DNB FINANCIAL CORP /PA/
Form 10-Q
August 12, 2016

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, 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: 1-34242

DNB Financial Corporation

(Exact name of registrant as specified in its charter)

Pennsylvania	23-2222567

Pennsylvania	23-2222567
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4 Brandywine Avenue - Downingtown, PA 19335

(Address of principal executive offices and Zip Code)

(610) 269-1040

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since 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 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock ($1.00 Par Value)	
(Class)	2,853,434 (Shares Outstanding as of August 12, 2016)

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DNB FINANCIAL CORPORATION AND SUBSIDIARY

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PART I – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

DNB Financial Corporation and Subsidiary

Consolidated Statements of Financial Condition (Unaudited)

(Dollars in thousands, except share and per share data)	June 30, 2016	December 31, 2015
Assets		
Cash and due from banks	$ 20,146	$ 21,119
Cash and cash equivalents	20,146	21,119
Available-for-sale investment securities at fair value (amortized cost of $147,645 and $153,559)	148,305	152,379
Held-to-maturity investment securities (fair value of $76,403 and $68,431)	74,835	67,829
Total investment securities	223,140	220,208
Loans	494,417	481,758
Allowance for credit losses	(5,247)	(4,935)
Net loans	489,170	476,823
Restricted stock	3,318	3,447
Office property and equipment, net	8,557	6,806
Accrued interest receivable	2,390	2,410
Other real estate owned & other repossessed property	2,952	2,581
Bank owned life insurance (BOLI)	9,436	9,326
Core deposit intangible	59	66
Net deferred taxes	2,930	3,733
Other assets	2,074	2,299
Total assets	$ 764,172	$ 748,818
Liabilities and Stockholders' Equity		
Liabilities		
Non-interest-bearing deposits	$ 135,212	$ 125,581
Interest-bearing deposits:		
NOW	185,279	185,973
Money market	149,108	137,555
Savings	75,236	72,660
Time	73,560	66,018
Brokered deposits	23,449	18,488

Total deposits	641,844	606,275
Federal Home Loan Bank of Pittsburgh (FHLBP) advances	20,000	30,000
Repurchase agreements	17,748	32,416
Junior subordinated debentures	9,279	9,279
Subordinated debt	9,750	9,750
Other borrowings	442	464
Total borrowings	57,219	81,909
Accrued interest payable	377	345
Other liabilities	5,195	4,801
Total liabilities	704,635	693,330
Stockholders' Equity		
Preferred stock, $10.00 par value;		
1,000,000 shares authorized; $1,000 liquidation preference per share; 0 and 0 issued, respectively	-	-
Common stock, $1.00 par value;		
10,000,000 shares authorized; 2,951,128 and 2,933,049 issued, respectively; 2,848,773 and 2,823,840 outstanding, respectively	2,972	2,955
Treasury stock, at cost; 102,355 and 109,209 shares, respectively	(1,890)	(2,015)
Surplus	35,521	35,097
Retained earnings	23,703	21,436
Accumulated other comprehensive loss	(769)	(1,985)
Total stockholders' equity	59,537	55,488
Total liabilities and stockholders' equity	$ 764,172	$ 748,818

See accompanying notes to unaudited consolidated financial statements.

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DNB Financial Corporation and Subsidiary

Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share data)	2016	2015	2016	2015
Interest Income:				
Interest and fees on loans	$ 5,091	$ 5,011	$ 10,159	$ 9,923
Interest and dividends on investment securities:				
Taxable	752	759	1,434	1,494
Exempt from federal taxes	294	346	628	688
Interest on cash and cash equivalents	43	15	64	22
Total interest and dividend income	6,180	6,131	12,285	12,127
Interest Expense:				
Interest on NOW, money market and savings	194	153	358	302
Interest on time deposits	140	98	257	207
Interest on brokered deposits	71	26	133	50
Interest on FHLB advances	90	197	184	391
Interest on repurchase agreements	10	10	21	19
Interest on junior subordinated debentures	84	73	165	147
Interest on subordinated debt	103	104	207	134
Interest on other borrowings	16	17	33	34
Total interest expense	708	678	1,358	1,284
Net interest income	5,472	5,453	10,927	10,843
Provision for credit losses	200	415	530	715
Net interest income after provision for credit losses	5,272	5,038	10,397	10,128
Non-interest Income:				
Service charges	240	272	547	568
Wealth management	441	422	838	774
Mortgage banking	81	51	113	89
Increase in cash surrender value of BOLI	55	56	110	111
Gain on sale of investment securities, net	203	11	234	64
Gain on sale of loans	-	185	39	416
Gains from insurance proceeds	-	-	1,150	-
Other fees	367	341	685	651
Total non-interest income	1,387	1,338	3,716	2,673
Non-interest Expense:				
Salaries and employee benefits	2,693	2,638	5,819	5,282
Furniture and equipment	342	303	671	605
Occupancy	467	466	935	1,069
Professional and consulting	333	261	642	589
Advertising and marketing	166	170	349	339

