Section 1: 10-Q (10-Q)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2020
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
(State or other jurisdiction of incorporation or organization)

23-2428543
(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.)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, $2.50 par value	CVLY	NASDAQ Global Market

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions 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 ☒

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. On July 27, 2020, 9,787,598 shares of common stock, par value $2.50, were outstanding.

Codorus Valley Bancorp, Inc.

Form 10-Q Index

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

Codorus Valley Bancorp, Inc.
Consolidated Balance Sheets
(Unaudited)

(dollars in thousands, except per share data)		**June 30, 2020**		**December 31, 2019**
Assets				
Interest bearing deposits with banks	$	197,432	$	110,742
Cash and due from banks		17,929		20,849
Total cash and cash equivalents		215,361		131,591
Securities, available-for-sale		159,715		159,675
Restricted investment in bank stocks, at cost		2,593		4,551
Loans held for sale		17,534		11,803
Loans (net of deferred fees of $8,372 - 2020 and $3,463 - 2019)		1,601,129		1,505,135
Less-allowance for loan losses		(21,038)		(21,066)
Net loans		1,580,091		1,484,069
Premises and equipment, net		26,316		25,967
Operating leases right-of-use assets		2,683		3,021
Goodwill		2,301		2,301
Other assets		64,411		63,567
Total assets	$	2,071,005	$	1,886,545
Liabilities				
Deposits				
Noninterest bearing	$	397,968	$	273,968
Interest bearing		1,409,674		1,316,596
Total deposits		1,807,642		1,590,564
Short-term borrowings		9,477		7,925
Long-term debt		46,619		81,632
Operating leases liabilities		2,824		3,184
Other liabilities		12,608		12,072
Total liabilities		1,879,170		1,695,377
Shareholders' equity				
Preferred stock, par value $2.50 per share; 1,000,000 shares authorized; shares issued and outstanding: 0 at June 30, 2020 and 0 at December 31, 2019		0		0
Common stock, par value $2.50 per share; 30,000,000 shares authorized; Shares issued and outstanding: 9,787,598 at June 30, 2020 and 9,755,976 at December 31, 2019		24,469		24,390
Additional paid-in capital		140,968		140,450
Retained earnings		21,957		25,019
Accumulated other comprehensive income		4,441		1,309
Total shareholders' equity		191,835		191,168
Total liabilities and shareholders' equity	$	2,071,005	$	1,886,545

See accompanying notes.

Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

(dollars in thousands, except per share data)	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
Interest income				
Loans, including fees	$ 17,880	$ 19,974	$ 36,644	$ 39,484
Investment securities:				
Taxable	761	744	1,581	1,420
Tax-exempt	126	171	267	380
Dividends	23	88	95	207
Other	48	558	440	920
Total interest income	18,838	21,535	39,027	42,411
Interest expense				
Deposits	3,501	4,616	7,777	9,236
Federal funds purchased and other short-term borrowings	11	11	20	20
Long-term debt	426	665	963	1,381
Total interest expense	3,938	5,292	8,760	10,637
Net interest income	14,900	16,243	30,267	31,774
Provision for loan losses	2,550	1,200	11,985	2,250
Net interest income after provision for loan losses	12,350	15,043	18,282	29,524
Noninterest income				
Trust and investment services fees	946	881	1,940	1,721
Income from mutual fund, annuity and insurance sales	249	296	510	531
Service charges on deposit accounts	975	1,208	2,105	2,366
Income from bank owned life insurance	279	292	565	659
Other income	482	645	921	1,054
Gain on sales of loans held for sale	554	319	852	537
Gain (loss) on sales of securities	50	1	65	(3)
Total noninterest income	3,535	3,642	6,958	6,865
Noninterest expense				
Personnel	7,196	7,391	15,001	15,097
Occupancy of premises, net	865	900	1,791	1,863
Furniture and equipment	841	775	1,694	1,547
Postage, stationery and supplies	205	175	422	359
Professional and legal	245	222	450	331
Marketing	311	374	636	723
FDIC insurance	172	223	339	460
Debit card processing	284	317	673	640
Charitable donations	93	134	965	979
Telecommunications	144	130	265	256
External data processing	704	616	1,408	1,172
(Gain)/loss on foreclosed real estate, including (recovery of) provision for losses	(193)	47	(173)	134
Impaired loan carrying costs	190	80	476	119
Other	1,073	1,120	1,502	1,385
Total noninterest expense	12,130	12,504	25,449	25,065
Income (loss) before income taxes	3,755	6,181	(209)	11,324
Provision (benefit) for income taxes	705	1,322	(270)	2,374
Net income	$ 3,050	$ 4,859	$ 61	$ 8,950
Net income per share, basic	$ 0.31	$ 0.49	$ 0.01	$ 0.90
Net income per share, diluted	$ 0.31	$ 0.49	$ 0.01	$ 0.90

See accompanying notes.

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

(dollars in thousands)	Three months ended June 30, 2020	2019
Net income	$ 3,050	$ 4,859
Other comprehensive income (loss):		
Securities available for sale:		
Net unrealized holding gains arising during the period (net of tax expense of $99 and $457, respectively)	373	1,720
Reclassification adjustment for gains included in net income (net of tax expense of $11 and $0, respectively) (a) (b)	(39)	(1)
Net unrealized gains	334	1,719
Comprehensive income	$ 3,384	$ 6,578

(dollars in thousands)	Six months ended June 30, 2020	2019
Net income	$ 61	$ 8,950
Other comprehensive income (loss):		
Securities available for sale:		
Net unrealized holding gains arising during the period (net of tax expense of $846 and $828, respectively)	3,183	3,116
Reclassification adjustment for (gains) losses included in net income (net of tax expense (benefit) of $14 and ($1), respectively) (a) (b)	(51)	2
Net unrealized gains	3,132	3,118
Comprehensive income	$ 3,193	$ 12,068

(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 the provision for income taxes on the Consolidated Statements of Income.

See accompanying notes.

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

(dollars in thousands)	Six months ended June 30, 2020	2019
Cash flows from operating activities		
Net income	$ 61	$ 8,950
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation/amortization	1,386	1,309
Net amortization of premiums on securities	390	132
Amortization of deferred loan origination fees and costs	(1,236)	(630)
Net amortization of operating lease right of use assets	336	334
Net amortization of finance lease right of use assets	24	34
Net change in operating lease liabilities	(345)	(293)
Provision for loan losses	11,985	2,250
Provision for losses on foreclosured real estate	18	0
Increase in bank owned life insurance	(565)	(659)
Originations of mortgage loans held for sale	(28,865)	(16,807)
Originations of SBA loans held for sale	(872)	(5,430)
Proceeds from sales of mortgage loans held for sale	24,663	15,835
Proceeds from sales of SBA loans held for sale	140	2,311
Gain on sales of mortgage loans held for sale	(843)	(355)
Gain on sales of SBA loans held for sale	(9)	(182)
Gain on disposal of premises and equipment	0	(15)
(Gain) loss on sales of securities, available-for-sale	(65)	3
(Gain) loss on sales of foreclosed real estate	(214)	3
Stock-based compensation	250	253
(Increase) decrease in interest receivable	(1,519)	334
(Increase) in other assets	(245)	(476)
(Decrease) increase in interest payable	(225)	47
Increase in other liabilities	98	1,367
Net cash provided by operating activities	4,348	8,315
Cash flows from investing activities		
Purchases of securities, available-for-sale	(43,705)	(21,669)
Maturities, repayments and calls of securities, available-for-sale	21,679	11,386
Sales of securities, available-for-sale	26,288	9,777
Net decrease in restricted investment in bank stock	1,958	1,371
Net (increase) decrease in loans made to customers	(106,892)	12,212
Purchases of premises and equipment	(1,758)	(2,270)
Investment in bank owned life insurance	0	(6,600)
Proceeds from sales of foreclosed real estate	1,011	16
Net cash (used in) provided by investing activities	(101,419)	4,223
Cash flows from financing activities		
Net increase (decrease) in demand and savings deposits	211,867	(18,729)
Net increase in time deposits	5,211	56,544
Net increase in short-term borrowings	1,551	2,964
Repayment of long-term debt	(35,000)	(20,000)
Net change in finance lease liabilities	(12)	(21)
Cash dividends paid to shareholders	(3,123)	(3,025)
Payment of taxes related to stock withheld	(2)	0
Treasury stock reissued	89	88
Treasury stock purchased	(87)	(762)
Issuance of stock	347	201
Net cash provided by financing activities	180,841	17,260
Net increase in cash and cash equivalents	83,770	29,798
Cash and cash equivalents at beginning of year	131,591	96,782
Cash and cash equivalents at end of period	$ 215,361	$ 126,580

See accompanying notes.

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

(dollars in thousands, except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2020	$ 24,390	$ 140,450	$ 25,019	$ 1,309	$ 0	$ 191,168
Net loss			(2,989)			(2,989)
Other comprehensive income, net of tax				2,798		2,798
Cash dividends ($0.160 per share)			(1,561)			(1,561)
Stock-based compensation		120				120
Repurchased stock - 5,335 shares					(87)	(87)
Withheld stock - 102 shares					(2)	(2)
Issuance and reissuance of stock:						
6,706 shares under the dividend reinvestment and stock purchase plan	17	132				149
6,468 shares of stock-based compensation awards	16	(16)				0
Balance, March 31, 2020	$ 24,423	$ 140,686	$ 20,469	$ 4,107	$ (89)	$ 189,596
Balance, April 1, 2020	$ 24,423	$ 140,686	$ 20,469	$ 4,107	$ (89)	$ 189,596
Net income			3,050			3,050
Other comprehensive income, net of tax				334		334
Cash dividends ($0.160 per share)			(1,562)			(1,562)
Stock-based compensation		130				130
Issuance and reissuance of stock:						
12,536 shares under the dividend reinvestment and stock purchase plan	18	44			89	151
1,000 shares under the stock option plan	2	3				5
(767) shares of stock-based compensation awards	(2)	2				0
11,116 shares under employee stock purchase plan	28	103				131
Balance, June 30, 2020	$ 24,469	$ 140,968	$ 21,957	$ 4,441	$ 0	$ 191,835
Balance, January 1, 2019	$ 23,629	$ 134,506	$ 22,837	$ (2,226)	$ 0	$ 178,746
Adoption of ASC topic 842 (leases)			(199)			(199)
Net income			4,091			4,091
Other comprehensive income, net of tax				1,399		1,399
Cash dividends ($0.152 per share, adjusted)			(1,512)			(1,512)
Stock-based compensation		135				135
Forfeiture and withheld shares of restricted stock		2			(4)	(2)
Issuance and reissuance of stock:						
6,646 shares under the dividend reinvestment and stock purchase plan	17	132				149
Balance, March 31, 2019	$ 23,646	$ 134,775	$ 25,217	$ (827)	$ (4)	$ 182,807
Balance, April 1, 2019	$ 23,646	$ 134,775	$ 25,217	$ (827)	$ (4)	$ 182,807
Net income			4,859			4,859
Other comprehensive income, net of tax				1,719		1,719
Cash dividends ($0.152 per share, adjusted)			(1,513)			(1,513)
Stock-based compensation		118				118
Forfeiture of restricted stock and withheld shares		5			(5)	0
Repurchased stock - 35,600 shares					(762)	(762)
Issuance and reissuance of stock:						
6,605 shares under the dividend reinvestment and stock purchase plan	9	128			9	146
4,221 shares under the stock option plan		(69)			88	19
6,694 shares under employee stock purchase plan		(14)			141	127
Balance, June 30, 2019	$ 23,655	$ 134,943	$ 28,563	$ 892	$ (533)	$ 187,520

See accompanying notes.

Note 1—Summary of Significant Accounting Policies

Nature of Operations and Basis of Presentation

The accompanying consolidated balance sheet at December 31, 2019 has been derived from audited financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, the instructions to Form 10-Q, and FASB Accounting Standards Codification (ASC) 270. Accordingly, the interim financial statements do not include all of the financial information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the interim consolidated financial statements include all adjustments necessary to present fairly the financial condition and results of operations for the reported periods, and all such adjustments are of a normal and recurring nature.

Codorus Valley Bancorp, Inc. (“Corporation” or “Codorus Valley”) is a one-bank holding company headquartered in York, Pennsylvania that provides a full range of banking services through its subsidiary, PeoplesBank, A Codorus Valley Company (“PeoplesBank” or “Bank”). As of June 30, 2020, PeoplesBank operates one wholly-owned subsidiary, Codorus Valley Financial Advisors, Inc. d/b/a PeoplesWealth Advisors, which sells nondeposit investment products. 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 period ended June 30, 2020. The accounts of CVB Statutory Trust No. 1 and No. 2 are not included in the consolidated financial statements as discussed in Note 7—Short-Term Borrowings and Long-Term Debt. All significant intercompany account balances and transactions have been eliminated in consolidation. The accounting and reporting policies of Codorus Valley and subsidiaries conform to accounting principles generally accepted in the United States of America and have been followed on a consistent basis.

These consolidated statements should be read in conjunction with the notes to the audited consolidated financial statements contained in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2019.

The results of operations for the three and six months ended June 30, 2020 are not necessarily indicative of the results to be expected for the full year.

In accordance with FASB ASC 855, the Corporation evaluated the events and transactions that occurred after the balance sheet date of June 30, 2020 and through the date these consolidated financial statements were issued, for items of potential recognition or disclosure.

In December 2019, a coronavirus (COVID-19) was reported in China, and, in March 2020, the World Health Organization declared it a pandemic. Since first being reported in China, the coronavirus has spread to additional countries including the United States. On March 13, 2020, President Trump declared the ongoing COVID–19 pandemic of sufficient severity and magnitude to warrant an emergency declaration for all states, territories, and the District of Columbia.

In response, many state and local governments, including the Commonwealth of Pennsylvania and the State of Maryland, have instituted emergency restrictions that have substantially limited the operation of non-essential businesses and the activities of individuals. It has been widely reported that these restrictions have resulted in significant adverse effects for many different types of businesses, particularly those in the travel, hospitality and food and beverage industries, among many others, and has resulted in a significant number of layoffs and furloughs of employees nationwide and in the regions in which the Corporation operates. The ultimate effect of COVID-19 on the local or broader economy is not known nor is the ultimate length of the restrictions described and any accompanying effects. Moreover, the Federal Reserve has taken action to lower the Federal Funds rate, which has negatively affected interest income and, therefore, earnings. Given the ongoing and dynamic nature of the circumstances, it is difficult to predict the full impact of the coronavirus outbreak, and there is no guarantee that the Corporation’s efforts to address the adverse impacts of the coronavirus will be effective. The extent of such impact will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and actions taken to contain the coronavirus or its impact, among others.

