar investment and most risk are listed separately. The “Other” commercial loans category is comprised of various industries. The consumer related segment is comprised of residential mortgages, home equity and other consumer loans. The Corporation has not engaged in sub-prime residential mortgage originations.

	<b>December 31, 2018</b>	<b>% Total Loans</b>	<b>December 31, 2017</b>	<b>% Total Loans</b>
<i>(dollars in thousands)</i>				
Builder & developer	\$ 154,977	10.4	\$ 184,402	13.2
Commercial real estate investor	210,501	14.2	230,827	16.5
Residential real estate investor	231,118	15.6	209,414	15.0
Hotel/Motel	77,480	5.2	63,195	4.5
Wholesale & retail	117,280	7.9	103,040	7.3
Manufacturing	80,075	5.4	62,510	4.5
Agriculture	65,540	4.4	59,931	4.3
Other	342,839	23.0	284,511	20.3
Total commercial related loans	1,279,810	86.1	1,197,830	85.6
Residential mortgages	83,977	5.7	79,325	5.6
Home equity	98,019	6.6	97,950	7.0
Other	23,874	1.6	24,659	1.8
Total consumer related loans	205,870	13.9	201,934	14.4
Total loans	\$ 1,485,680	100.0	\$ 1,399,764	100.0

*Concentrations of Credit Risk*

Concentrations of credit risk arise when a number of clients are engaged in similar business activities in the same geographic region or have similar economic features that could cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Most of the Corporation's business is with clients in south central Pennsylvania, specifically York County and Lancaster County and north central Maryland, specifically Baltimore County, Harford County and Baltimore City. Although this focus may pose a concentration risk geographically, the Corporation believes that the diverse local economy and our detailed knowledge of the client base

lessens this risk. At December 31, 2018, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: residential real estate investor, which represented 15.6 percent of the portfolio; commercial real estate investor, which represented 14.2 percent of the portfolio; and builder & developer, which represented 10.4 percent of the portfolio. At December 31, 2017, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor, which represented 16.5 percent of the portfolio; residential real estate investor, which represented 15.0 percent of the portfolio; and builder & developer, which represented 13.2 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

The principal balance of outstanding loans to directors, executive officers, principal shareholders and any affiliates of such persons was \$7,502,000 at December 31, 2018 and \$8,580,000 at December 31, 2017. During 2018, total additions were \$144,000 and total repayments and reductions were \$1,222,000. As of year-end 2018, all loans to this group were current and performing in accordance with contractual terms.



### *Loan Risk Ratings*

The Corporation's internal risk rating system follows regulatory guidance as to risk classifications and definitions. Every approved loan is assigned a risk rating. Generally, risk ratings for commercial related loans and residential mortgages held for investment are determined by a formal evaluation of risk factors performed by the Corporation's underwriting staff. For consumer loans, and commercial loans up to \$500,000, the Corporation uses third-party credit scoring software models for risk rating purposes. The loan portfolio is monitored on a continuous basis by loan officers, loan review personnel and senior management. Adjustments of loan risk ratings are generally performed by the Special Asset Committee, which includes senior management. The Committee, which typically meets at least quarterly, 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. In addition to review by the Committee, existing loans are monitored by the primary loan officer and loan review to determine if any changes, upward or downward, in risk ratings are appropriate. Primary loan officers and loan review may downgrade existing loans, except to non-accrual status. Only the Committee, Executive Chairman or President/CEO may upgrade a loan that is classified.

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

The table below presents a summary of loan risk ratings by loan class at December 31, 2018 and 2017.

<i>(dollars in thousands)</i>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Nonaccrual</b>	<b>Total</b>
<b>December 31, 2018</b>					
Builder & developer	\$ 152,188	\$ 1,604	\$ 411	\$ 774	\$ 154,977
Commercial real estate investor	204,141	1,808	4,317	235	210,501
Residential real estate investor	222,227	3,597	235	5,059	231,118
Hotel/Motel	77,480	0	0	0	77,480
Wholesale & retail	94,726	9,973	4,952	7,629	117,280
Manufacturing	72,058	4,991	1,302	1,724	80,075
Agriculture	61,636	3,244	0	660	65,540
Other	318,940	7,760	12,689	3,450	342,839
Total commercial related loans	1,203,396	32,977	23,906	19,531	1,279,810
Residential mortgage	83,305	7	82	583	83,977
Home equity	97,395	13	0	611	98,019
Other	23,601	1	9	263	23,874
Total consumer related loans	204,301	21	91	1,457	205,870
Total loans	\$ 1,407,697	\$ 32,998	\$ 23,997	\$ 20,988	\$ 1,485,680
<b>December 31, 2017</b>					
Builder & developer	\$ 179,897	\$ 1,832	\$ 581	\$ 2,092	\$ 184,402
Commercial real estate investor	224,822	360	4,339	1,306	230,827
Residential real estate investor	204,139	4,065	711	499	209,414
Hotel/Motel	63,195	0	0	0	63,195
Wholesale & retail	95,128	254	7,658	0	103,040
Manufacturing	58,082	588	3,840	0	62,510
Agriculture	57,140	2,476	0	315	59,931
Other	283,086	507	918	0	284,511
Total commercial related loans	1,165,489	10,082	18,047	4,212	1,197,830
Residential mortgage	79,068	10	85	162	79,325
Home equity	97,498	0	0	452	97,950
Other	24,394	30	9	226	24,659
Total consumer related loans	200,960	40	94	840	201,934
Total loans	\$ 1,366,449	\$ 10,122	\$ 18,141	\$ 5,052	\$ 1,399,764

*Impaired Loans*

The table below presents a summary of impaired loans at December 31, 2018 and 2017. Generally, impaired loans are certain loans risk rated substandard and all loans risk rated nonaccrual or classified as troubled debt restructurings. An allowance is established for those individual loans that are commercial related where the Corporation has doubt as to full recovery of the outstanding principal balance. Typically, impaired consumer related loans are partially or fully charged-off eliminating the need for a specific allowance. The recorded investment represents outstanding unpaid principal loan balances adjusted for charge-offs.

<i>(dollars in thousands)</i>	<b>With No Allowance</b>		<b>With A Related Allowance</b>			<b>Total</b>	
	<b>Recorded Investment</b>	<b>Unpaid Principal</b>	<b>Recorded Investment</b>	<b>Unpaid Principal</b>	<b>Related Allowance</b>	<b>Recorded Investment</b>	<b>Unpaid Principal</b>
<b>December 31, 2018</b>							
Builder & developer	\$1,047	\$1,318	\$138	\$138	\$ 51	\$1,185	\$1,456
Commercial real estate investor	4,552	4,552	0	0	0	4,552	4,552
Residential real estate investor	909	909	4,385	4,385	1,218	5,294	5,294
Hotel/Motel	0	0	0	0	0	0	0
Wholesale & retail	5,200	5,200	7,629	7,629	757	12,829	12,829
Manufacturing	1,320	1,320	1,706	1,706	539	3,026	3,026
Agriculture	660	660	0	0	0	660	660
Other commercial	13,245	13,245	2,894	2,894	1,114	16,139	16,139
Total impaired commercial related loans	26,933	27,204	16,752	16,752	3,679	43,685	43,956
Residential mortgage	665	689	0	0	0	665	689
Home equity	611	611	0	0	0	611	611
Other consumer	272	272	0	0	0	272	272
Total impaired consumer related loans	1,548	1,572	0	0	0	1,548	1,572
Total impaired loans	\$ 28,481	\$ 28,776	\$ 16,752	\$ 16,752	\$ 3,679	\$ 45,233	\$ 45,528
<b>December 31, 2017</b>							
Builder & developer	\$2,673	\$3,008	\$0	\$0	\$ 0	\$2,673	\$3,008
Commercial real estate investor	4,585	4,601	1,060	1,060	243	5,645	5,661
Residential real estate investor	1,210	1,510	0	0	0	1,210	1,510
Hotel/Motel	0	0	0	0	0	0	0
Wholesale & retail	7,912	7,912	0	0	0	7,912	7,912
Manufacturing	3,840	3,840	0	0	0	3,840	3,840
Agriculture	315	315	0	0	0	315	315
Other commercial	918	918	0	0	0	918	918
Total impaired commercial related loans	21,453	22,104	1,060	1,060	243	22,513	23,164
Residential mortgage	247	276	0	0	0	247	276
Home equity	452	452	0	0	0	452	452
Other consumer	235	235	0	0	0	235	235
	934	963	0	0	0	934	963

Total impaired consumer related  
loans

Total impaired loans	\$ 22,387	\$ 23,067	\$ 1,060	\$ 1,060	\$ 243	\$ 23,447	\$ 24,127
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The table below presents a summary of average impaired loans and related interest income that was included in net income for the years ended December 31, 2018, 2017 and 2016. Interest income on loans with a related allowance is the result of interest collected prior to the loan moving to nonaccrual status.