Printing and supplies	60	39	93	87
FDIC insurance	121	124	250	247
PA shares tax	157	151	319	301
Telecommunications	61	60	122	121
Postage	21	22	42	45
Loss on sale or write down of OREO, net	4	-	4	-
Due diligence and merger expense	275	-	463	-
Other expenses	472	490	881	863
Total non-interest expense	5,172	4,724	10,590	9,548
Income before income tax expense	1,487	1,652	3,523	3,253
Income tax expense	378	417	858	766
Net income	$ 1,109	$ 1,235	$ 2,665	$ 2,487
Preferred stock dividends and accretion of discount	-	8	-	34
Net income available to common shareholders	$ 1,109	$ 1,227	$ 2,665	$ 2,453
Earnings per common share:				
Basic	$ 0.39	$ 0.44	$ 0.94	$ 0.88
Diluted	$ 0.39	$ 0.43	$ 0.93	$ 0.86
Cash dividends per common share	$ 0.07	$ 0.07	$ 0.14	$ 0.14
Weighted average common shares outstanding:				
Basic	2,848,648	2,802,292	2,840,677	2,794,283
Diluted	2,882,729	2,847,638	2,876,016	2,840,380

See accompanying notes to unaudited consolidated financial statements

DNB Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Net income	$ 1,109	$ 1,235	$ 2,665	$ 2,487
Other Comprehensive Income (Loss):				
Unrealized holding gains (losses) arising during the period				
Before tax amount	605	(1,140)	2,074	(53)
Tax effect	(207)	388	(706)	18
	398	(752)	1,368	(35)
Accretion of discount on AFS to HTM reclassification(1)				
Before tax amount	1	1	3	4
Tax effect(2)	-	-	(1)	(1)
	1	1	2	3
Less reclassification for gains included in net income				
Before tax amount	(203)	(11)	(234)	(64)
Tax effect(2)	70	3	80	21
	(133)	(8)	(154)	(43)
Total other comprehensive income (loss)	266	(759)	1,216	(75)
Total comprehensive income	$ 1,375	$ 476	$ 3,881	$ 2,412

(1) Amounts are included in interest and dividends on investment securities in the consolidated statements of income.
(2) Amounts are included in income tax expense in the consolidated statements of income.
See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corportation and Subsidiary

Consolidated Statements of Stockholders’ Equity (Unaudited)

(Dollars in thousands)	Preferred Stock	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2016	$ -	$ 2,955	$ (2,015)	$ 35,097	$ 21,436	$ (1,985)	$ 55,488
Net income for six months ended June 30, 2016	-	-	-	-	2,665	-	2,665
Other comprehensive income	-	-	-	-	-	1,216	1,216
Restricted stock compensation expense (18,079 shares vested)	-	32	-	698	-	-	730
Taxes on share award vest	-	(15)	-	(421)	-	-	(436)
Tax benefit for restricted stock vest	-	-	-	64	-	-	64
Cash dividends - common ($0.14 per share)	-	-	-	-	(398)	-	(398)
Sale of treasury shares to 401(k) (4,288 shares)	-	-	78	52	-	-	130
Sale of treasury shares to deferred comp. plan (2,566 shares)	-	-	47	31	-	-	78
Balance at June 30, 2016	$ -	$ 2,972	$ (1,890)	$ 35,521	$ 23,703	$ (769)	$ 59,537