The effect of COVID-19 and related events, including those described above and those not yet known or knowable, could have a negative effect on the Corporation's business prospects, financial condition and results of operations, as a result of quarantines; market volatility; market downturns; changes in consumer behavior; business closures; deterioration in the credit quality of borrowers or the inability of borrowers to satisfy their obligations (and any related forbearances or restructurings that may be implemented); changes in the value of collateral securing outstanding loans; changes in the value of the investment securities portfolio; effects on key employees, including operational management personnel and those charged with preparing, monitoring and evaluating the Corporation's financial reporting and internal controls; declines in the demand for loans and other banking services and products;

declines in demand resulting from adverse impacts of the disease on businesses deemed to be "non-essential" by governments; and branch or office closures and business interruptions.

In addition, the adverse economic effects of the coronavirus may lead to an increase in credit risk on the Corporation's commercial and residential loan portfolios. Likewise, the Corporation is also monitoring the fluctuations in the markets as it pertains to interest rates and fair value of our investments for OTTI. To curtail the spread of the virus, we are currently operating with modified branch access and taking other precautionary measures.

On March 27, 2020, the President of the United States signed into law the Coronavirus Aid, Relief and Economic Security (CARES) Act in response to the coronavirus pandemic. This legislation aims at providing relief for individuals and businesses that have been negatively impacted by the coronavirus pandemic.

The CARES Act includes a provision for the Corporation to opt out of applying the TDR accounting guidance in ASC 310-40 for certain loan modifications. Loan modifications made between March 1, 2020 and the earlier of i) December 30, 2020 or ii) 60 days after the President declares a termination of the COVID-19 national emergency are eligible for this relief if the related loans were not more than 30 days past due as of December 31, 2019.

While the Corporation continues to evaluate the disruption caused by the pandemic and impact of the CARES Act, these events may have a material adverse impact on the Corporation's results of future operations, financial position, capital, and liquidity in fiscal year 2020. Further, a decrease in results of future operations may place a strain on the Corporation's capital reserve ratios.

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.

Generally, for all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A past due loan may remain on accrual status if it is in the process of collection and well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to the Corporation's judgment as to the collectability of principal. Generally, nonaccrual 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 by management to be adequate to provide for probable incurred losses. The Corporation performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired, generally nonaccrual loans and troubled debt restructurings. 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 international, US 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
Impact of imposed tariffs
Impact of COVID-19 pandemic

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 higher risk to the Corporation because economic and housing market conditions can adversely affect the underlying value of the collateral, which could render the Corporation under-secured or unsecured. In addition, economic and housing market conditions can adversely affect 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 eliminates 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.

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 write-down. 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 June 30, 2020 there was $103,000 of foreclosed real estate, all of which was residential real estate. Included within loans receivable as of June 30, 2020 was a recorded investment of $172,000 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.

Mortgage Servicing Rights

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. 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 estimate of future net servicing income 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 June 30, 2020, the balance of residential mortgage loans serviced for third parties was $107,430,000 compared to $115,620,000 at December 31, 2019.

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	**2020**	**2019**	**2020**	**2019**
Amortized cost:				
Balance at beginning of period	$ 739	$ 922	$ 965	$ 925
Originations of mortgage servicing rights	42	74	55	124
Amortization expense	(122)	(47)	(188)	(83)
Valuation allowance	(10)	(44)	(183)	(61)
Balance at end of period	$ 649	$ 905	$ 649	$ 905

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 1st of each year. Based upon a qualitative analysis of goodwill, the Corporation concluded that the amount of recorded goodwill was not impaired as of October 1, 2019.

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 June 30, 2020, the Corporation performed an interim analysis of goodwill due to the deterioration in general economic conditions as a result of the COVID-19 pandemic that represented a triggering event prompting an evaluation of goodwill impairment. Based upon this interim analysis, it does not appear more likely than not, that the fair value of the reporting unit is less than the carrying amount. The core operations of the bank continue to function as intended and profitability is expected to return to a level supportive of a stock price over the organization's book value.

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.

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 cards 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 for these fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received within a one to three day lag or in the following month.

Per Share Data

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

(in thousands, except per share data)	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
Net income	$ 3,050	$ 4,859	$ 61	$ 8,950
Weighted average shares outstanding (basic)	9,770	9,926	9,765	9,927
Effect of dilutive stock options	24	65	33	67
Weighted average shares outstanding (diluted)	9,794	9,991	9,798	9,994
Basic earnings per share	$ 0.31	$ 0.49	$ 0.01	$ 0.90
Diluted earnings per share	$ 0.31	$ 0.49	$ 0.01	$ 0.90

Comprehensive Income

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

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)	Six months ended June 30, 2020	Six months ended June 30, 2019
Cash paid during the period for:		
Income taxes	$ 0	$ 2,450
Interest	$ 8,985	$ 10,590
Noncash investing and financing activities:		
Transfer of loans to foreclosed real estate	$ 121	$ 0
Initial recognition of financing lease right-of-use assets	$ 0	$ 1,358
Initial recognition of financing lease liabilities	$ 0	$ 1,480
Initial recognition of operating lease right-of-use assets	$ 186	$ 2,958
Initial recognition of operating lease liabilities	$ 186	$ 3,035
Increase in other liabilities for purchase of securities settling after quarter end	$ 663	$ 0

Recent Accounting Pronouncements

Pronouncements Adopted in 2020

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. The Corporation adopted this standard effective with its January 1, 2020 goodwill impairment test. The adoption of this standard did not have a material impact on its consolidated financial statements.

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 adoption of this update did not have a material impact on its consolidated financial statements.

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 adoption of this update did not have a material impact on its consolidated financial statements.

Pronouncements Not Yet Effective

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 was delayed and is now effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. 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 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.

Note 2 – Securities

A summary of securities available-for-sale at June 30, 2020 and December 31, 2019 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 June 30, 2020, 87 percent of the fair value of the municipal bond portfolio was concentrated in the Commonwealth of Pennsylvania and 11 percent was concentrated in the state of Texas. The portfolio was intentionally distributed to limit exposure with the largest issuer at $2.0 million.

	Amortized	Gross Unrealized		Fair
(dollars in thousands)	Cost	Gains	Losses	Value
June 30, 2020				
Debt securities:				
U.S. Treasury notes	$ 4,999	$ 54	$ 0	$ 5,053
U.S. agency mortgage-backed, residential	126,374	5,132	(3)	131,503
State and municipal	21,730	326	(5)	22,051
Corporate debt	991	117	0	1,108
Total debt securities	$ 154,094	$ 5,629	$ (8)	$ 159,715
December 31, 2019				
Debt securities:				
U.S. Treasury notes	$ 9,834	$ 119	$ 0	$ 9,953
U.S. agency	15,000	0	(77)	14,923
U.S. agency mortgage-backed, residential	106,799	1,443	(87)	108,155
State and municipal	26,385	260	(1)	26,644
Total debt securities	$ 158,018	$ 1,822	$ (165)	$ 159,675

The amortized cost and estimated fair value of debt securities at June 30, 2020 by contractual maturity are shown below. Actual maturities may differ from contractual maturities if call options on select debt issues are exercised in the future. Mortgage-backed securities are included in the maturity categories based on average expected life.

	Available-for-sale	
(dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 10,634	$ 10,715
Due after one year through five years	101,065	104,618
Due after five years through ten years	30,577	31,697
Due after ten years	11,818	12,685
Total debt securities	$ 154,094	$ 159,715

Gross realized gains and losses on sales of securities available-for-sale are shown below. Realized gains and losses are computed on the basis of specific identification of the adjusted cost of each security and are shown net as a separate line item in the income statement. Proceeds from the sale of securities were $6,372,000, with a related tax expense of $11,000 for the three months ended June 30, 2020. Proceeds from the sale of securities were $3,760,000, with no related tax benefit or expense for the three months ended June 30, 2019. Proceeds from the sale of securities were $26,288,000, with a related tax expense of $14,000 for the six months ended June 30, 2020. Proceeds from the sale securities were $9,777,000, with a related tax benefit of $1,000 for the six months ended June 30, 2019.

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2020	2019	2020	2019
Realized gains	$ 50	$ 11	$ 124	$ 14
Realized losses	0	(10)	(59)	(17)
Net gains (losses)	$ 50	$ 1	$ 65	$ (3)

Investment securities having a carrying value of $130,662,000 and $128,427,000 on June 30, 2020 and December 31, 2019, 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 June 30, 2020 and December 31, 2019.

	Less than 12 months			12 months or more			Total		
(dollars in thousands)	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
June 30, 2020									
Debt securities:									
U.S. agency mortgage-backed, residential	2	2,128	(3)	0	0	0	2	2,128	(3)
State and municipal	1	1,023	(5)	0	0	0	1	1,023	(5)
Total temporarily impaired debt securities, available-for-sale	3	$ 3,151	$ (8)	0	$ 0	$ 0	3	$ 3,151	$ (8)
December 31, 2019									
Debt securities:									
U.S. agency	1	4,983	(17)	2	9,940	(60)	3	14,923	(77)
U.S. agency mortgage-backed, residential	12	21,821	(82)	2	1,163	(5)	14	22,984	(87)
State and municipal	1	466	(1)	0	0	0	1	466	(1)
Total temporarily impaired debt securities, available-for-sale	14	$ 27,270	$ (100)	4	$ 11,103	$ (65)	18	$ 38,373	$ (165)

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

The Corporation believes that unrealized losses at June 30, 2020 were primarily the result of changes in market interest rates and that the Corporation has the ability to hold these investments for a time necessary to recover the amortized cost. Through June 30, 2020 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 3—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 June 30, 2020 and December 31, 2019, 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 member banks, including PeoplesBank, are required to maintain a minimum stock investment. The FHLBP uses a formula to determine the minimum stock investment, which is based on the volume of loans outstanding, unused borrowing capacity and other factors.

The FHLBP paid dividends during the periods ended June 30, 2020 and 2019. 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 June 30, 2020 and 2019.

Note 4—Loans

Loan Portfolio Composition

The table below provides the composition of the loan portfolio at June 30, 2020 and December 31, 2019. The portfolio is comprised of two segments, commercial and consumer loans. The commercial loan segment is disaggregated by industry class which allows the Corporation to monitor risk and performance. Those industries representing the largest dollar investment and most risk are listed separately. The "Other" commercial loans category is comprised of various industries. The consumer related segment is comprised of residential mortgages, home equity and other consumer loans. The Corporation has not engaged in sub-prime residential mortgage originations.

(dollars in thousands)	**June 30, 2020**	**% Total Loans**	**December 31, 2019**	**% Total Loans**
Builder & developer	$ 174,312	10.9	$ 159,312	10.6
Commercial real estate investor	204,852	12.8	207,227	13.8
Residential real estate investor	253,941	15.9	247,969	16.5
Hotel/Motel	80,748	5.0	80,260	5.3
Wholesale & retail	113,515	7.1	109,238	7.3
Manufacturing	98,722	6.2	86,511	5.7
Agriculture	77,386	4.8	80,719	5.4
Other	384,259	24.0	313,371	20.7
Total commercial related loans	1,387,735	86.7	1,284,607	85.3
Residential mortgages	90,072	5.6	94,868	6.3
Home equity	99,835	6.2	100,827	6.7
Other	23,487	1.5	24,833	1.7
Total consumer related loans	213,394	13.3	220,528	14.7
Total loans	$ 1,601,129	100.0	$ 1,505,135	100.0

Loan Risk Ratings

The Corporation's internal risk rating system follows regulatory guidance as to risk classifications and definitions. Every approved loan is assigned a risk rating. Generally, risk ratings for commercial related loans and residential mortgages held for investment are determined by a formal evaluation of risk factors performed by the Corporation's underwriting staff. For consumer loans, and commercial loans up to $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 (the '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 officer to determine if any changes, upward or downward, in risk ratings are appropriate. An external consultant is also used to review a portion of the existing portfolio and recommend rating changes as appropriate. Primary loan officers and internal loan review officers may downgrade existing loans, except to nonaccrual 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 June 30, 2020 and December 31, 2019.

(dollars in thousands)	Pass	Special Mention	Substandard	Nonaccrual	Total
June 30, 2020					
Builder & developer	$ 162,795	$ 10,739	$ 250	$ 528	$ 174,312
Commercial real estate investor	197,112	6,470	1,055	215	204,852
Residential real estate investor	244,589	3,339	142	5,871	253,941
Hotel/Motel	50,033	17,541	13,174	0	80,748
Wholesale & retail	102,769	8,963	1,783	0	113,515
Manufacturing	92,471	521	5,730	0	98,722
Agriculture	69,683	3,720	401	3,582	77,386
Other	358,040	4,714	12,900	8,605	384,259
Total commercial related loans	1,277,492	56,007	35,435	18,801	1,387,735
Residential mortgage	89,763	144	12	153	90,072
Home equity	99,122	59	0	654	99,835
Other	23,271	0	0	216	23,487
Total consumer related loans	212,156	203	12	1,023	213,394
Total loans	$ 1,489,648	$ 56,210	$ 35,447	$ 19,824	$ 1,601,129
December 31, 2019					
Builder & developer	$ 151,672	$ 6,503	$ 252	$ 885	$ 159,312
Commercial real estate investor	201,967	3,890	1,145	225	207,227
Residential real estate investor	238,216	3,780	202	5,771	247,969
Hotel/Motel	67,732	12,528	0	0	80,260
Wholesale & retail	89,556	10,513	1,954	7,215	109,238
Manufacturing	76,721	1,058	7,597	1,135	86,511
Agriculture	76,350	1,123	404	2,842	80,719
Other	277,634	16,490	13,748	5,499	313,371
Total commercial related loans	1,179,848	55,885	25,302	23,572	1,284,607
Residential mortgage	94,388	131	74	275	94,868
Home equity	100,089	61	0	677	100,827
Other	24,600	0	7	226	24,833
Total consumer related loans	219,077	192	81	1,178	220,528
Total loans	$ 1,398,925	$ 56,077	$ 25,383	$ 24,750	$ 1,505,135

Impaired Loans

The table below presents a summary of impaired loans at June 30, 2020 and December 31, 2019 generally, impaired loans are all loans risk rated nonaccrual or classified troubled debt restructuring. An allowance is established for individual loans that are commercial related where the Corporation has doubt as to the full recovery of the outstanding principal balance. Typically, impaired consumer related loans are partially or fully charged-off eliminating the need for specific allowance. The recorded investment represents outstanding unpaid principal loan balances adjusted for payments collected on a non-cash basis and charge-offs.

