CODORUS VALLEY BANCORP INC
Form 10-K
March 15, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2016

or

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

For the transition period from _____________ to _____________.

Commission file Number 0-15536

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

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

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

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| **Common Stock, $2.50 par value** | **NASDAQ Stock Market LLC** |

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

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

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

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

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

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

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

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller Reporting Company |

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

The aggregate market value of Codorus Valley Bancorp, Inc.’s voting stock held by non-affiliates was approximately $155,106,213 as of June 30, 2016.

As of March 1, 2017, Codorus Valley Bancorp, Inc. had 8,431,256 shares of common stock outstanding, par value $2.50 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference to the registrant’s Proxy Statement for the Annual Meeting of Shareholders to be held May 16, 2017.

**Codorus Valley Bancorp, Inc.**

Form 10-K Index

**PART I**

Item 1: Business

Codorus Valley Bancorp, Inc. ("Codorus Valley" or the "Corporation") is a Pennsylvania business corporation, incorporated on October 7, 1986. On March 2, 1987, Codorus Valley became a bank holding company under the Bank Holding Company Act of 1956, as amended. PeoplesBank, A Codorus Valley Company ("PeoplesBank") is its wholly owned bank subsidiary. The Corporation's business consists primarily of managing PeoplesBank, and its principal source of income is dividends received from PeoplesBank. The Corporation also wholly-owns two non-bank subsidiaries, SYC Realty Co., Inc., a subsidiary for holding certain foreclosed assets pending liquidation, and CVLY Subsidiary Corp., which may be used, as needed, for the financial and legal management of acquisition transactions. On December 31, 2016, Codorus Valley had total consolidated assets of $1.61 billion, total deposits and other liabilities of $1.46 billion, and total shareholders' equity of $154,957,000.

Bank Subsidiary

PeoplesBank, organized in 1934, is a Pennsylvania chartered bank that offers a full range of business and consumer banking services. As of December 31, 2016, PeoplesBank operated twenty-six full service financial centers located in York, Cumberland and Lancaster Counties in Pennsylvania, and in Baltimore, Harford and Carroll Counties, and Baltimore City, in Maryland. PeoplesBank, with origins dating back to 1864, is focused on acquiring and nurturing financial relationships with small and mid-sized businesses. It also provides personal banking, mortgage banking, wealth management and real estate settlement services. The Federal Deposit Insurance Corporation insures the deposits of PeoplesBank to the maximum extent provided by law. On December 31, 2016, PeoplesBank had total gross loans of $1.27 billion, excluding loans held for sale, and total deposits of $1.26 billion. PeoplesBank had the second largest share of deposits in York County, Pennsylvania, with deposits totaling 14.1 percent of the market as of June 30, 2016, the latest available measurement date.

PeoplesBank is not dependent on deposits of, or exposed to a loan concentration to, a single client, or a small group of clients. Therefore, the loss of a single client, or a small client group, would not have a material adverse effect on the financial condition of PeoplesBank. At December 31, 2016, the largest indebtedness of a single PeoplesBank client was approximately $21,390,000 or 1.7 percent of the total loan portfolio, which was within PeoplesBank's 2016 regulatory lending limit of $26,224,000.

Most of the Corporation's business is with clients in York County, Pennsylvania and northern Maryland. Although this market area may pose a concentration risk geographically, we believe that the diverse local economy and our detailed knowledge of the client base lessens this risk. At December 31, 2016, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor represented 19.2 percent of the portfolio; residential real estate investor represented 14.4 percent of the portfolio; and builder and developer represented 11.7 percent of the portfolio. At December 31, 2015, the Corporation had three industry concentrations that exceeded 10 percent of the total loan portfolio: commercial real estate investor represented 17.1 percent of the portfolio; residential real estate investor represented 14.3 percent of the portfolio; and builder and developer represented 11.9 percent of the portfolio. Loans to borrowers within these industries are usually collateralized by real estate.

**Nonbank Subsidiaries of PeoplesBank**

PeoplesBank had six wholly-owned nonbank subsidiaries as of December 31, 2016, that were consolidated for financial reporting purposes.

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

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

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

Periodically, PeoplesBank creates nonbank subsidiaries for the purpose of temporarily holding certain foreclosed assets pending liquidation. On December 31, 2016, two of three of these foreclosed asset subsidiaries were active.

Nonbank Subsidiaries of Codorus Valley Bancorp, Inc.

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

In 1991, SYC Realty Co., Inc. was incorporated as a wholly owned subsidiary of Codorus Valley, and originally commenced operations in October 1995. Codorus Valley created this nonbank subsidiary primarily for the purpose of holding certain foreclosed properties obtained by PeoplesBank pending liquidation of those properties. SYC Realty was inactive during the entire reporting period of 2016.

