CODORUS VALLEY BANCORP INC
Form 10-Q
November 14, 2008

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

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2008
or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________
Commission file number: 0-15536
CODORUS VALLEY BANCORP, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2428543
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
105 Leader Heights Road, P.O. Box 2887, York, Pennsylvania	17405
(Address of principal executive offices)	(Zip code)

717-747-1519
(Registrant s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since the last report.)

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. On November 6, 2008, 3,997,000 shares of common stock, par value $2.50, were outstanding.

Codorus Valley Bancorp, Inc.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Codorus Valley Bancorp, Inc.
Consolidated Balance Sheets
Unaudited

(dollars in thousands, except per share data)	September 30, 2008	December 31, 2007
Assets		
Interest bearing deposits with banks	$ 118	$ 118
Cash and due from banks	9,803	13,946
Federal funds sold	0	24,989
Total cash and cash equivalents	9,921	39,053
Securities available-for-sale	75,504	80,921
Securities held-to-maturity (fair value $2,315 for 2008 and $3,624 for 2007)	2,432	3,448
Loans held for sale	7,531	1,778
Loans (net of deferred fees of $499 in 2008 and $315 in 2007)	527,749	445,719
Less-allowance for loan losses	(4,359)	(3,434)
Net loans	523,390	442,285
Premises and equipment, net	11,632	10,252
Other assets	19,279	16,870
Total assets	$ 649,689	$ 594,607
Liabilities		
Deposits		
Noninterest bearing	$ 51,409	$ 46,719
Interest bearing	501,482	465,249
Total deposits	552,891	511,968
Short-term borrowings	12,400	0
Long-term debt	19,481	20,350
Junior subordinated debentures	10,310	10,310
Other liabilities	4,038	3,564
Total liabilities	599,120	546,192
Shareholders equity		
Preferred stock, par value $2.50 per share; 1,000,000 shares authorized; 0 shares issued and outstanding	0	0
Common stock, par value $2.50 per share; 10,000,000 shares authorized; 3,997,000 shares issued and outstanding on 9/30/08 and 3,738,950 on 12/31/07	9,993	9,347
Additional paid-in capital	35,763	32,516
Retained earnings	4,696	6,267
Accumulated other comprehensive income	117	285

Total shareholders equity	50,569	48,415
Total liabilities and shareholders equity	$ 649,689	$ 594,607

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands, except per share data)	2008	2007	2008	2007
Interest income				
Loans, including fees	$ 8,215	$ 8,778	$ 24,286	$ 25,221
Investment securities				
Taxable	569	639	1,823	2,002
Tax-exempt	315	307	949	895
Dividends	18	33	49	121
Federal funds sold	48	332	330	890
Other	0	1	2	5
Total interest income	9,165	10,090	27,439	29,134
Interest expense				
Deposits	3,674	4,205	10,712	12,406
Federal funds purchased and other short-term borrowings	33	0	34	0
Long-term debt	324	536	1,016	1,664
Total interest expense	4,031	4,741	11,762	14,070
Net interest income	5,134	5,349	15,677	15,064
Provision for (recovery of) loan losses	353	(35)	1,413	(919)
Net interest income after provision for loan losses	4,781	5,384	14,264	15,983
Noninterest income				
Trust and investment services fees	307	317	983	945
Service charges on deposit accounts	592	499	1,675	1,436
Income from mutual fund, annuity and insurance sales	390	410	1,374	1,092
Income from bank owned life insurance	73	71	208	204
Other income	121	102	367	324
Gain on sales of mortgages	135	51	303	208
Gain (loss) on sales of securities	0	0	123	(7)
Total noninterest income	1,618	1,450	5,033	4,202
Noninterest expense				
Personnel	2,744	2,741	8,277	7,845
Occupancy of premises, net	367	314	1,144	1,005
Furniture and equipment	349	347	1,067	1,032
Postage, stationery and supplies	117	101	352	341
Professional and legal	85	105	239	235
Marketing and advertising	249	247	531	474
Other	1,012	807	2,951	2,486

Total noninterest expense	4,923	4,662	14,561	13,418
Income before income taxes	1,476	2,172	4,736	6,767
Provision for income taxes	346	531	1,112	1,730
Net income	$ 1,130	$ 1,641	$ 3,624	$ 5,037
Net income per share, basic	$ 0.28	$ 0.42	$ 0.92	$ 1.30
Net income per share, diluted	$ 0.28	$ 0.41	$ 0.91	$ 1.27

See accompanying notes.