(Dollars in thousands)	Preferred Stock	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2015	$ 13,000	$ 2,931	$ (2,301)	$ 34,745	$ 17,132	$ (1,599)	$ 63,908
Net income for six months ended June 30, 2015	-	-	-	-	2,487	-	2,487
Other comprehensive loss	-	-	-	-	-	(75)	(75)
Redemption of preferred stock (9,750 shares)	(9,750)	-	-	-	-	-	(9,750)
Restricted stock compensation expense	-	9	-	156	-	-	165
Exercise of stock options (95,834 shares)	-	16	-	247	-	-	263
Taxes on stock option exercise and share award vest	-	-	-	(152)	-	-	(152)
Cash dividends - common ($0.14 per share)	-	-	-	-	(391)	-	(391)
Cash dividends SBLF preferred	-	-	-	-	(34)	-	(34)
Sale of treasury shares to 401(k) (5,855 shares)	-	-	107	31	-	-	138

Sale of treasury shares to deferred comp. plan (2,807 shares)	-	-	51	14	-	-	65
Balance at June 30, 2015	$ 3,250	$ 2,956	$ (2,143)	$ 35,041	$ 19,194	$ (1,674)	$ 56,624

See accompanying notes to unaudited consolidated financial statements.

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DNB Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,			
(Dollars in thousands)	2016		2015	
Cash Flows From Operating Activities:				
Net income	$	2,665	$	2,487
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, amortization and accretion		743		931
Provision for credit losses		530		715
Stock based compensation		730		165
Net gain on sale of securities		(234)		(64)
Net loss on sale and write down of OREO and other repossessed property		4		-
Earnings from investment in BOLI		(110)		(111)
Deferred tax expense (benefit)		176		(424)
Proceeds from sales of loans		5,584		12,049
Loans originated for sale		(5,432)		(10,927)
Gain on sale of loans and mortgage banking income		(152)		(505)
Write off of property and equipment		-		731
Decrease (increase) in accrued interest receivable		20		(135)
Decrease (increase) in other assets		226		(614)
Increase in accrued interest payable		32		4
Increase (decrease) in other liabilities		394		(120)
Net Cash Provided By Operating Activities		5,176		4,182
Cash Flows From Investing Activities:				

Activity in available-for-sale securities:				
Sales		28,215		9,731
Maturities, repayments and calls		28,147		15,844
Purchases		(50,573)		(20,478)
Activity in held-to-maturity securities:				
Maturities, repayments and calls		6,533		1,006
Purchases		(13,507)		(6,709)
Net decrease (increase) in restricted stock		129		(277)
Net increase in loans		(12,877)		(18,346)
Purchases of property and equipment		(2,158)		(116)
Costs capitalized in OREO and other repossessed property		(735)		-
Proceeds from sale of OREO and other repossessed property		360		-
Net Cash Used in Investing Activities		(16,466)		(19,345)
Cash Flows From Financing Activities:				
Net increase in deposits		35,569		21,293
Repayment of FHLBP advances		(10,000)		-
Net (decrease) increase in repurchase agreements		(14,668)		8,990
Proceeds from issuance of subordinated debt		-		9,750
Repayment of other borrowings		(22)		(20)
Dividends paid		(398)		(425)
Proceeds from the exercise of stock options		-		263
Taxes on exercise of stock options		(436)		(152)
Tax benefit for restricted stock vest		64		-
Redemption of preferred stock		-		(9,750)
Sale of treasury stock		208		203
Net Cash Provided by Financing Activities		10,317		30,152
Net Change in Cash and Cash Equivalents		(973)		14,989
Cash and Cash Equivalents at Beginning of Period		21,119		12,504
Cash and Cash Equivalents at End of Period	$	20,146	$	27,493

Supplemental Disclosure of Cash Flow Information:				
Cash paid during the period for:				
Interest	$	1,326	$	1,280
Income taxes		250		1,427
Supplemental Disclosure of Non-cash Flow Information:				
Transfers from loans to real estate owned and other repossessed property		-		1,101

See accompanying notes to unaudited consolidated financial statements.

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NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of DNB Financial Corporation (referred to herein as the "Corporation" or "DNB") and its subsidiary, DNB First, National Association (the "Bank") have been prepared in accordance with the instructions for Form 10-Q and therefore do not include certain information or footnotes necessary for the presentation of financial condition, statement of operations and statement of cash flows required by generally accepted accounting principles. However, in the opinion of management, the consolidated financial statements reflect all adjustments (which consist of normal recurring adjustments) necessary for a fair presentation of the results for the unaudited periods. Prior amounts not affecting net income are reclassified when necessary to conform to current period classifications. The results of operations for the six months ended June 30, 2016 are not necessarily indicative of the results which may be expected for the entire year. The consolidated financial statements should be read in conjunction with the Annual Report and report on Form 10-K for the year ended December 31, 2015.