	With No Related Allowance			With A Related Allowance			Total		
	Average Recorded Investment	Total Interest Income	Cash Basis Interest Income	Average Recorded Investment	Total Interest Income	Cash Basis Interest Income	Average Recorded Investment	Total Interest Income	Cash Basis Interest Income
(dollars in thousands)									
<b>December 31, 2018</b>									
Builder & developer Commercial real estate investor	\$1,716	\$ 17	\$ 0	\$55	\$ 9	\$ 0	\$1,771	\$26	\$ 0
Residential real estate investor	5,147	269	18	212	0	0	5,359	269	18
Hotel/Motel	1,492	41	15	877	7	0	2,369	48	15
Wholesale & retail	0	0	0	0	0	0	0	0	0
Manufacturing	5,292	34	0	3,089	301	0	8,381	335	0
Agriculture	2,733	90	3	712	206	0	3,445	296	3
Other commercial	474	26	17	0	0	0	474	26	17
Total impaired commercial related loans	3,474	94	3	579	14	14	4,053	108	17
Residential mortgage	20,328	571	56	5,524	537	14	25,852	1,108	70
Home equity	395	23	19	0	0	0	395	23	19
Other consumer	516	26	26	0	0	0	516	26	26
Total impaired consumer related loans	247	17	17	0	0	0	247	17	17
Total impaired loans	1,158	66	62	0	0	0	1,158	66	62
	\$ 21,486	\$ 637	\$ 118	\$ 5,524	\$ 537	\$ 14	\$ 27,010	\$ 1,174	\$ 132
<b>December 31, 2017</b>									
Builder & developer Commercial real estate investor	\$3,528	\$ 140	\$ 0	\$1,088	\$ 0	\$ 0	\$4,616	\$140	\$ 0
Residential real estate investor	5,142	248	20	432	0	0	5,574	248	20
Hotel/Motel	1,371	52	13	303	0	0	1,674	52	13
Wholesale & retail	72	0	0	7	0	0	79	0	0
Manufacturing	5,741	260	0	0	0	0	5,741	260	0
Agriculture	2,713	214	0	730	0	0	3,443	214	0
Other commercial	242	0	0	210	0	0	452	0	0
Total impaired commercial related loans	1,052	55	0	110	0	0	1,162	55	0
Residential mortgage	19,861	969	33	2,880	0	0	22,741	969	33
Home equity	134	1	0	0	0	0	134	1	0
Other consumer	368	17	17	0	0	0	368	17	17
	258	8	7	0	0	0	258	8	7
	760	26	24	0	0	0	760	26	24

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Total impaired consumer  
related loans

Total impaired loans	\$ 20,621	\$ 995	\$ 57	\$ 2,880	\$ 0	\$ 0	\$ 23,501	\$ 995	\$ 57
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**December 31, 2016**

Builder & developer	\$3,835	\$ 230	\$ 0	\$153	\$ 0	\$ 0	\$ 3,988	\$ 230	\$ 0
Commercial real estate investor	5,880	301	0	0	0	0	5,880	301	0
Residential real estate investor	937	29	2	489	0	0	1,426	29	2
Hotel/Motel	386	2	2	0	0	0	386	2	2
Wholesale & retail	280	11	0	0	0	0	280	11	0
Manufacturing	622	39	0	0	0	0	622	39	0
Agriculture	368	26	26	385	0	0	753	26	26
Other commercial	1,258	76	20	110	0	0	1,368	76	20
Total impaired commercial related loans	13,566	714	50	1,137	0	0	14,703	714	50
Residential mortgage	225	2	1	0	0	0	225	2	1
Home equity	285	2	2	0	0	0	285	2	2
Other consumer	216	11	4	0	0	0	216	11	4
Total impaired consumer related loans	726	15	7	0	0	0	726	15	7
Total impaired loans	\$ 14,292	\$ 729	\$ 57	\$ 1,137	\$ 0	\$ 0	\$ 15,429	\$ 729	\$ 57

*Past Due and Nonaccrual*

The performance and credit quality of the loan portfolio is also monitored by using an aging schedule which shows the length of time a loan is past due. The table below presents a summary of past due loans, nonaccrual loans and current loans by loan segment and class at December 31, 2018 and 2017.

<i>(dollars in thousands)</i>	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>≥ 90 Days Past Due and Accruing</b>		<b>Total Past Due and Nonaccrual</b>		<b>Total Loans</b>
			<b>Nonaccrual</b>	<b>Nonaccrual</b>	<b>Current</b>		
<b>December 31, 2018</b>							
Builder & developer	\$ 159	\$ 547	\$ 43	\$ 774	\$ 1,523	\$ 153,454	\$ 154,977
Commercial real estate investor	0	0	1,828	235	2,063	208,438	210,501
Residential real estate investor	244	812	0	5,059	6,115	225,003	231,118
Hotel/Motel	0	0	0	0	0	77,480	77,480
Wholesale & retail	0	0	97	7,629	7,726	109,554	117,280
Manufacturing	0	0	0	1,724	1,724	78,351	80,075
Agriculture	0	0	0	660	660	64,880	65,540
Other	4,877	0	0	3,450	8,327	334,512	342,839
Total commercial related loans	5,280	1,359	1,968	19,531	28,138	1,251,672	1,279,810
Residential mortgage	0	10	66	583	659	83,318	83,977
Home equity	206	94	0	611	911	97,108	98,019
Other	263	2	94	263	622	23,252	23,874
Total consumer related loans	469	106	160	1,457	2,192	203,678	205,870
Total loans	\$ 5,749	\$ 1,465	\$ 2,128	\$ 20,988	\$ 30,330	\$ 1,455,350	\$ 1,485,680
<b>December 31, 2017</b>							
Builder & developer	\$ 615	\$ 26	\$ 0	\$ 2,092	\$ 2,733	\$ 181,669	\$ 184,402
Commercial real estate investor	0	0	0	1,306	1,306	229,521	230,827
Residential real estate investor	347	0	0	499	846	208,568	209,414
Hotel/Motel	0	0	0	0	0	63,195	63,195
Wholesale & retail	0	0	0	0	0	103,040	103,040
Manufacturing	0	0	0	0	0	62,510	62,510
Agriculture	0	137	0	315	452	59,479	59,931
Other	203	117	0	0	320	284,191	284,511
Total commercial related loans	1,165	280	0	4,212	5,657	1,192,173	1,197,830
Residential mortgage	392	72	67	162	693	78,632	79,325
Home equity	264	5	0	452	721	97,229	97,950
Other	123	5	9	226	363	24,296	24,659
Total consumer related loans	779	82	76	840	1,777	200,157	201,934
Total loans	\$ 1,944	\$ 362	\$ 76	\$ 5,052	\$ 7,434	\$ 1,392,330	\$ 1,399,764





*Troubled Debt Restructurings*

Loans classified as troubled debt restructurings (TDRs) are designated impaired and arise when the Corporation grants borrowers experiencing financial difficulties concessions that it would not otherwise consider. Concessions granted with respect to these loans involve an extension of the maturity date or a below market interest rate relative to new debt with similar credit risk. Generally, these loans are secured by real estate. If repayment of the loan is determined to be collateral dependent, the loan is evaluated for impairment loss based on the fair value of the collateral. For loans that are not collateral dependent, the present value of expected future cash flows, discounted at the loan's original effective interest rate, is used to determine any impairment loss. A nonaccrual TDR represents a nonaccrual loan, as previously defined, which includes an economic concession. Nonaccrual TDRs are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive payments after the modification and future principal and interest payments are reasonably assured. In contrast, an accruing TDR represents a loan that, at the time of the modification, has a demonstrated history of payments and with respect to which management believes that future loan payments are reasonably assured under the modified terms.

The table below shows loans whose terms have been modified under TDRs during the years ended December 31, 2018 and 2017. There was no impairment loss recognized on any of these TDRs. There were no defaults during the year ended December 31, 2018 for TDRs entered into during the previous 12 month period, with the exception of one loan modified in the third quarter of 2018 in the amount of \$930,000 that is not performing under their modified terms.

	<b>Modifications</b>		<b>Post-Modification Outstanding Recorded Investment</b>	<b>Recorded Investment at Period End</b>
	<b>Number of Contracts</b>	<b>Pre-Modification Outstanding Recorded Investment</b>		
<i>(dollars in thousands)</i>				
<b><u>Years ended:</u></b>				
<b>December 31, 2018</b>	3	\$ 1,264	\$ 1,305	\$ 1,291
<b>December 31, 2017</b>				
None				

**NOTE 5-Allowance for Loan Losses**

The table below shows the activity in and the composition of the allowance for loan losses by loan segment and class detail as of and for the years ended December 31, 2018, 2017 and 2016.