	With No Allowance		**With A Related Allowance**			**Total**	
(dollars in thousands)	**Recorded Investment**	**Unpaid Principal**	**Recorded Investment**	**Unpaid Principal**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal**
June 30, 2020							
Builder & developer	$ 591	$ 793	$ 140	$ 141	$ 83	$ 731	$ 934
Commercial real estate investor	1,270	1,271	0	0	0	1,270	1,271
Residential real estate investor	905	1,020	4,966	5,032	1,796	5,871	6,052
Hotel/Motel	0	0	0	0	0	0	0
Wholesale & retail	240	240	0	0	0	240	240
Manufacturing	0	0	0	0	0	0	0
Agriculture	2,360	2,411	1,222	1,243	534	3,582	3,654
Other commercial	4,981	12,640	3,624	3,888	1,641	8,605	16,528
Total impaired commercial related loans	10,347	18,375	9,952	10,304	4,054	20,299	28,679
Residential mortgage	153	153	0	0	0	153	153
Home equity	654	666	0	0	0	654	666
Other consumer	216	224	0	0	0	216	224
Total impaired consumer related loans	1,023	1,043	0	0	0	1,023	1,043
Total impaired loans	$ 11,370	$ 19,418	$ 9,952	$ 10,304	$ 4,054	$ 21,322	$ 29,722
December 31, 2019							
Builder & developer	$ 621	$ 651	$ 473	$ 474	$ 238	$ 1,094	$ 1,125
Commercial real estate investor	1,370	1,371	0	0	0	1,370	1,371
Residential real estate investor	734	753	5,037	5,137	1,873	5,771	5,890
Hotel/Motel	0	0	0	0	0	0	0
Wholesale & retail	273	273	7,184	7,811	2,537	7,457	8,084
Manufacturing	13	13	1,122	1,220	463	1,135	1,233
Agriculture	1,784	1,791	1,058	1,058	701	2,842	2,849
Other commercial	1,864	1,974	3,635	3,888	1,608	5,499	5,862
Total impaired commercial related loans	6,659	6,826	18,509	19,588	7,420	25,168	26,414
Residential mortgage	275	277	0	0	0	275	277
Home equity	677	677	0	0	0	677	677
Other consumer	226	231	0	0	0	226	231
Total impaired consumer related loans	1,178	1,185	0	0	0	1,178	1,185
Total impaired loans	$ 7,837	$ 8,011	$ 18,509	$ 19,588	$ 7,420	$ 26,346	$ 27,599

The table below presents a summary of average impaired loans and related interest income that was included in net income for the three and six months ended June 30, 2020 and 2019.

	With No Related Allowance		With A Related Allowance		Total	
(dollars in thousands)	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income	Average Recorded Investment	Total Interest Income
Three months ended June 30, 2020						
Builder & developer	$ 942	10	141	0	$ 1,083	$ 10
Commercial real estate investor	1,297	18	0	0	1,297	18
Residential real estate investor	929	16	4,984	0	5,913	16
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	256	1	3,535	0	3,791	1
Manufacturing	6	0	512	0	518	0
Agriculture	2,386	40	1,094	0	3,480	40
Other commercial	4,376	21	3,629	0	8,005	21
Total impaired commercial related loans	10,192	106	13,895	0	24,087	106
Residential mortgage	153	0	0	0	153	0
Home equity	660	16	0	0	660	16
Other consumer	218	4	0	0	218	4
Total impaired consumer related loans	1,031	20	0	0	1,031	20
Total impaired loans	$ 11,223	$ 126	$ 13,895	$ 0	$ 25,118	$ 126
Three months ended June 30, 2019						
Builder & developer	$ 1,196	$ 14	$ 0	$ 0	$ 1,196	$ 14
Commercial real estate investor	2,644	34	0	0	2,644	34
Residential real estate investor	362	6	4,283	0	4,645	6
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	245	3	7,204	0	7,449	3
Manufacturing	16	4	1,454	0	1,470	4
Agriculture	652	20	0	0	652	20
Other commercial	1,953	0	6,778	0	8,731	0
Total impaired commercial related loans	7,068	81	19,719	0	26,787	81
Residential mortgage	276	3	0	0	276	3
Home equity	564	5	0	0	564	5
Other consumer	271	5	0	0	271	5
Total impaired consumer related loans	1,111	13	0	0	1,111	13
Total impaired loans	$ 8,179	$ 94	$ 19,719	$ 0	$ 27,898	$ 94

(dollars in thousands)	With No Related Allowance Average Recorded Investment	With No Related Allowance Total Interest Income	With A Related Allowance Average Recorded Investment	With A Related Allowance Total Interest Income	Total Average Recorded Investment	Total Total Interest Income
Six months ended June 30, 2020						
Builder & developer	$ 835	22	252	0	$ 1,087	$ 22
Commercial real estate investor	1,322	40	0	0	1,322	40
Residential real estate investor	864	22	5,002	0	5,866	22
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	261	3	4,751	0	5,012	3
Manufacturing	8	3	716	0	724	3
Agriculture	2,185	59	1,082	0	3,267	59
Other commercial	3,539	52	3,631	0	7,170	52
Total impaired commercial related loans	9,014	201	15,434	0	24,448	201
Residential mortgage	194	3	0	0	194	3
Home equity	666	37	0	0	666	37
Other consumer	220	7	0	0	220	7
Total impaired consumer related loans	1,080	47	0	0	1,080	47
Total impaired loans	$ 10,094	$ 248	$ 15,434	$ 0	$ 25,528	$ 248
Six months ended June 30, 2019						
Builder & developer	$ 1,147	$ 28	$ 45	$ 0	$ 1,192	$ 28
Commercial real estate investor	3,280	68	0	0	3,280	68
Residential real estate investor	544	11	4,318	0	4,862	11
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	1,897	6	7,346	0	9,243	6
Manufacturing	451	9	1,538	0	1,989	9
Agriculture	654	33	0	0	654	33
Other commercial	5,717	0	5,483	0	11,200	0
Total impaired commercial related loans	13,690	155	18,730	0	32,420	155
Residential mortgage	406	9	0	0	406	9
Home equity	579	11	0	0	579	11
Other consumer	271	9	0	0	271	9
Total impaired consumer related loans	1,256	29	0	0	1,256	29
Total impaired loans	$ 14,946	$ 184	$ 18,730	$ 0	$ 33,676	$ 184

Past Due and Nonaccrual

The performance and credit quality of the loan portfolio is also monitored by using an aging schedule that 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 June 30, 2020 and December 31, 2019.

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	≥ 90 Days Past Due and Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans
June 30, 2020							
Builder & developer	$ 696	$ 0	$ 0	$ 528	$ 1,224	$ 173,088	$ 174,312
Commercial real estate investor	0	0	0	215	215	204,637	204,852
Residential real estate investor	0	0	0	5,871	5,871	248,070	253,941
Hotel/Motel	0	159	0	0	159	80,589	80,748
Wholesale & retail	32	0	0	0	32	113,483	113,515
Manufacturing	0	0	0	0	0	98,722	98,722
Agriculture	0	0	0	3,582	3,582	73,804	77,386
Other	962	3,788	520	8,605	13,875	370,384	384,259
Total commercial related loans	1,690	3,947	520	18,801	24,958	1,362,777	1,387,735
Residential mortgage	0	107	487	153	747	89,325	90,072
Home equity	185	30	0	654	869	98,966	99,835
Other	0	874	78	216	1,168	22,319	23,487
Total consumer related loans	185	1,011	565	1,023	2,784	210,610	213,394
Total loans	$ 1,875	$ 4,958	$ 1,085	$ 19,824	$ 27,742	$ 1,573,387	$ 1,601,129
December 31, 2019							
Builder & developer	$ 0	$ 0	$ 43	$ 885	$ 928	$ 158,384	$ 159,312
Commercial real estate investor	0	0	0	225	225	207,002	207,227
Residential real estate investor	295	0	0	5,771	6,066	241,903	247,969
Hotel/Motel	0	0	0	0	0	80,260	80,260
Wholesale & retail	0	0	0	7,215	7,215	102,023	109,238
Manufacturing	409	0	0	1,135	1,544	84,967	86,511
Agriculture	14	0	0	2,842	2,856	77,863	80,719
Other	463	1,865	120	5,499	7,947	305,424	313,371
Total commercial related loans	1,181	1,865	163	23,572	26,781	1,257,826	1,284,607
Residential mortgage	0	70	104	275	449	94,419	94,868
Home equity	249	276	0	677	1,202	99,625	100,827
Other	750	68	13	226	1,057	23,776	24,833
Total consumer related loans	999	414	117	1,178	2,708	217,820	220,528
Total loans	$ 2,180	$ 2,279	$ 280	$ 24,750	$ 29,489	$ 1,475,646	$ 1,505,135

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 generally 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 management believes that future loan payments are reasonably assured under the modified terms. TDRs included as impaired loan totaled $1,548,000, $1,650,000 and $3,824,000 as of June 30, 2020, December 31, 2019 and June 30, 2019, respectively. There are no commitments to lend additional amounts to these TDRs as of June 30, 2020, December 31, 2019 and June 30, 2019.

As of June 30, 2020, there have been modifications to 25 consumer loans totaling approximately $1,700,000, 23 mortgage loans totaling approximately $8,000,000 and 374 commercial loans totaling approximately $261,000,000 under the CARES Act, which are not considered TDRs.

The table below shows loans whose terms have been modified under TDRs during the three and six months ended June 30, 2020 and 2019. There were no impairment losses recognized on these TDRs. There were no defaults during the six months ended June 30, 2020 and June 30, 2019 for TDRs entered into during the previous 12 month period.

(dollars in thousands)	Modifications Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments	Recorded Investment at Period End
Three months ended:				
June 30, 2020				
None				
June 30, 2019				
None				
Six months ended:				
June 30, 2020				
None				
June 30, 2019				
Commercial related loans accruing	1	$ 63	$ 63	$ 59

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 three and six months ended June 30, 2020 and 2019.

	Allowance for Loan Losses				
(dollars in thousands)	April 1, 2020 Balance	Charge-offs	Recoveries	Provision	June 30, 2020 Balance
Builder & developer	$ 2,226	$ (674)	$ 0	$ 824	$ 2,376
Commercial real estate investor	2,682	0	0	50	2,732
Residential real estate investor	4,759	0	3	5	4,767
Hotel/Motel	1,056	0	0	474	1,530
Wholesale & retail	4,558	(3,116)	0	956	2,398
Manufacturing	1,316	(392)	0	(23)	901
Agriculture	1,140	0	0	(28)	1,112
Other commercial	4,465	(179)	0	324	4,610
Total commercial related loans	22,202	(4,361)	3	2,582	20,426
Residential mortgage	235	0	0	(6)	229
Home equity	304	0	0	(7)	297
Other consumer	97	(6)	14	(11)	94
Total consumer related loans	636	(6)	14	(24)	620
Unallocated	0	0	0	(8)	(8)
Total	$ 22,838	$ (4,367)	$ 17	$ 2,550	$ 21,038

(dollars in thousands)	April 1, 2019 Balance	Charge-offs	Recoveries	Provision	June 30, 2019 Balance
	Allowance for Loan Losses				
Builder & developer	$ 2,967	$ 0	$ 0	$ (259)	$ 2,708
Commercial real estate investor	2,652	0	0	(84)	2,568
Residential real estate investor	4,010	0	3	(125)	3,888
Hotel/Motel	799	0	0	(53)	746
Wholesale & retail	1,801	0	0	1,681	3,482
Manufacturing	1,266	0	0	89	1,355
Agriculture	578	0	0	(22)	556
Other commercial	5,185	0	0	(40)	5,145
Total commercial related loans	19,258	0	3	1,187	20,448
Residential mortgage	132	0	0	5	137
Home equity	195	(97)	1	173	272
Other consumer	199	(30)	16	(25)	160
Total consumer related loans	526	(127)	17	153	569
Unallocated	297	0	0	(140)	157
Total	$ 20,081	$ (127)	$ 20	$ 1,200	$ 21,174

(dollars in thousands)	January 1, 2020 Balance	Charge-offs	Recoveries	Provision	June 30, 2020 Balance
	Allowance for Loan Losses				
Builder & developer	$ 2,263	$ (844)	$ 0	$ 957	$ 2,376
Commercial real estate investor	2,565	0	0	167	2,732
Residential real estate investor	4,632	0	6	129	4,767
Hotel/Motel	742	0	0	788	1,530
Wholesale & retail	3,575	(3,116)	7	1,932	2,398
Manufacturing	1,252	(392)	0	41	901
Agriculture	1,304	0	0	(192)	1,112
Other commercial	4,204	(7,690)	0	8,096	4,610
Total commercial related loans	20,537	(12,042)	13	11,918	20,426
Residential mortgage	158	0	0	71	229
Home equity	203	0	0	94	297
Other consumer	167	(11)	27	(89)	94
Total consumer related loans	528	(11)	27	76	620
Unallocated	1	0	0	(9)	(8)
Total	$ 21,066	$ (12,053)	$ 40	$ 11,985	$ 21,038

(dollars in thousands)	January 1, 2019 Balance	Charge-offs	Recoveries	Provision	June 30, 2019 Balance
	Allowance for Loan Losses				
Builder & developer	$ 2,835	$ 0	$ 0	$ (127)	$ 2,708
Commercial real estate investor	2,636	0	0	(68)	2,568
Residential real estate investor	3,945	0	6	(63)	3,888
Hotel/Motel	732	0	0	14	746
Wholesale & retail	1,813	0	0	1,669	3,482
Manufacturing	1,287	0	0	68	1,355
Agriculture	579	0	0	(23)	556
Other commercial	4,063	(46)	0	1,128	5,145
Total commercial related loans	17,890	(46)	6	2,598	20,448
Residential mortgage	126	0	0	11	137
Home equity	265	(117)	2	122	272
Other consumer	144	(90)	25	81	160
Total consumer related loans	535	(207)	27	214	569
Unallocated	719	0	0	(562)	157
Total	$ 19,144	$ (253)	$ 33	$ 2,250	$ 21,174

The table below shows the allowance amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for June 30, 2019.