Subsequent Events-- Management has evaluated events and transactions occurring subsequent to June 30, 2016 for items that should potentially be recognized or disclosed in these Consolidated Financial Statements. The evaluation was conducted through the date these financial statements were issued.

Recent Accounting Pronouncements-

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. DNB is currently evaluating the impact of the pending adoption of the ASU on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." This ASU simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods therein. DNB is currently evaluating the impact of this ASU on its consolidated financial statements and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," (ASU 2016-13), which addresses concerns regarding the perceived delay in recognition of credit losses under the existing incurred loss model. The amendment introduces a new, single model for recognizing credit losses on all financial instruments presented on cost basis. Under the new model, entities must estimate current expected credit losses by considering all available relevant information, including historical and current information, as well as reasonable and supportable forecasts of future events. The update also requires additional qualitative and quantitative information to allow users to better understand the credit risk within the portfolio and the methodologies for determining allowance. ASU 2016-13 is effective for DNB on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted. DNB is currently evaluating the impact of this ASU on its consolidated financial statements and disclosures.

NOTE 2: INVESTMENT SECURITIES

The amortized cost and fair values of investment securities, as of the dates indicated, are summarized as follows:

	June 30, 2016			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 8,098	$ 521	$ -	$ 8,619
Government Sponsored Entities (GSE) mortgage-backed securities	2,459	108	-	2,567
Corporate bonds	12,887	398	(7)	13,278
Collateralized mortgage obligations GSE	2,300	43	-	2,343
State and municipal taxable	1,009	41	-	1,050
State and municipal tax-exempt	48,082	464	-	48,546
Total	$ 74,835	$ 1,575	$ (7)	$ 76,403
Available For Sale				
US Government agency obligations	$ 54,442	$ 223	$ -	$ 54,665
GSE mortgage-backed securities	48,290	425	(1)	48,714
Collateralized mortgage obligations GSE	14,706	56	(64)	14,698
Corporate bonds	17,877	90	(90)	17,877
State and municipal tax-exempt	12,330	24	(3)	12,351
Total	$ 147,645	$ 818	$ (158)	$ 148,305

	December 31, 2015			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 7,973	$ 320	$ -	$ 8,293
Government Sponsored Entities (GSE) mortgage-backed securities	2,759	83	-	2,842
Corporate bonds	11,518	234	(42)	11,710
Collateralized mortgage obligations GSE	2,623	9	(26)	2,606

State and municipal tax-exempt	42,956	300	(276)	42,980
Total	$ 67,829	$ 946	$ (344)	$ 68,431
Available For Sale				
US Government agency obligations	$ 58,460	$ -	$ (252)	$ 58,208
GSE mortgage-backed securities	40,663	13	(325)	40,351
Collateralized mortgage obligations GSE	16,241	3	(438)	15,806
Corporate bonds	20,921	-	(350)	20,571
State and municipal tax-exempt	17,274	180	(11)	17,443
Total	$ 153,559	$ 196	$ (1,376)	$ 152,379

Included in unrealized losses are market losses on securities that have been in a continuous unrealized loss position for twelve months or more and those securities that have been in a continuous unrealized loss position for less than twelve months. The following table details the aggregate unrealized losses and aggregate fair value of the underlying securities whose fair values are below their amortized cost at June 30, 2016 and December 31, 2015.

(Dollars in thousands)	June 30, 2016 Total Fair Value	Total Unrealized Loss	Fair Value Impaired Less Than 12 Months	Unrealized Loss Less Than 12 Months	Fair Value Impaired More Than 12 Months	Unrealized Loss More Than 12 Months
Held To Maturity						
Corporate bonds	$ 1,987	$ (7)	$ 1,987	$ (7)	$ -	$ -
State and municipal tax-exempt	558	-	558	-	-	-
Total	$ 2,545	$ (7)	$ 2,545	$ (7)	$ -	$ -
Available For Sale						
GSE mortgage-backed securities	$ 2,598	$ (1)	$ 2,598	$ (1)	$ -	$ -
Collateralized mortgage obligations GSE	8,610	(64)	703	(7)	7,907	(57)
Corporate bonds	5,432	(90)	996	(26)	4,436	(64)
State and municipal tax-exempt	7,735	(3)	7,735	(3)	-	-
Total	$ 24,375	$ (158)	$ 12,032	$ (37)	$ 12,343	$ (121)