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

	Nine months ended September 30,	
(dollars in thousands)	2008	2007
Cash flows from operating activities		
Net income	$ 3,624	$ 5,037
Adjustments to reconcile net income to net cash provided (used in) operations		
Depreciation	880	853
Provision for (recovery of) loan losses	1,413	(919)
Amortization of investment in real estate partnership	392	378
Increase in cash surrender value of life insurance investment	(208)	(204)
Originations of held for sale mortgages	(29,376)	(13,797)
Proceeds from sales of held for sale mortgages	23,926	15,056
Gain on sales of held for sale mortgages	(303)	(208)
(Gain) loss on sales of securities	(123)	7
Loss on sales of foreclosed real estate	0	2
Stock-based compensation expense	40	36
(Increase) decrease in accrued interest receivable and other assets	(857)	75
(Decrease) increase in accrued interest payable and other liabilities	(226)	161
Other, net	(181)	95
Net cash provided by (used in) operating activities	(999)	6,572
Cash flows from investing activities		
Securities available-for-sale		
Purchases	(16,016)	(19,847)
Maturities and calls	15,665	11,028
Sales	6,639	961
Net (increase) decrease in FHLB and ACBB stock	(980)	70
Securities, held-to-maturity, calls	1,036	4,172
Net increase in loans made to customers	(84,009)	(35,861)
Purchases of premises and equipment	(2,276)	(570)
Investment in life insurance	(7)	(7)
Proceeds from sales of foreclosed real estate	0	167
Net cash used in investing activities	(79,948)	(39,887)
Cash flows from financing activities		
Net (decrease) increase in demand and savings deposits	(25,000)	12,997
Net increase in time deposits	65,923	28,650
Net increase in short-term borrowings	12,400	0
Repayment of long-term debt	(869)	(4,395)
Dividends paid	(1,526)	(1,445)
Issuance of common stock	915	329
Purchase of treasury stock	(127)	0
Reissuance of treasury stock	104	0
Cash paid in lieu of fractional shares	(5)	(6)

Net cash provided by financing activities		51,815		36,130
Net (decrease) increase in cash and cash equivalents		(29,132)		2,815
Cash and cash equivalents at beginning of year		39,053		35,372
Cash and cash equivalents at end of period	$	9,921	$	38,187

See accompanying notes.

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

(dollars in thousands, except share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
For the nine months ended September 30, 2008						
Balance, December 31, 2007	$ 9,347	$ 32,516	$ 6,267	$ 285	$ 0	$ 48,415
Cumulative effect adjustment for adoption of EITF Issue No. 06-04			(703)			(703)
Comprehensive income:						
Net income			3,624			3,624
Other comprehensive loss, net of tax:						
Unrealized losses on securities, net				(168)		(168)
Total comprehensive income						3,456
Cash dividends ($.386 per share, adjusted)			(1,526)			(1,526)
5% stock dividend 187,363 shares at fair value	469	2,492	(2,966)			(5)
Purchase of 8,002 shares for treasury					(127)	(127)
Stock-based compensation		40				40
Issuance of common stock						
62,710 shares under stock option plan	157	661				818
7,997 shares under the dividend reinvestment and stock purchase plan	20	77				97
Re-issuance of 8,002 shares under Employee Stock Purchase Plan		(23)			127	104
Balance, September 30, 2008	$ 9,993	$ 35,763	$ 4,696	$ 117	$ 0	$ 50,569
For the nine months ended September 30, 2007						
Balance, December 31, 2006	$ 8,757	$ 28,839	$ 5,434	$ (244)	$ 0	$ 42,786
Comprehensive income:						
Net income			5,037			5,037
Other comprehensive income, net of tax:						
Unrealized gains on securities, net				177		177
Total comprehensive income						5,214

Cash dividends ($.374 per share, adjusted)			(1,445)			(1,445)
5% stock dividend 175,148 shares at fair value	438	2,942	(3,386)			(6)
Stock-based compensation		36				36
Issuance of common stock 22,995 shares under stock option plan	57	272				329
Balance, September 30, 2007	$ 9,252	$ 32,089	$ 5,640	$ (67)	$ 0	$ 46,914

See accompanying notes.

Notes to Consolidated Financial Statements

Note 1 Basis of Presentation

The interim unaudited financial statements reflect all adjustments that are, in the opinion of management, necessary to present fairly the financial condition and results of operations for the reported periods, and are of a normal and recurring nature. The December 31, 2007 balance sheet was derived from the audited financial statements.

These statements should be read in conjunction with the notes to the audited financial statements contained in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2007.

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

The results of operations for the nine-month period ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year.