	Allowance for Loan Losses			Loans		
(dollars in thousands)	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance
June 30, 2020						
Builder & developer	$ 83	$ 2,293	$ 2,376	$ 731	$ 173,581	$ 174,312
Commercial real estate investor	0	2,732	2,732	1,270	203,582	204,852
Residential real estate investor	1,796	2,971	4,767	5,871	248,070	253,941
Hotel/Motel	0	1,530	1,530	0	80,748	80,748
Wholesale & retail	0	2,398	2,398	240	113,275	113,515
Manufacturing	0	901	901	0	98,722	98,722
Agriculture	534	578	1,112	3,582	73,804	77,386
Other commercial	1,641	2,969	4,610	8,605	375,654	384,259
Total commercial related	4,054	16,372	20,426	20,299	1,367,436	1,387,735
Residential mortgage	0	229	229	153	89,919	90,072
Home equity	0	297	297	654	99,181	99,835
Other consumer	0	94	94	216	23,271	23,487
Total consumer related	0	620	620	1,023	212,371	213,394
Unallocated	0	(8)	(8)	0	0	0
Total	$ 4,054	$ 16,984	$ 21,038	$ 21,322	$ 1,579,807	$ 1,601,129
December 31, 2019						
Builder & developer	$ 238	$ 2,025	$ 2,263	$ 1,094	$ 158,218	$ 159,312
Commercial real estate investor	0	2,565	2,565	1,370	205,857	207,227
Residential real estate investor	1,873	2,759	4,632	5,771	242,198	247,969
Hotel/Motel	0	742	742	0	80,260	80,260
Wholesale & retail	2,537	1,038	3,575	7,457	101,781	109,238
Manufacturing	463	789	1,252	1,135	85,376	86,511
Agriculture	701	603	1,304	2,842	77,877	80,719
Other commercial	1,608	2,596	4,204	5,499	307,872	313,371
Total commercial related	7,420	13,117	20,537	25,168	1,259,439	1,284,607
Residential mortgage	0	158	158	275	94,593	94,868
Home equity	0	203	203	677	100,150	100,827
Other consumer	0	167	167	226	24,607	24,833
Total consumer related	0	528	528	1,178	219,350	220,528
Unallocated	0	1	1	0	0	0
Total	$ 7,420	$ 13,646	$ 21,066	$ 26,346	$ 1,478,789	$ 1,505,135

Note 6—Deposits

The composition of deposits as of June 30, 2020 and December 31, 2019 is shown below. The aggregate amount of demand deposit overdrafts that were reclassified as loans is $52,000 at June 30, 2020, compared to $86,000 at December 31, 2019.

(dollars in thousands)	June 30, 2020	December 31, 2019
Noninterest bearing demand	$ 397,968	$ 273,968
Interest bearing demand	201,746	174,248
Money market	558,220	513,948
Savings	101,586	85,489
Time deposits less than $100	296,808	303,527
Time deposits $100 to $250	184,971	175,477
Time deposits $250 or more	66,343	63,907
Total deposits	$ 1,807,642	$ 1,590,564

Note 7—Short-Term Borrowings and Long-Term Debt

Short-term borrowings consist of securities sold under agreements to repurchase, federal funds purchased and other borrowings. At June 30, 2020, the balance of securities sold under agreements to repurchase was $9,477,000 compared to $7,925,000 at December 31, 2019. At June 30, 2020 and December 31, 2019, there were no other short-term borrowings.

The following table presents a summary of long-term debt as of June 30, 2020 and December 31, 2019. PeoplesBank's long-term debt obligations to the FHLBP are fixed rate instruments. Under terms of a blanket collateral agreement with the FHLBP, the obligations are secured by FHLBP stock and PeoplesBank qualifying loan receivables, principally real estate secured loans.

(dollars in thousands)	**June 30, 2020**	**December 31, 2019**
PeoplesBank's obligations:		
Federal Home Loan Bank of Pittsburgh (FHLBP)		
Due March 2020, 1.86%	$ 0	$ 10,000
Due June 2020, 1.87%	0	15,000
Due June 2020, 2.70%	0	10,000
Due June 2021, 2.81%	10,000	10,000
Due June 2021, 2.14%	15,000	15,000
Due May 2022, 2.93%	10,000	10,000
Total FHLBP	$ 35,000	$ 70,000
Codorus Valley Bancorp, Inc. obligations:		
Junior subordinated debt		
Due 2034, 2.33%, floating rate based on 3 month LIBOR plus 2.02%, callable quarterly	3,093	3,093
Due 2036, 2.76% floating rate based on 3 month LIBOR plus 1.54%, callable quarterly	7,217	7,217
Total junior subordinated debt	$ 10,310	$ 10,310
Lease obligations included in long-term debt:		
Finance lease liabilities	1,309	1,322
Total long-term debt	$ 46,619	$ 81,632

At June 30, 2020 and December 31, 2019, 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.

Note 8—Leases

A lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration. On January 1, 2019, the Corporation adopted ASU 2016-02 "*Leases" (Topic 842)* and all subsequent ASUs that modified Topic 842. For the Corporation, Topic 842 affected the accounting treatment for operating lease agreements in which the Corporation is the lessee.

Substantially all of the leases in which the Corporation is the lessee are comprised of real estate property, ATM locations, and office space. Substantially all of our leases are classified as operating leases, and therefore, were previously not recognized on the Corporation's consolidated statements of condition. With the adoption of Topic 842, operating lease agreements are required to be recognized on the consolidated statements of condition as a right-of-use ("ROU") asset and a corresponding lease liability. The Corporation has one finance lease for one financial center. Leases with an initial term of 12 months or less are not recorded on the consolidated statement of condition. All other leases have remaining lease terms of 1 year to 25 years, some of which include options to extend. Upon opening a new financial center, we typically install brand-specific leasehold improvements which are depreciated over the shorter of the useful life or length of the lease. To the extent that the initial lease term of the related lease is less than the useful life of the leasehold improvements and, taking into consideration the dollar amount of the improvements, we conclude that it is reasonably certain that a renewal option will be exercised, the renewal period is included in the lease term, and the related payments are reflected in the ROU asset and lease liability. Regarding the discount rate, Topic 842 requires the use of the rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, the Corporation utilizes its incremental borrowing rate at lease inception, on an amortizing and collateralized basis, over a similar term. For operating leases existing prior to January 1, 2019, the rate for the remaining lease term as of January 1, 2019 was used. For the Corporation's financing lease, the Corporation utilized its incremental borrowing rate at lease inception.

All of our leases include fixed rental payments. We commonly enter into leases under which the lease payments increase at pre-determined dates based on the change in the consumer price index. While the majority of our leases are gross leases, we also have a number of leases in which we make separate payments to the lessor based on the lessor's property and casualty insurance cost and the property taxes assessed on the property, as well as a portion of the common area maintenance associated with the property. We have elected the practical expedient not to separate lease and nonlease components for all of our building leases.

The components of lease expense were as follows:

	Three months ended June 30,	
(dollars in thousands)	**2020**	**2019**
Operating lease cost	$ 192	$ 188
Finance lease cost:		
Amortization of right-of-use assets	$ 12	$ 17
Interest on lease liability	12	13
Total finance lease cost	$ 24	$ 30
Total lease cost	$ 216	$ 218

	Six months ended June 30,	
(dollars in thousands)	**2020**	**2019**
Operating lease cost	$ 395	$ 376
Finance lease cost:		
Amortization of right-of-use assets	$ 24	$ 34
Interest on lease liability	24	26
Total finance lease cost	$ 48	$ 60
Total lease cost	$ 443	$ 436

Supplemental cash flow information related to leases was as follows:

	Six months ended June 30,	
	2020	**2019**
Operating cash flows from operating leases	$ 404	$ 387
Operating cash flows from financing leases	24	26
Financing cash flows from financing leases	13	22
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	186	0
Finance leases	0	0

Amounts recognized as right-of-use assets related to finance leases are included in fixed assets in the accompanying statement of financial position, while related lease liabilities are included in long-term debt. Supplemental balance sheet information related to leases was as follows:

	June 30, 2020	December 31, 2019
Assets:		
Operating leases right-of-use assets	$ 2,683	$ 3,021
Finance leases assets	1,111	1,134
Total lease assets	$ 3,794	$ 4,155
Liabilities:		
Operating	$ 2,824	$ 3,184
Financing	1,309	1,322
Total lease liabilities	$ 4,133	$ 4,506
Weighted Average Remaining Lease Term (years)		
Operating leases	5.6	5.6
Finance leases	23.7	24.2
Weighted Average Discount Rate		
Operating leases	2.70%	2.72%
Finance leases	3.69%	3.69%

Future minimum payments for financing leases and operating leases as of June 30, 2020 and December 31, 2019 were as follows:

(dollars in thousands:)	**June 30, 2020**	
Year Ending December 31,	**Operating Leases**	**Finance Leases**
2020	$ 343	$ 38
2021	667	75
2022	604	75
2023	489	75
2024	413	75
Thereafter	508	1,666
Total lease payments	3,024	2,004
Less imputed interest	(200)	(695)
Total	$ 2,824	$ 1,309

(dollars in thousands:)	**December 31, 2019**	
Year Ending December 31,	**Operating Leases**	**Finance Leases**
2020	$ 767	$ 74
2021	706	75
2022	545	75
2023	491	75
2024	413	75
Thereafter	507	1,668
Total lease payments	3,429	2,042
Less imputed interest	(245)	(720)
Total	$ 3,184	$ 1,322

Note 9—Regulatory Matters

The Corporation and PeoplesBank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action that, if imposed, could have a material adverse effect on the Corporation's financial statements. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of June 30, 2020, the Corporation and PeoplesBank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of June 30, 2020 and December 31, 2019, the most recent regulatory notifications categorized PeoplesBank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

The table below 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. Minimum amounts and ratios include the full phase in of the capital conservation buffer of 2.5 percent required by the Basel III framework.

	Actual		Minimum for Basel III Capital Adequacy		Well Capitalized Minimum (1)	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Codorus Valley Bancorp, Inc. (consolidated)						
at June 30, 2020						
Capital ratios:						
Common equity Tier 1	$ 184,862	12.85 %	$ 100,688	7.00 %	n/a	n/a
Tier 1 risk based	194,862	13.55	122,264	8.50	n/a	n/a
Total risk based	212,880	14.80	151,032	10.50	n/a	n/a
Leverage	194,862	9.50	82,048	4.00	n/a	n/a
at December 31, 2019						
Capital ratios:						
Common equity Tier 1	$ 187,312	12.45 %	$ 105,359	7.00 %	n/a	n/a
Tier 1 risk based	197,312	13.11	127,936	8.50	n/a	n/a
Total risk based	216,154	14.36	158,039	10.50	n/a	n/a
Leverage	197,312	10.55	74,820	4.00	n/a	n/a
PeoplesBank, A Codorus Valley Company						
at June 30, 2020						
Capital ratios:						
Common equity Tier 1	$ 191,102	13.32 %	$ 100,452	7.00 %	$ 93,276	6.50 %
Tier 1 risk based	191,102	13.32	121,977	8.50	114,802	8.00
Total risk based	209,078	14.57	150,677	10.50	143,502	10
Leverage	191,102	9.33	81,909	4.00	102,386	5.00
at December 31, 2019						
Capital ratios:						
Common equity Tier 1	$ 193,421	12.88 %	$ 105,118	7.00 %	$ 97,610	6.50 %
Tier 1 risk based	193,421	12.88	127,643	8.50	120,135	8.00
Total risk based	212,220	14.13	157,677	10.50	150,169	10
Leverage	193,421	10.36	74,673	4.00	93,341	5.00

(1) 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

Stock Dividend

Periodically, the Corporation distributes stock dividends on its common stock. The Corporation distributed 5 percent stock dividends on December 10, 2019 and December 11, 2018, which resulted in the issuance of 463,193 and 447,092 additional shares, respectively.

Share Repurchase

The Corporation's Board of Directors approved a new Share Repurchase Program ("Program") in March 2020. Under the newly approved Program, the Corporation is authorized to repurchase up to $5 million of the Corporation's issued and outstanding common stock. All shares of common stock repurchased pursuant to the Program shall be held as treasury shares and be available for use and reissuance for purposes as and when determined by the Board of Directors including, without limitation, pursuant to the Corporation's Dividend Reinvestment and Stock Purchase Plan and its equity compensation program. During the first quarter of 2020 the Corporation repurchased 5,335 shares at an average price of $16.37. Shortly after the Program began, and in response to COVID-19, the Corporation suspended the Program. There was no activity under the program for the quarter ended June 30, 2020.

Note 11—Contingent Liabilities

There are no legal proceedings pending against Codorus Valley Bancorp, Inc. or any of its subsidiaries which are expected to have a material impact upon the consolidated financial position and/or operating results of the Corporation, other than routine litigation incidental to the business. Management is not aware of any proceedings known or contemplated by government authorities.

Note 12—Guarantees

Codorus Valley does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by PeoplesBank to guarantee the performance of a client to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to clients. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $17,866,000 of standby letters of credit outstanding on June 30, 2020, compared to $17,253,000 on December 31, 2019. 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 payments required under the corresponding letters of credit. The amount of the liability as of June 30, 2020 and December 31, 2019, for guarantees under standby letters of credit issued, was not material. Many of the commitments are expected to expire without being drawn upon and, therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

Note 13—Fair Value of Assets and Liabilities

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. 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.

		Fair Value Measurements		
(dollars in thousands)	**Total**	**(Level 1) Quoted Prices in Active Markets for Identical Assets**	**(Level 2) Significant Other Observable Inputs**	**(Level 3) Significant Other Unobservable Inputs**
June 30, 2020				
Securities available-for-sale:				
U.S. Treasury notes	$ 5,053	$ 5,053	$ 0	$ 0
U.S. agency mortgage-backed, residential	131,503	0	131,503	0
State and municipal	22,051	0	22,051	0
Corporate debt	1,108	0	1,108	0
December 31, 2019				
Securities available-for-sale:				
U.S. Treasury notes	$ 9,953	$ 9,953	$ 0	$ 0
U.S. agency	14,923	0	14,923	0
U.S. agency mortgage-backed, residential	108,155	0	108,155	0
State and municipal	26,644	0	26,644	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 June 30, 2020, the fair value of impaired loans with a valuation allowance or partial charge-off was $6,560,000, net of valuation allowances of $4,054,000 and partial charge-offs of $7,634,000. At December 31, 2019 the fair value of impaired loans with a valuation allowance or charge-off was $11,297,000, net of valuation allowances of $7,420,000 and charge-offs of $134,000.

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 on an independent third-party appraisal of the property or occasionally on a recent sales offer. At June 30, 2020 with a valuation allowance or write-down was $103,000 which is net of write-downs of $18,000, and at December 31, 2019, the fair value of foreclosed real estate with a valuation allowance or write-down was $797,000 which is net of write-downs of $617,000.

Mortgage Servicing Rights

Mortgage servicing rights are initially recorded at fair value upon the sale of residential mortgage loans to secondary market investors. The fair value of servicing rights is based on the present value of estimated future cash flows on pools of mortgages stratified by rate and original time to maturity. Mortgage servicing rights are subsequently evaluated for impairment on a quarterly basis. Significant inputs to the valuation include expected cash flow, expected net servicing income, a cash flow discount rate and the expected life of the underlying loans. At June 30, 2020, the fair value of the mortgage servicing rights asset was $649,000. At December 31, 2019, the fair value of the mortgage servicing rights asset was $1,047,000.