(Dollars in thousands)	December 31, 2015 Total Fair Value	Total Unrealized Loss	Fair Value Impaired Less Than 12 Months	Unrealized Loss Less Than 12 Months	Fair Value Impaired More Than 12 Months	Unrealized Loss More Than 12 Months
Held To Maturity						
Corporate bonds	$ 7,597	$ (42)	$ 7,597	$ (42)	$ -	$ -
Collateralized mortgage obligations GSE	1,482	(26)	388	(10)	1,094	(16)
State and municipal tax-exempt	13,161	(276)	4,380	(34)	8,781	(242)
Total	$ 22,240	$ (344)	$ 12,365	$ (86)	$ 9,875	$ (258)
Available For Sale						
US Government agency obligations	$ 58,208	$ (252)	$ 58,208	$ (252)	$ -	$ -
GSE mortgage-backed securities	38,307	(325)	33,984	(238)	4,323	(87)
Collateralized mortgage obligations GSE	15,231	(438)	4,187	(41)	11,044	(397)
Corporate bonds	20,571	(350)	16,157	(264)	4,414	(86)
State and municipal tax-exempt	6,660	(11)	6,660	(11)	-	-
Total	$ 138,977	$ (1,376)	$ 119,196	$ (806)	$ 19,781	$ (570)

As of June 30, 2016, there were nine collateralized mortgage obligations GSE, one GSE mortgage-backed security, seven tax-exempt municipalities, and four corporate bonds which were in an unrealized loss position. DNB does not intend to sell these securities and management of DNB does not expect to be required to sell any of these securities prior to a recovery of its cost basis. Management has reviewed all of these securities and believes that DNB will collect all principal and interest that is due on debt securities on a timely basis. Management does not believe any individual unrealized loss as of June 30, 2016 represents an other-than-temporary impairment (OTTI). DNB reviews its investment portfolio on a quarterly basis judging each investment for OTTI. The OTTI analysis focuses on condition of the issuers as well as duration and severity of impairment in determining OTTI. As of June 30, 2016, the following securities were reviewed:

Collateralized mortgage obligations GSE There are nine impaired securities classified as collateralized mortgage obligations, eight of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 1.46% of its book value. All of these securities were issued and insured by FNMA, FHLMC or GNMA. DNB receives monthly principal and interest payments on all of these securities on a timely basis and none of these agencies has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from June 30, 2016 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2016.

GSE mortgage-backed securities There is one impaired security classified as a GSE mortgage-backed security, which has been impaired for less than 12 months and is currently at 0.04% of its book value. This security was issued and insured by FNMA, FHLMC or GNMA. DNB receives monthly principal and interest payments on this security on a timely basis and it has never defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the security approaches its maturity date or if interest rates decline from June 30, 2016 levels. Management concluded that this security was not other-than-temporarily impaired at June 30, 2016.

State and municipal tax-exempt There are seven impaired securities in this category, which are comprised of intermediate to long-term municipal bonds, all of which have been impaired for less than 12 months. The largest unrealized loss of a security in this group is 0.07% of its book value. All of the issues carry an “A+” or better underlying credit rating and/or have strong underlying fundamentals; included but not limited to annual financial reports, geographic location, population and debt ratios. In certain cases, options for calls reduce the effective duration and in turn, future market value fluctuations. All issues are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. There have not been disruptions of any payments, associated with any of these municipal securities. These bonds are investment grade and the value decline is related to the changes in interest rates. Of the seven municipal securities, there are two uninsured school districts, two insured townships, and three uninsured townships, all of which have strong underlying ratings. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2016.

Corporate bonds There are four impaired bonds classified as corporate bonds, two of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 2.61% of its book value. The bonds are investment grade and the value decline is related to the changes in interest rates that occurred since the time of purchase and subsequent changes in spreads affecting the market prices. All of the issues carry a "BBB+" or better underlying credit support and were evaluated on the basis on their underlying fundamentals; included but not limited to annual financial reports, rating agency reports, capital strength and debt ratios. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from June 30, 2016 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2016.

The amortized cost and fair value of investment securities as of June 30, 2016, by final contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid without penalties.