In 2015, CVLY Subsidiary Corp., a wholly owned subsidiary of Codorus Valley and known formerly as Madison Bancorp, Inc., was the surviving merged entity resulting from the acquisition of Madison Bancorp, Inc. (which was completed on January 16, 2015). This entity was inactive during the entire reporting period of 2016 but may be used, as needed, for acquisition or other legal activities.

**Employees**

At year-end 2016, PeoplesBank employed 269 full-time employees and 35 part-time employees, which equated to approximately 306 full-time equivalent employees. Employees are not covered by a collective bargaining agreement, and PeoplesBank considers its relations with employees to be satisfactory.

**Segment Reporting**

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

Competition

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

**Supervision and Regulation**

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

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

*Bank Holding Company Regulations*

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

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

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

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

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

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

*Regulation of PeoplesBank*

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

State and federal banking laws and regulations govern such things as: the scope of a bank’s business; permissible investments; the reserves against deposits a bank must maintain; the types and terms of loans a bank may make and the collateral it may take; the activities of a bank with respect to mergers and consolidations; the establishment of branches; and the sale of non-deposit investment products by the bank and its subsidiaries.

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

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

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

*Federal Deposit Insurance and Premiums*

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

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

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

*Dividend Restrictions*

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

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

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

*Other Laws and Regulations Affecting the Corporation and PeoplesBank*

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

Among other things, the Dodd-Frank Act:

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

Increases bank supervision by restructuring the supervision of holding companies and depository institutions; establishes the equivalent of a prompt corrective action program for large bank holding companies; requires that capital requirements for holding companies be at least as strict as capital requirements for depository institutions; disallows new issuances of trust preferred securities from qualifying for Tier 1 capital treatment; directs federal bank regulators to develop specific capital requirements for holding companies and depository institutions that address activities that pose risk to the financial system, such as significant activities in higher risk areas, or concentrations in assets whose reported values are based on models;

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

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

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

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

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

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

*Future Laws and Regulations*

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

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Other Information

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

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

**Item 1A: Risk Factors**

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

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

**Risks Related to Our Business and Industry**

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

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

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

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

- increase loan delinquencies;
- increase problem assets and foreclosures;
- increase claims and lawsuits;
- decrease the demand for our products and services; and
- decrease the value of collateral for loans, especially real estate, in turn reducing clients' borrowing power, the value of assets associated with nonperforming loans and collateral coverage.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We use various technology systems to manage our client relationships, general ledger, securities investments, deposits, and loans. We have established policies and procedures to prevent or limit the impact of system failures, interruptions, and security breaches (including privacy breaches and cyber-attacks), but such events may still occur or may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter clients from using our products and services. Although we take protective measures, the security of our computer systems, software, and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious code and cyber-attacks that could have an impact on information security.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Risks Related to Our Common Stock**

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

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

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

- actual or anticipated variations in quarterly results of operations or quality of our assets;
- recommendations by securities analysts;
- operating and stock price performance of other companies that investors deem comparable to us;
- any failure to pay dividends on our common stock or a reduction in cash dividends;
- continued levels of loan quality and volume origination;
- the adequacy of loan loss reserves;
- the willingness of clients to substitute competitors’ products and services for our products and services and vice versa, based on price, quality, relationship or otherwise;
- interest rate, market and monetary fluctuations;
- declines in the fair value of our available-for-sale securities that are deemed to be other-than-temporarily impaired;
- the timely development of competitive new products and services by us and the acceptance of such products and services by clients;
- changes in consumer spending and saving habits relative to the financial services we provide;
- relationships with major clients;
- our ability to continue to grow our business internally and through acquisition and successful integration of new or acquired entities while controlling costs;
- news reports relating to trends, concerns and other issues in the financial services industry, including the failures of other financial institutions in the current economic downturn;
- perceptions in the marketplace regarding us and/or our competitors;
- rapidly changing technology, or new technology used, or services offered, by competitors;
- deposit flows;
- changes in accounting principles, policies and guidelines;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- changes in and compliance with laws and government regulations of federal, state and local agencies;
- geopolitical conditions such as acts or threats of terrorism or military conflicts;

- failure to retain or attract key personnel;
- operating results that vary from the expectations of management, analysts and investors;
- future sales of our equity or equity-related securities;
- the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and developments with respect to financial institutions generally; and
- the relatively low trading volume of our common stock.

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

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

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

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

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

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

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

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

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

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

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

We are currently authorized to issue up to 15,000,000 shares of common stock of which 8,426,873 shares were outstanding as of December 31, 2016, and up to 1,000,000 shares of preferred stock, none of which were outstanding as of December 31, 2016. Our board of directors has authority, without action or vote of the shareholders of common stock, to issue all or part of the authorized but unissued shares. Authorized but unissued shares of our common stock or preferred stock could be issued on terms or in circumstances that could dilute the interests of other shareholders.