		Fair Value Measurements		
(dollars in thousands)	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
June 30, 2020				
Impaired loans	$ 6,560	$ 0	$ 0	$ 6,560
Foreclosed real estate	103	0	0	103
Mortgage servicing rights	649	0	0	649
December 31, 2019				
Impaired loans	$ 11,297	$ 0	$ 0	$ 11,297
Foreclosed real estate	797	0	0	797
Mortgage servicing rights	1,047	0	0	1,047

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:

	Quantitative Information about Level 3 Fair Value Measurements				
(dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range	Weighted Average
June 30, 2020					
Impaired loans	$ 6,560	Appraisal (1)	Appraisal adjustments (2)	15% -50%	41%
Foreclosed real estate	103	Appraisal (1)	Appraisal adjustments (2)	15% - 15%	15%
Mortgage Servicing Rights	649	Multiple of annual service fee	Estimated prepayment speed based on rate and term	15.6% - 19.2%	18.4%
December 31, 2019					
Impaired loans	$ 5,991	Appraisal (1)	Appraisal adjustments (2)	15% - 55%	44%
Impaired loans	5,306	Business asset valuation (3)	Business asset valuation adjustments (4)	10% - 73%	70%
Foreclosed real estate	797	Appraisal (1)	Appraisal adjustments (2)	22% - 22%	22%
Mortgage Servicing Rights	1,047	Multiple of annual service fee	Estimated prepayment speed based on rate and term	7.9% - 8.9%	8.7%

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

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

(3) Fair value is generally determined through customer-provided financial statements and bankruptcy court documents.

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

The following presents the carrying amounts and estimated fair values of the Corporation’s financial instruments as of June 30, 2020 and December 31, 2019.

			Fair Value Estimates		
(dollars in thousands)	**Carrying Amount**	**Estimated Fair Value**	**(Level 1) Quoted Prices in Active Markets for Identical Assets**	**(Level 2) Significant Other Observable Inputs**	**(Level 3) Significant Other Unobservable Inputs**
June 30, 2020					
Financial assets					
Cash and cash equivalents	$ 215,361	$ 215,361	$ 215,361	$ 0	$ 0
Securities available-for-sale	159,715	159,715	5,053	154,662	0
Loans held for sale	17,534	18,274	0	18,274	0
Loans, net	1,580,091	1,587,083	0	0	1,587,083
Interest receivable	6,534	6,534	0	6,534	0
Financial liabilities					
Deposits	$ 1,807,642	$ 1,814,706	$ 0	$ 1,814,706	$ 0
Short-term borrowings	9,477	9,477	0	9,477	0
Long-term debt (1)	45,310	44,427	0	35,899	8,528
Interest payable	617	617	0	617	0
Off-balance sheet instruments	0	0	0	0	0
December 31, 2019					
Financial assets					
Cash and cash equivalents	$ 131,591	$ 131,591	$ 131,591	$ 0	$ 0
Securities available-for-sale	159,675	159,675	9,953	149,722	0
Restricted investment in bank stocks	4,551	4,551	0	4,551	0
Loans held for sale	11,803	12,460	0	12,460	0
Loans, net	1,484,069	1,472,772	0	0	1,472,772
Interest receivable	5,016	5,016	0	5,016	0
Financial liabilities					
Deposits	$ 1,590,564	$ 1,582,179	$ 0	$ 1,582,179	$ 0
Short-term borrowings	7,925	7,925	0	7,925	0
Long-term debt (1)	80,310	79,579	0	70,486	9,093
Interest payable	842	842	0	842	0
Off-balance sheet instruments	0	0	0	0	0

(1) Exclude leases included in Long-term debt

Note 14—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. Thus, there is no offsetting or netting of the securities with the repurchase agreement liabilities.

				Gross amounts Not Offset in the Statements of Condition			
				Financial Instruments			
(dollars in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	U.S. agency mortgage-backed, residential	U.S. agency	Cash Collateral Pledged	Net Amount
June 30, 2020							
Repurchase Agreements	$ 9,477	$ 0	$ 9,477	$ (10,114)	$ 0	$ 0	$ (637)
December 31, 2019							
Repurchase Agreements	$ 7,925	$ 0	$ 7,925	$ (9,601)	$ 0	$ 0	$ (1,676)

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

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

Forward-looking Statements

Management of the Corporation has made forward-looking statements in this Form 10-Q. These forward-looking statements 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 occur in the Form 10-Q, management is making forward-looking statements.

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

- Operating, legal and regulatory risks;
- 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, which 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;
- Occurrence of natural or man-made disasters or calamities, including health emergencies, the spread of infectious diseases, or pandemics;
- 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.

COVID – 19 Pandemic

The coronavirus has affected nearly every aspect of personal and business life over the last quarter. The Company has needed to react quickly to changing guidelines from the CDC and at the state levels. The changes in how the Company must conduct its essential services to the community are continuing to evolve. Thru the second quarter, efforts to mitigate the spread of this virus have been successful in both Pennsylvania and Maryland, allowing a path for re-opening businesses.

In recent weeks, the nation has seen a resurgence of hot spots resulting in some states tightening up guidelines and issuing lockdowns. The impact on the Company's market area from the number of growing cases in other parts of the country is still unknown, but is starting to show signs of potential impact. Governor Wolf has recently announced a need to create stricter guidelines and travel restrictions in Pennsylvania in order to slow the spread of COVID-19 due to higher infection rates in other states.

The PeoplesBank Crisis Management Team has been monitoring the situation closely and is meeting weekly to manage the changing dynamics of COVID-19.

Associates

Approximately 40 percent of the Company's associates are continuing to work off-premise. A phased approach and a comprehensive plan to safely return associates working remotely has been developed, and will be implemented as the number of COVID-19 cases decline and as permitted by state municipal authorities. On-going associate communication and training related to staying healthy and safe during a pandemic has been a priority. At the time of this release, one associate has tested positive for COVID-19.

Re-Opening

A phased plan to re-open the majority of Financial Centers was also implemented in the second quarter. This involved developing and training associates on new lobby protocols, installing new signage, removing upholstered furniture, and adding plastic shields on the teller line.

The first eight financial centers re-opened with lobby service on June 15th. The locations identified to open in the first phase were based on transaction volumes, higher staffing levels and the ability to serve clients across a geographic region. By the end of June, nineteen financial centers and three Retirement Community Office lobbies were open with several modifications to ensure the safety of clients and associates. These include shorter lobby hours, designated hours for seniors and clients at high risk, a designated lobby manager to screen and limit the number of clients in a lobby at a time, and additional cleaning protocols. Five Financial Centers continue to offer drive-thru and by appointment only hours, and four Retirement Community Offices and three Loan Production Offices (Young Manor, Centerville, Bel Air) remain closed.

The Company purchased electrostatic machines to reduce third-party expenses and internally manage the sanitizing of all facilities.

Client Hardship

In addition to higher volume of calls to our Client Care Center, financial hardship telephone lines were set-up to assist clients with loan deferments, SBA loans, and fee waivers. The Company continued to waive ATM foreign fees throughout the entire second quarter for all clients.

PeoplesBank continues to responsibly and prudently extend credit to qualified borrowers. In addition, we were active participants in the SBA Paycheck Protection Program (PPP). As of July 15th, PeoplesBank has processed approximately 1,300 PPP loans totaling $180 million with projected fees exceeding $6 million. The majority of these loans (83 percent) were supporting small businesses with loan amounts below $150,000.

Digital Adoption

In mid-June, PeoplesBank began promoting video call appointments to clients as another option for connecting with a financial mentor. Associates who serve as financial mentors participated in extensive training on how to conduct professional and effective video calls with clients.

During this quarter, digital adoption continued to rise as record numbers of clients utilized online banking and mobile deposit features.

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 Policies

The Corporation's critical accounting policies, as summarized in Note 1—Summary of Significant Accounting Policies, include those related to the allowance for loan losses, valuation of foreclosed real estate, evaluation of other-than-temporary impairment of securities, and determination of acquisition-related goodwill and fair value adjustments, which require management to make significant judgments, estimates and assumptions that have a material impact on the carrying value of the respective assets and liabilities. For this Form 10-Q, there were no material changes made to the Corporation's critical accounting policies, which are more fully disclosed in Item 7 of the Corporation's previously filed Annual Report on Form 10-K for the year ended December 31, 2019.

Three Months Ended June 30, 2020 vs. Three Months Ended June 30, 2019

FINANCIAL HIGHLIGHTS

The Corporation's net income (earnings) was $3,050,000 for the quarter ended June 30, 2020, as compared to $4,859,000 for the quarter ended June 30, 2019, a decrease of $1,809,000 or 37 percent.

Net interest income for the second quarter of 2020 decreased $1,343,000 or 8 percent below the same period in 2019, primarily due to lower rates of interest on loans and lower rates on interest bearing deposits with banks, partially offset by lower rates on interest bearing demand deposits in the second quarter 2020 as compared to the second quarter 2019.

The Corporation's net interest margin (tax-equivalent basis) for the second quarter 2020 was 3.07 percent, compared to 3.75 percent for the second quarter 2019. The net interest margin contraction was a result of lower rates on interest bearing deposits with banks and lower rates on loans, partially offset by lower rates on interest bearing demand deposits.

The provision for loan losses for the second quarter 2020 was $2,550,000, as compared to a provision of $1,200,000 for the second quarter 2019. The increased provision expense in the second quarter 2020 was attributed primarily to a partial charge off arising from a single commercial lending relationship. The partial charge off did not exceed the specific reserve allocation for the relationship, however, it did increase the historical loss factor in the allowance for loan loss analysis. In addition, changes in the external environment created by COVID-19 caused management to increase the qualitative factors for certain loan segments in the allowance for loan loss analysis, which resulted in additional provision for loan losses in the quarter. Both periods supported adequate allowance for loan loss coverage, however, changing economic conditions associated with the COVID-19 pandemic may require future adjustments. The allowance as a percentage of total loans was 1.31 percent at June 30, 2020 as compared to 1.40 percent at December 31, 2019 and 1.44 percent at June 30, 2019.

Noninterest income for the second quarter 2020 decreased $107,000 or 3 percent compared to the second quarter 2019. Service charges on deposit accounts decreased. The decrease was offset by trust and investment service fees and gain on sales from loans held for sale increased in 2020.

Noninterest expense in the second quarter 2020 was $374,000 or 3 percent lower than the second quarter 2019. Lower personnel costs, marketing and foreclosed real estate accounted for a majority of the decrease. The decrease was partially offset by an increase in external data processing and impaired loan carrying cost.

The provision for income taxes for the second quarter 2020 decreased by $617,000 or 47 percent as compared to the second quarter 2019 as a result of the lower income before taxes in the second quarter 2020 as compared to the second quarter 2019.

The schedule below presents selected performance metrics for the second quarter of both 2020 and 2019. Per share computations include the effect of stock dividends, including the most recent, a 5 percent stock dividend distributed in the fourth quarter of 2019.

	Three months ended June 30,	
	2020	**2019**
Basic earnings per share	$ 0.31	$ 0.49
Diluted earnings per share	$ 0.31	$ 0.49
Cash dividend payout ratio	51.22 %	31.14 %
Return on average assets	0.59 %	1.06 %
Return on average equity	6.37 %	10.45 %
Net interest margin (tax equivalent basis)	3.07 %	3.75 %
Net overhead ratio	1.68 %	1.93 %
Efficiency ratio	65.52 %	62.42 %
Average equity to average assets	9.30 %	10.13 %

A more detailed analysis of the factors and trends affecting the Corporation's earnings and financial position follows.

INCOME STATEMENT ANALYSIS

Net Interest Income

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 quarter ended June 30, 2020 was $14,900,000, a decrease of $1,343,000 or 8 percent compared to net interest income of $16,243,000 for the second quarter 2019. The decrease was primarily attributable to lower rates of interest on loans, lower rates on interest bearing deposits with banks and was partially offset by lower rates on interest bearing demand deposits in the second quarter 2020 as compared to the second quarter 2019.

The Corporation's net interest margin, computed as interest income (tax-equivalent basis) annualized as a percentage of average interest earning assets, was 3.07 percent for the second quarter 2020 compared to the 3.75 percent for the second quarter 2019. The net interest margin contraction was a result of lower interest rates on interest bearing deposits with banks and lower interest rates on loans, partially offset by lower rates on interest bearing demand deposits.

Total interest income for the second quarter 2020 totaled $18,838,000, a decrease of $2,697,000 or 13 percent below the amount of total interest income for the second quarter 2019. The change was primarily a result of lower rates on interest bearing deposits with banks and lower rates on commercial loans.

Interest and dividend income on investments decreased $93,000 or 9 percent in the second quarter 2020 compared to the same period in 2019. The average balance of the investment securities portfolio increased $7,469,000 or 5 percent when comparing the second quarter 2020 to the same period in 2019. The tax-equivalent yield on investments for the second quarter 2020 was 2.29 percent or 37 basis points lower than the 2.66 percent experienced in the second quarter 2019.

Interest income on loans decreased $2,094,000 or 10 percent in the second quarter 2020 compared to the same period in 2019. The average balance of outstanding loans, primarily commercial loans, increased approximately $109,221,000 or 7 percent comparing the second quarter 2020 to the same period in 2019. Lower rates on the loan portfolio were the primary driver of the decrease in interest income on loans. The tax-equivalent yield on loans for the second quarter 2020 was 4.50 percent or 88 basis points less than the 5.38 percent experienced in the second quarter 2019.

Total interest expense for the second quarter 2020 was $3,938,000, a decrease of $1,354,000 or 26 percent as compared to total interest expense of $5,292,000 for the second quarter 2019. The change was primarily the result of a decrease in the cost of interest bearing demand deposits.

Interest expense on deposits decreased $1,115,000 or 24 percent in the second quarter 2020 compared to the same period in 2019. The average rate paid on interest bearing deposits was 1.01 percent in the second quarter 2020 or 45 basis points lower than the average rate paid of 1.46 percent in the second quarter 2019. The average balance of interest bearing deposits for the second quarter 2020 increased by $134,873,000 or 11 percent compared to the second quarter 2019. Also, the Corporation experienced favorable growth in noninterest-bearing deposits, with the average volume for the second quarter 2020 increasing 47 percent to $378,549,000 as compared to $257,451,000 for the second quarter 2019.

For the second quarter 2020 interest expense on borrowings decreased $239,000 or 35 percent compared to the second quarter 2019. Short-term borrowings consisting of repurchase agreements and other short-term borrowings averaged $8,234,000 for the second quarter 2020, compared to an average balance of $8,066,000 for the second quarter 2019. The rate on average short-term borrowings for the second quarter 2020 was 0.54 percent, a decrease as compared to a rate of 0.55 percent for the second quarter 2019. Long-term debt, primarily from the Federal Home Loan Bank of Pittsburgh (FHLBP), averaged $66,406,000 for the second quarter 2020 and $106,495,000 for the second quarter 2019. For the second quarter 2020, the rate on average long-term borrowings was 2.58 percent, an increase as compared to a rate of 2.50 percent for the second quarter 2019.