Note 2 Significant Accounting Policies

Stock dividend and per share computations

All per share computations include the effect of stock dividends distributed through September 30, 2008. The weighted average number of shares of common stock outstanding used for basic and diluted calculations are provided below. Excluded from the calculation were 85,000 anti-dilutive options for the three and nine months ended September 30, 2008, respectively, and 0 anti-dilutive options for the three and nine months ended September 30, 2007.

	Three months ended September 30,		Nine months ended September 30,	
(in thousands, except per share data)	2008	2007	2008	2007
Net income	$ 1,130	$ 1,641	$ 3,624	$ 5,037
Weighted average shares outstanding (basic)	3,986	3,875	3,953	3,868
Effect of dilutive stock options	16	88	35	93
Weighted average shares outstanding (diluted)	4,002	3,963	3,988	3,961
Basic earnings per share	$ .28	$ .42	$ .92	$ 1.30
Diluted earnings per share	$ .28	$ .41	$ .91	$ 1.27

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Comprehensive income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income (loss) and related tax effects are presented in the following table:

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	2008	2007	2008	2007
Unrealized holding gains (losses) arising during the period	$ 326	$ 1,016	$ (132)	$ 261
Reclassification adjustment for (gains) losses included in income	0	0	(123)	7
Net unrealized gains (losses)	326	1,016	(255)	268
Tax effect	(111)	(345)	87	(91)
Net of tax amount	$ 215	$ 671	$ (168)	$ 177

Cash Flow Information

For purposes of the statements of cash flows, the Corporation considers interest bearing deposits with banks, cash and due from banks, and federal funds sold to be cash and cash equivalents. Noncash items for the nine-month periods ended September 30, 2008 and 2007 consisted of the transfer of loans to foreclosed real estate for $1,674,000 and $576,000, respectively.

Post Retirement Benefit Liability Accrual

Management has elected the cumulative-effect adjustment method under EITF Issue No. 06-4 and recorded a one time charge of $703,000 to retained earnings on January 1, 2008. Recognition of the current liability as an expense through the income statement is expected to approximate $56,000 for 2008.

Recent Accounting Pronouncements

In October 2008, the FASB issued FSP SFAS No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active (FSP 157-3), to clarify the application of the provisions of SFAS No. 157 in an inactive market and how an entity would determine fair value in an inactive market. FSP 157-3 is effective immediately and applies to our September 30, 2008 financial statements. The application of the provisions of FSP 157-3 did not materially affect our results of operations or financial condition as of and for the periods ended September 30, 2008.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This Statement is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Corporation is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (Statement 161). Statement 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 have been applied, and the impact that hedges have on an entity s financial position, financial performance, and cash flows. Statement 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Corporation is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

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In February 2008, the FASB issued FASB Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157, that permits a one-year deferral in applying the measurement provisions of Statement No. 157 to non-financial assets and non-financial liabilities (non-financial items) that are not recognized or disclosed at fair value in an entity s financial statements on a recurring basis (at least annually). Therefore, if the change in fair value of a non-financial item is not required to be recognized or disclosed in the financial statements on an annual basis or more frequently, the effective date of application of Statement 157 to that item is deferred until fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. This deferral does not apply, however, to an entity that applies Statement 157 in interim or annual financial statements before proposed FSP 157-2 is finalized. The Corporation elected to delay the application of SFAS 157 to nonfinancial assets and liabilities and does not expect the adoption to have a significant impact on the consolidated financial statements.

FASB Statement No. 141 (R) Business Combinations was issued in December of 2007. This Statement establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The Statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance will impact business combinations which occur after January 1, 2009.

Note 3 Deposits

The composition of deposits on September 30, 2008 and December 31, 2007, was as follows:

(dollars in thousands)	September 30, 2008	December 31, 2007
Noninterest bearing demand	$ 51,409	$ 46,719
NOW	47,551	44,086
Money market	113,756	148,832
Savings	20,112	18,191
Time CDs less than $100,000	191,369	173,674
Time CDs $100,000 or more	128,694	80,466
Total deposits	$ 552,891	$ 511,968

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Note 4 Long-term Debt

A summary of long-term debt at September 30, 2008 and December 31, 2007 follows:

(dollars in thousands)	September 30, 2008	December 31, 2007
Obligations of PeoplesBank to FHLBP		
Due 2009, 3.47%, convertible quarterly after December 2006	$ 5,000	$ 5,000
Due 2010, 4.32%	6,000	6,000
Due 2011, 4.30%, amortizing	4,034	4,240
Due 2012, 4.25%, amortizing	1,402	1,663
Due 2013, 3.46%, amortizing	2,548	2,921
Obligations of Codorus Valley Bancorp, Inc.		
Due 2034, floating rate based on 3 month LIBOR plus 2.02%, callable quarterly after December 2009	3,093	3,093
Due 2036, floating rate based on 3 month LIBOR plus 1.54%, callable quarterly after July 2011	7,217	7,217
	29,294	30,134
Capital lease obligation	497	526
Total long-term debt	$ 29,791	$ 30,660

