CODORUS VALLEY BANCORP INC
Form 10-Q
August 14, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2012
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from_____________to______________

Commission file number: 0-15536

CODORUS VALLEY BANCORP, INC.

(Exact name of registrant as specified in its charter)

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

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

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

Not Applicable
(Former name, former address and former fiscal year,
if changed since the last report.)

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. On August 1, 2012, 4,233,847 shares of common stock, par value $2.50, were outstanding.

Codorus Valley Bancorp, Inc.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Codorus Valley Bancorp, Inc.
Consolidated Balance Sheets
Unaudited

(dollars in thousands, except share and per share data)	**June 30, 2012**	**December 31, 2011**
Assets		
Interest bearing deposits with banks	$ 41,917	$ 19,640
Cash and due from banks	14,091	12,555
Total cash and cash equivalents	56,008	32,195
Securities, available-for-sale	235,206	233,861
Restricted investment in bank stocks, at cost	3,288	3,635
Loans held for sale	1,794	2,869
Loans (net of deferred fees of $940 - 2012 and $692 - 2011)	706,244	693,515
Less-allowance for loan losses	(8,690)	(8,702)
Net loans	697,554	684,813
Premises and equipment, net	10,658	10,861
Other assets	40,043	43,898
Total assets	$ 1,044,551	$ 1,012,132
Liabilities		
Deposits		
Noninterest bearing	$ 84,816	$ 73,760
Interest bearing	793,227	780,639
Total deposits	878,043	854,399
Short-term borrowings	25,328	10,257
Long-term debt	36,140	46,628
Other liabilities	6,918	7,606
Total liabilities	946,429	918,890
Shareholders equity		
Preferred stock, par value $2.50 per share; $1,000 liquidation preference, 1,000,000 shares authorized; 25,000 Series B shares issued and outstanding - 2012 and 2011	25,000	25,000
Common stock, par value $2.50 per share; 15,000,000 shares authorized; 4,233,847 shares issued and outstanding - 2012 and 10,000,000 shares authorized; 4,202,606 shares issued and outstanding - 2011	10,585	10,507
Additional paid-in capital	37,703	37,253
Retained earnings	18,611	14,558
Accumulated other comprehensive income	6,223	5,924
Total shareholders equity	98,122	93,242
Total liabilities and shareholders equity	$ 1,044,551	$ 1,012,132

See accompanying notes.

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Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

(dollars in thousands, except per share data)	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Interest income				
Loans, including fees	$ 10,164	$ 9,600	$ 20,034	$ 18,912
Investment securities:				
Taxable	910	1,045	1,817	1,987
Tax-exempt	592	606	1,189	1,242
Dividends	3	2	7	4
Other	23	10	38	25
Total interest income	11,692	11,263	23,085	22,170
Interest expense				
Deposits	2,415	2,839	4,871	5,674
Federal funds purchased and other short-term borrowings	29	25	53	53
Long-term debt	196	263	407	543
Total interest expense	2,640	3,127	5,331	6,270
Net interest income	9,052	8,136	17,754	15,900
Provision for loan losses	250	550	500	1,225
Net interest income after provision for loan losses	8,802	7,586	17,254	14,675
Noninterest income				
Trust and investment services fees	405	383	813	740
Income from mutual fund, annuity and insurance sales	243	241	431	583
Service charges on deposit accounts	633	676	1,244	1,277
Income from bank owned life insurance	174	160	330	325
Other income	170	159	332	300
Net gain on sales of loans held for sale	281	120	540	296
Net gain (loss) on sales of securities	0	0	49	(25)
Total noninterest income	1,906	1,739	3,739	3,496
Noninterest expense				
Personnel	3,761	3,433	7,439	6,964
Occupancy of premises, net	504	487	1,012	984
Furniture and equipment	461	422	924	871
Postage, stationery and supplies	134	129	268	269
Professional and legal	150	173	309	275
Marketing and advertising	197	233	407	383
FDIC insurance	189	218	408	562
Debit card processing	178	165	355	319
Charitable donations	34	8	481	235
Telephone	135	120	267	255
External data processing	142	110	270	229
Foreclosed real estate including (gains) losses on sales	211	606	804	1,091
Impaired loan carrying costs	185	160	230	426
Other	671	668	1,048	1,107
Total noninterest expense	6,952	6,932	14,222	13,970
Income before income taxes	3,756	2,393	6,771	4,201
Provision for income taxes	977	521	1,702	818
Net income	2,779	1,872	5,069	3,383
Preferred stock dividends and discount accretion	71	246	259	491
Net income available to common shareholders	$ 2,708	$ 1,626	$ 4,810	$ 2,892

Net income per common share, basic	$	0.64	$	0.39	$	1.14	$	0.70
Net income per common share, diluted	$	0.63	$	0.39	$	1.13	$	0.69

See accompanying notes.

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

(dollars in thousands)	Three months ended June 30, 2012	2011
Net income	$ 2,779	$ 1,872
Other comprehensive income:		
Securities available for sale:		
Net unrealized holding gains arising during the period (net of tax expense of $110 and $1,042, respectively)	214	2,024
Reclassification adjustment for (gains) losses included in net income	0	0
Net unrealized gains	214	2,024
Comprehensive income	$ 2,993	$ 3,896

(dollars in thousands)	Six months ended June 30, 2012	2011
Net income	$ 5,069	$ 3,383
Other comprehensive income:		
Securities available for sale:		
Net unrealized holding gains arising during the period (net of tax expense of $171 and $1,166, respectively)	331	2,266
Reclassification adjustment for (gains) losses included in net income (net of tax expense of $17 and tax benefit of $9, respectively)	(32)	16
Net unrealized gains	299	2,282
Comprehensive income	$ 5,368	$ 5,665

See accompanying notes.