	Held to Maturity		Available for Sale	
(Dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ 16,704	$ 16,684
Due after one year through five years	20,077	20,947	61,561	61,787
Due after five years through ten years	30,280	30,749	24,278	24,567
Due after ten years	24,478	24,707	45,102	45,267
Total investment securities	$ 74,835	$ 76,403	$ 147,645	$ 148,305

Gains and losses resulting from investment sales, redemptions or calls were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2016	2015	2016	2015
Gross realized gains-AFS	$ 203	$ 11	$ 264	$ 64
Gross realized losses-AFS	-	-	(30)	-
Net realized gain	$ 203	$ 11	$ 234	$ 64

At June 30, 2016 and December 31, 2015, investment securities with a carrying value of approximately $133.9 million and $147.9 million, respectively, were pledged to secure public funds, repurchase agreements and for other purposes as required by law.

NOTE 3: LOANS

The following table sets forth information concerning the composition of total loans outstanding, as of the dates indicated.

(Dollars in thousands)	June 30, 2016	December 31, 2015
Residential mortgage	$ 26,938	$ 28,651
Commercial mortgage	275,689	274,132
Commercial:		
Commercial term	105,989	102,178
Commercial construction	29,772	20,364
Consumer:		
Home equity	50,248	51,270
Other	5,781	5,163
Total loans	$ 494,417	$ 481,758
Less allowance for credit losses	(5,247)	(4,935)
Net loans	$ 489,170	$ 476,823

Information concerning non-accrual loans is shown in the following tables:

			Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
(Dollars in thousands)	December 31, 2015	June 30, 2016	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:								
Residential mortgage	$ 1,619	$ 1,772	$ 17	$ -	$ 17	$ 36	$ -	$ 36
Commercial mortgage	1,048	3,140	45	-	45	65	-	65
Commercial:								
Commercial term	188	207	3	-	3	6	-	6

Commercial construction	1,028	1,524	47	-	47	88	-	88
Consumer:								
Home equity	563	564	8	-	-	16	-	16
Other	189	222	4	-	4	9	-	9
Total non-accrual loans	$ 4,635	$ 7,429	$ 124	$ -	$ 116	$ 220	$ -	$ 220
Loans 90 days past due and accruing	457	162	1	1	-	2	2	-
Total non-performing loans	$ 5,092	$ 7,591	$ 125	$ 1	$ 116	$ 222	$ 2	$ 220

(Dollars in thousands)	June 30, 2015	Three Months Ended June 30, 2015 Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income	Six Months Ended June 30, 2015 Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:							
Residential mortgage	$ 1,671	$ 24	$ -	$ 24	$ 40	$ -	$ 40
Commercial mortgage	1,251	22	-	22	43	-	43
Commercial:							
Commercial term	193	3	-	3	5	-	5
Commercial construction	749	86	-	86	170	-	170
Consumer:							
Home equity	431	5	-	5	12	-	12
Other	169	3	-	3	8	-	8
Total non-accrual loans	$ 4,464	$ 143	$ -	$ 143	$ 278	$ -	$ 278
Loans 90 days past due and accruing	168	-	-	-	5	5	-
Total non-performing loans	$ 4,632	$ 143	$ -	$ 143	$ 283	$ 5	$ 278

NOTE 4: ALLOWANCE FOR CREDIT LOSSES

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a scheduled payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of June 30, 2016 and December 31, 2015.

Age Analysis of Past Due Loans Receivable

June 30, 2016

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable > 90 Days and Accruing
Residential mortgage	$ 134	$ 381	$ 1,860	$ 2,375	$ 24,563	$ 26,938	$ 162
Commercial mortgage	-	2,140	210	2,350	273,339	275,689	-
Commercial:							
Commercial term	-	-	24	24	105,965	105,989	-
Commercial construction	-	-	1,524	1,524	28,248	29,772	-
Consumer:							
Home equity	84	-	411	495	49,753	50,248	-
Other	72	62	158	292	5,489	5,781	-
Total	$ 290	$ 2,583	$ 4,187	$ 7,060	$ 487,357	$ 494,417	$ 162

December 31, 2015

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable > 90 Days and Accruing
Residential mortgage	$ 502	$ 552	$ 2,076	$ 3,130	$ 25,521	$ 28,651	$ 457
Commercial mortgage	36	86	96	218	273,914	274,132	-
Commercial:							
Commercial term	-	-	-	-	102,178	102,178	-

Commercial construction	-	581	447	1,028	19,336	20,364	-
Consumer:							
Home equity	7	310	153	470	50,800	51,270	-
Other	100	-	148	248	4,915	5,163	-
Total	$ 645	$ 1,529	$ 2,920	$ 5,094	$ 476,664	$ 481,758	$ 457

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The following tables summarize information in regards to impaired loans by loan portfolio class as of and for the three and six months ended June 30, 2016 and 2015 and as of December 31, 2015.