PeoplesBank s obligations to Federal Home Loan Bank of Pittsburgh (FHLBP) are fixed rate and fixed/floating (convertible) rate instruments. The FHLBP has an option on the convertible borrowings to convert the rate to a floating rate after the expiration of a specified period. The floating rate is based on the LIBOR index plus a spread. If the FHLBP elects to exercise its conversion option, PeoplesBank may repay the converted loan without a prepayment penalty.

Note 5 Regulatory Matters

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

Quantitative measures established by regulators to ensure capital adequacy require Codorus Valley and PeoplesBank to maintain minimum ratios, as set forth below, to total and Tier 1 capital as a percentage of risk-weighted assets, and of Tier 1 capital to quarter-to-date average assets (leverage ratio). Codorus Valley and PeoplesBank were well capitalized on September 30, 2008, based on FDIC capital guidelines.

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(dollars in thousands)	Actual Amount	Actual Ratio	Minimum for Capital Adequacy Amount	Minimum for Capital Adequacy Ratio	Well Capitalized Minimum* Amount	Well Capitalized Minimum* Ratio
Codorus Valley Bancorp, Inc. *(consolidated)*						
at September 30, 2008						
Capital ratios:						
Tier 1 risk based	$ 60,078	10.80%	$ 22,244	4.0%	n/a	n/a
Total risk based	64,437	11.59	44,488	8.0	n/a	n/a
Leverage	60,078	9.37	25,645	4.0	n/a	n/a
at December 31, 2007						
Capital ratios:						
Tier 1 risk based	$ 57,727	12.14%	$ 19,022	4.0%	n/a	n/a
Total risk based	61,161	12.86	38,043	8.0	n/a	n/a
Leverage	57,727	9.84	23,473	4.0	n/a	n/a
PeoplesBank, A Codorus Valley Company						
at September 30, 2008						
Capital ratios:						
Tier 1 risk based	$ 56,222	10.21%	$ 22,029	4.0%	$ 33,043	6.0%
Total risk based	60,581	11.00	44,057	8.0	55,072	10.0
Leverage	56,222	8.84	25,432	4.0	31,790	5.0
at December 31, 2007						
Capital ratios:						
Tier 1 risk based	$ 53,759	11.39%	$ 18,885	4.0%	$ 28,328	6.0%
Total risk based	57,183	12.11	37,770	8.0	47,213	10.0
Leverage	53,759	9.22	23,324	4.0	29,155	5.0

* To be well capitalized under prompt corrective action provisions.

Note 6 Stock-Based Compensation

A summary of stock options from all plans, adjusted for stock dividends distributed, is shown below.

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2008	234,176	$ 12.46	3.6 years	$ 879
Granted				
Exercised	(63,449)	12.04		

Outstanding at September 30, 2008	170,727	$	12.62	4.0 years	$	228
Exerciseable at September 30, 2008	155,112	$	12.35	3.7 years	$	228

As of September 30, 2008, total unrecognized compensation cost related to nonvested options was $26,000. The cost is expected to be recognized over a weighted average period of 1.1 years.

Note 7 Contingent Liabilities

Management was not aware of any material contingent liabilities on September 30, 2008.

Note 8 Guarantees

Codorus Valley does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by PeoplesBank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Commitments and letters of credit do not necessarily represent future cash needs as they may expire without being drawn upon. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $4,194,000 of standby letters of credit outstanding on September 30, 2008, compared to $3,381,000 on December 31, 2007. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required under the corresponding letters of credit. The current amount of the liability as of September 30, 2008 and December 31, 2007, under standby letters of credit issued, was not material.

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Note 9 Fair Values of Financial Instruments

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. Statement 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Statement primarily resulted in expansion of disclosures pertaining to the methods used to determine fair values for the Company.

Statement 157 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). An asset 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. The three levels of the fair value hierarchy under Statement 157 are as follows:

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

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

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

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

		Fair Value Measurements at September 30, 2008 Using		
(dollars in thousands)	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Securities available-for-sale	$ 75,504	$ 40,834	$ 34,670	$
Loans held for sale	7,531	7,531		
Impaired loans	13,845			13,845
Other real estate owned	2,030			2,030
Total	$ 98,910	$ 48,365	$ 34,670	$ 15,875

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A description of the valuation methodologies as of September 30, 2008 for the above listed assets follows.