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

(dollars in thousands)	Six months ended June 30, 2012	Six months ended June 30, 2011
Cash flows from operating activities		
Net income	$ 5,069	$ 3,383
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation/amortization	682	652
Net amortization of premiums on securities	670	724
Amortization of deferred loan origination fees and costs	(122)	(132)
Amortization of intangible assets	15	19
Provision for loan losses	500	1,225
Provision for losses on foreclosed real estate	1,088	235
Deferred income tax benefit	0	(21)
Amortization of investment in real estate partnership	172	291
Increase in cash surrender value and death benefit on bank owned life insurance	(330)	(325)
Originations of loans held for sale	(31,487)	(16,266)
Proceeds from sales of loans held for sale	33,102	20,585
Net gain on sales of loans held for sale	(540)	(296)
Loss on disposal of premises and equipment	7	1
Net (gain) loss on sales of securities available-for-sale	(49)	25
Loss (gain) on sales of foreclosed real estate	8	(45)
Stock-based compensation expense	201	157
Decrease in accrued interest receivable	286	54
Decrease (increase) in other assets	19	(242)
Decrease in accrued interest payable	(43)	(25)
(Decrease) increase in other liabilities	(398)	2,177
Net cash provided by operating activities	8,850	12,176
Cash flows from investing activities		
Purchases of securities, available-for-sale	(31,488)	(34,296)
Maturities, repayments and calls of securities, available-for-sale	21,929	17,495
Sales of securities, available-for-sale	8,047	6,077
Redemption of restricted investment in bank stock	347	390
Net increase in loans made to customers	(13,276)	(41,281)
Purchases of premises and equipment	(486)	(520)
Investment in bank owned life insurance	(230)	0
Proceeds from bank owned life insurance	206	0
Investment in foreclosed real estate	(17)	(3,645)
Proceeds from sales of foreclosed real estate	2,635	464
Net cash used in investing activities	(12,333)	(55,316)
Cash flows from financing activities		
Net increase in demand and savings deposits	20,510	29,412
Net increase (decrease) in time deposits	3,134	(3,319)
Net increase in short-term borrowings	15,071	4,033
Repayment of long-term debt	(10,488)	(17,902)
Cash dividends paid to preferred shareholders	(501)	(413)
Cash dividends paid to common shareholders	(757)	(704)
Issuance of common stock	327	292
Net cash provided by financing activities	27,296	11,399
Net increase (decrease) in cash and cash equivalents	23,813	(31,741)
Cash and cash equivalents at beginning of year	32,195	43,269

Cash and cash equivalents at end of period	$	56,008	$	11,528

See accompanying notes.

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

(dollars in thousands, except per share data)	**Preferred Stock**	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income**	**Total**
Balance, January 1, 2012	$ 25,000	$ 10,507	$ 37,253	$ 14,558	$ 5,924	$ 93,242
Net income				5,069		5,069
Other comprehensive income, net of tax					299	299
Common stock cash dividends ($0.18 per share)				(757)		(757)
Preferred stock dividends				(259)		(259)
Stock-based compensation			201			201
Issuance of common stock:						
11,673 shares under the dividend reinvestment and stock purchase plan		29	107			136
13,602 shares under the stock option plan		34	114			148
5,966 shares under employee stock purchase plan		15	28			43
Balance, June 30, 2012	$ 25,000	$ 10,585	$ 37,703	$ 18,611	$ 6,223	$ 98,122
Balance, January 1, 2011	$ 15,983	$ 10,330	$ 37,290	$ 10,798	$ 2,138	$ 76,539
Net income				3,383		3,383
Other comprehensive income, net of tax					2,282	2,282
Preferred stock discount accretion	78			(78)		0
Common stock cash dividends ($0.17 per share)				(704)		(704)
Preferred stock dividends				(413)		(413)
Stock-based compensation			157			157
Issuance of common stock:						
12,853 shares under the dividend reinvestment and stock purchase plan		32	105			137
12,642 shares under the stock option plan		32	81			113
5,330 shares under employee stock purchase plan		13	29			42
Balance, June 30, 2011	$ 16,061	$ 10,407	$ 37,662	$ 12,986	$ 4,420	$ 81,536

See accompanying notes.

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Notes to Consolidated Financial Statements (Unaudited)

Note 1 Basis of Presentation

The accompanying consolidated balance sheet at December 31, 2011 has been derived from audited financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, the instructions to Form 10-Q, and FASB Accounting Standards Codification (ASC) 270. Accordingly, the interim financial statements do not include all of the financial information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the interim consolidated financial statements include all adjustments necessary to present fairly the financial condition and results of operations for the reported periods, and all such adjustments are of a normal and recurring nature.

These consolidated statements should be read in conjunction with the notes to the audited consolidated financial statements contained in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2011.

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

The results of operations for the six-month period ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year.

In accordance with FASB ASC 855, the Corporation evaluated the events and transactions that occurred after the balance sheet date of June 30, 2012, and through the date these consolidated financial statements were issued, for items of potential recognition or disclosure.

Note 2 Significant Accounting Policies

Loans

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

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

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Allowance for Loan Losses

The allowance for loan losses represents the Corporation s estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely.

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

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

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

Each factor is assigned a value to reflect improving, stable or declining conditions based on the Corporation s best judgment using relevant information available at the time of the evaluation. An unallocated component is maintained to cover uncertainties that could affect the Corporation s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the loan portfolio.

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As disclosed in Note 5-Loans, the Corporation engages in commercial and consumer lending. Loans are made within the Corporation s primary market area and surrounding areas, and include the purchase of whole loan or participation interests in loans from other financial institutions. Commercial related loans, which pose the greatest risk of loss to the Corporation, whether originated or purchased, are generally secured by real estate. Within the broad commercial loan segment, the builder & developer and commercial real estate investor loan classes generally present a higher level of risk than other commercial loan classifications. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties, unstable real estate prices and the dependency upon successful construction and sale or operation of the real estate project. Within the consumer loan segment, junior (i.e., second) liens present a slightly higher risk to the Corporation because economic and housing market conditions can adversely affect the underlying value of the collateral and the ability of some borrowers to service their debt.