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

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

As described below in the next risk factor, the terms of our outstanding junior subordinated debt securities prohibit us from paying dividends on or repurchasing our common stock at any time when we have elected to defer the payment of interest on such debt securities or certain events of default under the terms of those debt securities have occurred and are continuing. These restrictions could have a negative effect on the value of our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, as and if declared by our board of directors.

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

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

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

As of December 31, 2016, we had outstanding approximately $10,000,000 aggregate principal amount of junior subordinated debt securities issued in connection with the sale of trust preferred securities by certain of our subsidiaries that are statutory business trusts. We have also guaranteed those trust preferred securities. There are currently two separate series of these junior subordinated debt securities outstanding, each series having been issued under a separate indenture and with a separate guarantee. Each of these indentures, together with the related guarantee, prohibits us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock at any time when (i) there shall have occurred and be continuing an event of default under the indenture or any event, act or condition that with notice or lapse of time or both would constitute an event of default under the indenture; or (ii) we are in default with respect to payment of any obligations under the related guarantee; or (iii) we have deferred payment of interest on the junior subordinated debt securities outstanding under that indenture. In that regard, we are entitled, at our option but subject to certain conditions, to defer payments of interest on the junior subordinated debt securities of each series from time to time for up to five years.

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

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

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

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

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

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

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

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

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

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

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

eliminate cumulative voting in the election of directors; and

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

**Item 1B: Unresolved Staff Comments**

Not applicable.

Item 2: Properties

Codorus Valley owns the Codorus Valley Corporate Center ("Corporate Center"), located at 105 Leader Heights Road, York, PA 17403, subject to a first lien held by ACNB Bank and a second lien held by its wholly owned subsidiary, PeoplesBank. The first lien held by ACNB Bank supports a $3,000,000 line of credit. No draws have been made on the line and on December 31, 2016, the balance was zero. The second lien held by PeoplesBank totaled $549,000 on December 31, 2016. This facility serves as the corporate headquarters and is approximately 40,000 square feet, a portion of which is leased to third-parties. The Corporate Center is adjacent to PeoplesBank's Data Operations Center and the Leader Heights financial center and is approximately one half mile from PeoplesBank's Administrative Services Center.

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

| | Owned | Leased | Total |
|---|---|---|---|
| Pennsylvania | | | |
| Financial Centers | 11 | 8 | 19 |
| Administrative Services Center | 1 | - | 1 |
| Other Property[1] | 1 | 1 | 2 |
| | | | |
| Maryland | | | |
| Financial Centers | 3 | 4 | 7 |
| Other Property[2] | - | 1 | 1 |

[1] The other property located in Pennsylvania consists of a limited services facility located in Lancaster County and a maintenance facility for storage of maintenance equipment and other PeoplesBank items.

[2] The other property located in Maryland consists of a facility formerly used as an administrative office for Madison Federal Savings Bank, acquired as a result of the merger completed on January 16, 2015.

We believe that the above properties are adequate for the Corporation's present levels of operation.

Item 3: Legal Proceedings

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

Item 4: Mine Safety Disclosures

Not applicable.

**PART II**

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

**Market Information**

Codorus Valley Bancorp, Inc. common stock is listed on the NASDAQ Global Market under the symbol CVLY. Codorus Valley had approximately 2,232 holders of record as of March 1, 2017. The closing price per share of Codorus Valley's common stock on March 1, 2017, was $26.41. The following table sets forth high and low sales prices and dividends paid per common share for Codorus Valley as reported by NASDAQ during the periods indicated. All amounts reflect the impact of the common stock dividends distributed by the Corporation.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| Quarter | High | Low | Dividends Per Share | High | Low | Dividends Per Share |
| First | $20.00 | $18.72 | $ 0.124 | $19.05 | $16.96 | $ 0.113 |
| Second | 20.79 | 18.82 | $ 0.124 | 19.79 | 17.43 | $ 0.113 |
| Third | 20.86 | 19.00 | $ 0.124 | 19.95 | 17.84 | $ 0.118 |
| Fourth | 29.34 | 19.99 | $ 0.124 | 20.10 | 18.37 | $ 0.118 |

**Dividend Policy**

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

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

The annualized dividend rate on the Series B preferred stock issued by Codorus Valley to the Treasury under the SBLF Program was 1 percent for the years ended December 31, 2015, 2014 and through the redemption date of February 18, 2016.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table provides information about options outstanding and securities available for future issuance under the Corporation's 2000 Stock Incentive Plan, 2001 Employee Stock Bonus Plan, 2007 Long Term Incentive Plan and 2007 Employee Stock Purchase Plan, as adjusted for stock dividends distributed.

**Equity Compensation Plan Information**

| Plan Category | **Number of securities to be issued upon exercise of outstanding options, warrants, and rights** | **Weighted-average exercise price of outstanding options, warrants and rights** | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column) | |
|---|---|---|---|---|
| Equity compensation plans approved by security holders | 217,369 | $ 14.52 | 255,626 | (1) |
| Equity compensation plans not approved by security holders | 0 | 0 | 18,241 | (2) |
| Total | 217,369 | $ 14.52 | 273,867 | |

(1) Includes 172,790 shares available for issuance under the 2007 Employee Stock Purchase Plan.