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

	Three months ended June 30,					
	2020			**2019**		
(dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
Assets						
Interest bearing deposits with banks	$ 194,820	$ 48	0.10 %	$ 93,302	$ 558	2.40 %
Investment securities:						
Taxable	143,861	784	2.19	128,243	832	2.60
Tax-exempt	21,304	157	2.96	29,453	212	2.89
Total investment securities	165,165	941	2.29	157,696	1,044	2.66
Loans:						
Taxable (1)	1,590,244	17,800	4.50	1,480,696	19,890	5.39
Tax-exempt	10,103	100	3.98	10,430	104	4.00
Total loans	1,600,347	17,900	4.50	1,491,126	19,994	5.38
Total earning assets	1,960,332	18,889	3.88	1,742,124	21,596	4.97
Other assets (2)	97,777			94,278		
Total assets	$ 2,058,109			$ 1,836,402		
Liabilities and Shareholders' Equity						
Deposits:						
Interest bearing demand	$ 747,550	$ 654	0.35 %	$ 674,048	$ 2,035	1.21 %
Savings	97,506	15	0.06	86,832	21	0.10
Time	555,683	2,832	2.05	504,986	2,560	2.03
Total interest bearing deposits	1,400,739	3,501	1.01	1,265,866	4,616	1.46
Short-term borrowings	8,234	11	0.54	8,066	11	0.55
Long-term debt	66,406	426	2.58	106,495	665	2.50
Total interest bearing liabilities	1,475,379	3,938	1.07	1,380,427	5,292	1.54
Noninterest bearing deposits	378,549			257,451		
Other liabilities	12,684			12,526		
Shareholders' equity	191,497			185,998		
Total liabilities and shareholders' equity	$ 2,058,109			$ 1,836,402		
Net interest income (tax equivalent basis)		$ 14,951			$ 16,304	
Net interest margin (3)			3.07 %			3.75 %
Tax equivalent adjustment		(51)			(61)	
Net interest income		$ 14,900			$ 16,243	

(1) Average balance includes average nonaccrual loans of $25,749,000 for 2020 and $24,987,000 for 2019. Interest includes net loan fees of $1,190,000 for 2020 and $759,000 for 2019.

(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 percentage of average earning assets.

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

(dollars in thousands)	Three months ended June 30, 2020 vs. 2019 — Increase (decrease) due to change in* Volume	Rate	Net
Interest Income			
Interest bearing deposits with banks	$ 607	$ (1,117)	$ (510)
Investment securities:			
Taxable	102	(150)	(48)
Tax-exempt	(59)	4	(55)
Loans:			
Taxable	1,794	(3,884)	(2,090)
Tax-exempt	(4)	0	(4)
Total interest income	2,440	(5,147)	(2,707)
Interest Expense			
Deposits:			
Interest bearing demand	216	(1,597)	(1,381)
Savings	3	(9)	(6)
Time	257	15	272
Short-term borrowings	0	0	0
Long-term debt	(230)	(9)	(239)
Total interest expense	246	(1,600)	(1,354)
Net interest income (tax equivalent basis)	$ 2,194	$ (3,547)	$ (1,353)

*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 the estimated losses attributable to uncollected loans. The provision reflects management's judgment of an appropriate level for the allowance for loan losses. Provision for loan losses for the second quarter 2020 was $2,550,000, a $1,350,000 increase as compared to a provision of $1,200,000 for the second quarter 2019. The increased provision expense in the second quarter 2020 was attributed primarily to a partial charge off arising from a single commercial lending relationship. The partial charge off did not exceed the specific reserve allocation for the relationship, however, it did increase the historical loss factor in the allowance for loan loss analysis. In addition, changes in the external environment created by COVID-19 caused management to increase the qualitative factors for certain loan segments in the allowance for loan loss analysis, which resulted in additional provision for loan losses in the quarter. Both periods supported adequate allowance for loan loss coverage, however, changing economic conditions associated with the COVID-19 pandemic may require future adjustments. The allowance as a percentage of total loans was 1.31 percent at June 30, 2020, as compared to 1.40 percent at December 31, 2019 and 1.44 percent at June 30, 2019.

More information about the allowance for loan losses can be found in this report under the caption Allowance for Loan Losses on page 52.

Noninterest Income

The following table presents the components of total noninterest income for the second quarter 2020, compared to the second quarter 2019.

Table 3 - Noninterest income

	Three months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	**2020**	**2019**	**$**	**%**
Trust and investment services fees	$ 946	$ 881	$ 65	7 %
Income from mutual fund, annuity and insurance sales	249	296	(47)	(16)
Service charges on deposit accounts	975	1,208	(233)	(19)
Income from bank owned life insurance	279	292	(13)	(4)
Other income	482	645	(163)	(25)
Gain on sales of loans held for sale	554	319	235	74
Gain on sales of securities	50	1	49	*nm
Total noninterest income	$ 3,535	$ 3,642	$ (107)	(3)%

*nm – not meaningful

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

Income from mutual fund, annuity and insurance sales**—**The $47,000 or 16 percent decrease in income from mutual fund, annuity and insurance sales is due to a slow down in new business impacted by the changing rate environment.

Service charges on deposit accounts**—**The $233,000 or 19 percent decrease in service charges on deposit accounts is attributed to a lower assessment of overdraft fees in the second quarter 2020 compared to the second quarter 2019. The lower assessment is partially due to the waiver of fees associated with the COVID-19 pandemic followed by an overall reduction in overdraft fees once fee assessment resumed. In addition foreign ATM fees were waived during the second quarter 2020.

Other income**—**The $163,000 or 25 percent decrease in other income is due to lower swap fee referrals during the second quarter 2020 compared to the second quarter 2019.

Gain on sales of loans held for sale**—**The $235,000 or 74 percent increase in gain on sales of loans was due to the sale of a larger volume of the mortgage loans to the secondary market during the second quarter 2020 compared to the second quarter 2019.

Noninterest Expense

The following table presents the components of total noninterest expense for the second quarter 2020, compared to the second quarter 2019.

Table 4 - Noninterest expense

(dollars in thousands)	Three months ended June 30, 2020	2019	Change Increase (Decrease) $	%
Personnel	$ 7,196	$ 7,391	$ (195)	(3)%
Occupancy of premises, net	865	900	(35)	(4)
Furniture and equipment	841	775	66	9
Postage, stationery and supplies	205	175	30	17
Professional and legal	245	222	23	10
Marketing	311	374	(63)	(17)
FDIC insurance	172	223	(51)	(23)
Debit card processing	284	317	(33)	(10)
Charitable donations	93	134	(41)	(31)
Telecommunications	144	130	14	11
External data processing	704	616	88	14
(Gain)/loss on foreclosed real estate, including (recovery of) provision for losses	(193)	47	(240)	(511)
Impaired loan carrying costs	190	80	110	138
Other	1,073	1,120	(47)	(4)
Total noninterest expense	$ 12,130	$ 12,504	$ (374)	(3)%

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

Personnel—The $195,000 or 3 percent decrease in personnel expense is primarily the result of a lower number of full time equivalent employees.

Postage, stationery and supplies—The $30,000 or 17 percent increase in postage, stationery and supplies expense is attributed to an increase in customer mailings during the second quarter 2020.

Marketing—The $63,000 or 17 percent decrease in marketing expense is attributed to marketing campaigns delayed in 2020 due to the COVID-19 pandemic.

FDIC insurance—The $51,000 or 23 percent decrease in FDIC insurance expense is attributed to a lower assessment factor.

Charitable donations—The $41,000 or 31 percent decrease in charitable donations expense is attributed to a delay in charitable donations due to the COVID-19 pandemic.

(Gain)/loss on foreclosed real estate, including (recovery of) provision for losses—The $240,000 or 511 percent decrease in foreclosed real estate expense is primarily attributed to the recovery of a provision for losses on foreclosed real estate that was sold during the second quarter 2020.

Impaired loan carrying costs—The $110,000 or 138 percent increase in impaired loan carrying costs expense is primarily attributed to increased expenses associated with impaired loans.

Provision for Income Taxes

The provision for income taxes for the second quarter 2020 was $705,000, a decrease of $617,000 or 47 percent as compared to the second quarter 2019. The decrease was attributed to lower pre-tax net income for the second quarter 2020 compared to the second quarter 2019. The effective tax rate for the three months ended June 30, 2020 was 18.8 percent and the effective tax rate for the three months ended June 30, 2019 was 21.4 percent. The effective tax rate differs from the statutory tax rate primarily due to the impact of certain elements with specific tax benefits, including tax-exempt income, such as income from tax-exempt investments, tax-exempt loans, and bank-owned life insurance.

Six Months Ended June 30, 2020 vs. Six Months Ended June 30, 2019

FINANCIAL HIGHLIGHTS

The Corporation’s net income (earnings) was $61,000 for the first six months of 2020 compared to $8,950,000 for the first six months of 2019, a decrease of $8,889,000 or 99 percent.

Net interest income for the first six months of 2020 decreased $1,507,000 or 5 percent below the first six months of 2019, primarily due to lower rates on interest bearing deposits with banks and lower rates on loans, partially offset by lower rates on interest bearing demand deposits over the previous period.

The Corporation’s net interest margin (tax-equivalent basis) for the six months ended June 30, 2020 was 3.25 percent, compared to 3.72 percent for the first six months of 2019. The net interest margin contraction was a result of lower rates on interest bearing deposits with banks, lower rates on loans, partially offset by lower rates on interest bearing demand deposits.

The provision for loan losses for the first six months of 2020 was $11,985,000 a $9,735,000 increase as compared to a provision of $2,250,000 for the first six months of 2019. The increased provision expense in 2020 was primarily due to partial charge offs on two commercial lending relationships. In addition, changes in the external environment created by COVID-19 caused management to increase the qualitative factors for certain loan segments in the allowance for loan loss analysis, which resulted in additional provision for loan losses during the year. The provision for both periods supported adequate allowance for loan loss coverage, however, changing economic conditions associated with the COVID-19 pandemic may require future adjustments. The allowance as a percentage of total loans was 1.31 percent at June 30, 2020, as compared to 1.40 percent at December 31, 2019, and 1.44 percent at June 30, 2019.

Noninterest income for the first six months of 2020 increased $93,000 1 percent compared to the first six months of 2019. Contributing to the rise in noninterest income were trust and investment services fees and gain on sale of loans held for sale. A decline in service charges on deposit accounts offset some of the increase.

Noninterest expense for the first six months of 2020 were $25,449,000 2 percent higher than the first six months of 2019. The increase was primarily attributable to higher furniture and equipment, professional and legal, external data processing and impaired loans carrying costs. Offsetting some of the increase were declines in marketing and FDIC insurance.

The provision for income taxes for the first six months of 2020 decreased $2,644,000 or 111 percent as compared to the first six months of 2019 as a result of lower income before taxes in the first six months of 2020 compared to the first six months of 2019.

On June 30, 2020, the Corporation’s total assets were $2.07 billion, an increase of 10 percent since December 31, 2019. The increase was primarily attributed to loan growth.

The Corporation’s capital level remained sound as evidenced by regulatory capital ratios that exceed current regulatory requirements for well capitalized institutions. As of June 30, 2020, the Corporation’s capital calculations and ratios reflect full compliance with the Basel III regulatory capital framework, which became effective on January 1, 2015.

The schedule below presents selected performance metrics for the first six months of both 2020 and 2019. Per share computations include the effect of stock dividends, including the most recent, 5 percent stock dividend distributed in the fourth quarter of 2019.

	Six months ended June 30, 2020	Six months ended June 30, 2019
Basic earnings per share	$ 0.01	$ 0.90
Diluted earnings per share	$ 0.01	$ 0.90
Cash dividend payout ratio	5,119.67 %	33.80 %
Return on average assets	0.01 %	0.98 %
Return on average equity	0.06 %	9.75 %
Net interest margin (tax equivalent basis)	3.25 %	3.72 %
Net overhead ratio	1.88 %	2.00 %
Efficiency ratio	68.00 %	64.33 %
Average equity to average assets	9.75 %	10.08 %

A more detailed analysis of the factors and trends affecting the Corporation’s earnings and financial position follows.

INCOME STATEMENT ANALYSIS

Net Interest Income

Net interest income for the six months ended June 30, 2020 was $30,267,000, a decrease of $1,507,000 or 5 percent compared to net interest income of $31,774,000 for the first six months of 2019. The decrease was primarily attributable to lower rates on interest bearing deposits with banks and lower rates on loans, partially offset by lower rates on interest bearing demand deposits over the previous period.

The Corporation’s net interest margin, computed as interest income (tax-equivalent basis) annualized as a percentage of average interest earning assets, was 3.25 percent for the first six months of 2020, representing an decrease compared to the 3.72 percent net interest margin for the first six months of 2019. The net interest margin contraction was a result of lower rates on interest bearing deposits with banks, lower rates on loans, partially offset by lower rates on interest bearing demand deposits.

Total interest income for the first six months of 2020 totaled $39,027,000, a decrease of $3,384,000 or 8 percent below the amount of total interest income for the first six months of 2019. The change was primarily a result of a decrease in loan interest income due to lower rates on commercial loans and lower rates on interest bearing deposits with banks.

Interest income on loans decreased $2,840,000 or 7 percent in the first six months of 2020 compared to the same period in 2019. The average balance of outstanding loans increased approximately $56,828,000 or 4 percent in the first six months of 2020 compared to the first six months of 2019, reflecting commercial loan growth between the two periods.

Investment income for the first six months of 2020 decreased $64,000 or 3 percent compared to the first six months of 2019. The tax-equivalent yield on investments for the first six months of 2020 was 2.46 percent or 24 basis points lower than the 2.70 percent experienced during the first six months of 2019.

Total interest expense for the first six months of 2020 was $8,760,000, a decrease of $1,877,000 or 18 percent as compared to total interest expense of $10,637,000 for the first six months of 2019. The change in interest expense was primarily a result of a decrease in the cost of interest bearing demand deposits and lower volume of long-term debt between the two periods.

Interest expense on deposits decreased $1,459,000 or 16 percent in the first six months of 2020 compared to the same period in 2019. The change was due primarily to a decrease in the cost of interest bearing demand deposits. The average balance of interest-bearing deposits for the first six months of 2020, primarily in lower cost core deposits, increased by $112,602,000 or 9 percent compared to the average for the first six months of 2019. The average rate paid on interest-bearing deposits in the first six months of 2020 was 1.14 percent, a decrease from the average rate of 1.49 percent paid on interest-bearing deposits during the first six months of 2019. Also, the Corporation experienced favorable growth in noninterest-bearing deposits, with the average volume for the first six months of 2020 increasing to $322,962,000, as compared to $251,188,000 for the first six months of 2019.