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

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

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

Federal regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to the Corporation. Based on a comprehensive analysis of the loan portfolio, the Corporation believes that the level of the allowance for loan losses at June 30, 2012 is adequate.

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Foreclosed Real Estate

Foreclosed real estate, included in other assets, is comprised of property acquired through a foreclosure proceeding or property that is acquired through acceptance of a deed-in-lieu of foreclosure. Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Any difference between the carrying value and the new cost basis is charged against the allowance for loan losses. Appraisals are generally used to determine fair value. After foreclosure, management reviews valuations at least quarterly and adjusts the asset to the lower of cost or fair value minus estimated costs to sell through a valuation allowance. Costs related to the improvement of foreclosed real estate are generally capitalized until the real estate reaches a saleable condition subject to fair value limitations. Revenue and expense from operations and changes in the valuation allowance are included in expense. When a foreclosed real estate asset is ultimately sold, any gain or loss on the sale is included in the income statement as a component of noninterest expense. At June 30, 2012, foreclosed real estate, net of allowance, was $12,685,000, compared to $16,243,000 for December 31, 2011.

Per Common Share Computations

The computation of net income per common share is provided in the table below.

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except per share data)	**2012**	**2011**	**2012**	**2011**
Net income available to common shareholders	$ 2,708	$ 1,626	$ 4,810	$ 2,892
Weighted average shares outstanding (basic)	4,221	4,150	4,214	4,144
Effect of dilutive stock options	60	58	45	51
Weighted average shares outstanding (diluted)	4,281	4,208	4,259	4,195
Basic earnings per common share	$ 0.64	$ 0.39	$ 1.14	$ 0.70
Diluted earnings per common share	$ 0.63	$ 0.39	$ 1.13	$ 0.69
Anti-dilutive stock options and common stock warrants excluded from the computation of earnings per share	75	83	75	83

Comprehensive Income

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

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Cash Flow Information

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

Supplemental cash flow information is provided in the table below.

(dollars in thousands)	Six months ended June 30, 2012	2011
Cash paid during the period for:		
Income taxes	$ 1,882	$ 1,285
Interest	$ 5,374	$ 6,295
Noncash investing and financing activities:		
Transfer of loans to foreclosed real estate	$ 156	$ 1,693
Increase in other liabilities for pre-funded client ACH disbursements	$ 0	$ 1,883
Increase in other liabilities for investment in foreclosed real estate	$ 0	$ 545

Reclassification

Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation, which did not impact net income or shareholders equity.

Recent Accounting Pronouncements

The FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S GAAP and IFRSs. This Update amends FASB ASC Topic 820, Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The Update clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity s stockholder s equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The Update also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The Update also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. The Corporation adopted the provisions of ASU No. 2011-04 effective January 1, 2012. The fair value measurement provisions of ASU No. 2011-04 had no impact on the Corporation s consolidated financial statements. See Note 13 to the consolidated financial statements for enhanced disclosures required by ASU No. 2011-04.

In November 2008, the Securities and Exchange Commission (SEC) released a proposed roadmap regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards (IFRS). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board (IASB). Under the proposed roadmap, the Corporation may be required to prepare financial statements in accordance with IFRS as early as 2015. The SEC has indicated it will make a determination in 2012 regarding the mandatory adoption of IFRS. The Corporation is currently assessing the impact that this potential change would have on its consolidated financial statements, and it will continue to monitor the development of the potential implementation of IFRS.

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Note 3-Securities

A summary of securities available-for-sale at June 30, 2012 and December 31, 2011 is provided below. The securities available-for-sale portfolio is generally comprised of high quality debt instruments, principally obligations of the United States government or agencies thereof. Also included in the portfolio are investments in the obligations of states and municipalities. With the exception of an approximately $15 million portfolio (fair value) of Texas municipal utility district bonds, which has its own criteria for investment, the remaining municipal bonds were almost all rated A or above by at least one national rating service at June 30, 2012. The majority of municipal bonds in the portfolio are general obligation bonds, which can draw upon multiple sources of revenue, including taxes, for payment. Only a few bonds are revenue bonds, which are dependent upon a single revenue stream for payment, but they are for critical services such as water and sewer. In many cases, municipal debt issues are insured or, in the case of school districts of selected states, backed by specific loss reserves. At June 30, 2012, the fair value of the municipal bond portfolio was concentrated in the states of Pennsylvania at 37 percent and Texas at 21 percent.

	Amortized	Gross Unrealized		Estimated Fair
(dollars in thousands)	Cost	Gains	Losses	Value
June 30, 2012				
Debt securities:				
U.S. Treasury notes	$ 10,000	$ 73	$ 0	$ 10,073
U.S. agency	19,556	1,104	0	20,660
U.S. agency mortgage-backed, residential	110,156	3,958	0	114,114
State and municipal	86,065	4,319	(25)	90,359
Total debt securities	$ 225,777	$ 9,454	$ (25)	$ 235,206
December 31, 2011				
Debt securities:				
U.S. Treasury notes	$ 10,003	$ 131	$ 0	$ 10,134
U.S. agency	29,593	1,080	0	30,673
U.S. agency mortgage-backed, residential	103,017	3,456	(29)	106,444
State and municipal	82,272	4,340	(2)	86,610
Total debt securities	$ 224,885	$ 9,007	$ (31)	$ 233,861

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The amortized cost and estimated fair value of debt securities at June 30, 2012 by contractual maturity are shown below. Actual maturities may differ from contractual maturities if call options on select debt issues are exercised in the future. Mortgage-backed securities are included in the maturity categories based on average expected life.