Impaired Loans

	June 30, 2016			December 31, 2015		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential mortgage	$ 930	$ 968	$ -	$ 1,620	$ 1,919	$ -
Commercial mortgage	3,140	3,451	-	1,181	1,461	-
Commercial:						
Commercial term	24	25	-	-	-	-
Commercial construction	1,077	1,077	-	1,140	3,526	-
Consumer:						
Home equity	666	690	-	691	716	-
Other	116	124	-	82	90	-
Total	$ 5,953	$ 6,335	$ -	$ 4,714	$ 7,712	$ -
With allowance recorded:						
Residential mortgage	842	1,103	101	-	-	-
Commercial:						
Commercial term	183	199	104	200	211	110
Commercial construction	447	2,833	89	-	-	-
Consumer:						
Other	106	106	3	107	107	4
Total	$ 1,578	$ 4,241	$ 297	$ 307	$ 318	$ 114
Total:						
Residential mortgage	1,772	2,071	101	1,620	1,919	-
Commercial mortgage	3,140	3,451	-	1,181	1,461	-
Commercial:						
Commercial term	207	224	104	200	211	110
Commercial construction	1,524	3,910	89	1,140	3,526	-
Consumer:						
Home equity	666	690	-	691	716	-
Other	222	230	3	189	197	4
Total	$ 7,531	$ 10,576	$ 297	$ 5,021	$ 8,030	$ 114

	Three Months Ended June 30, 2016		Three Months Ended June 30, 2015		Six Months Ended June 30, 2016		Six Months Ended June 30, 2015	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:								
Residential mortgage	$ 1,284	$ -	$ 1,927	$ -	$ 1,396	$ -	$ 2,103	$ -
Commercial mortgage	2,083	-	3,367	29	1,782	-	3,378	57
Commercial:								
Commercial term	24	-	-	-	16	-	-	-
Commercial construction	934	-	672	-	1,002	-	1,017	-
Consumer:								
Home equity	671	1	503	1	678	2	518	2
Other	104	-	182	-	97	-	152	-
Total	$ 5,100	$ 1	$ 6,651	$ 30	$ 4,971	$ 2	$ 7,168	$ 59
With allowance recorded:								
Residential mortgage	493	-	204	-	329	-	136	-
Commercial mortgage	-	-	202	-	-	-	201	-
Commercial:								
Commercial term	185	-	200	-	190	-	200	-
Commercial construction	447	-	837	-	298	-	708	-
Consumer:								
Home equity	-	-	44	-	-	-	29	-
Other	107	-	-	-	107	-	-	-
Total	$ 1,232	$ -	$ 1,487	$ -	$ 924	$ -	$ 1,274	$ -
Total:								
Residential mortgage	1,777	-	2,131	-	1,725	-	2,239	-
Commercial mortgage	2,083	-	3,569	29	1,782	-	3,579	57
Commercial:								
Commercial term	209	-	200	-	206	-	200	-
Commercial construction	1,381	-	1,509	-	1,300	-	1,725	-
Consumer:								
Home equity	671	1	547	1	678	2	547	2
Other	211	-	182	-	204	-	152	-
Total	$ 6,332	$ 1	$ 8,138	$ 30	$ 5,895	$ 2	$ 8,442	$ 59

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within DNB's internal risk rating system as of June 30, 2016 and December 31, 2015.

Credit Quality Indicators

	June 30, 2016				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 24,901	$ -	$ 2,037	$ -	$ 26,938
Commercial mortgage	260,724	3,298	11,667	-	275,689
Commercial:					
Commercial term	99,943	48	5,998	-	105,989
Commercial construction	26,433	-	3,339	-	29,772
Consumer:					
Home equity	49,531	-	717	-	50,248
Other	5,559	-	222	-	5,781
Total	$ 467,091	$ 3,346	$ 23,980	$ -	$ 494,417