	<b>Allowance for Loan Losses</b>				
	<b>January</b>				<b>December</b>
	<b>1, 2018</b>				<b>31, 2018</b>
<i>(dollars in thousands)</i>	<b>Balance</b>	<b>Charge-offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Balance</b>
Builder & developer	\$3,388	\$(144)	) \$84	\$(493)	) \$2,835
Commercial real estate investor	3,013	0	) 0	(377)	) 2,636
Residential real estate investor	2,505	(2)	) 80	1,362	3,945
Hotel/Motel	637	0	) 0	95	732
Wholesale & retail	909	0	) 3	901	1,813
Manufacturing	592	0	) 0	695	1,287
Agriculture	431	0	) 0	148	579
Other commercial	2,643	0	) 19	1,401	4,063
Total commercial related loans	14,118	(146)	) 186	3,732	17,890
Residential mortgage	108	(10)	) 10	18	126
Home equity	217	(123)	) 1	170	265
Other consumer	66	(203)	) 40	241	144
Total consumer related loans	391	(336)	) 51	429	535
Unallocated	2,180	0	) 0	(1,461)	) 719
Total	\$ 16,689	\$( 482)	) \$ 237	\$ 2,700	\$ 19,144

	<b>Allowance for Loan Losses</b>				
	<b>January</b>				<b>December</b>
	<b>1, 2017</b>				<b>31, 2017</b>
<i>(dollars in thousands)</i>	<b>Balance</b>	<b>Charge-offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Balance</b>
Builder & developer	\$2,384	\$(1,674)	) \$32	\$2,646	\$ 3,388
Commercial real estate investor	2,870	0	) 0	143	3,013
Residential real estate investor	2,517	(518)	) 62	444	2,505
Hotel/Motel	807	(36)	) 36	(170)	) 637
Wholesale & retail	803	0	) 1	105	909
Manufacturing	307	0	) 0	285	592
Agriculture	619	0	) 0	(188)	) 431
Other commercial	2,467	(104)	) 0	280	2,643
Total commercial related loans	12,774	(2,332)	) 131	3,545	14,118
Residential mortgage	85	0	) 5	18	108
Home equity	179	(223)	) 0	261	217
Other consumer	193	(82)	) 23	(68)	) 66
Total consumer related loans	457	(305)	) 28	211	391
Unallocated	1,761	0	) 0	419	2,180
Total	\$ 14,992	\$( 2,637)	) \$ 159	\$ 4,175	\$ 16,689

**Allowance for Loan Losses**

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

The table below shows the allowance amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment at December 31, 2018, 2017 and 2016 along with the related loan balances for those years.

	Allowance for Loan Losses			Loans		
	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance
<i>(dollars in thousands)</i>						
<b>December 31, 2018</b>						
Builder & developer	\$ 51	\$ 2,784	\$ 2,835	\$ 1,185	\$ 153,792	\$ 154,977
Commercial real estate investor	0	2,636	2,636	4,552	205,949	210,501
Residential real estate investor	1,218	2,727	3,945	5,294	225,824	231,118
Hotel/Motel	0	732	732	0	77,480	77,480
Wholesale & retail	757	1,056	1,813	12,829	104,451	117,280
Manufacturing	539	748	1,287	3,026	77,049	80,075
Agriculture	0	579	579	660	64,880	65,540
Other commercial	1,114	2,949	4,063	16,139	326,700	342,839
Total commercial related	3,679	14,211	17,890	43,685	1,236,125	1,279,810
Residential mortgage	0	126	126	665	83,312	83,977
Home equity	0	265	265	611	97,408	98,019
Other consumer	0	144	144	272	23,602	23,874
Total consumer related	0	535	535	1,548	204,322	205,870
Unallocated	0	719	719	—	—	—
Total	\$ 3,679	\$ 15,465	\$ 19,144	\$ 45,233	\$ 1,440,447	\$ 1,485,680
<b>December 31, 2017</b>						
Builder & developer	\$ 0	\$ 3,388	\$ 3,388	\$ 2,673	\$ 181,729	\$ 184,402
Commercial real estate investor	243	2,770	3,013	5,645	225,182	230,827
Residential real estate investor	0	2,505	2,505	1,210	208,204	209,414
Hotel/Motel	0	637	637	0	63,195	63,195
Wholesale & retail	0	909	909	7,912	95,128	103,040
Manufacturing	0	592	592	3,840	58,670	62,510
Agriculture	0	431	431	315	59,616	59,931
Other commercial	0	2,643	2,643	918	283,593	284,511
Total commercial related	243	13,875	14,118	22,513	1,175,317	1,197,830
Residential mortgage	0	108	108	247	79,078	79,325
Home equity	0	217	217	452	97,498	97,950
Other consumer	0	66	66	235	24,424	24,659
Total consumer related	0	391	391	934	201,000	201,934
Unallocated	0	2,180	2,180	—	—	—
Total	\$ 243	\$ 16,446	\$ 16,689	\$ 23,447	\$ 1,376,317	\$ 1,399,764
<b>December 31, 2016</b>						
Builder & developer	\$ 200	\$ 2,184	\$ 2,384	\$ 3,892	\$ 144,743	\$ 148,635
Commercial real estate investor	0	2,870	2,870	5,893	237,730	243,623
Residential real estate investor	136	2,381	2,517	1,703	181,920	183,623
Hotel/Motel	0	807	807	361	81,724	82,085

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Wholesale & retail	0	803	803	260	87,802	88,062
Manufacturing	0	307	307	613	32,003	32,616
Agriculture	263	356	619	929	50,919	51,848
Other commercial	82	2,385	2,467	1,144	241,728	242,872
Total commercial related	681	12,093	12,774	14,795	1,058,569	1,073,364
Residential mortgage	0	85	85	142	73,354	73,496
Home equity	0	179	179	244	93,978	94,222
Other consumer	0	193	193	172	29,517	29,689
Total consumer related	0	457	457	558	196,849	197,407
Unallocated	0	1,761	1,761	—	—	—
Total	\$ 681	\$ 14,311	\$ 14,992	\$ 15,353	\$ 1,255,418	\$ 1,270,771

## NOTE 6-Premises and Equipment

The following table presents a summary of premises and equipment as of December 31, 2018 and 2017.

(dollars in thousands)	2018	2017
Land	\$4,829	\$4,543
Buildings and improvements	26,172	25,371
Equipment	21,519	20,057
	52,520	49,971
Less accumulated depreciation/amortization	(27,796)	(25,589)
Premises and equipment, net	\$24,724	\$24,382

PeoplesBank leases certain banking branches under noncancellable operating leases. The terms include various renewal options and provide for rental increases based upon predetermined factors. Total lease expenses under operating leases amounted to \$841,000 in 2018, \$796,000 in 2017, and \$762,000 in 2016.

At December 31, 2018, future minimum lease payments for these leases are payable as follows:

(dollars in thousands)	Operating Leases
2019	\$ 814
2020	592
2021	460
2022	340
2023	334
Thereafter	283
Total future minimum lease payments	\$ 2,823

## NOTE 7-Deposits

The composition of deposits as of December 31, 2018 and 2017 is shown below.

(dollars in thousands)	December 31,	
	2018	2017
Noninterest bearing demand	\$252,777	\$246,866
Interest bearing demand	156,858	157,903

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Money market	535,454	447,425
Savings	85,415	86,292
Time deposits less than \$100	271,794	260,482
Time deposits \$100 to \$250	144,866	135,242
Time deposits \$250 or more	48,116	50,297
Total deposits	\$1,495,280	\$1,384,507

Included above in time deposits less than \$100,000 are brokered time deposits in the amount of \$10,299,000 and \$10,682,000 at December 31, 2018 and 2017, respectively. Included above in time deposits \$100,000 to \$250,000 are brokered time deposits in the amount of \$1,035,000 and \$1,633,000 at December 31, 2018 and 2017, respectively.

The deposits from members of the board of directors, executive officers, principal shareholders and any affiliates of such persons were \$4,162,000 at December 31, 2018 and \$4,319,000 at December 31, 2017.

The following table presents scheduled maturities of time deposits by year as of December 31, 2018.

(dollars in thousands)	2018
2019	\$187,087
2020	144,716
2021	93,433
2022	25,036
2023	13,950
Thereafter	554
Total time deposits	\$464,776

Demand deposit overdrafts reclassified as loans were \$116,000 and \$199,000 at December 31, 2018 and 2017, respectively.

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

The schedule below provides a summary of short-term borrowings that consist of securities sold under agreements to repurchase, federal funds purchased and other borrowings. Securities sold under agreements to repurchase are overnight borrowings between PeoplesBank and its commercial depositors and are subject to daily repricing. Federal Funds purchased from correspondent banks mature in one business day and reprice daily based on the Federal Funds rate. As of December 31, 2018, PeoplesBank's total availability under Federal Funds lines was \$13,000,000. Other short-term borrowings consist of credit available through the Federal Home Loan Bank of Pittsburgh (FHLBP). PeoplesBank maintains a line-of credit (Open Repo Plus) with the FHLBP which is a revolving term commitment used on an overnight basis. The term of this commitment may not exceed 364 days and it reprices daily at market rates. Under terms of a blanket collateral agreement with the FHLBP, the line-of-credit and long term advances are secured by FHLBP stock and qualifying real estate secured loans. As of December 31, 2018, PeoplesBank's total availability was \$409,978,250 with the FHLBP.

The Corporation maintains a \$3,000,000 line of credit with ACNB Bank to provide a source of liquidity. The line, renewable annually, is secured by a first lien on the Codorus Valley Corporate Center. The interest rate on the ACNB Bank line is Wall Street Journal Prime. No draws have been made on the line and on December 31, 2018 and 2017, the balance was zero.

The following table presents a summary of aggregate short-term borrowings as of and for the years ended December 31, 2018, 2017 and 2016.