	Available-for-sale	
(dollars in thousands)	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 12,994	$ 13,084
Due after one year through five years	143,222	150,202
Due after five years through ten years	60,569	62,615
Due after ten years	8,992	9,305
Total debt securities	$ 225,777	$ 235,206

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

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	**2012**	**2011**	**2012**	**2011**
Realized gains	$ 0	$ 0	$ 50	$ 79
Realized losses	0	0	(1)	(104)
Net gains (losses)	$ 0	$ 0	$ 49	$ (25)

Securities, issued by agencies of the federal government, with a carrying value of $142,575,000 and $136,827,000 on June 30, 2012 and December 31, 2011, respectively, were pledged to secure public and trust deposits, repurchase agreements, other short-term borrowings and Federal Home Loan Bank debt.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time, for securities that have been in a continuous unrealized loss position, at June 30, 2012 and December 31, 2011.

	Less than 12 months		12 months or more		Total	
(dollars in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
June 30, 2012						
Debt securities:						
State and municipal	$ 4,248	$ (25)	$ 0	$ 0	$ 4,248	$ (25)
Total temporarily impaired debt securities, available for sale	$ 4,248	$ (25)	$ 0	$ 0	$ 4,248	$ (25)
December 31, 2011						
Debt securities:						
U.S. agency mortgage-backed, residential	$ 13,430	$ (29)	$ 0	$ 0	$ 13,430	$ (29)
State and municipal	856	(2)	0	0	856	(2)
Total temporarily impaired debt securities, available for sale	$ 14,286	$ (31)	$ 0	$ 0	$ 14,286	$ (31)

At June 30, 2012, the unrealized losses of $25,000 within the less than 12 months category were attributable to nine municipal securities. Two of the securities were rated AA3 and one AA2 by Moody s rating service and two were rated AA and four were rated AA- by Standard and Poor s rating service.

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

The Corporation believes that unrealized losses at June 30, 2012 were primarily the result of changes in market interest rates and that it has the ability to hold these investments for a time necessary to recover the amortized cost. Through June 30, 2012, the Corporation has collected all interest and principal on its investment securities as scheduled. The Corporation believes that collection of the contractual principal and interest is probable and, therefore, all impairment is considered to be temporary.

Note 4 Restricted Investment in Bank Stocks

Restricted stock, which represents required investments in the common stock of correspondent banks, is carried at cost and, as of June 30, 2012 and December 31, 2011, consisted primarily of the common stock of the Federal Home Loan Bank of Pittsburgh (FHLBP) and, to a lesser degree, Atlantic Central Bankers Bank (ACBB). Under the FHLBP s Capital Plan, PeoplesBank is required to maintain a minimum member stock investment, both as a condition of becoming and remaining a member and as a condition of obtaining borrowings from the FHLBP. The FHLBP uses a formula to determine the minimum stock investment, which is based on the volume of loans outstanding, unused borrowing capacity and other factors.

During the first quarter of 2012, the FHLBP began paying a quarterly cash dividend on its common stock. Prior to 2012, dividend payments had been suspended by the FHLBP since December 2008. The FHLBP reported that future dividends will be dependent upon the condition of its private-label residential mortgage-backed securities portfolio, its overall financial performance, retained earnings and other factors. The FHLBP restricts the repurchase of the excess capital stock of member banks. The amount of excess capital stock that can be repurchased from any member is currently the lesser of five percent of the member s total capital stock outstanding or its excess capital stock outstanding.

Management evaluates the restricted stock for impairment in accordance with FASB ASC Topic 942. Management s determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. Using the FHLBP as an example, the determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLBP as compared to the capital stock amount for the FHLBP and the length of time this situation has persisted; (2) commitments by the FHLBP to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLBP; and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLBP. Management believes no impairment charge was necessary related to the restricted stock during the periods ended June 30, 2012 and 2011.

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Note 5 Loans

The table below provides the composition of the loan portfolio at June 30, 2012 and December 31, 2011. The portfolio is comprised of two segments, commercial and consumer loans. The commercial loan segment is disaggregated by industry class which allows the Corporation to monitor risk and performance. Those industries representing the largest dollar investment and most risk are listed separately. The other commercial loans category is comprised of a multitude of industries, including health services, professional services, public administration, restaurant, service, transportation, finance, natural resources, recreation and religious organizations. The consumer related segment is comprised of residential mortgages, home equity and other consumer loans. The Corporation has not engaged in sub-prime residential mortgage originations.

(dollars in thousands)	**June 30, 2012**	**December 31, 2011**
Builder & developer	$ 99,228	$ 103,514
Commercial real estate investor	119,335	118,133
Residential real estate investor	63,610	62,564
Hotel/Motel	60,176	52,871
Wholesale & retail	58,111	60,328
Manufacturing	28,420	25,976
Agriculture	19,382	17,368
Other	128,736	124,821
Total commercial related loans	576,998	565,575
Residential mortgages	22,426	21,324
Home equity	60,492	58,390
Other	46,328	48,226
Total consumer related loans	129,246	127,940
Total loans	$ 706,244	$ 693,515

The Corporation s internal risk rating system follows regulatory guidance as to risk classifications and definitions. Every approved loan is assigned a risk rating. Generally, risk ratings for commercial related loans and residential mortgages held for investment are determined by a formal evaluation of risk factors performed by the Corporation s underwriting staff. For consumer loans, and commercial loans up to $750,000, the Corporation uses third-party credit scoring software models for risk rating purposes. The loan portfolio is monitored on a continuous basis by loan officers, loan review personnel and senior management. Adjustments of loan risk ratings are generally performed by the Special Asset Committee, which includes senior management. The Committee, which meets monthly, makes changes, as appropriate, to risk ratings when it becomes aware of credit events such as payment delinquency, cessation of a business or project, bankruptcy or death of the borrower, or changes in collateral value.

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

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The table below presents a summary of loan risk ratings by loan class at June 30, 2012 and December 31, 2011.