Securities available-for-sale: Fair values of securities available-for-sale were based on quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Unrealized gains and losses related to securities available-for-sale are reported as a component of other comprehensive income.

Loans held for sale: Fair values of loans held for sale are based on quoted market prices and reported at the lower of cost or fair value, as determined in the aggregate. 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 change. There was no valuation allowance established as of September 30, 2008.

Impaired loans: Loans included in the preceding table are those that are accounted for under SFAS 114, Accounting by Creditors for Impairment of a Loan, in which the Company 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. A portion of the allowance for loan losses is allocated to impaired loans if the value of the collateral supporting such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes that the uncollectability of a loan is confirmed. These loans are included as Level 3 fair values, based on the lowest level of input that is significant to the fair value measurements. The fair value consists of loan balances less valuation allowances as determined under SFAS 114.

Other real estate owned: Fair values of real estate owned through foreclosure were based on independent third-party appraisals of the properties or sales contracts.

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements of impaired loans and other real estate owned using significant unobservable (Level 3) inputs:

(dollars in thousands)	Impaired Loans	Other Real Estate Owned
Beginning balance at December 31, 2007	$ 14,403	$ 403
Loans added/Acquisitions/Capital Improvements	2,252	
Payments and other credits	(277)	
Sales		
Specific allowance	(260)	
Balance at March 31, 2008	16,118	403
Loans added/Acquisitions/Capital Improvements	4,158	1,674
Payments and other credits	(6,814)	(54)
Sales		
Specific allowance	(140)	
Balance at June 30, 2008	13,322	2,023
Loans added/Acquisitions/Capital Improvements	1,366	7
Payments and other credits	(785)	
Sales		
Specific allowance	(58)	
Ending balance at September 30, 2008	$ 13,845	$ 2,030

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

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

Forward-looking statements:

Management of the Corporation has made forward-looking statements in this Form 10-Q. These forward-looking statements are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of the Corporation and its subsidiaries. When words such as believes, expects, anticipates or similar expressions occur in the Form 10-Q, management is making forward-looking statements. Readers should note that many factors, some of which are discussed elsewhere in this report and in the documents that are incorporated by reference, could affect the future financial results of the Corporation and its subsidiaries, both individually and collectively, and could cause those results to differ materially from those expressed in the forward-looking statements contained or incorporated by reference in this Form 10-Q. These factors include:

- current disruptions in the financial and credit markets;
- operating, legal and regulatory risks;
- economic, political and competitive forces affecting banking, securities, asset management and credit services businesses; and
- the risk that management s analysis of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

The Corporation undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in Item 1A of Part B of this quarterly Form 10-Q Report and Item 1A of the 2007 Annual Report on Form 10-K for the period ended December 31, 2007, and other documents that Codorus Valley files periodically with the Securities and Exchange Commission.

Critical accounting estimates:

Disclosure of Codorus Valley s significant accounting policies is included in Note 1 to the consolidated financial statements of the 2007 Annual Report on Form 10-K for the period ended December 31, 2007. 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. Management considers a variety of factors in establishing this estimate such as current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strengths of borrowers, adequacy of collateral, if collateral dependent, and present value of future cash flows and other relevant factors. Estimates related to the value of collateral also have a significant impact on whether or not management continues to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded on the statement of financial condition. 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 19 and 26 of this Form 10-Q.

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Effective January 1, 2008, the Corporation adopted FASB Statement No. 157, which is disclosed in this report under Note 9 Fair Values of Financial Instruments. Statement No. 157 expands disclosures pertaining to the methods used to determine fair values and establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure the fair value of selected assets and liabilities. Also on January 1, 2008, the Corporation adopted the FASB s Emerging Issues Task Force Issue No. 06-4 that pertains to recognizing a liability related to postretirement benefits covered by an endorsement split-dollar life insurance arrangement. The impact of adopting EITF Issue No. 06-4 is disclosed in this report under the Recent Accounting Pronouncements section of Note 2 Significant Accounting Policies.

Management discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosure with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report.