(dollars in thousands)	2018			2017			2016					
	Repurchase agreements	Other Short-term borrowings		Repurchase agreements	Other Short-term borrowings		Repurchase agreements	Other Short-term borrowings				
Amount outstanding at end of year	\$7,022	\$ 0		\$10,295	\$ 10,200		\$23,637	\$ 33,000				
Weighted average interest rate at end of year	0.52	%	0	%	0.56	%	1.55	%	0.47	%	0.94	%
Maximum amount outstanding at any month-end	\$12,964	\$ 15,000		\$28,596	\$ 30,000		\$36,231	\$ 33,000				
Daily average amount outstanding	\$9,911	\$ 193		\$22,078	\$ 16,910		\$27,677	\$ 3,452				
Approximate weighted average interest rate for the year	0.56	%	1.86	%	0.56	%	1.14	%	0.50	%	0.66	%

Securities that serve as collateral for securities sold under agreements to repurchase and pledged to provide access to the Federal Reserve Bank Discount Window and other short-term borrowing remain in available-for-sale securities. The fair value of these securities was \$9,768,000 and \$16,542,000 on December 31, 2018 and 2017, respectively.

The following table presents a summary of long-term debt as of December 31, 2018 and 2017:

(dollars in thousands)	<b>December 31,</b>	
	<b>2018</b>	<b>2017</b>
PeoplesBank's obligations:		
FHLBP		
Due March 2018, 1.17%	0	10,000
Due June 2018, 1.87%	0	5,000
Due June 2018, 1.41%	0	10,000
Due November 2018, 1.62%	0	5,000
Due December 2018, 1.60%	0	15,000
Due April 2019, 1.64%	10,000	10,000
Due June 2019, 1.64%	5,000	5,000
Due June 2019, 2.10%	5,000	5,000
Due December 2019, 1.89%	15,000	15,000
Due March 2020, 1.86%	10,000	10,000
Due June 2020, 1.87%	15,000	15,000
Due June 2020, 2.70%	10,000	0
Due June 2021, 2.81%	10,000	0
Due June 2021, 2.14%	15,000	15,000
Due May 2022, 2.98%	10,000	0
Total FHLBP	105,000	120,000
Codorus Valley Bancorp, Inc. obligations:		
Junior subordinated debt		
Due 2034, 4.81%, floating rate based on 3 month LIBOR plus 2.02%, callable quarterly	3,093	3,093
Due 2036, 3.98% floating rate based on 3 month LIBOR plus 1.54%, callable quarterly	7,217	7,217
Total long-term debt	\$ 115,310	\$ 130,310

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

At December 31, 2018 and 2017, municipal deposit letters of credit issued by the FHLBP on behalf of PeoplesBank naming applicable municipalities as beneficiaries were \$42,000,000. The letters of credit took the place of securities pledged to the municipalities for their deposits maintained at PeoplesBank.

In June 2006, Codorus Valley formed CVB Statutory Trust No. 2, a wholly-owned special purpose subsidiary whose sole purpose was to facilitate a pooled trust preferred debt issuance of \$7,217,000. In November 2004, Codorus Valley formed CVB Statutory Trust No. 1 to facilitate a pooled trust preferred debt issuance of \$3,093,000. The Corporation owns all of the common stock of these nonbank subsidiaries, and the debentures are the sole assets of the Trusts. The

accounts of both Trusts are not consolidated for financial reporting purposes in accordance with FASB ASC 810. For regulatory capital purposes, all of the Corporation's trust preferred securities qualified as Tier 1 capital for all reported periods. Trust preferred securities are subject to capital limitations under the FDIC's risk-based capital guidelines. The Corporation used the net proceeds from these offerings to fund its operations.

The following table presents long-term debt maturities by year as of December 31, 2018.

(dollars in thousands)	2018
2019	\$35,000
2020	35,000
2021	25,000
2022	10,000
2034 - 2036	10,310
Total long-term debt	\$115,310

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

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

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

On July 2, 2013, the Board of Governors of the Federal Reserve System finalized its rule implementing the Basel III regulatory capital framework, which the FDIC adopted on July 9, 2013. Under the rule, minimum requirements increased both the quantity and quality of capital held by banking organizations. Consistent with the Basel III framework, the rule included a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5 percent, and a common equity Tier 1 conservation buffer of 2.5 percent of risk-weighted assets, that applies to all supervised financial institutions, which is to be phased in over a four year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019. The rule also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4 percent to 6 percent, and includes a minimum leverage ratio of 4 percent for all banking organizations. The new rule also increased the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors. The rule

for smaller, less complex institutions, including the Corporation, took effect January 1, 2015.

Quantitative measures established by regulators to ensure capital adequacy require the Corporation and PeoplesBank to maintain minimum ratios, as set forth below, to total and Tier 1 capital as a percentage of risk-weighted assets, and of Tier 1 capital to quarter-to-date average assets (leverage ratio). In December 2018, PeoplesBank received the most recent notification from the Federal Deposit Insurance Corporation, which categorized PeoplesBank as “well capitalized”, as of September 30, 2018, under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes would change PeoplesBank’s well capitalized category. As of December 31, 2017, PeoplesBank was also categorized as “well capitalized”.

(dollars in thousands)	Actual		Minimum for Capital Adequacy (1)		Well Capitalized Minimum (2)		
	Amount	Ratio	Amount	Ratio	Amount	Ratio	
<b>Codorus Valley Bancorp, Inc. (consolidated) at</b>							
December 31, 2018							
Capital ratios:							
Common Equity Tier 1	\$178,656	12.15 %	\$93,708	6.375 %	\$n/a	n/a	%
Tier 1 risk based	188,656	12.83	115,757	7.875	n/a	n/a	
Total risk based	207,040	14.08	145,155	9.875	n/a	n/a	
Leverage	188,656	10.46	72,119	4.00	n/a	n/a	
at December 31, 2017							
Capital ratios:							
Common Equity Tier 1	\$162,860	11.58 %	\$80,842	5.750 %	\$n/a	n/a	%
Tier 1 risk based	172,860	12.29	101,932	7.250	n/a	n/a	
Total risk based	189,549	13.48	130,051	9.250	n/a	n/a	
Leverage	172,860	10.26	67,382	4.00	n/a	n/a	
PeoplesBank, A Codorus Valley Company at							
December 31, 2018							
Capital ratios:							
Common Equity Tier 1	\$184,420	12.58 %	\$93,466	6.375 %	\$95,298	6.50 %	%
Tier 1 risk based	184,420	12.58	115,457	7.875	117,290	8.00	
Total risk based	202,757	13.83	144,780	9.875	146,613	10.00	
Leverage	184,420	10.25	71,968	4.00	89,960	5.00	
at December 31, 2017							
Capital ratios:							
Common Equity Tier 1	\$168,879	12.04 %	\$80,630	5.750 %	\$91,147	6.50 %	%
Tier 1 risk based	168,879	12.04	101,664	7.250	112,181	8.00	
Total risk based	185,568	13.23	129,709	9.250	140,226	10.00	
Leverage	168,879	10.05	67,234	4.00	84,043	5.00	

(1)

Minimum amounts and ratios as of December 31, 2018 include the third year phase in of the capital conservation buffer of 1.875 percent required by the Basel III framework. At December 31, 2017, the minimum amounts and ratios included the second year phase in of the capital conservation buffer of 1.25 percent required by the Basel III framework. The conservation buffer is to be phased in over a four year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019.

- (2) To be “well capitalized” under the prompt corrective action provisions in the Basel III framework. “Well capitalized” applies to PeoplesBank only.

## **NOTE 10-Shareholders' Equity**

### *Preferred Stock Issued under the US Treasury's Small Business Lending Fund Program*

The U.S. Department of the Treasury ("Treasury") had a capital investment in the Corporation pursuant to the Corporation's participation in the Treasury's Small Business Lending Funding Program ("SBLF Program"). In August 2011, the Corporation sold to the Treasury, for an aggregate purchase price of \$25,000,000, 25,000 shares of non-cumulative, perpetual preferred stock, Series B, \$1,000 liquidation value, \$2.50 par value. On May 30, 2014, the Corporation redeemed 13,000 of the 25,000 outstanding shares of the Corporation's preferred stock that had been issued to the Treasury, leaving 12,000 outstanding shares representing \$12,000,000 of preferred stock. On February 18, 2016, the Corporation redeemed the remaining \$12,000,000 of Series B preferred stock issued to the Treasury as reported on Form 8-K filed on February 19, 2016.

The annualized dividend rate on the preferred stock issued under the SBLF Program was 1 percent for the year ended December 31, 2015 and through the redemption date of February 18, 2016.

### *Authorized Shares*

At the May 15, 2018 annual shareholder meeting, the shareholders of the Corporation approved a change in the Articles of Incorporation to increase the number of authorized shares of common stock from 15,000,000 to 30,000,000.

### *Common Stock Dividend*

Periodically, the Corporation distributes stock dividends on its common stock. The Corporation distributed 5 percent common stock dividends on December 11, 2018 and December 12, 2017 which resulted in the issuance of 447,092 and 422,439 additional common shares, respectively. All share and per share amounts are adjusted for stock dividends that are declared prior to the issuance of the consolidated financial statements.

## **NOTE 11- Benefit Plans**



### **Defined Contribution Plan**

PeoplesBank maintains a 401(k) savings and investment plan covering substantially all employees. Under the plan, employees can contribute a percentage of their compensation subject to certain limits based on federal tax law. In 2018, 2017, and 2016, PeoplesBank made 100 percent matching contributions up to the first 4 percent of each employee's compensation contributed to the plan, and both the employee and employer contributions vest immediately. PeoplesBank's expense for the 401(k) savings and investment plan was \$590,000 for 2018, \$587,000 for 2017, and \$522,000 for 2016.