(dollars in thousands)	Pass	Special Mention	Substandard	Nonaccrual	Total
June 30, 2012					
Builder & developer	$ 85,077	$ 6,814	$ 6,026	$ 1,311	$ 99,228
Commercial real estate investor	103,808	10,991	2,471	2,065	119,335
Residential real estate investor	59,410	1,596	2,052	552	63,610
Hotel/Motel	60,176	0	0	0	60,176
Wholesale & retail	53,758	2,282	0	2,071	58,111
Manufacturing	27,712	0	708	0	28,420
Agriculture	18,901	0	481	0	19,382
Other	118,812	5,285	65	4,574	128,736
Total commercial related loans	527,654	26,968	11,803	10,573	576,998
Residential mortgage	22,333	6	33	54	22,426
Home equity	60,155	115	188	34	60,492
Other	45,575	293	241	219	46,328
Total consumer related loans	128,063	414	462	307	129,246
Total loans	$ 655,717	$ 27,382	$ 12,265	$ 10,880	$ 706,244
December 31, 2011					
Builder & developer	$ 90,429	$ 11,392	$ 533	$ 1,160	$ 103,514
Commercial real estate investor	102,374	13,519	161	2,079	118,133
Residential real estate investor	58,331	3,681	0	552	62,564
Hotel/Motel	52,871	0	0	0	52,871
Wholesale & retail	54,193	2,354	811	2,970	60,328
Manufacturing	25,262	0	714	0	25,976
Agriculture	16,879	0	489	0	17,368
Other	111,227	9,095	0	4,499	124,821
Total commercial related loans	511,566	40,041	2,708	11,260	565,575
Residential mortgage	21,113	7	34	170	21,324
Home equity	58,088	79	188	35	58,390
Other	47,359	597	34	236	48,226
Total consumer related loans	126,560	683	256	441	127,940
Total loans	$ 638,126	$ 40,724	$ 2,964	$ 11,701	$ 693,515

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The table below presents a summary of impaired loans at June 30, 2012 and December 31, 2011. Generally, impaired loans are loans risk rated substandard and nonaccrual or classified as troubled debt restructurings. An allowance is established for individual commercial related loans where the Corporation has doubt as to full recovery of the outstanding principal balance. Typically, impaired consumer related loans are partially or fully charged-off obviating the need for a specific allowance. The recorded investment represents outstanding unpaid principal loan balances adjusted for charge-offs.

	June 30, 2012			December 31, 2011		
(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans with no related allowance:						
Builder & developer	$ 8,275	$ 8,275	$ 0	$ 2,627	$ 2,627	$ 0
Commercial real estate investor	4,536	4,636	0	3,965	4,065	0
Residential real estate investor	464	464	0	463	463	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,071	4,346	0	3,781	6,056	0
Manufacturing	708	708	0	714	714	0
Agriculture	0	0	0	0	0	0
Other commercial	3,760	3,888	0	3,619	3,619	0
Residential mortgage	87	113	0	204	314	0
Home equity	222	222	0	223	223	0
Other consumer	460	460	0	270	270	0
Total impaired loans with no related allowance	$ 20,583	$ 23,112	$ 0	$ 15,866	$ 18,351	$ 0
Impaired loans with a related allowance:						
Builder & developer	$ 260	$ 260	$ 147	$ 264	$ 264	$ 147
Commercial real estate investor	0	0	0	0	0	0
Residential real estate investor	2,140	2,140	430	89	89	30
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	0	0	0	0	0	0
Manufacturing	0	0	0	0	0	0
Agriculture	481	481	100	489	489	100
Other commercial	879	879	120	880	880	120
Residential mortgage	0	0	0	0	0	0
Home equity	0	0	0	0	0	0
Other consumer	0	0	0	0	0	0
Total impaired loans with a related allowance	$ 3,760	$ 3,760	$ 797	$ 1,722	$ 1,722	$ 397
Total impaired loans:						
Builder & developer	$ 8,535	$ 8,535	$ 147	$ 2,891	$ 2,891	$ 147
Commercial real estate investor	4,536	4,636	0	3,965	4,065	0
Residential real estate investor	2,604	2,604	430	552	552	30
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,071	4,346	0	3,781	6,056	0
Manufacturing	708	708	0	714	714	0
Agriculture	481	481	100	489	489	100
Other commercial	4,639	4,767	120	4,499	4,499	120
Residential mortgage	87	113	0	204	314	0
Home equity	222	222	0	223	223	0
Other consumer	460	460	0	270	270	0
Total impaired loans	$ 24,343	$ 26,872	$ 797	$ 17,588	$ 20,073	$ 397

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The tables below present a summary of average impaired loans and related interest income that was included in net income for the three and six months ended June 30, 2012 and 2011.

	For the three months ended					
	June 30, 2012			June 30, 2011		
(dollars in thousands)	Average Recorded Investment	Interest Income	Cash Basis	Average Recorded Investment	Interest Income	Cash Basis
Impaired loans with no related allowance:						
Builder & developer	$ 8,070	$ 117	$ 11	$ 6,081	$ 156	$ 150
Commercial real estate investor	4,546	76	39	1,010	15	12
Residential real estate investor	464	0	0	438	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,100	3	3	1,219	22	0
Manufacturing	710	10	0	0	0	0
Agriculture	0	0	0	0	0	0
Other commercial	5,443	102	101	5,658	111	89
Residential mortgage	144	1	1	316	5	4
Home equity	245	1	1	114	0	0
Other consumer	390	7	4	616	8	3
Total impaired loans with no related allowance	$ 22,112	$ 317	$ 160	$ 15,452	$ 317	$ 258
Impaired loans with a related allowance:						
Builder & developer	$ 262	$ 2	$ 2	$ 1,517	7	7
Commercial real estate investor	113	0	0	171	0	0
Residential real estate investor	1,114	2	0	94	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	0	0	0	4,842	0	0
Manufacturing	0	0	0	0	0	0
Agriculture	483	9	0	499	9	0
Other commercial	925	0	0	705	8	0
Residential mortgage	0	0	0	0	0	0
Home equity	0	0	0	0	0	0
Other consumer	0	0	0	0	0	0
Total impaired loans with a related allowance	$ 2,897	$ 13	$ 2	$ 7,828	$ 24	$ 7
Total impaired loans:						
Builder & developer	$ 8,332	$ 119	$ 13	$ 7,598	$ 163	$ 157
Commercial real estate investor	4,659	76	39	1,181	15	12
Residential real estate investor	1,578	2	0	532	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,100	3	3	6,061	22	0
Manufacturing	710	10	0	0	0	0
Agriculture	483	9	0	499	9	0
Other commercial	6,368	102	101	6,363	119	89
Residential mortgage	144	1	1	316	5	4
Home equity	245	1	1	114	0	0
Other consumer	390	7	4	616	8	3
Total impaired loans	$ 25,009	$ 330	$ 162	$ 23,280	$ 341	$ 265