Three months ended September 30, 2008,
compared to three months ended September 30, 2007

FINANCIAL HIGHLIGHTS

The Corporation earned $1,130,000 or $.28 per share ($.28 diluted), for the three-month period ended September 30, 2008, compared to $1,641,000 or $.42 per share ($.41 diluted), for the same period of 2007. The $511,000 or 31 percent decrease in net income was the result of increases in the provision for loan losses and noninterest expense, and a decrease in net interest income. The Corporation increased the provision for loan losses by $388,000 to support a substantial increase in the loan portfolio and the risk of a prolonged downturn in the US economy. The $261,000 or 6 percent increase in total noninterest expense was due in part to expansion of the Corporation s banking franchise. PeoplesBank, the Corporation s banking subsidiary, recently opened a second full-service financial center in the Hanover, Pennsylvania market, which followed the bank s expansion, in January, to Hunt Valley, Maryland. Increases in assessments by the Federal Deposit Insurance Corporation on the banking industry, miscellaneous services expenses and impaired loan carrying costs also contributed to the increase in total noninterest expense. Net interest income decreased by $215,000 or 4 percent as yields on earning assets declined more rapidly than rates paid on deposits. These decreases in yields and rates paid were due in part to aggressive interest rate cuts by the Federal Reserve Bank to stimulate the struggling US economy. Total noninterest income for the current quarter increased $168,000 or 12 percent primarily as a result of increases in service charges on deposits and gains on the sale of mortgages.

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

INCOME STATEMENT ANALYSIS

Net interest income

Net interest income for the three-month period ended September 30, 2008, was $5,134,000, a decrease of $215,000 or 4 percent compared to the third quarter of 2007. Earning assets for the current quarter averaged $599 million and yielded 6.20 percent (tax equivalent basis), compared to $542 million and 7.50 percent, respectively, for the third quarter of 2007. While the volume of average earning assets, principally business loans, increased in the current quarter, yields decreased. Yields on floating rate instruments in particular were adversely affected by aggressive interest rate cuts by the Federal Reserve Bank in its effort to stimulate the US economy. The Federal Reserve Bank lowered interest rates a total of 3.25 percent from September 2007 to April 2008. In addition to a decrease in interest income from loans, loan fees also decreased. Loan fees totaled $184,000 for the third quarter of 2008, compared to $619,000 for the third quarter of 2007. The prior period included $329,000 in loan fees from a single business loan account that did not recur in the current quarter. Total interest bearing deposits for the current quarter averaged $503 million at an average rate of 2.91 percent, compared to $447 million and 3.73 percent, respectively, for the third quarter of 2007. During the current quarter, deposit customers continued to replace floating rate money market and time deposits, in response to the low level of short-term market interest rates, with relatively higher yielding fixed rate time deposits to increase their return. The net interest margin, on a taxable equivalent basis, was 3.52 percent for the third quarter of 2008, compared to 3.69 percent for the second quarter of 2008 and 4.03 percent for the third quarter of 2007.

Provision for loan losses

A $353,000 provision expense for loan losses was recorded for the third quarter of 2008, compared to a $35,000 recovery (credit) for the same quarter in 2007. The current quarter s loan loss provision bolstered the allowance to support strong the growth in the Company s business loan portfolio and the risk of a prolonged downturn in the US economy.

Noninterest income

The following table presents the components of total noninterest income for the third quarter of 2008, compared to the third quarter of 2007.

Table 1 Noninterest income

	Three months ended September 30,		Change Increase (Decrease)	
(dollars in thousands)	2008	2007	$	%
Trust and investment services fees	$ 307	$ 317	$ (10)	(3)%
Service charges on deposit accounts	592	499	93	19
Income from mutual fund, annuity and insurance sales	390	410	(20)	(5)
Income from bank owned life insurance	73	71	2	3
Other income	121	102	19	19
Gain on sales of mortgages	135	51	84	165
Gain (loss) on sales of securities	0	0	0	nm
Total noninterest income	$ 1,618	$ 1,450	$ 168	12%

nm not meaningful

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

Service charges on deposit accounts The $93,000 or 19 percent increase in service charges on deposit accounts for the third quarter of 2008, compared to the same quarter of 2007 was the result of increases in overdraft and debit card fees related to an increase in the number of deposit accounts and increased transaction volumes.

Gain on sales of mortgages The $84,000 or 165 percent increase in gains on sales of mortgages for the third quarter of 2008, compared to the same quarter of 2007, was the result of an increase in the sales staff and the volume of sales.

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Noninterest expense

The following table presents the components of total noninterest expense for the third quarter of 2008, compared to the third quarter of 2007.