### **Supplemental Benefit Plans**

PeoplesBank maintains supplemental retirement plans for selected executives. The expense associated with these plans was approximately \$261,000 for 2018, \$256,000 for 2017 and \$255,000 for 2016. The accrued liability for the supplemental retirement plans was \$4,140,000 at December 31, 2018 and \$4,063,000 at December 31, 2017. Income earned from bank owned life insurance policies was used to finance the cost of supplemental benefit plans, and provide a tax-exempt return to PeoplesBank.

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

PeoplesBank recorded net expense of \$43,000 in 2018, \$39,000 in 2017 and \$104,000 in 2016, on bank owned life insurance policies with a post retirement split-dollar life insurance benefit. The accrued liability for the post retirement split-dollar benefit was \$444,000 at December 31, 2018 and \$401,000 at December 31, 2017.

**NOTE 12-Stock-Based Compensation**

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

The following table presents information about the Corporation's stock plans, adjusted for stock dividends distributed, as of December 31, 2018.

Plan	Types of grants	Number of shares reserved (1)	Number of awards outstanding (1)	Number of shares available for future issuance (1)
2007 Long Term Incentive Plan (07LTIP)	Stock options			
	Stock appreciation rights			
2007 Long Term Incentive Plan (07LTIP)	Restricted stock			
	Stock awards	178,492	178,492 (3)	(2)
2017 Long Term Incentive Plan (17LTIP)	Stock options			
	Stock appreciation rights			
2017 Long Term Incentive Plan (17LTIP)	Restricted stock			
	Stock awards	375,737	63,260 (4)	312,477
2007 Employee Stock Purchase Plan (ESPP)	Stock option	168,171	0	168,171
Employee Stock Bonus Plan (ESBP)	Stock awards	20,111	0	20,111

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

(2) Plan expired on May 15, 2017.

(3) Amount includes 6,991 of unvested options and 7,108 of unvested restricted stock.

(4) Amount includes 28,008 of unvested options and 30,206 of unvested restricted stock.

**2007 Long-Term Incentive Plan (07LTIP) and 2017 Long-Term Incentive Plan (17LTIP)**

Options awarded under these plans to date have been granted with an exercise price equal to the fair value of the stock on the grant date, a minimum vesting period of six months and an expiration period of ten years. Restricted awards are granted at fair value. 1,046 and 909 restricted shares granted in 2018 and 2017, respectively, vest 100% four years from the date of grant. All of the remaining restricted shares granted in 2018, 2017 and 2016 vest as follows: one-third at the end of the first year from the date of grant; one-third at the end of the second year from the date of grant; and one-third at the end of the third year from the date of grant. Restricted stock awards are participating securities but have no impact on basic EPS at December 31, 2018 and 2017. The plans also permit the granting of stock awards, which are unrestricted shares of common stock. Upon exercise and/or award, the Corporation has historically issued treasury stock, if available, and/or authorized, but unissued, common stock to satisfy the options/awards.

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

(dollars in thousands)	2018	2017	2016
Compensation expense	\$634	\$693	\$491
Tax benefit	(133)	(243)	(164)
Net income effect	\$501	\$450	\$327

The tax benefit shown in the preceding table is less than the benefit that would be calculated using the Corporation's 21%, 35% and 35% statutory Federal tax rate for 2018, 2017 and 2016, respectively. Under FASB ASC Topic 718, tax benefits are only recognized over the vesting period for options that ordinarily will generate a tax deduction when exercised (non-qualified stock options) and restricted stock awards.

The Corporation granted the following stock options, restricted stock and stock awards during the years ended December 31, 2018, 2017 and 2016, as adjusted for stock dividends.

	2018	2017	2016
Nonqualified stock options	17,924	17,085	23,949
Incentive stock options	0	0	0
Restricted stock	21,507	16,504	22,972
Stock award	7,766	9,065	0

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

	2018	2017	2016
Fair value	\$5.27	\$5.75	\$3.30
Expected life (in years)	5.5	5.3	4.5
Risk-free interest rate	2.75 %	2.19 %	1.57 %
Expected volatility	25.55 %	24.82 %	24.31 %
Expected dividend yield	2.14 %	1.86 %	2.42 %

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

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

	Weighted Average	Weighted Average	Aggregate
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	<b>Options</b>	<b>Exercise Price</b>	<b>Remaining Contractual Term</b>	<b>Intrinsic Value (\$000)</b>
Outstanding at January 1, 2018	239,297	\$ 14.00	6.0 years	\$ 3,239
Granted	17,924	23.88		
Exercised	(48,608 )	10.37		
Cancelled/Forfeited	(2,944 )	24.57		
Expired	(1,251 )	6.40		
Outstanding at December 31, 2018	204,418	\$ 15.62	5.9 years	\$ 1,293
Vested and exercisable at December 31, 2018	169,419	\$ 13.88	5.2 years	\$ 1,280

100

The following table presents information about stock options exercised for the years ended December 31, 2018, 2017 and 2016.

<i>(dollars in thousands)</i>	2018	2017	2016
Total intrinsic value of options exercised	\$499	\$142	\$338
Cash received from options exercised	\$505	\$195	\$364
Tax deduction realized from options exercised	\$105	\$50	\$113

The following table presents information about non-vested options and restricted stock, adjusted for stock dividends distributed, for the year ended December 31, 2018.

	<b>Stock Options</b>		<b>Restricted Stock</b>	
	<b>Options</b>	<b>Weighted Average Exercise Price Per Share</b>	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Non-vested at January 1, 2018	44,534	\$22.10	37,470	\$22.37
Vested	(24,515 )	20.33	(19,562)	20.66
Cancelled/Forfeited	(2,944 )	24.57	(2,101 )	24.09
Granted	17,924	23.88	21,507	24.58
Non-vested at December 31, 2018	34,999	\$24.04	37,314	\$24.45

As of December 31, 2018, total unrecognized compensation cost related to non-vested options and restricted stock was \$802,000, of which \$511,000 will be recognized in 2019, \$213,000 will be recognized in 2020, \$72,000 in 2021 and \$6,000 in 2022 with a weighted average recognition period of 1.1 years. The unrecognized compensation expense does not include an estimate for forfeiture of stock awards. The Corporation recognizes forfeitures in the period in which the forfeiture occurs.

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

Under the ESPP, eligible employees can purchase common stock of the Corporation at 85% of the fair market value of the stock at the beginning or end of the six-month offering period, whichever is lower. The ESPP is considered to be a compensatory plan. The following table presents information about the ESPP for the years ended December 31, 2018, 2017 and 2016.

	<b>2018</b>	<b>2017</b>	<b>2016</b>
ESPP shares purchased	10,607	10,732	9,897

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Average purchase price per share (85% of market value)	\$20.620	\$23.330	\$16.860
Compensation expense recognized (in thousands)	\$63	\$59	\$34
Shares issued from treasury stock to satisfy the purchase of ESPP shares	2,509	2,772	1,416
Shares issued from authorized but unissued common stock to satisfy the purchase of ESPP shares	8,044	7,960	8,481

**Employee Stock Bonus Plan (ESBP)**

The ESBP is administered by the Compensation Committee which is comprised of non-employee members of the Corporation's Board of Directors. Under the ESBP the Corporation may issue shares of its common stock to employees as performance based compensation. There were no shares of common stock issued under the ESBP in 2018, 2017 and 2016.

**NOTE 13-Income Taxes**

The following table presents the provision for income taxes for the years ended December 31, 2018, 2017 and 2016.

(dollars in thousands)	<b>2018</b>	<b>2017</b>	<b>2016</b>
Current tax provision			
Federal	\$4,648	\$6,151	\$6,221
State	568	466	686
Total current tax provision	5,216	6,617	6,907
Deferred tax expense (benefit)			
Federal	10	3,211	(838 )
State	(44 )	76	(183 )
Total deferred tax expense (benefit)	(34 )	3,287	(1,021)
Total tax provision	\$5,182	\$9,904	\$5,886

The differences between the effective income tax rate and the Federal statutory income tax rate for the years ended December 31, 2018, 2017 and 2016 are shown below.

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Statutory tax rate	21.0%	35.0%	35.0%
Increase (decrease) resulting from:			
Tax-exempt interest income	(1.2 )	(2.6 )	(3.6 )
Bank owned life insurance income	(0.8 )	(1.6 )	(1.6 )
State income taxes, net of federal tax benefit	2.0	1.6	1.7
Other, net	0.0	0.2	(0.5 )
Change in enacted tax rate	0.0	12.6	0.0
Effective income tax rate	21.0%	45.2%	31.0%

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law reducing the federal tax rate to 21 percent beginning on January 1, 2018. The revaluation of net deferred tax assets as of December 22, 2017 resulted in \$2,755,000 of additional tax expense on the date of enactment. The impact on the 2017 effective tax rate is shown in the table above.

Significant components of the Corporation's net deferred tax asset, included in other assets as of December 31, 2018 and 2017 are shown below.