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	For the six months ended					
	June 30, 2012			June 30, 2011		
(dollars in thousands)	Average Recorded Investment	Interest Income	Cash Basis	Average Recorded Investment	Interest Income	Cash Basis
Impaired loans with no related allowance:						
Builder & developer	$ 6,256	$ 234	$ 54	$ 6,807	$ 232	$ 220
Commercial real estate investor	4,352	136	73	673	14	12
Residential real estate investor	463	1	1	423	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,660	(1)	3	1,152	40	0
Manufacturing	711	21	0	0	0	0
Agriculture	0	0	0	0	0	0
Other commercial	4,835	79	125	5,512	237	199
Residential mortgage	164	4	3	293	10	9
Home equity	238	3	1	109	0	0
Other consumer	350	11	8	565	19	10
Total impaired loans with no related allowance	$ 20,029	$ 488	$ 268	$ 15,534	$ 552	$ 450
Impaired loans with a related allowance:						
Builder & developer	$ 263	$ 2	$ 2	$ 1,151	12	12
Commercial real estate investor	75	0	0	223	0	0
Residential real estate investor	773	2	0	95	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	0	0	0	4,842	0	0
Manufacturing	0	0	0	0	0	0
Agriculture	485	17	0	499	18	0
Other commercial	910	0	0	708	15	0
Residential mortgage	0	0	0	0	0	0
Home equity	0	0	0	0	0	0
Other consumer	0	0	0	0	0	0
Total impaired loans with a related allowance	$ 2,506	$ 21	$ 2	$ 7,518	$ 45	$ 12
Total impaired loans:						
Builder & developer	$ 6,519	$ 236	$ 56	$ 7,958	$ 244	$ 232
Commercial real estate investor	4,427	136	73	896	14	12
Residential real estate investor	1,236	3	1	518	0	0
Hotel/Motel	0	0	0	0	0	0
Wholesale & retail	2,660	(1)	3	5,994	40	0
Manufacturing	711	21	0	0	0	0
Agriculture	485	17	0	499	18	0
Other commercial	5,745	79	125	6,220	252	199
Residential mortgage	164	4	3	293	10	9
Home equity	238	3	1	109	0	0
Other consumer	350	11	8	565	19	10
Total impaired loans	$ 22,535	$ 509	$ 270	$ 23,052	$ 597	$ 462

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The performance and credit quality of the loan portfolio is also monitored by using an aging schedule which shows the length of time a loan is past due. The table below presents a summary of past due loans, nonaccrual loans and current loans by loan segment and class at June 30, 2012 and December 31, 2011.

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater Past Due	Total Past Due Accruing	Nonaccrual	Current	Total Loans
June 30, 2012							
Builder & developer	$ 450	$ 0	$ 0	$ 450	$ 1,311	$ 97,467	$ 99,228
Commercial real estate investor	0	0	0	0	2,065	117,270	119,335
Residential real estate investor	2,052	0	0	2,052	552	61,006	63,610
Hotel/Motel	0	0	0	0	0	60,176	60,176
Wholesale & retail	0	0	0	0	2,071	56,040	58,111
Manufacturing	0	0	0	0	0	28,420	28,420
Agriculture	0	0	0	0	0	19,382	19,382
Other	0	0	0	0	4,574	124,162	128,736
Total commercial related loans	2,502	0	0	2,502	10,573	563,923	576,998
Residential mortgage	67	0	0	67	54	22,305	22,426
Home equity	42	0	0	42	34	60,416	60,492
Other	1,068	115	0	1,183	219	44,926	46,328
Total consumer related loans	1,177	115	0	1,292	307	127,647	129,246
Total loans	$ 3,679	$ 115	$ 0	$ 3,794	$ 10,880	$ 691,570	$ 706,244
December 31, 2011							
Builder & developer	$ 1,709	$ 0	$ 0	$ 1,709	$ 1,160	$ 100,645	$ 103,514
Commercial real estate investor	0	0	0	0	2,079	116,054	118,133
Residential real estate investor	0	0	0	0	552	62,012	62,564
Hotel/Motel	0	0	0	0	0	52,871	52,871
Wholesale & retail	525	0	0	525	2,970	56,833	60,328
Manufacturing	0	0	0	0	0	25,976	25,976
Agriculture	0	0	0	0	0	17,368	17,368
Other	109	0	0	109	4,499	120,213	124,821
Total commercial related loans	2,343	0	0	2,343	11,260	551,972	565,575
Residential mortgage	320	0	0	320	170	20,834	21,324
Home equity	236	0	0	236	35	58,119	58,390
Other	677	1	0	678	236	47,312	48,226
Total consumer related loans	1,233	1	0	1,234	441	126,265	127,940
Total loans	$ 3,576	$ 1	$ 0	$ 3,577	$ 11,701	$ 678,237	$ 693,515

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Loans classified as troubled debt restructurings (TDRs) are designated impaired and arise when the Corporation grants borrowers experiencing financial difficulties concessions that it would not otherwise consider. Concessions granted with respect to these loans involve an extension of the maturity date or a below market interest rate relative to new debt with similar risk. Generally, these loans are secured by real estate. If repayment of the loan is determined to be collateral dependent, the loan is evaluated for impairment loss based on the fair value of the collateral. For loans that are not collateral dependent, the present value of expected future cash flows, discounted at the loan s effective interest rate, is used to determine any impairment loss.