Table 2 Noninterest expense

	Three months ended September 30,		Change Increase (Decrease)	
(dollars in thousands)	2008	2007	$	%
Personnel	$ 2,744	$ 2,741	$ 3	0%
Occupancy of premises, net	367	314	53	17
Furniture and equipment	349	347	2	1
Postage, stationery and supplies	117	101	16	16
Professional and legal	85	105	(20)	(19)
Marketing and advertising	249	247	2	1
Other	1,012	807	205	25
Total noninterest expense	$ 4,923	$ 4,662	$ 261	6%

Personnel Personnel expense, comprised of wages, payroll taxes and employee benefits for the third quarter of 2008 was flat compared to the same quarter of 2007. The prior period included a $200,000 wage expense allocation for an annual companywide performance bonus based on projected 2007 core earnings. No comparable performance bonus accrual was recorded for the current period. On an adjusted basis, the $203,000 or 8 percent increase in personnel expense was due to staff additions to support planned corporate growth.

Occupancy of premises, net The $53,000 or 17 percent increase in occupancy expense for the third quarter of 2008, compared to the same quarter of 2007, was due primarily to the addition of the Hunt Valley office in Maryland in January 2008.

Other The $205,000 or 25 percent increase in other expense for the third quarter of 2008, compared to the same quarter of 2007 was due in part to increases in the following expenses: an insurance assessment imposed on the industry by the Federal Deposit Insurance Corporation, miscellaneous services, and impaired loan carrying costs.

Income taxes

The provision for income tax was $346,000 for the third quarter of 2008, compared to $531,000 for the same period in 2007. The $185,000 decrease in the tax provision was the result of a 32 percent decrease in pretax income. Codorus Valley s effective federal income tax rate was 21 percent and 25 percent, respectively, for quarters ended September 30, 2008, and 2007. The Company s marginal tax rate was 34 percent for both periods.

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Nine months ended September 30, 2008,
compared to nine months ended September 30, 2007

FINANCIAL HIGHLIGHTS

The Corporation earned $3,624,000 or $.92 per share ($.91 diluted) for the nine-month period ended September 30, 2008, compared to $5,037,000 or $1.30 per share ($1.27 diluted), for the same period of 2007. The $1,413,000 or 28 percent decrease in net income was primarily the result of a $2,332,000 pre-tax ($1,539,000 after-tax) increase in the provision for loan losses. The current period provision and allowance were primarily increased to support strong loan growth in the Corporation s loan portfolio and the risk of a prolonged downturn in the US economy and secondarily to replenish the allowance for loan losses for a previously disclosed loan loss of $481,000 in the second quarter of 2008. In contrast, during 2007 the Corporation recognized the positive financial impact of a one-time $839,000 pre-tax recovery ($554,000 after-tax) of loan losses that were incurred by PeoplesBank during 2002-2003. Due to the adequacy of the Corporation s allowance for loan losses in 2007, the full amount of the recovery was recorded as a reduction to the loan loss provision at that time. On a comparable basis, net income for the nine-month period ended September 30, 2008, decreased $859,000 or 19 percent, compared to the same period in 2007, as adjusted ($5,037,000 of reported 2007 earnings less $554,000 for the after-tax effect of the loan recovery).

Net income for the 2008 period was also constrained by net interest margin compression as yields on earning assets declined more rapidly than rates paid on deposits due in part to aggressive interest rate cuts by the Federal Reserve Bank to stimulate the struggling US economy. Operating costs increased for the current period primarily as a result of corporate expansion and increased Federal Deposit Insurance Corporation deposit premiums. PeoplesBank recently opened a second full-service financial center in the Hanover, Pennsylvania market, which followed the Bank s expansion, in January, to Hunt Valley, Maryland. A second Maryland banking office, located in the Bel Air area, is scheduled to open in November 2008.

On September 30, 2008, total assets were $650 million, representing a $60 million or 10 percent increase above September 30, 2007. Asset growth occurred primarily in business and home equity loan portfolios, which were funded by strong deposit growth, principally time deposits.

Net income as a percentage of average shareholders equity (ROE) was 9.72 percent for the first nine months (annualized) of 2008, compared to 14.94 percent for the same period of 2007. Net income as a percentage of average total assets (ROA) was 0.78 percent for the first nine months (annualized) of 2008, compared to 1.18 percent for the same period of 2007. The efficiency ratio (noninterest expense as a percentage of net interest income plus noninterest income) was 68.5 percent for the first nine months of 2008, compared to 67.3 percent for the same period of 2007.

On September 30, 2008, the nonperforming assets ratio was 1.93 percent, compared to 1.02 percent for September 30, 2007. Information regarding nonperforming assets is provided in the Risk Management section of this report, including Table 5 Nonperforming Assets. Based on a recent evaluation of probable loan losses and the current loan portfolio, management believes that the allowance is adequate to support losses inherent in the loan portfolio on September 30, 2008. An analysis of the allowance is provided in Table 6 Analysis of Allowance for Loan Losses.