(2) Shares available for issuance under the 2001 Employee Stock Bonus Plan that provides for shares of common stock to employees as performance-based compensation. For a description of this plan, see Note 12 - Stock-Based Compensation, to the consolidated financial statements.

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

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

For the years ended December 31, 2016 and 2015, the Corporation did not acquire any of its common stock under the current repurchase program.

**Performance Graph**

The following five-year performance graph compares the cumulative total shareholders return (including reinvestment of dividends) on Codorus Valley Bancorp, Inc.'s common stock to the S&P 500 Index and the ABA Community Bank NASDAQ Index. The stock performance graph assumes that $100 was invested on December 31, 2011, and the cumulative return is measured as of each subsequent fiscal year end.

**Total Return Performance**

| | Period Ending | | | | | |
|---|---|---|---|---|---|---|
| Index | 12/31/11 | 12/31/12 | 12/31/13 | 12/31/14 | 12/31/15 | 12/31/16 |
| Codorus Valley Bancorp, Inc. | $100.00 | $196.01 | $274.18 | $296.68 | $329.95 | $499.25 |
| S&P 500 | 100.00 | 116.00 | 153.57 | 174.60 | 177.01 | 198.18 |
| ABA Community Bank Index(1) | 100.00 | 115.33 | 160.59 | 165.10 | 177.40 | 241.24 |

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

Item 6: Selected financial data

Codorus Valley Bancorp, Inc.

| | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| **Summary of operations** *(in thousands)* | | | | | |
| Interest income | $62,230 | $56,002 | $50,400 | $46,972 | $46,512 |
| Interest expense | 8,649 | 8,174 | 8,040 | 8,619 | 10,527 |
| Net interest income | 53,581 | 47,828 | 42,360 | 38,353 | 35,985 |
| Provision for loan losses | 3,000 | 3,500 | 1,600 | 1,470 | 1,750 |
| Noninterest income | 10,030 | 9,047 | 8,153 | 7,754 | 8,190 |
| Noninterest expense | 41,623 | 37,427 | 32,476 | 30,154 | 29,928 |
| Income before income taxes | 18,988 | 15,948 | 16,437 | 14,483 | 12,497 |
| Provision for income taxes | 5,886 | 4,813 | 4,668 | 3,917 | 3,103 |
| Net income | 13,102 | 11,135 | 11,769 | 10,566 | 9,394 |
| Preferred stock dividends | 16 | 120 | 174 | 250 | 384 |
| Net income available to common shareholders | $13,086 | $11,015 | $11,595 | $10,316 | $9,010 |
| | | | | | |
| Per common share (adjusted for stock dividends) | | | | | |
| Net income, basic | $1.56 | $1.68 | $1.88 | $1.88 | $1.67 |
| Net income, diluted | $1.55 | $1.67 | $1.84 | $1.84 | $1.65 |
| Cash dividends paid | $0.496 | $0.462 | $0.424 | $0.378 | $0.314 |
| Stock dividends distributed | 5 % | 5 % | 5 % | 5 % | 5 % |
| Book value | $18.39 | $17.61 | $16.55 | $14.88 | $14.01 |
| Tangible book value (1) | $18.11 | $17.33 | $16.55 | $14.88 | $14.01 |
| Cash dividend payout ratio | 32.0 % | 27.2 % | 22.5 % | 20.1 % | 18.8 % |
| Weighted average shares outstanding | 8,374,680 | 6,555,258 | 6,187,016 | 5,492,422 | 5,398,670 |
| Weighted average diluted shares outstanding | 8,446,361 | 6,625,865 | 6,295,404 | 5,602,141 | 5,472,396 |
| | | | | | |
| Profitability ratios | | | | | |
| Return on average shareholders' equity (ROE) | 8.47 % | 8.94 % | 10.22 % | 10.08 % | 9.55 % |
| Return on average assets (ROA) | 0.88 % | 0.82 % | 0.98 % | 0.96 % | 0.90 % |
| Net interest margin | 3.89 % | 3.79 % | 3.84 % | 3.83 % | 3.81 % |
| Efficiency ratio | 64.09 % | 64.60 % | 62.83 % | 63.01 % | 65.65 % |
| Net overhead ratio | 2.15 % | 2.12 % | 2.08 % | 2.05 % | 2.13 % |
| | | | | | |
| Capital ratios | | | | | |
| Common equity tier 1 ratio | 11.88 % | 12.56 % | n/a | n/a | n/a |
| Tier 1 risk-based capital | 12.66 % | 14.49 % | 13.24 % | 12.79 % | 13.59 % |
| Total risk-based capital | 13.81 % | 15.60 % | 14.42 % | 13.89 % | 14.79 % |
| Average shareholders' equity to average assets | 10.44 % | 9.15 % | 9.62 % | 9.57 % | 9.45 % |