A nonaccrual TDR represents a nonaccrual loan, as previously defined, which includes an economic concession. Nonaccrual TDRs are restored to accrual status if principal and interest payments, under the modified terms, are current for at least six consecutive payments after the modification and future principal and interest payments are reasonably assured. In contrast, an accruing TDR represents a loan that, at the time of the modification, has a demonstrated history of payments and with respect to which management believes that future loan payments are reasonably assured under the modified terms.

The table below shows loans whose terms have been modified under TDRs during the three months and six months ended June 30, 2012 and 2011. There was no impairment loss recognized on any of these TDRs, and they are all performing under their modified terms. There were no defaults during the six months ended June 30, 2012 for TDRs entered into for the last 12 months.

Three months ended June 30, 2012:

(dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investments**	**Post-Modification Outstanding Recorded Investments**
Troubled Debt Restructurings:			
Commercial related loans			
nonaccrual	0	$ 0	$ 0

Six months ended June 30, 2012:

(dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investments**	**Post-Modification Outstanding Recorded Investments**
Troubled Debt Restructurings:			
Commercial related loans			
nonaccrual	1	$ 286	$ 286

Three months ended June 30, 2011:

(dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investments**	**Post-Modification Outstanding Recorded Investments**
Troubled Debt Restructurings:			
Consumer related loans			
accruing	1	$ 188	$ 188

Six months ended June 30, 2011:

(dollars in thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investments**	**Post-Modification Outstanding Recorded Investments**
Troubled Debt Restructurings:			
Consumer related loans			
accruing	1	$ 188	$ 188

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NOTE 6 Allowance for Loan Losses

The table below shows the activity in and the composition of the allowance for loan losses by loan segment and class detail as of and for the three and six months ended June 30, 2012 and 2011.

(dollars in thousands)	**Builder & developer**	**Commercial real estate investor**	**Residential real estate investor**	**Hotel/ Motel**	**Wholesale & retail**	**Manufacturing**	**Agriculture**	**Other**	**Total commercial related**
Allowance for loan losses:									
Balance, April 1, 2012	$ 1,979	$ 2,013	$ 500	$ 443	$ 1,716	$ 151	$ 193	$ 1,015	$ 8,010
Charge-offs	(2)	(68)	0	0	0	0	0	(263)	(333)
Recoveries	0	0	0	0	5	0	0	0	5
Provisions	(297)	(706)	400	6	(31)	13	1	310	(304)
Balance, June 30, 2012	$ 1,680	$ 1,239	$ 900	$ 449	$ 1,690	$ 164	$ 194	$ 1,062	$ 7,378
Balance, April 1, 2011	$ 1,801	$ 1,705	$ 700	$ 345	$ 1,011	$ 150	$ 167	$ 1,014	$ 6,893
Charge-offs	(25)	0	0	0	0	0	0	0	(25)
Recoveries	0	0	0	0	1	0	0	1	2
Provisions	600	192	(112)	52	(74)	1	22	144	825
Balance, June 30, 2011	$ 2,376	$ 1,897	$ 588	$ 397	$ 938	$ 151	$ 189	$ 1,159	$ 7,695

(dollars in thousands)	**Residential mortgage**	**Home equity**	**Other**	**Total consumer related**	**Unallocated**	**Total**
Allowance for loan losses:						
Balance, April 1, 2012	$ 117	$ 87	$ 163	$ 367	$ 512	$ 8,889
Charge-offs	0	(128)	(25)	(153)	0	(486)
Recoveries	24	0	8	32	0	37
Provisions	(63)	193	(9)	121	433	250
Balance, June 30, 2012	$ 78	$ 152	$ 137	$ 367	$ 945	$ 8,690

Balance, April 1, 2011	$ 130	$ 244	$ 262	$ 636	$ 327	$ 7,856
Charge-offs	0	0	(42)	(42)	0	(67)
Recoveries	0	7	3	10	0	12
Provisions	(57)	(96)	(39)	(192)	(83)	550
Balance, June 30, 2011	$ 73	$ 155	$ 184	$ 412	$ 244	$ 8,351

(dollars in thousands)	**Builder & developer**	**Commercial real estate investor**	**Residential real estate investor**	**Hotel/ Motel**	**Wholesale & retail**	**Manufacturing**	**Agriculture**	**Other**	**Total commercial related**
Allowance for loan losses:									
Balance, January 1, 2012	$ 2,170	$ 2,003	$ 505	$ 394	$ 1,806	$ 151	$ 184	$ 907	$ 8,120
Charge-offs	(2)	(68)	0	0	0	0	0	(263)	(333)
Recoveries	0	0	0	0	11	0	0	0	11
Provisions	(488)	(696)	395	55	(127)	13	10	418	(420)
Balance, June 30, 2012	$ 1,680	$ 1,239	$ 900	$ 449	$ 1,690	$ 164	$ 194	$ 1,062	$ 7,378
Balance, January 1, 2011	$ 1,561	$ 1,887	$ 698	$ 345	$ 843	$ 155	$ 175	$ 1,123	$ 6,787
Charge-offs	(33)	0	0	0	(146)	0	0	(39)	(218)
Recoveries	0	0	0	0	1	0	0	1	2
Provisions	848	10	(110)	52	240	(4)	14	74	1,124
Balance, June 30, 2011	$ 2,376	$ 1,897	$ 588	$ 397	$ 938	$ 151	$ 189	$ 1,159	$ 7,695