Throughout the current period, Codorus Valley maintained a capital level well above minimum regulatory quantitative requirements. Currently, there are three federal regulatory definitions of capital that take the form of minimum ratios. Note 5 Regulatory Matters, shows that the Corporation and PeoplesBank were well capitalized on September 30, 2008. Management is presently evaluating the Capital Purchase Program recently announced by the US Department of the Treasury. More information about this program is provided within the Shareholders Equity and Capital Adequacy section of this report.

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

INCOME STATEMENT ANALYSIS

Net interest income

Net interest income for the nine-month period ended September 30, 2008, was $15,677,000, an increase of $613,000 or 4 percent above the same period in 2007 due to a larger volume of earning assets and lower funding costs. The growth in net interest income was constrained by net interest margin compression as the yields on earning assets declined more rapidly than rates paid on deposits. The net interest margin, on a tax equivalent basis, was 3.75 percent for the first nine months of 2008, compared to 3.90 percent for the same period in 2007. The decline in loan yields and deposit rates, particularly floating rate products, reflected a series of aggressive interest rate cuts by the Federal Reserve Bank that began in September 2007 and ended in April 2008 to stimulate the US economy. (Note: During October 2008 the Federal Reserve Bank cut its target federal funds rate two times for a total of 100 basis points. As of October 29, 2008, the target federal funds rate was 1%, which equates to a 4% prime lending rate.)

Earning assets averaged $576 million and yielded 6.48 percent (tax equivalent basis) for the current nine-month period, compared to $532 million and 7.44 percent, respectively, for 2007. The $44 million or 8 percent increase in average earning assets was the result of loan growth primarily in the business loan portfolio and secondarily in the home equity loan portfolio. Total loans averaged $479 million and yielded 6.80 percent (tax equivalent basis) for 2008, compared to $426 million and 7.95 percent, respectively, for 2007. The investment securities portfolio averaged $81 million and yielded 5.36 percent (tax equivalent basis) for 2008, compared to $84 million and 5.45 percent for 2007. Interest income from investment securities decreased as a result of decreases in volume and yield. For the first nine months of 2008, total interest income decreased $1,695,000 or 6 percent, compared to 2007, due primarily to lower yields on floating rate loans and overnight investments, and decreased loan fees.

For the first nine months of 2008, total interest expense decreased $2,308,000 or 16 percent, compared to 2007 due to a decrease in the weighted average rate paid on deposits and borrowings. Total interest bearing liabilities averaged $517 million at an average rate of 3.04 percent, compared to $478 million and 3.93 percent, respectively, for 2007. The $39 million or 8 percent increase in average interest bearing liabilities was driven by an increase in time deposits. Interest expense on deposits for the current period decreased $1,694,000 or 14 percent below the prior year due to lower market interest rates. During the current nine-month period deposit customers continued to replace floating rate money market and time deposits with higher yielding fixed rate time deposits to increase their return. Interest expense on long-term debt decreased for the current period by $648,000 or 39 percent below the prior year due to a decrease in volume, which resulted from a scheduled maturity in 2007 that was not refinanced and the pay-off of two borrowings prior to maturity that also occurred in 2007.

Provision for loan losses

For the nine-month period ended September 30, 2008, the provision for loan losses was $1,413,000, representing a $2,332,000 increase compared to the $919,000 recovery (credit) for the same period in 2007. The current period provision and allowance were primarily increased to support strong loan growth in the Corporation s loan portfolio and the risk of a prolonged downturn in the US economy and secondarily to replenish the allowance for a previously disclosed loan loss in the second quarter of 2008. In contrast, during 2007 the Corporation recognized the positive financial impact of a one-time $839,000 pre-tax recovery ($554,000 after-tax) of loan losses that were incurred by PeoplesBank during 2002-2003. Due to the adequacy of the Corporation s allowance for loan losses in 2007, the full amount of the recovery was recorded as a reduction to the loan loss provision at that time.

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Noninterest income

The following table presents the components of total noninterest income for the first nine months of 2008, compared to the first nine months of 2007. After removing the impact of infrequent gains (losses) from the sale of securities, total noninterest income for the current nine-month period increased $701,000 or 17 percent above 2007.

Table 3 Noninterest income

	Nine months ended September 30,		Change Increase (Decrease)	
(dollars in thousands)	2008	2007	$	%
Trust and investment services fees	$ 983	$ 945	$ 38	4%
Service charges on deposit accounts	1,675	1,436	239	17
Income from mutual fund, annuity and insurance sales	1,374	1,092	282	26
Income from bank owned life insurance	208	204	4	2
Other income	367	324	43	13
Gain on sales of mortgages	303	208	95	