| | | | | | |
|---|---|---|---|---|---|
| **Summary of financial condition at year-end** *(in thousands)* | | | | | |
| Investment securities | $201,665 | $218,498 | $216,973 | $233,483 | $236,925 |
| Loans | 1,272,319 | 1,123,775 | 920,554 | 859,898 | 740,225 |
| Assets | 1,611,587 | 1,456,334 | 1,213,846 | 1,150,641 | 1,059,737 |
| Deposits | 1,264,177 | 1,094,149 | 954,973 | 925,303 | 901,307 |
| Borrowings | 181,947 | 194,820 | 132,590 | 110,856 | 50,171 |
| Equity | 154,957 | 159,141 | 118,440 | 107,649 | 101,331 |
| | | | | | |
| Other data | | | | | |
| Full service financial centers | 26 | 24 | 21 | 20 | 18 |
| Number of employees (*full-time equivalents*) | 306 | 282 | 238 | 229 | 219 |
| Wealth Management assets, market value (*in thousands*) | $562,865 | $514,728 | $307,000 | $261,044 | $329,626 |

(1) Book value less goodwill and core deposit intangibles

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

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

**Forward-looking Statements**

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

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

Operating, legal and regulatory risks;
Credit risk, including an increase in nonperforming assets requiring loss provisions and the incurrence of carrying costs related to nonperforming assets;
Interest rate fluctuations which could increase our cost of funds or decrease our yield on earning assets and therefore reduce our net interest income;

Declines in the market value of investment securities considered to be other-than-temporary;
Unavailability of capital when needed or availability at less than favorable terms;
Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of our computer systems or otherwise, may adversely affect the Corporation's operations, net income or reputation;
Inability to achieve merger-related synergies, and difficulties in integrating the business and operations of acquired institutions;
A prolonged economic downturn;
Political and competitive forces affecting banking, securities, asset management and credit services businesses;
The effects of and changes in the rate of FDIC premiums, including special assessments;

- Future legislative or administrative changes to U.S. governmental capital programs;
- Enacted financial reform legislation, e.g., Dodd-Frank Wall Street Reform and Consumer Protection Act, may have a significant impact on the Corporation's business and results of operations; and
- The risk that management's analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

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

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**Critical Accounting Estimates**

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

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

Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Appraisals are generally used to determine fair value. After foreclosure, management reviews valuations at least quarterly and adjusts the asset to the lower of cost or fair value minus estimated costs to sell. Estimates related to the value of collateral can have a significant impact on whether or not management continues to accrue income on delinquent and impaired loans and on the amounts at which foreclosed real estate is recorded on the statement of financial condition.

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

Management discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosures with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report. Additional information is contained in Management's Discussion and Analysis regarding critical accounting estimates, including the provision and allowance for loan losses located on pages 37 and 55 of this report.

## FINANCIAL HIGHLIGHTS

### Executive Summary

The Corporation’s net income available to common shareholders (earnings) was $13,086,000 for the full year 2016, compared to $11,015,000 of earnings in 2015, an increase of $2,071,000 or 19 percent.

Net interest income for 2016 increased $5,753,000 or 12 percent when compared to 2015, primarily due to an increase in the volume of commercial loans.

Net interest margin (tax-equivalent basis) for 2016 was 3.89 percent, compared to 3.79 percent for 2015. The Corporation continues to have success in growing low cost core deposits, while maintaining reasonable yields on new loan growth in a highly competitive, low interest rate environment. The average yield on earning assets increased to 4.51 percent in 2016 as compared to 4.43 percent in 2015 and the cost of interest-bearing liabilities increased slightly to 0.76 percent in 2016, as compared to 0.75 percent in 2015.

The loan loss provision for 2016 decreased $500,000 compared to 2015, primary due to a reduction in net charge-offs in 2016 as compared to the prior year.

Noninterest income for 2016, excluding gains on sales of investment securities, increased $1,281,000 or 15 percent when compared to 2015, primarily due to increases in trust fees, income from mutual fund, annuity and insurance sales, service fees on deposits, income from bank owned life insurance, other income and gains on sales of loans held for sale. Gains on sales of investment securities for 2016 decreased $298,000 when compared to 2015.

Noninterest expense for 2016 increased $4,196,000 or 11 percent above 2015. Personnel, costs associated with other real estate owned, external data processing, debit card processing and marketing expenses accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the expansion of our business and consumer banking services in our Maryland and Pennsylvania markets.

The provision for income taxes for 2016 increased $1,073,000 above the income tax provision for 2015, primarily due to an increase in pre-tax net income and a slight decrease in the amount of tax-exempt income when compared to 2015.