Interest expense on borrowings for the first six months of 2020 decreased $30 percent compared to the first six months of 2019, due to a lower volume of long-term debt. Outstanding long-term debt, consisting primarily of Federal Home Loan Bank of Pittsburgh (FHLBP) advances, averaged $75,538,000 for the first six months of 2020, compared to an average balance of approximately $113,090,000 for the same period of 2019. The rate on average long-term debt for the first six months of 2020 was 2.56 percent, an increase as compared to the rate of 2.46 percent for the same period of 2019.

Table 5-Average Balances and Interest Rates (tax equivalent basis)

	Six months ended June 30,					
	2020			**2019**		
(dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
Assets						
Interest bearing deposits with banks	$ 163,666	$ 440	0.54 %	$ 76,941	$ 920	2.41 %
Investment securities:						
Taxable	141,878	1,676	2.38	123,524	1,627	2.66
Tax-exempt	22,442	332	2.97	33,043	471	2.87
Total investment securities	164,320	2,008	2.46	156,567	2,098	2.70
Loans:						
Taxable (1)	1,541,876	36,468	4.76	1,485,434	39,315	5.34
Tax-exempt	10,965	221	4.05	10,579	210	4.00
Total loans	1,552,841	36,689	4.75	1,496,013	39,525	5.33
Total earning assets	1,880,827	39,137	4.18	1,729,521	42,543	4.96
Other assets (2)	97,972			91,767		
Total assets	$ 1,978,799			$ 1,821,288		
Liabilities and Shareholders' Equity						
Deposits:						
Interest bearing demand	$ 721,070	$ 1,951	0.54 %	$ 678,079	$ 4,417	1.31 %
Savings	92,527	35	0.08	86,738	43	0.10
Time	553,009	5,791	2.11	489,187	4,776	1.97
Total interest bearing deposits	1,366,606	7,777	1.14	1,254,004	9,236	1.49
Short-term borrowings	7,637	20	0.53	7,255	20	0.56
Long-term debt	75,538	963	2.56	113,090	1,381	2.46
Total interest bearing liabilities	1,449,781	8,760	1.22	1,374,349	10,637	1.56
Noninterest bearing deposits	322,962			251,188		
Other liabilities	13,172			12,239		
Shareholders' equity	192,884			183,512		
Total liabilities and shareholders' equity	$ 1,978,799			$ 1,821,288		
Net interest income (tax equivalent basis)		$ 30,377			$ 31,906	
Net interest margin (3)			3.25 %			3.72 %
Tax equivalent adjustment		(110)			(132)	
Net interest income		$ 30,267			$ 31,774	

(1) Average balance includes average nonaccrual loans of $26,148,000 for 2020 and $21,561,000 for 2019. Interest includes net loan fees of $2,009,000 for 2020 and $1,271,000 for 2019.

(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 percentage of average interest earning assets.

Table 6-Rate/Volume Analysis of Changes in Net Interest Income (tax equivalent basis)

	Six months ended June 30, 2020 vs. 2019		
	Increase (decrease) due to change in*		
(dollars in thousands)	**Volume**	**Rate**	**Net**
Interest Income			
Interest bearing deposits with banks	$ 1,037	$ (1,517)	$ (480)
Investment securities:			
Taxable	216	(167)	49
Tax-exempt	(151)	12	(139)
Loans:			
Taxable	2,049	(4,896)	(2,847)
Tax-exempt	8	3	11
Total interest income	3,159	(6,565)	(3,406)
Interest Expense			
Deposits:			
Interest bearing demand	204	(2,670)	(2,466)
Savings	3	(11)	(8)
Time	623	392	1,015
Short-term borrowings	0	0	0
Long-term debt	(421)	3	(418)
Total interest expense	409	(2,286)	(1,877)
Net interest income (tax equivalent basis)	$ 2,750	$ (4,279)	$ (1,529)

*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

For the first six months of 2020, the provision for loan losses was $11,985,000, as compared to a provision of $2,250,000 for the first six months of 2019, an increase of $9,735,000. The increased provision expense in 2020 was primarily due to partial charge offs on two commercial lending relationships. In addition, changes in the external environment created by COVID-19 caused management to increase the qualitative factors for certain loan segments in the allowance for loan loss analysis, which resulted in additional provision for loan losses during the year. The provision for both periods supported adequate allowance for loan loss coverage, however, changing economic conditions associated with the COVID-19 pandemic may require future adjustments. The allowance as a percentage of total loans was 1.31 percent at June 30, 2020, as compared to 1.40 percent at December 31, 2019, and 1.44 percent at June 30, 2019.

More information about the allowance for loan losses can be found in this report under the caption Allowance for Loan Losses on page 52.

Noninterest Income

The following table presents the components of total noninterest income for the first six months of 2020, compared to the first six months of 2019.

Table 7 - Noninterest income

	Six months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	**2020**	**2019**	**$**	**%**
Trust and investment services fees	$ 1,940	$ 1,721	$ 219	13 %
Income from mutual fund, annuity and insurance sales	510	531	(21)	(4)
Service charges on deposit accounts	2,105	2,366	(261)	(11)
Income from bank owned life insurance	565	659	(94)	(14)
Other income	921	1,054	(133)	(13)
Gain on sales of loans held for sale	852	537	315	59
Gain (loss) on sales of securities	65	(3)	68	*nm
Total noninterest income	$ 6,958	$ 6,865	$ 93	1 %

*nm – not meaningful

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

Trust and investment services fees—The $219,000 or 13 percent increase in trust and investment services fees is due to growth of new business.

Service charges on deposit accounts—The $261,000 or 11 percent decrease in service charges on deposit accounts is due to a lower assessment of overdraft fees in 2020 compared to 2019. The lower assessment is partially due to the waiver of fees associated with the COVID-19 pandemic followed by an overall reduction in overdraft fees once fee assessment resumed. In addition foreign ATM fees were waived during the second quarter 2020.

Gain on sales of loans held for sale—The $315,000 or 59 percent increase in gain on sales of loans is due to the sale of a larger volume of mortgage loans to the secondary market.

Noninterest Expense

The following table presents the components of total noninterest expense for the first six months of 2020, compared to the first six months of 2019.

Table 8 - Noninterest expense

	Six months ended June 30,		Change Increase (Decrease)	
(dollars in thousands)	**2020**	**2019**	**$**	**%**
Personnel	$ 15,001	$ 15,097	$ (96)	(1)%
Occupancy of premises, net	1,791	1,863	(72)	(4)
Furniture and equipment	1,694	1,547	147	10
Postage, stationery and supplies	422	359	63	18
Professional and legal	450	331	119	36
Marketing	636	723	(87)	(12)
FDIC insurance	339	460	(121)	(26)
Debit card processing	673	640	33	5
Charitable donations	965	979	(14)	(1)
Telecommunications	265	256	9	4
External data processing	1,408	1,172	236	20
(Gain)/loss on roreclosed real estate, including (recovery of) provision for losses	(173)	134	(307)	(229)
Impaired loan carrying costs	476	119	357	300
Other	1,502	1,385	117	8
Total noninterest expense	$ 25,449	$ 25,065	$ 384	2 %

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

Personnel—The $96,000 or 1 percent decrease in personnel is primarily the result of fewer full-time equivalent employees in 2020 compared to the prior period.

Professional and legal—The $119,000 or 36 percent increase in professional and legal is primarily due to an increase in CPA and consulting fees.

FDIC insurance—The $121,000 or 26 percent decrease in FDIC insurance is due to a lower assessment rate.

External data processing—The $236,000 or 20 percent increase in external data processing expenses reflects increased reliance on outsourcing transaction processing to specialized vendors, which is typically performed on such vendors' hosted and secure websites. In addition, increased volumes in both accounts and transactions year over year due to business expansion resulted in higher costs. The Corporation continues to expand and enhance electronic banking services provided to our clients which contributed to the increase in the expense.

(Gain)/loss on foreclosed real estate including, (recovery of) provision for losses—The $307,000 or 229 percent decrease in foreclosed real estate including provision for losses is attributed to the recovery of provision for loss associated with the sale of foreclosed real estate.

Impaired loan carrying costs—The $357,000 or 300 percent increase in impaired loan carrying costs is attributed to the volume of impaired loans and the associated costs to maintain these loans.

Provision for Income Taxes

The income tax benefit for the first six months of 2020 was $ (270,000), a decrease of $2,644,000 or 111 percent as compared to the first six months of 2019. The effective tax benefit for the six months ended June 30, 2020 was 129.2 percent and the effective tax rate for the six months ended June 30, 2019 was 21.0 percent. The effective tax rate differs from the statutory tax rate primarily due to the impact of certain elements with specific tax benefits, including tax-exempt income, such as income from tax-exempt investments, tax-exempt loans, and bank-owned life insurance.

BALANCE SHEET REVIEW

Interest Bearing Deposits with Banks

On June 30, 2020, interest bearing deposits with banks totaled $197,432,000, an increase of $86,690,000 or 78 percent, compared to the level at year-end 2019. The increase is primarily the result of the growth in client deposits, offset by loan growth and a decrease in long-term debt.

Investment Securities (Available-for-Sale)

The Corporation's entire investment securities portfolio is classified available-for-sale, and is comprised primarily of interest-earning debt securities. The overall composition of the Corporation's investment securities portfolio is provided in Note 2—Securities. On June 30, 2020, the fair value of investment securities available-for-sale totaled $159,715,000, which represented an increase of $40,000 as compared to the fair value of investment securities at year-end 2019. New investments during the first six months of 2020 replaced principal reductions from investment maturities, mortgage-backed security payments, and sales.

Loans

On June 30, 2020, total loans, net of deferred fees, were $1.58 billion, which was $96,022,000 or 6 percent higher than the level at year-end 2019. The change in volume was due primarily to an increase in PPP loans, which totaled approximately $177 million at June 30, 2020. Commercial loans within the builder and developer, commercial real estate investor and residential real estate investor sectors each represented more than 10 percent of the total portfolio. The composition of the Corporation's loan portfolio is provided in Note 4—Loans.

Deposits

Deposits are the Corporation's principal source of funding for earning assets. On June 30, 2020, deposits totaled $1.81 billion, which reflected a $217,078,000 or 14 percent increase compared to the level at year-end 2019. Of the increase in total deposits, $124,000,000 is attributable to noninterest bearing deposits and $93,078,000 is related to growth in interest bearing deposits. The composition of the Corporation's total deposit portfolio is provided in Note 6—Deposits.

Short-term Borrowings

Short-term borrowings, which consist of securities sold under agreements to repurchase (repurchase agreements), federal funds purchased, and other short-term borrowings, totaled $9,477,000 at June 30, 2020, which reflected a $1,552,000 or 20 percent increase compared to the level at year-end 2019.

Long-term Debt

The Corporation uses long-term borrowings as a secondary funding source for asset growth and to manage interest rate risk. On June 30, 2020, long-term debt totaled $46,619,000 compared to $81,632,000 at year-end 2019. The $35,013,000 decrease is primarily the result of $10,000,000 in FHLBP borrowings that were repaid at maturity during the first quarter 2020 and $25,000,000 in FHLBP borrowings that were repaid at maturity during the second quarter 2020. A listing of outstanding long-term debt obligations is provided in Note 7—Short-Term Borrowings and Long-Term Debt. The composition of the Corporation's leases is provided in Note 8—Leases.

Shareholders' Equity and Capital Adequacy

Shareholders' equity, or capital, enables Codorus Valley to maintain asset growth and absorb losses. Capital adequacy can be affected by a multitude of factors, including profitability, new stock issuances, corporate expansion and acquisitions, dividend policy and distributions, and regulatory mandates. The Corporation's total shareholders' equity was approximately $191,835,000 on June 30, 2020, an increase of approximately $667,000 or less than 1 percent, compared to the level at year-end 2019.

Cash Dividends on Stock

The Corporation has historically paid cash dividends on its 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 relevant factors. As recently announced, the Board of Directors declared a quarterly cash dividend of $0.10 per share on July 14, 2020, payable on August 11, 2020, to shareholders of record at the close of business on July 28, 2020. This cash dividend follows the $0.16 cash dividend distributed in February 2020 and May 2020.

Capital Adequacy

The Corporation and PeoplesBank are subject to various regulatory capital requirements administered by banking regulators that involve quantitative guidelines and qualitative judgments. The regulatory capital measures for the Corporation and PeoplesBank as of June 30, 2020 and the minimum capital ratios established by regulators are set forth in Note 8—Regulatory Matters to the financial statements. We believe that both Codorus Valley and PeoplesBank were well capitalized on June 30, 2020 and had no regulatory dividend restrictions (see Note 9—Regulatory Matters to the financial statements).

RISK MANAGEMENT

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, and has established a lending policy which management believes is sound given the nature and scope of our operations. The Credit Risk Management section included in Item 7 of the Corporation’s previously filed Annual Report on Form 10-K for the year ended December 31, 2019, provides a more detailed overview of the Corporation’s credit risk management process.

Nonperforming Assets

Nonperforming assets, as shown in the table below, are asset categories that pose the greatest risk of loss. The level of nonperforming assets at June 30, 2020 has decreased by approximately $4,815,000 or 19 percent when compared to year-end 2019. The decrease was primarily the result of a net decrease in nonaccrual loans.

The Corporation regularly monitors large and criticized assets in its commercial loan portfolio recognizing that prolonged low economic growth, or a weakening economy, could have negative effects on these commercial borrowers. Nonperforming assets are monitored and managed for collection of these accounts. Collection efforts, including modification of contractual terms for individual accounts based on prevailing market conditions and liquidation of collateral assets, are employed to maximize recovery. A special assets committee meets regularly, at a minimum quarterly, to review nonperforming assets. 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: an account reaches 90 days past due, unless a certified appraisal was completed within the past twelve months; market values have changed significantly; the condition of the property has changed significantly; or the existing appraisal is outdated based upon regulatory or policy requirements. In instances where the value of the collateral, net of costs to sell, is less than the net carrying amount for impaired commercial related loans, a specific loss allowance is established for the difference. Further provisions for loan losses may be required for nonaccrual loans as additional information becomes available or conditions change. When it is probable that some portion or an entire loan balance will not be collected, that amount is charged off as loss against the allowance.

The paragraphs and table below address significant changes in the nonperforming asset categories as of June 30, 2020 compared to December 31, 2019.