(dollars in thousands)	<b>2018</b>	<b>2017</b>
Deferred tax assets		
Allowance for loan losses	\$4,508	\$3,954
Deferred compensation	1,138	1,135
Low-income housing partnerships	57	79
Acquisition accounting adjustments	106	115
Net unrealized losses on available-for-sale securities	592	255
Acquired net operating loss carryforwards	34	131
Other	92	32
Total deferred tax assets	\$6,527	\$5,701
Deferred tax liabilities		
Deferred loan fees	\$842	\$475
Depreciation	446	310
Other	221	201
Total deferred tax liabilities	\$1,509	\$986
Net deferred tax assets	\$5,018	\$4,715

Based on the level of historical income projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes that, as of December 31, 2018, it is more likely than not that the Corporation will realize the benefits of its deferred tax assets.

#### NOTE 14-Commitments

The Bank entered into an agreement of sale to purchase a 3-building complex in York County, Pennsylvania in the amount of \$970,000 on November 7, 2018. The transaction was settled on January 31, 2019.

In the normal course of business, the Corporation is a party to various financial transactions that are not funded as of the balance sheet date. Off-balance sheet financial instruments, which enable PeoplesBank clients to meet their financing needs, are comprised mainly of commitments to extend credit and standby letters of credit. Standby letters of credit are written conditional commitments issued by PeoplesBank to guarantee the performance of a client to a third party. The credit and market risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. To manage these risks, the Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments and requires collateral to support these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability as of December 31, 2018 and 2017, for guarantees under standby letters of credit issued was considered not material by management. Normally, commitments to extend credit and letters of credit have fixed expiration dates or termination clauses, have specific rates and are for specific purposes. Many of the commitments are expected to expire without being extended; therefore, total commitment amounts do not necessarily represent future cash requirements.

A summary of outstanding commitments at December 31, 2018 and 2017 is shown below.

(dollars in thousands)	2018	2017
Commitments to grant loans		
Fixed rate	\$22,995	\$57,727
Variable rate	15,027	29,838
Unfunded commitments of existing loans		
Fixed rate	\$45,481	\$63,327
Variable rate	335,029	334,080
Standby letters of credit	\$23,737	\$23,603

NOTE 15-Contingent Liabilities

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

NOTE 16-Fair Value Measurements and Fair Values of Financial Instruments

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

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date. GAAP establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that utilize model-based techniques for which all significant assumptions are observable in the market.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement; inputs to the valuation methodology that utilize model-based techniques for which significant assumptions are not observable in the market; or inputs to the valuation methodology that require significant management judgment or estimation, some of which may be internally developed.

Since management maximizes the use of observable inputs and minimizes the use of unobservable inputs when determining fair value, an asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Management reviews and updates the fair value hierarchy classifications on a quarterly basis.

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

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

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

received from the third-party pricing service by comparing it to price quotes from third-party brokers. Historically, price deviations have been immaterial.

(dollars in thousands)	Total	Fair Value Measurements		
		(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
December 31, 2018				
Securities available-for-sale:				
U.S. Treasury notes	\$19,003	\$19,003	\$0	\$0
U.S. agency	15,063	0	15,063	0
U.S. agency mortgage-backed, residential	74,555	0	74,555	0
State and municipal	40,972	0	40,972	0
December 31, 2017				
Securities available-for-sale:				
U.S. Treasury notes	\$14,071	\$14,071	\$0	\$0
U.S. agency	17,303	0	17,303	0
U.S. agency mortgage-backed, residential	75,175	0	75,175	0
State and municipal	52,042	0	52,042	0

#### Assets Measured at Fair Value on a Nonrecurring Basis

#### Impaired Loans

Impaired loans are those that are accounted for under FASB ASC Topic 310, in which the Corporation has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These loans are included as Level 3 fair values, based on the lowest level of input that is significant to the fair value measurements. At December 31, 2018, the fair value consists of impaired loan balances of \$13,297,000, net of valuation allowances of \$3,679,000 and charge-offs of \$134,000, compared to impaired loan balances of \$1,331,000, net of valuation allowances of \$243,000 and charge-offs of \$506,000, at December 31, 2017.

#### Foreclosed Real Estate

Other real estate property acquired through foreclosure is initially recorded at fair value of the property at the transfer date less estimated selling cost. Subsequently, other real estate owned is carried at the lower of its carrying value or the fair value less estimated selling cost. Fair value is usually determined based upon an independent third-party

appraisal of the property or occasionally upon a recent sales offer. At December 31, 2018 and 2017 there were no foreclosed real estate assets with a valuation allowance or write-down.

(dollars in thousands)	<b>Total</b>	<b>Fair Value Measurements</b>		
		<b>(Level 1) Quoted Prices in Active Markets for Identical Assets</b>	<b>(Level 2) Significant Other Observable Inputs</b>	<b>(Level 3) Significant Other Unobservable Inputs</b>
December 31, 2018				
Impaired loans	\$ 13,297	\$ 0	\$ 0	\$ 13,297
December 31, 2017				
Impaired loans	\$ 1,331	\$ 0	\$ 0	\$ 1,331

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

<b>Quantitative Information about Level 3 Fair Value Measurements</b>						
<i>(dollars in thousands)</i>	<b>Fair Value</b>	<b>Valuation</b>	<b>Unobservable</b>		<b>Weighted</b>	
	<b>Estimate</b>	<b>Techniques</b>	<b>Input</b>	<b>Range</b>	<b>Average</b>	
<b>December 31, 2018</b>						
Impaired loans	\$5,257	Appraisal (1)	Appraisal adjustments (2)	15% - 50%	39	%
Impaired loans	8,040	Business asset valuation (3)	Business asset valuation adjustments (4)	10% - 53%	51	%
<b>December 31, 2017</b>						
Impaired loans	\$1,331	Appraisal (1)	Appraisal adjustments (2)	24% - 52%	38	%

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

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

(3) Fair value is generally determined through customer-provided financial statements.

Business asset valuations may be adjusted downward by the Corporation's management for qualitative factors such as (4) economic conditions, and estimated liquidation expenses. The range of liquidation expenses and other adjustments are presented as a percent of the financial statement book value.



The following presents the carrying amount and estimated fair value of the Corporation's financial instruments as of December 31, 2018 and 2017.

	Carrying	Estimated	Fair Value Estimates		
			(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
(dollars in thousands)	Amount	Fair Value			
December 31, 2018					
Financial assets					
Cash and cash equivalents	\$96,782	\$96,782	\$96,782	\$0	\$0
Securities available-for-sale	149,593	149,593	19,003	130,590	0
Restricted investment in bank stocks	5,922	5,922	0	5,922	0
Loans held for sale	4,127	4,302	0	4,302	0
Loans, net	1,466,536	1,437,415	0	0	1,437,415
Interest receivable	5,552	5,552	0	5,552	0
Mortgage servicing rights	925	1,052	0	0	1,052
Financial liabilities					
Deposits	\$1,495,280	\$1,479,997	\$0	\$1,479,997	\$0
Short-term borrowings	7,022	7,022	0	7,022	0
Long-term debt	115,310	112,406	0	104,332	8,074
Interest payable	836	836	0	836	0
Off-balance sheet instruments	0	0	0	0	0
December 31, 2017					
Financial assets					
Cash and cash equivalents	\$79,524	\$79,524	\$79,524	\$0	\$0
Securities available-for-sale	158,591	158,591	14,071	144,520	0
Restricted investment in bank stocks	6,311	6,311	0	6,311	0
Loans held for sale	1,715	1,798	0	1,798	0
Loans, net	1,383,075	1,368,753	0	0	1,368,753
Interest receivable	4,968	4,968	0	4,968	0
Mortgage servicing rights	672	769	0	0	769
Financial liabilities					
Deposits	\$1,384,507	\$1,369,008	\$0	\$1,369,008	\$0
Short-term borrowings	20,495	20,495	0	20,495	0
Long-term debt	130,310	127,586	0	119,474	8,112
Interest payable	626	626	0	626	0

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

PeoplesBank enters into agreements with clients in which it sells securities subject to an obligation to repurchase the same securities (“repurchase agreements”). The contractual maturity of the repurchase agreement is overnight and continues until either party terminates the agreement. These repurchase agreements are accounted for as a collateralized financing arrangement (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability (short-term borrowings) in the Corporation’s consolidated financial statements of condition, while the securities underlying the repurchase agreements are appropriately segregated for safekeeping purposes and remain in the respective securities asset accounts.