Preferred stock dividends for 2016 compared to 2015 decreased $104,000. In February 2016, the Corporation redeemed the remaining $12,000,000 in outstanding shares of preferred stock issued under the U.S. Treasury’s Small Business Lending Fund Program (SBLF Program).

Earnings per share was $1.56 basic and $1.55 diluted for 2016 compared to $1.68 basic and $1.67 diluted for 2015. The decrease is primarily a result of the issuance of 1,746,850 of common shares in the $34,500,000 public offering completed in December 2015.

On December 31, 2016, total assets were approximately $1.61 billion, representing an 11 percent increase compared to December 31, 2015. The growth for 2016 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The Corporation’s capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. In December 2015, the Corporation raised approximately $32,500,000 in capital from the net proceeds of a public offering of common stock of 1,746,850 shares as previously reported on Form 8-Ks filed on December 15, 2015 and December 23, 2015.

The closing price for the Corporation's common stock (NASDAQ: CVLY) was $28.60 per share on December 31, 2016, compared to $19.37 per share on December 31, 2015, as adjusted. Cash dividends paid on common shares for the year 2016 totaled $0.496 per share, as adjusted for stock dividends, representing an increase of $0.034 or 7 percent above the cash dividends of $0.462, as adjusted, paid in 2015. Also, the Corporation distributed a 5 percent common stock dividend on December 13, 2016. The **Selected Financial Data** schedule, located on page 29 of this report, provides a summary of operations and performance metrics for the past five years in a comparative format.

**Year Ended December 31, 2016 vs. Year Ended December 31, 2015**

The full year 2016 net income available to common shareholders of $13,086,000 represents an increase of $2,071,000 compared to the full year 2015 earnings of $11,015,000. Earnings per share was $1.56 basic and $1.55 diluted for 2016 compared to $1.68 basic and $1.67 diluted for 2015. The decrease is primarily a result of the issuance of 1,746,850 of common shares in the $34,500,000 public offering completed in December 2015. The Corporation used the funds from the public offering to redeem the remaining $12,000,000 of shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, as reported on a Form 8-K filed on February 19, 2016. In addition, approximately $19,800,000 of the net proceeds were invested in the Corporation's Bank subsidiary PeoplesBank and the remaining proceeds were used for general corporate purposes.

Net interest income, which totaled $53,581,000 for the year ended December 31, 2016, represented an increase of $5,753,000 or 12 percent above net interest income of $47,828,000 for 2015. The growth in net interest income reflects the increased volume of interest-earning assets, primarily commercial loans; however, the additional interest income from this new loan volume was partially offset by increased costs associated with the growth in core deposits and higher long-term borrowing costs.

The loan loss provision for 2016 totaled $3,000,000 as compared to the loan loss provision of $3,500,000 for 2015, a decrease of $500,000. The decrease in the provision was primarily a result of a reduction in net charge-offs of $1,246,000 in 2016 compared to 2015. The allowance for loan losses as a percentage of total period-end loans was 1.18 percent and 1.13 percent as of December 31, 2016 and 2015, respectively. The increased allowance for loan losses reflected both the overall commercial loan growth for 2016, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

Noninterest income, excluding gains on sales of investment securities, for the year ended December 31, 2016, totaled $9,836,000 representing an increase of $1,281,000 or 15 percent compared to noninterest income of $8,555,000 for 2015. Specific noninterest income increases included trust fees, income from mutual fund, annuity and insurance sales, service fees on deposits, income from bank owned life insurance and gains on sales of loans held for sale. Gains on sales of investment securities for 2016 decreased $298,000 when compared to 2015.

Noninterest expense for the year ended December 31, 2016, totaled $41,623,000 representing an increase of $4,196,000 or 11 percent compared to $37,427,000 for 2015. Higher costs associated with: personnel, other real estate owned, external data processing, debit card processing and marketing expenses, accounted for the majority of the increase. The primary driver of the aforementioned increase in noninterest expense was the expansion of our business and consumer banking services in our Maryland and Pennsylvania markets.

The provision for income taxes for 2016 totaled $5,886,000 which was $1,073,000 or 22 percent above the provision for income taxes for 2015 of $4,813,000. The increase was due to higher pre-tax net income and a slight decrease in the amount of tax-exempt income.

Preferred stock dividends for 2016 were $16,000, a decrease of $104,000, compared to $120,000 in 2015. The preferred stock dividend rate for both years was 1 percent. On February 18, 2016, as reported on a Form 8-K filed on February 19, 2016, the Corporation redeemed the remaining $12,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, resulting in the reduction in dividends expense for the year.

On December 31, 2016, total assets were $1.61 billion, representing an 11 percent increase compared to total assets of $1.46 billion as of December 31, 2015. Asset growth for 2016 occurred primarily in the commercial loan portfolio and was funded primarily by an increase in deposits.