(dollars in thousands)	**Residential mortgage**	**Home equity**	**Other**	**Total consumer related**	**Unallocated**	**Total**
Allowance for loan losses:						
Balance, January 1, 2012	$ 88	$ 86	$ 171	$ 345	$ 237	$ 8,702
Charge-offs	(39)	(128)	(76)	(243)	0	(576)
Recoveries	41	0	12	53	0	64

Provisions		(12)		194		30		212		708		500
Balance, June 30, 2012	$	78	$	152	$	137	$	367	$	945	$	8,690
Balance, January 1, 2011	$	30	$	83	$	201	$	314	$	525	$	7,626
Charge-offs		(56)		(164)		(75)		(295)		0		(513)
Recoveries		0		7		4		11		0		13
Provisions		99		229		54		382		(281)		1,225
Balance, June 30, 2011	$	73	$	155	$	184	$	412	$	244	$	8,351

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The table below shows the allowance amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment at June 30, 2012 and 2011 and December 31, 2011.

(dollars in thousands)	Builder & developer	Commercial real estate investor	Residential real estate investor	Hotel/Motel	Wholesale & retail	Manufacturing	Agriculture	Other	Total commercial related
Allowance for loan losses:									
Individually evaluated for impairment	$ 147	$ 0	$ 430	$ 0	$ 0	$ 0	$ 100	$ 120	$ 797
Collectively evaluated for impairment	1,533	1,239	470	449	1,690	164	94	942	6,581
Balance, June 30, 2012	$ 1,680	$ 1,239	$ 900	$ 449	$ 1,690	$ 164	$ 194	$ 1,062	$ 7,378
Individually evaluated for impairment	$ 147	$ 0	$ 30	$ 0	$ 0	$ 0	$ 100	$ 120	$ 397
Collectively evaluated for impairment	2,023	2,003	475	394	1,806	151	84	787	7,723
Balance, December 31, 2011	$ 2,170	$ 2,003	$ 505	$ 394	$ 1,806	$ 151	$ 184	$ 907	$ 8,120
Individually evaluated for impairment	$ 672	$ 25	$ 30	$ 0	$ 675	$ 0	$ 100	$ 200	$ 1,702
Collectively evaluated for impairment	1,704	1,872	558	397	263	151	89	959	5,993
Balance, June 30, 2011	$ 2,376	$ 1,897	$ 588	$ 397	$ 938	$ 151	$ 189	$ 1,159	$ 7,695
Loans:									
Individually evaluated for impairment	$ 8,535	$ 4,536	$ 2,604	$ 0	$ 2,071	$ 708	$ 481	$ 4,639	$ 23,574
Collectively evaluated for impairment	90,693	114,799	61,006	60,176	56,040	27,712	18,901	124,097	553,424

Balance, June 30, 2012	$ 99,228	$ 119,335	$ 63,610	$ 60,176	$ 58,111	$ 28,420	$ 19,382	$ 128,736	$ 576,998
Individually evaluated for impairment	$ 2,891	$ 3,965	$ 552	$ 0	$ 3,781	$ 714	$ 489	$ 4,499	$ 16,891
Collectively evaluated for impairment	100,623	114,168	62,012	52,871	56,547	25,262	16,879	120,322	548,684
Balance, December 31, 2011	$ 103,514	$ 118,133	$ 62,564	$ 52,871	$ 60,328	$ 25,976	$ 17,368	$ 124,821	$ 565,575
Individually evaluated for impairment	$ 8,189	$ 2,188	$ 576	$ 0	$ 6,261	$ 0	$ 498	$ 6,777	$ 24,489
Collectively evaluated for impairment	95,999	105,933	59,216	49,931	44,328	25,202	16,177	127,377	524,163
Balance, June 30, 2011	$ 104,188	$ 108,121	$ 59,792	$ 49,931	$ 50,589	$ 25,202	$ 16,675	$ 134,154	$ 548,652

(dollars in thousands)	**Residential mortgage**	**Home equity**	**Other**	**Total consumer related**	**Unallocated**	**Total**
Allowance for loan losses:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 797
Collectively evaluated for impairment	78	152	137	367	945	7,893
Balance, June 30, 2012	$ 78	$ 152	$ 137	$ 367	$ 945	$ 8,690
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 397
Collectively evaluated for impairment	88	86	171	345	237	8,305
Balance, December 31, 2011	$ 88	$ 86	$ 171	$ 345	$ 237	$ 8,702
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 1,702
	73	155	184	412	244	6,649

Collectively evaluated for impairment						
Balance, June 30, 2011	$ 73	$ 155	$ 184	$ 412	$ 244	$ 8,351
Loans:						
Individually evaluated for impairment	$ 87	$ 222	$ 460	$ 769		$ 24,343
Collectively evaluated for impairment	22,339	60,270	45,868	128,477		681,901
Balance, June 30, 2012	$ 22,426	$ 60,492	$ 46,328	$ 129,246		$ 706,244
Individually evaluated for impairment	$ 204	$ 223	$ 270	$ 697		$ 17,588
Collectively evaluated for impairment	21,120	58,167	47,956	127,243		675,927
Balance, December 31, 2011	$ 21,324	$ 58,390	$ 48,226	$ 127,940		$ 693,515
Individually evaluated for impairment	$ 315	$ 208	$ 718	$ 1,241		$ 25,730
Collectively evaluated for impairment	21,382	57,630	51,164	130,176		654,339
Balance, June 30, 2011	$ 21,697	$ 57,838	$ 51,882	$ 131,417		$ 680,069

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Note 7 Deposits

The composition of deposits as of June 30, 2012 and December 31, 2011 is shown below.

(dollars in thousands)	**June 30, 2012**	**December 31, 2011**
Noninterest bearing demand	$ 84,816	