	<b>Gross</b>	<b>Gross</b>	<b>Net Amounts</b>	<b>Gross amounts Not Offset in</b>			<b>Net</b>
				<b>Amounts</b>	<b>of Liabilities</b>	<b>the Statements of Condition</b>	
	<b>Amounts of</b>	<b>Offset in</b>	<b>Presented in</b>	<b>U.S Agency</b>	<b>Cash</b>		
	<b>Recognized</b>	<b>the</b>	<b>the Statements</b>	<b>mortgage-backed,</b>	<b>Collateral</b>		
(dollars in thousands)	<b>Liabilities</b>	<b>Statements</b>	<b>of Condition</b>	<b>residential</b>	<b>U.S. agency</b>	<b>Pledged</b>	<b>Amount</b>
		<b>of</b>					
December 31, 2018		<b>Condition</b>					
Repurchase Agreements	\$ 7,022		\$7,022	\$ (8,981 )	\$ 0	\$ 0	\$(1,959 )
December 31, 2017							
Repurchase Agreements	\$ 10,295		\$10,295	\$ (15,545 )	\$ 0	\$ 0	\$(5,250 )

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

## Condensed Balance Sheets

(dollars in thousands)	December 31,	
	2018	2017
Assets		
Cash and due from banks	\$770	\$515
Investment in bank subsidiary	184,511	170,238
Investment in other subsidiaries	314	314
Premises and equipment, net	3,199	3,249
Other assets	510	635
Total assets	\$189,304	\$174,951
Liabilities		
Long-term debt	\$10,310	\$10,310
Long-term debt with bank subsidiary	169	363
Other liabilities	79	59
Total liabilities	10,558	10,732
Shareholders' equity	178,746	164,219
Total liabilities and shareholders' equity	\$189,304	\$174,951

## Condensed Statements of Income and Comprehensive Income

(dollars in thousands)	Years ended December 31,		
	2018	2017	2016
Income			
Interest from investment securities	\$12	\$9	\$7
Dividends from bank subsidiary	4,650	3,580	2,801
Total income	4,662	3,589	2,808
Expense			
Interest expense on long-term debt	415	320	275
Occupancy of premises, net	157	140	174
Other	414	419	463
Total expense	986	879	912
Income before applicable income tax benefit and undistributed earnings of subsidiaries	3,676	2,710	1,896
Applicable income tax benefit	326	416	445
Income before undistributed earnings of subsidiaries	4,002	3,126	2,341
Equity in undistributed earnings of bank subsidiary	15,540	8,878	10,761
Net income	\$19,542	\$12,004	\$13,102
Preferred stock dividends	0	0	16
Net income available to common shareholders	\$19,542	\$12,004	\$13,086
Comprehensive income	\$18,274	\$12,337	\$10,610



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

## Condensed Statements of Cash Flows

(dollars in thousands)	Years ended December 31,		
	2018	2017	2016
Cash flows from operating activities			
Net income	\$19,542	\$12,004	\$13,102
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation	197	202	208
Equity in undistributed earnings of subsidiaries, net	(15,540)	(8,878 )	(10,761)
Other, net	840	730	435
Net cash provided by operating activities	5,039	4,058	2,984
Cash flows from investing activities			
Return of investment in other subsidiary	0	3	0
Purchases of premises and equipment	(146 )	0	(12 )
Net cash (used in) provided by investing activities	(146 )	3	(12 )
Cash flows from financing activities			
Repayments of long-term debt	(194 )	(186 )	(179 )
Cash dividends paid to preferred shareholders	0	0	(46 )
Cash dividends paid to common shareholders	(5,539 )	(4,559 )	(4,144 )
Redemption of preferred stock	0	0	(12,000)
Net issuance of common stock	1,114	751	853
Cash paid in lieu of fractional shares	(19 )	(19 )	(12 )
Net cash used in financing activities	(4,638 )	(4,013 )	(15,528)
Net increase (decrease) in cash and cash equivalents	255	48	(12,556)
Cash and cash equivalents at beginning of year	515	467	13,023
Cash and cash equivalents at end of year	\$770	\$515	\$467

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

A summary of the quarterly results of operations for the years ended December 31, 2018 and 2017 is shown below. Management identified impaired credits during the third quarter of 2017 where a \$1,473,000 net charge-off was recognized. An additional relationship was identified during the third quarter of 2018 where a \$1,296,000 specific loan loss reserve was established. The identifications resulted in increased provision for loan losses in the applicable quarters.

(dollars in thousands, except per share data)	2018 Quarter				2017 Quarter			
	Fourth	Third	Second	First	Fourth	Third	Second	First
Interest income	\$21,098	\$20,796	\$19,834	\$18,593	\$18,552	\$18,063	\$17,295	\$16,505
Interest expense	5,034	4,364	3,755	3,248	2,985	2,771	2,667	2,445
Net interest income	16,064	16,432	16,079	15,345	15,567	15,292	14,628	14,060
Provision for loan losses	900	1,300	300	200	600	2,100	825	650
Noninterest income	2,972	2,872	2,985	2,774	2,577	2,542	2,498	2,392
Net gain on sales of loans held for sale	275	435	558	443	611	252	282	289
Noninterest expense	12,928	12,002	11,623	13,257	11,770	10,986	11,167	11,063
Income before taxes and securities gain	5,483	6,437	7,699	5,105	6,385	5,000	5,416	5,028
Net gain on sales of securities	0	0	0	0	0	16	63	0
Income before income taxes	5,483	6,437	7,699	5,105	6,385	5,016	5,479	5,028
Provision for income taxes	1,138	1,377	1,645	1,022	4,895	1,606	1,794	1,609
Net income	4,345	5,060	6,054	4,083	1,490	3,410	3,685	3,419
Net income available to common shareholders	\$4,345	\$5,060	\$6,054	\$4,083	\$1,490	\$3,410	\$3,685	\$3,419
Net income per common share, basic (1)	\$0.46	\$0.53	\$0.65	\$0.44	\$0.16	\$0.37	\$0.40	\$0.37
Net income per common share, diluted (1)	\$0.46	\$0.53	\$0.64	\$0.43	\$0.16	\$0.36	\$0.39	\$0.36

(1) adjusted for common stock dividends distributed.

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

None.

Item 9A: Controls and Procedures

The Corporation maintains controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based upon their evaluation of those controls and procedures required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Exchange Act performed as of December 31, 2018, the Chief Executive and Chief Financial Officers of the Corporation concluded that the Corporation's disclosure controls and procedures were effective. There was no change in the Corporation's internal control over financial reporting that occurred during the quarter ended December 31, 2018 that materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting. A Report of Management's Assessment of Internal Control Over Financial Reporting is located on page 60 of this Annual Report, and incorporated herein by reference.

The Chief Executive and Chief Financial Officers are not aware of any changes in internal controls over financial reporting or in other factors that has materially affected these controls subsequent to December 31, 2018, the date of their evaluation.

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Item 9B: Other information

None.

**PART III**

Item 10: Directors, executive officers and corporate governance

Information appearing in the Proxy Statement relating to the 2019 Annual Meeting of Shareholders to be held May 21, 2019 (“Proxy Statement”), under the heading, “Proposal 1-Election of Directors” and the caption “Information about Nominees and Continuing Directors,” under the heading “Information Concerning Security Ownership” and the caption “Executive Officers,” and under the heading “Governance of the Corporation” is incorporated by reference in response to this item.

The Corporation has adopted a Code of Business Conduct and Ethics (“Code of Ethics”) as defined in Item 406 of Regulation S-K. The Code of Ethics is filed herewith as Exhibit 14. The Code of Ethics is also accessible on PeoplesBank’s website at [www.peoplesbanknet.com](http://www.peoplesbanknet.com). Select “Investor Relations” at the bottom of the page and then select “Governance Documents”.

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

**Item 11: Executive compensation**

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

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

Information appearing on page 27 of this report under the caption “Securities Authorized for Issuance under Equity Compensation Plans” and in the Proxy Statement, under the caption “Information Concerning Security Ownership” is incorporated by reference in response to this item.

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

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

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

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

PART IV

Item 15: Exhibits and financial statement schedules

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

1. Financial Statements

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

Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income

Consolidated Statements of Cash Flows

Consolidated Statements of Changes in Shareholders' Equity

Notes to Consolidated Financial Statements

2. Financial Statement Schedules

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

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

See Exhibit Index.



## Signatures

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

Codorus Valley Bancorp, Inc. (Registrant)

/s/ Larry J. Miller

Larry J. Miller,      Date: March 15, 2019  
Chairman,  
President and  
Chief Executive  
Officer

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

### Signature and Capacity

/s/ Larry J. Miller Larry J. Miller (Principal Executive Officer)	President, Chief Executive Officer, 3/15/19 Chairman of the Board of Directors and Director	
/s/ Harry R. Swift Harry R. Swift, Esq.	Vice-Chairman of the Board of Directors and Lead Director	3/15/19
/s/ Brian D. Brunner Brian D. Brunner	Director	3/15/19
/s/ Cynthia A. Dotzel Cynthia A. Dotzel, CPA	Director	3/15/19
/s/ John W. Giambalvo John W. Giambalvo, Esq.	Director	3/15/19

/s/ Jeffrey R. Hines Jeffrey R. Hines, P.E.	Director	3/15/19
/s/ MacGregor S. Jones MacGregor S. Jones	Director	3/15/19
/s/ Dallas L. Smith Dallas L. Smith	Director	3/15/19
/s/ Larry D. Pickett Larry D. Pickett, CPA (Principal Financial and Accounting Officer)	Treasurer	3/15/19

**Exhibit Index**

Exhibit

Number Description of Exhibit

3.1 Amended Articles of Incorporation (Incorporated by reference to Exhibit 3.1 of the Quarterly Report on Form 10-Q for June 30, 2018, filed with the Commission on August 6, 2018)

3.2 Amended By-laws (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 12, 2016)

10.1 Employment Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Larry J. Miller, dated December 27, 2005 and amendment dated August 9, 2011(Incorporated by reference to Exhibit 10.1 of the Registrant's Annual Report on Form 10-K for December 31, 2015, filed with the Commission on March 8, 2016) and second amendment dated March 8, 2016

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

10.2 Change of Control Agreement by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Larry D. Pickett, dated August 9, 2018 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on August 9, 2018)\*

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

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

10.5 Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Larry J.