The growth in core deposits included a $37,694,000 increase in the average balance of noninterest bearing deposits for 2016 as compared to 2015. Growing core deposits remains a particular focus of the Corporation because the rates paid for such deposits are low, transactional activity on these deposits are a source of fee income, and a core deposit relationship provides the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

Cash dividends paid on common shares for the year 2016 totaled $0.496 per share, as adjusted for stock dividends, representing an increase of $0.034 or 7 percent above the cash dividends of $0.462, as adjusted, paid for the year 2015.

The Corporation distributed a 5 percent common stock dividend on December 13, 2016, the same common stock dividend percentage that was distributed in December 2015.

As a result of profitable operations and the public offering of common stock as previously reported on Form 8-Ks filed on December 15, 2015 and December 23, 2015, the Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Table 9 - Capital Ratios, following, shows that both the Corporation and PeoplesBank were well capitalized for all periods presented.

**Year Ended December 31, 2015 vs. Year Ended December 31, 2014**

The full year 2015 net income available to common shareholders of $11,015,000 represents a decrease of $580,000 compared to the full year 2014 earnings of $11,595,000. Earnings per share was $1.68 basic and $1.67 diluted for 2015 compared to $1.88 basic and $1.84 diluted for 2014. The decrease is due to the reduction in the net income available to common shareholders, and to a lesser extent, the dilutive impact of the Corporation's issuance of 650,000 common shares in the private placement completed in the first quarter of 2014. The Corporation used the funds from the private placement to redeem $13,000,000 of the $25,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury’s Small Business Lending Fund Program.

Net interest income, which totaled $47,828,000 for the year ended December 31, 2015, represented an increase of $5,468,000 or 13 percent above net interest income of $42,360,000 for 2014. The growth in net interest income reflects the increased volume of interest-earning assets, primarily commercial loans; however, the additional interest income from this new loan volume was partially offset by increased funding costs associated with the Corporation obtaining additional long-term borrowings, as loan growth outpaced deposit growth during the year.

The loan loss provision for 2015 totaled $3,500,000 as compared to the loan loss provision of $1,600,000 for 2014, contributing to an increase in allowance for loan losses from $11,162,000 at December 31, 2014, to $12,704,000 at December 31, 2015. The allowance for loan losses as a percentage of total period-end loans was 1.13 percent and 1.21 percent as of December 31, 2015 and 2014, respectively. The increased allowance for loan losses reflected both the overall commercial loan growth for 2015, and the Corporation's analysis of the adequacy of the allowance based upon the size, composition, and risks to the loan portfolio, the level of specific reserves, and realized net charge-offs.

Noninterest income for the year ended December 31, 2015, totaled $9,047,000 representing an increase of $894,000 or 11 percent compared to noninterest income of $8,153,000 for 2014. Specific noninterest income increases included trust fees, income from mutual fund, annuity and insurance sales, service fees on deposits, and gains on sales of loans held for sale.

Noninterest expense for the year ended December 31, 2015, totaled $37,427,000 representing an increase of $4,951,000 or 15 percent compared to $32,476,000 for 2014. Personnel and facility costs accounted for the majority of the increase, reflecting additional compensation, benefits, and occupancy expenses supporting expanded business banking and retail banking activities in the Maryland financial centers from the Madison acquisition, and the two financial centers in Shrewsbury, PA and Camp Hill, PA opened after the third quarter of 2014.

The provision for income taxes for 2015 totaled $4,813,000 which was $145,000 or 3 percent above the provision for income taxes for 2014 of $4,668,000. While pre-tax income was lower in 2015, the increase is primarily due to a reduction in the amount of tax-exempt income.

Preferred stock dividends for 2015 were $120,000, a decrease of $54,000, compared to $174,000 in 2014. The preferred stock dividend rate for both years was 1 percent. On May 30, 2014, as reported on a Form 8-K filed on the same date, the Corporation redeemed $13,000,000 of $25,000,000 in outstanding shares of Series B preferred stock issued under the U.S. Treasury's Small Business Lending Fund Program, resulting in the reduction in dividends expense for the year.

On December 31, 2015, total assets were $1.46 billion, representing a 20 percent increase compared to total assets of $1.21 billion as of December 31, 2014. Asset growth for 2015 occurred primarily in the commercial loan portfolio and was funded by increases in core deposits and low-rate advances from the Federal Home Loan Bank of Pittsburgh, as well as the loans added as a result of the acquisition of Madison Bancorp, Inc. in January 2015.

The growth in core deposits included a $28,000,000 increase in the average balance of noninterest bearing deposits for 2015 as compared to 2014, including $6,600,000 of core deposits from the Madison acquisition. Growing core deposits remains a particular focus of the Corporation because the rates paid for such deposits are low, transactional activity on these deposits are a source of fee income, and a core deposit relationship provides the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

Cash dividends paid on common shares for the year 2015 totaled $0.462 per share, as adjusted for stock dividends, representing an increase of $0.038 or 9 percent above the cash dividends of $0.424, as adjusted, paid for the year 2014.