Table 5 - Nonperforming Assets

(dollars in thousands)	**June 30, 2020**	**December 31, 2019**
Nonaccrual loans	$ 19,773	$ 24,696
Nonaccrual loans, troubled debt restructurings	51	54
Accruing loans 90 days or more past due	1,085	280
Total nonperforming loans	20,909	25,030
Foreclosed real estate, net of allowance	103	797
Total nonperforming assets	$ 21,012	$ 25,827
Accruing troubled debt restructurings	$ 1,497	$ 1,596
Total period-end loans, net of deferred fees	$ 1,601,129	$ 1,505,135
Allowance for loan losses (ALL)	$ 21,038	$ 21,066
ALL as a % of total period-end loans	1.31 %	1.40 %
Net charge-offs year-to-date, annualized as a % of average total loans	1.55 %	0.04 %
ALL as a % of nonperforming loans	100.62 %	84.16 %
Nonperforming loans as a % of total period-end loans	1.31 %	1.66 %
Nonperforming assets as a % of total period-end loans and net foreclosed real estate	1.31 %	1.72 %
Nonperforming assets as a % of total period-end assets	1.01 %	1.37 %
Nonperforming assets as a % of total period-end shareholders' equity	10.95 %	13.51 %

Nonperforming loans

Nonperforming loans consist of nonaccrual loans and accruing loans 90 days or more past due. We generally place a loan on nonaccrual status and cease accruing interest income (i.e., recognize 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. 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. 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. As of June 30, 2020, the nonperforming loan portfolio balance totaled $20,909,000, compared to $25,030,000 at year-end 2019. During the first six months of 2020, loans totaling $12,709,000 were transferred to nonaccrual status, offset by the transfer of loans out of nonaccrual status and payments to loans in nonaccrual status totaling approximately $5,694,000 and charge offs totaling $11,941,000. There was an $805,000 increase in 90 day past due loans, resulting in the net decrease of $4,121,000. For both periods, the nonperforming portfolio balance was comprised primarily of collateralized commercial loans.

Foreclosed Real Estate

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 June 30, 2020, net of allowance, totaled $103,000 compared to $797,000 at year-end 2019. The $694,000 decrease was the result of the disposition of one property totaling $797,000, offset by the addition of one property totaling $103,000, net of a $18,000 writedown.

Troubled Debt Restructurings

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 June 30, 2020, the accruing troubled debt restructuring portfolio balance totaled $1,497,000, compared to $1,596,000 at year-end 2019. The $99,000 decrease was the result of principal repayments of $99,000.

As of June 30, 2020, there have been modifications to 25 consumer loans totaling approximately $1,700,000, 23 mortgage loans totaling approximately $8,000,000 and 374 commercial loans totaling approximately $261,000,000 under the CARES Act, which are not considered TDRs.

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.
The allowance for loan losses consists primarily of three components: specific allowances for individually impaired commercial loans; allowances calculated for pools of loans; and 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.
The following table presents an analysis of the activity in the allowance for loan losses for the three and six months ended June 30, 2020 and 2019:

Table 6 - Analysis of Allowance for Loan Losses

(dollars in thousands)	**2020**	**2019**
Balance-January 1,	$ 21,066	$ 19,144
Provision charged to operating expense	11,985	2,250
Loans charged off:		
Commercial, financial and agricultural	11,945	46
Real estate - construction and land development	97	0
Consumer and home equity	11	207
Total loans charged off	12,053	253
Recoveries:		
Commercial, financial and agricultural	13	6
Consumer and home equity	27	27
Total recoveries	40	33
Net charge-offs	12,013	220
Balance-June 30,	$ 21,038	$ 21,174
Ratios:		
Annualized net charge-offs as a % of average total loans	1.55 %	0.03 %
Allowance for loan losses as a % of total period-end loans	1.31 %	1.44 %
Allowance for loan losses as a % of nonperforming loans	100.62 %	84.13 %

The provision for loan losses increased $9,735,000 from June 30, 2019 to June 30, 2020. The increased provision expense in 2020 was primarily due to partial charge offs on two commercial lending relationships. In addition, changes in the external environment created by COVID-19 caused management to increase the qualitative factors for certain loan segments in the allowance for loan loss analysis, which resulted in additional provision for loan losses during the year. Both periods supported adequate allowance for loan loss coverage, however, changing economic conditions associated with the COVID-19 pandemic may require future adjustments.
Net charge-offs for the first six months of 2020 were $12,013,000 compared to $220,000 for the same period in 2019. During the first six months of 2020, there were $12,053,000 of charge-offs as compared to $253,000 during the same period in 2019. Although the provision expense increased, a portion of the charge-off was part of the specific reserve allocation in the previous quarter; therefore, the overall allowance as a percentage of total loans decrased in the current period. The risks and uncertainties associated with the COVID-19 pandemic, weak economic and business conditions, or the erosion of real estate values may adversely affect our borrowers' ability to service their loans, causing significant fluctuations in the level of charge-offs and provision expense from one period to another. The allowance as a percentage of total loans was 1.31 percent at June 30, 2020, as compared to 1.40 percent at December 31, 2019 and 1.44 percent at June 30, 2019. There was no unallocated portion of the allowance as of June 30, 2020, as compared to $157,000 or 1 percent of the total allowance as of June 30, 2019.

Liquidity Risk Management

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, adequate liquidity 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 funds received from client loan payments, investment maturities and cash inflows from mortgage-backed securities, and the net proceeds of asset sales. The primary sources of liability liquidity are deposit growth, and funds obtained from 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 June 30, 2020, we believe that liquidity was adequate based upon the potential liquidation of unpledged available-for-sale securities with a fair value totaling approximately $29,053,000 and available credit from the Federal Home Loan Bank of Pittsburgh totaling approximately $549,804,000. The Corporation’s loan-to-deposit ratio was approximately 89 percent as of June 30, 2020, 95 percent as of December 31, 2019 and 96 percent as of June 30, 2019.

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. Unused commitments on June 30, 2020, totaled $551,310,000 and consisted of $479,450,000 in unfunded commitments under existing loan facilities, $53,994,000 to grant new loans and $17,866,000 in letters of credit. 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 upon and, therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

Recent Legislative Developments

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted in response to the COVID-19 pandemic. Since that time banking regulators, the SEC and FASB have all issued additional guidance and clarification on various sections of the CARES Act. Section 4013 of the CARES Act provides the option to not apply ASC 310-40 (TDRs) to a loan modification, related specifically to COVID-19 hardships, including the flexibility to not classify the loan as impaired for accounting purposes. Regulators have encouraged financial institutions to work constructively with borrowers in communities and industries affected by COVID-19 using prudent and proactive actions which are in the best interests of the financial institution, the borrower and the economy. The Corporation’s Board of Directors approved a number of options for loan modifications, including interest deferral, full payment deferral, additional extensions of credit, and SBA loan programs (i.e., Economic Injury Disaster Loans, Paycheck Protection Program). As of June 30, 2020, the Corporation has processed requests for loan modifications totaling approximately $270 million. The Corporation has been an active participant in the SBA Paycheck Protection Program, with outstanding PPP loans as of June 30, 2020 of approximately $177 million.

At its October 16, 2019 meeting, the FASB approved a deferral of the effective date for several of its recent standards. The proposal creates two new “buckets”: (1) SEC filers other than smaller reporting companies (SRCs, as defined by the SEC) and (2) all other entities. For the Corporation, this would apply to ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“CECL”), which has not yet been adopted by the Corporation. The effective date of the CECL standard would be for fiscal years beginning after December 15, 2022. The Corporation plans to delay CECL implementation, but to continue moving forward with the project.

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 as “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 September 17, 2019, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve Board, and the FDIC adopted a rule to implement the provisions of Section 201 of the Regulatory Relief Act. Under the rule, 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 rule 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 Corporation continues to analyze the changes implemented by the Regulatory Relief Act, including the CBLR framework included in the recently proposed rulemaking. The Corporation does not believe, however, that such changes will materially impact the Corporation’s business, operations, or financial results.

Item 3. 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 300 and 400 basis point decrease in interest rates cannot be 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 with the exception of a decrease of 100 basis points were within policy limits at June 30, 2020. The -100 scenario is expected to return within policy limits during 2020.

Change in Interest Rates (basis points)	**Annual Change in Net Interest Income (in thousands)**	**% Change in Net Interest Income**	**% Change Policy Limit**
+100	$ 3,682	6.11 %	(5.00) %
-100	$ (3,164)	(5.25) %	(5.00) %
+200	$ 8,463	14.05 %	(15.00) %
-200	$ (6,142)	(10.19) %	(15.00) %
+300	$ 13,083	21.71 %	(25.00) %
+400	$ 17,721	29.41 %	(35.00) %

Item 4. Controls and Procedures

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 Treasurer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation’s Chief Executive and Chief Financial Officers concluded that, as of June 30, 2020, the Corporation’s disclosure controls and procedures were effective. The Corporation’s disclosure controls and procedures are designed to provide reasonable, not absolute, assurance 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 Securities and Exchange Commission’s rules and forms. A control system, no matter how well conceived and operated, must reflect the fact that there are resource constraints and that the benefits of controls must be considered relative to their costs, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

There has been no change in the Corporation’s internal control over financial reporting that occurred during the three and six months ended June 30, 2020, that has materially affected, or is reasonably likely to materially affect, the Corporation’s internal control over financial reporting.

Part II—OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation and PeoplesBank are involved in routine litigation incidental to their business. In the opinion of management, there are no legal proceedings pending against the Corporation or any of its subsidiaries which are expected to have a material impact upon the consolidated financial position and/or operating results of the Corporation. Management is not aware of any adverse proceedings known or contemplated by government authorities.

Item 1A. Risk Factors

Except for the risk factor described immediately below, there have been no material changes to the risk factors as previously disclosed in Item 1A – Risk Factors – in our Annual Report on Form 10-K for the year ended December 31, 2019.

Coronavirus Outbreak – In December 2019, a coronavirus (COVID-19) was reported in China, and, in March 2020, the World Health Organization declared it a pandemic. Since first being reported in China, the coronavirus has spread to additional countries including the United States.

In response, many state and local governments, including the Commonwealth of Pennsylvania and the State of Maryland, have instituted emergency restrictions that have substantially limited the operation of non-essential businesses and the activities of individuals. It has been widely reported that these restrictions have resulted in significant adverse effects for many different types of businesses, particularly those in the travel, hospitality and food and beverage industries, among many others, and has resulted in a significant number of layoffs and furloughs of employees nationwide and in the regions in which the Corporation operates. The ultimate effect of COVID-19 on the local or broader economy is not known nor is the ultimate length of the restrictions described and any accompanying effects. Moreover, the Federal Reserve has taken action to lower the Federal Funds rate, which may negatively affect interest income and, therefore, earnings. Given the ongoing and dynamic nature of the circumstances, it is difficult to predict the impact of the coronavirus outbreak, and there is no guarantee that the Corporation's efforts to address the adverse impacts of the coronavirus will be effective. The extent of such impact will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and actions taken to contain the coronavirus or its impact, among others.

The effect of COVID-19 and related events, including those described above and those not yet known or knowable, could have a negative effect on the Corporation's business prospects, financial condition and results of operations, as a result of quarantines; market volatility; market downturns; changes in consumer behavior; business closures; deterioration in the credit quality of borrowers or the inability of borrowers to satisfy their obligations (and any related forbearances or restructurings that may be implemented); changes in the value of collateral securing outstanding loans; changes in the value of the investment securities portfolio; effects on key employees, including operational management personnel and those charged with preparing, monitoring and evaluating the Corporation's financial reporting and internal controls; declines in the demand for loans and other banking services and products; declines in demand resulting from adverse impacts of the disease on businesses deemed to be "non-essential" by governments; and branch or office closures and business interruptions.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Corporation relies on its subsidiary PeoplesBank, A Codorus Valley Company, for dividend distributions, which are subject to restrictions as reported in Note 9—Regulatory Matters of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2019.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
March 1 - 31, 2020	5,335	$ 16.37	5,335	$ 4,912,660

The Corporation's Board of Directors approved a new Share Repurchase Program ("Program") in March 2020. Under the newly approved Program, the Corporation is authorized to repurchase up to $5 million of the Corporation's issued and outstanding common stock. All shares of common stock repurchased pursuant to the Program shall be held as treasury shares and be available for use and reissuance for purposes as and when determined by the Board of Directors including, without limitation, pursuant to the Corporation's Dividend Reinvestment and Stock Purchase Plan and its equity compensation program. During the first quarter of 2020 the Corporation repurchased 5,335 shares at an average price of $16.37. Shortly after the Program began, and in response to COVID-19, the Corporation suspended the Program. There was no activity under the Program for the quarter ended June 30, 2020.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

This Item 4 is not applicable to the Corporation.

Item 5. Other Information

None

Item 6. Exhibits

Exhibit Number	Description of Exhibit
3.1	Amended Articles of Incorporation (Incorporated by reference to Exhibit 3.1 to 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 3.2 to the Quarterly Report on Form 10-Q/A for March 31, 2020, file with the Commission on May 15, 2020)
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	Financial statements from the Quarterly Report on Form 10-Q of Codorus Valley Bancorp, Inc. for the quarter ended June 30, 2020, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income (iii) the Consolidated Statements of Comprehensive Income (iv) the Consolidated Statements of Cash Flows, (v) the Consolidated Statements of Changes in Shareholder’s Equity, and (vi) the Notes to Consolidated Financial Statements – filed herewith.
104	Cover page interactive data file (formatted as inline XBRL and contained in Exhibit 101)

Signatures

Pursuant to the requirements 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)

August 3, 2020	/s/ Larry J. Miller
Date	Larry J. Miller, Chairman,President and Chief Executive Officer (Principal Executive Officer)
August 3, 2020	/s/ Larry D. Pickett
Date	Larry D. Pickett, CPA Treasurer (Principal Financial and Accounting Officer)

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Section 2: EX-31.1 (EX-31.1)

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

I, Larry J. Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Codorus Valley Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 3, 2020

/s/ Larry J. Miller
Larry J. Miller, Chairman,
President and Chief Executive Officer
(Principal Executive Officer)

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Section 3: EX-31.2 (EX-31.2)

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

I, Larry D. Pickett, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Codorus Valley Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 3, 2020

/s/ Larry D. Pickett
Larry D. Pickett, CPA
Treasurer
(Principal Financial and Accounting Officer)

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Section 4: EX-32 (EX-32)

EXHIBIT 32

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

The certification set forth below is being submitted in connection with the Quarterly Report of Codorus Valley Bancorp, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2020, as filed with the Securities and Exchange Commission (the "Report"), for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Larry J. Miller, the Chief Executive Officer, and Larry D. Pickett, the Principal Financial Officer, of the Company, each certifies that, to the best of his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 3, 2020

/s/ Larry J. Miller
Larry J. Miller, Chairman,
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Larry D. Pickett
Larry D. Pickett, CPA
Treasurer
(Principal Financial and Accounting Officer)

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