Miller dated October 1, 1998 (Incorporated by reference to Exhibit 10.6 of the Registrant's Annual Report on Form 10-K for December 31, 2014, filed with the Commission on March 10, 2015)

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

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

10.8 Amendment to Salary Continuation Agreement between PeoplesBank, A Codorus Valley Company and Larry J. Miller dated December

27, 2005 (Incorporated  
by reference to Exhibit  
10.9 of the Registrant's  
Annual Report on  
Form 10-K for  
December 31, 2014,  
filed with the  
Commission on March  
10, 2015) \*

Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Harry R. Swift  
dated December  
27, 2005

10.9 (Incorporated by  
reference to  
Exhibit 10.10 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)

\*  
-

Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Jann Allen  
Weaver dated  
December 27,  
2005

10.10 (Incorporated by  
reference to  
Exhibit 10.11 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)

\*  
-

Second  
Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Larry J. Miller  
dated December  
23, 2008  
10.11 (Incorporated by  
reference to  
Exhibit 10.12 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)  
\*

Second  
Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Harry R. Swift  
dated December  
23, 2008  
10.12 (Incorporated by  
reference to  
Exhibit 10.13 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)  
\*

Second  
Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Jann Allen  
Weaver dated  
December 23,

10.13 2008

(Incorporated by  
reference to  
Exhibit 10.14 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)

\*  
-

Third  
Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Larry J. Miller

10.14 dated May 10,  
2016

(Incorporated by  
reference to  
Exhibit 10.1 of  
the Registrant's  
Annual Report  
on Form 8-K  
filed with the  
Commission on  
May 16, 2016) \*

10.15 Form of Group  
Term  
Replacement

Plan, dated  
January 1, 2009  
pertaining to  
senior officers of  
the Corporation's  
subsidiary,  
PeoplesBank, A  
Codorus Valley  
Company  
(Incorporated by  
reference to  
Exhibit 10.16 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)  
\*

Form of Director  
Group Term  
Replacement  
Plan, dated  
December 1,  
1998, including  
Split Dollar  
Policy  
Endorsements  
pertaining to  
non-employee  
directors of the  
Corporation's  
subsidiary,

10.16 PeoplesBank, A  
Codorus Valley  
Company  
(Incorporated by  
reference to  
Exhibit 10.16 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2014, filed  
with the  
Commission on  
March 10, 2015)  
\*

Long-Term  
Nursing Care  
Agreement  
between  
Codus Valley  
Bancorp, Inc.,  
PeoplesBank, A  
Codus Valley  
Company and  
Larry J. Miller,  
dated December  
27, 2005  
10.17 (Incorporated by  
reference to  
Exhibit 10.16 of  
the Registrant's  
Annual Report  
on Form 10-K  
for December  
31, 2015, filed  
with the  
Commission on  
March 8, 2016)  
\*

10.18 Codus Valley  
Bancorp, Inc.  
Change in  
Control and  
Supplemental  
Benefit Trust  
Agreement  
between  
Codus Valley  
Bancorp, Inc.,  
PeoplesBank, A  
Codus Valley  
Company and  
Hershey Trust  
Company, dated  
January 25, 2006  
and Resignation  
and  
Appointment of  
Trustee  
(Incorporated by  
reference to  
Exhibit 10.17 of  
the Registrant's  
Annual Report

on Form 10-K  
for December  
31, 2015, filed  
with the  
Commission on  
March 8, 2016)  
\*



Amended and Restated Declaration of Trust of CVB Statutory Trust No. 2, dated as of June 28, 2006, among Codorus Valley Bancorp, Inc., as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on June 30, 2006)

10.20 Indenture, dated as of June 28, 2006, between Codorus Valley Bancorp, Inc., as issuer, and the trustee named therein, relating to the Junior Subordinated Debt Securities due 2036 (Incorporated by reference to

Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the Commission on June 30, 2006)

Guarantee Agreement, dated as of June 28, 2006, between Codorus Valley Bancorp, Inc. and guarantee trustee named

10.21 therein (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed with the Commission on June 30, 2006)

2007 Long-Term Incentive Plan of Codorus Valley Bancorp, Inc. (Incorporated

10.22 by reference to Exhibit A of the Registrant's definitive proxy statement, dated April 6, 2012) \*

10.23 2007 Employee Stock Purchase Plan

(Incorporated  
by reference to  
Exhibit B of  
the Registrant's  
definitive  
proxy  
statement,  
dated April 6,  
2012) \*

10.24 Executive  
Incentive Plan –  
filed herewith  
\*  
–

Form of  
Change of  
Control  
Agreement  
dated June 23,  
2016 by and  
among  
Codorus  
Valley  
Bancorp, Inc.,  
PeoplesBank,  
A Codorus  
Valley

10.25 Company and  
each of Diane  
E. Baker and  
Amy L. Doll  
(Incorporated  
by reference to  
Exhibit 10.1 to  
the Registrant's  
Current Report  
on Form 8-K,  
filed with the  
Commission  
on June 28,  
2016)

10.26 Employment  
Agreement of  
A. Dwight Utz  
dated  
September 17,  
2015  
(Incorporated  
by reference to

Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 22, 2015) \*

First Amendment to Employment Agreement of A. Dwight Utz dated April 14, 2016

10.27 (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on April 15, 2016) \*

Employment Agreement by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Craig L.

10.28 Kauffman, dated August 6, 2018 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on August 16, 2018)\*

Change of  
Control  
Agreement by  
and among  
Codorus  
Valley  
Bancorp, Inc.,  
PeoplesBank,  
A Codorus  
Valley  
Company and  
Matthew A.  
Clemens,  
dated July 14,  
2016  
(Incorporated  
by reference to  
Exhibit 10.29  
to the  
Registrant's  
Current Report  
on Form 10-K,  
filed with the  
Commission  
on March, 15,  
2017) \*

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Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Matthew A.  
Clemens, dated  
October 1, 2002  
10.30 (Incorporated by  
reference to  
Exhibit 10.30 to  
the Registrant's  
Current Report  
on Form 10-K,  
filed with the  
Commission on  
March 15, 2017)  
\*

Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Matthew A.  
Clemens, dated  
December 27,  
10.31 2005  
(Incorporated by  
reference to  
Exhibit 10.31 to  
the Registrant's  
Current Report  
on Form 10-K,  
filed with the  
Commission on  
March 15, 2017)  
\*

10.32 Second  
Amendment to  
Salary  
Continuation

Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Matthew A.  
Clemens, dated  
December 23,  
2008  
(Incorporated by  
reference to  
Exhibit 10.32 to  
the Registrant's  
Current Report  
on Form 10-K,  
filed with the  
Commission on  
March 15, 2017)

\*

Third  
Amendment to  
Salary  
Continuation  
Agreement  
between  
PeoplesBank, A  
Codorus Valley  
Company and  
Matthew A.  
Clemens, dated  
10.33 March 11, 2014  
(Incorporated by  
reference to  
Exhibit 10.33 to  
the Registrant's  
Current Report  
on Form 10-K,  
filed with the  
Commission on  
March 15, 2017)

\*

10.34 2017 Long  
Term Incentive  
Plan  
(Incorporated by  
reference to  
Exhibit 10.1 of  
Registration  
Statement No.

333-218031 on  
Form S-8, filed  
with the  
Commission on  
May 16, 2017) \*

Change of  
Control  
Agreement by  
and among  
Codus Valley  
Bancorp, Inc.,  
PeoplesBank, A  
Codus Valley  
Company and  
Timothy J.

10.35 Nieman, dated  
February 5,  
2018  
(Incorporated by  
reference to  
Exhibit 10.35 to  
the Registrant's  
Current Report  
on Form 10-K,  
filed with the  
Commission on  
March 13, 2018)  
\*

14 Code of Ethics –  
filed herewith.

21 List of  
subsidiaries of  
Codus Valley  
Bancorp, Inc. –  
filed herewith.

23 Consents of  
Independent  
Registered  
Public  
Accounting  
Firm – filed  
herewith.

24 Power of  
Attorney – filed  
herewith.



31.1 Certification of  
Principal  
Executive  
Officer Pursuant  
to Section 302  
of the  
Sarbanes-Oxley  
Act of 2002 –  
filed herewith

31.2 Certification of  
Principal  
Financial  
Officer Pursuant  
to Section 302  
of the  
Sarbanes-Oxley  
Act of 2002 –  
filed herewith

32 Certification of  
Principal  
Executive  
Officer and  
Principal  
Financial  
Officer Pursuant  
to Section 906  
of the  
Sarbanes-Oxley  
Act of 2002 –  
filed herewith

101 Interactive data file containing the following financial statements of Codorus Valley Bancorp, Inc. formatted in XBRL: (i) Consolidated Balance Sheets at December 31, 2018 and 2017, (ii) Consolidated Statements of Income for the years ended December 31, 2018, 2017, and 2016, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017, and 2016, (iv) Consolidated Statements of Cash Flow for the years ended December 31, 2018, 2017, and 2016, (v) Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2018, 2017, and 2016 and (vi) Notes to Consolidated Financial

Statements – filed  
herewith.

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

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