The Corporation distributed a 5 percent common stock dividend on December 8, 2015, the same common stock dividend percentage that was distributed in December 2014.

As a result of profitable operations and the public offering of common stock as previously reported on Form 8-Ks filed on December 15, 2015 and December 23, 2015, the Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Table 9 - Capital Ratios, following, shows that both the Corporation and PeoplesBank were well capitalized for all periods presented.

## INCOME STATEMENT ANALYSIS

### Net Interest Income

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

Net interest income for the year ended December 31, 2016, was $53,581,000, an increase of $5,753,000 or 12 percent above the full year 2015 net interest income. The increase was supported by a 9 percent increase in the average volume of interest-earning assets, primarily commercial loans. The additional interest income from the increased loan volume was partially offset by the costs associated with the growth in core deposits and higher long-term borrowing costs. The net interest margin, which reflects net interest income on a tax-equivalent basis as a percentage of average interest-earning assets, was 3.89 percent for 2016, compared to 3.79 percent for 2015.

Interest income for the full year 2016 totaled $62,230,000, an increase of $6,228,000 or 11 percent above 2015. The increase in total interest income was driven by a growth in the average volume of loans which was partially offset by a decrease in the average volume and yield on investment securities. Interest earning assets averaged $1.40 billion and yielded 4.51 percent (tax equivalent basis) for 2016, compared to $1.29 billion and a tax-equivalent yield of 4.43 percent, respectively, for 2015.

Interest expense for the full year 2016 totaled $8,649,000, an increase of $475,000 or 6 percent above 2015. The increase in total interest expense was primarily driven by an increase in volume and rate in core deposits (the Corporation defines core deposits as demand, savings, and money market deposits) and an increase in the rate paid on long-term borrowings. Interest expense on deposits increased $372,000 or 6 percent for 2016 compared to 2015 and was primarily attributed to the increase in interest bearing core deposits. The average volume of interest bearing core deposits was $581,565,000 for the full year 2016, a $70,630,000 or 14 percent increase above the average volume for 2015. Interest expense on long-term debt increased $136,000 or 8 percent for 2016. The average rate paid on long-term borrowings in 2016 was 1.65 percent an increase from the average rate paid of 1.55 percent in 2015. Long-term debt is comprised of advances from the Federal Home Loan Bank of Pittsburgh, with intermediate term bullet maturities that supplement deposit funding and provide a partial funding hedge against rising market interest rates.

Tables 1 and 2, following, are presented on a tax-equivalent basis to make it easier to compare taxable and tax-exempt assets. Interest on tax-exempt assets (which include securities issued by, or loans made to, state and local governments) is adjusted based upon a 34 percent federal income tax rate.

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

| (dollars in thousands) | **2016 Average Balance** | **Interest** | **Yield/ Rate** | **2015 Average Balance** | **Interest** | **Yield/ Rate** | **2014 Average Balance** | **Interest** | **Yield/ Rate** |
|---|---|---|---|---|---|---|---|---|---|
| Assets | | | | | | | | | |
| Interest bearing deposits with banks | $27,415 | $142 | 0.52 % | $39,671 | $103 | 0.26 % | $25,336 | $63 | 0.25 % |
| Investment securities: | | | | | | | | | |
| Taxable | 129,353 | 2,759 | 2.13 | 146,356 | 3,337 | 2.28 | 150,232 | 3,611 | 2.40 |
| Tax-exempt | 70,497 | 2,355 | 3.34 | 66,936 | 2,482 | 3.71 | 74,579 | 2,913 | 3.91 |
| Total investment securities | 199,850 | 5,114 | 2.56 | 213,292 | 5,819 | 2.73 | 224,811 | 6,524 | 2.90 |
| Loans: | | | | | | | | | |
| Taxable (1) | 1,157,918 | 57,216 | 4.94 | 1,016,751 | 50,249 | 4.94 | 867,122 | 44,151 | 5.09 |
| Tax-exempt | 18,869 | 794 | 4.21 | 21,072 | 969 | 4.60 | 18,754 | 926 | 4.94 |
| Total loans | 1,176,787 | 58,010 | 4.93 | 1,037,823 | 51,218 | 4.94 | 885,876 | 45,077 | 5.09 |
| Total earning assets | 1,404,052 | 63,266 | 4.51 | 1,290,786 | 57,140 | 4.43 | 1,136,023 | 51,664 | 4.55 |
| Other assets (2) | 77,794 | | | 70,201 | | | 60,721 | | |
| Total assets | $1,481,846 | | | $1,360,987 | | | $1,196,744 | | |
| Liabilities and Shareholders’ Equity | | | | | | | | | |
| Deposits: | | | | | | | | | |
| Interest bearing demand | $505,903 | $1,935 | 0.38 % | $441,948 | $1,517 | 0.34 % | $390,417 | $1,352 | 0.35 % |