	December 31, 2015				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 26,762	$ -	$ 1,889	$ -	$ 28,651
Commercial mortgage	262,036	4,802	7,294	-	274,132
Commercial:					
Commercial term	93,025	2,555	6,598	-	102,178
Commercial construction	17,521	-	2,843	-	20,364
Consumer:					
Home equity	50,551	-	719	-	51,270
Other	4,974	-	189	-	5,163
Total	$ 454,869	$ 7,357	$ 19,532	$ -	$ 481,758

Loans classified as troubled debt restructurings ("TDR") are considered impaired. As of June 30, 2016, DNB had no commercial mortgages classified as a TDR, compared to no commercial mortgages classified as a TDR at December 31, 2015, and one commercial mortgage classified as a TDR totaling $2,222,000 at June 30, 2015. This loan paid off during the third quarter of 2015. The rate on this loan was modified and the terms of the loans were changed to interest only while the project was being built out. The loan commenced normal principal and interest payments in June 2014. The loan was extended and there was no reduction of principal. The balance of the loan prior to modification was $2,272,000 and the balance after the modification was $2,272,000. During the six months ended June 30, 2015, there were no defaults on any terms of this loan.

As of June 30, 2016, DNB had one consumer home equity loan classified as a TDR totaling $102,000, compared to one consumer home equity loan classified as a TDR totaling $102,000 (the same loan) at December 31, 2015, and one consumer home equity loan classified as a TDR totaling $102,000 (the same loan) at June 30, 2015. The monthly payment on this loan was reduced for 36 months and the borrower will resume making contractual payments at the end of this period. The loan was extended and there was no reduction of principal. This loan was classified a TDR in June of 2014. The balance of the loan prior to modification was $102,000 and the balance after the modification was $102,000. During the three months ended March 31, 2016 and 2015, there were no defaults on any terms of this loan.

As of June 30, 2016, DNB had one consumer installment loan classified as a TDR totaling $40,000 compared to one consumer installment loan classified as a TDR totaling $40,000 (the same loan) at December 31, 2015, and no such loans at June 30, 2015. The interest rate on the loan was reduced. The loan was extended and there was no reduction of principal. This loan was classified as a TDR in December of 2015. The balance of the loan prior to modification was $42,000 and the balance after the modification was $42,000. DNB recognized a partial charge-off on the loan in the amount of $2,000. During the six months ended June 30, 2016 and 2015, there were no defaults on any terms of this loan.

The following tables set forth the composition of DNB's allowance for credit losses as of June 30, 2016 and December 31, 2015, the activity for the three and six months ended June 30, 2016 and 2015 and as of and for the year ended December 31, 2015.

Allowance for Credit Losses and Recorded Investment in Loans Receivables

(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - April 1, 2016	$ 220	$ 2,376	$ 948	$ 765	$ -	$ 188	$ 67	$ 608	$ 5,172
Charge-offs	(122)	-	(11)	-	-	-	-	-	(133)
Recoveries	7	-	-	-	-	-	1	-	8
Provisions	209	(6)	(46)	101	-	3	(4)	(57)	200
Ending balance - June 30, 2016	$ 314	$ 2,370	$ 891	$ 866	$ -	$ 191	$ 64	$ 551	$ 5,247

(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - January 1, 2016	$ 216	$ 2,375	$ 989	$ 569	$ -	$ 195	$ 64	$ 527	$ 4,935
Charge-offs	(206)	-	(24)	-	-	-	-	-	(230)
Recoveries	8	-	1	1	1	-	1	-	12
Provisions	296	(5)	(75)	296	(1)	(4)	(1)	24	530
Ending balance - June 30, 2016	$ 314	$ 2,370	$ 891	$ 866	$ -	$ 191	$ 64	$ 551	$ 5,247
Ending balance: individually evaluated for impairment	$ 101	$ -	$ 104	$ 89	$ -	$ -	$ 3	$ -	$ 297
Ending balance: collectively evaluated for impairment	$ 213	$ 2,370	$ 787	$ 777	$ -	$ 191	$ 61	$ 551	$ 4,950
Loans receivables:									

Ending balance	$ 26,938	$ 275,689	$ 105,989	$ 29,772	$ -	$ 50,248	$ 5,781		$ 494,417
Ending balance: individually evaluated for impairment	$ 1,772	$ 3,140	$ 207	$ 1,524	$ -	$ 666	$ 222		$ 7,531
Ending balance: collectively evaluated for impairment	$ 25,166	$ 272,549	$ 105,782	$ 28,248	$ -	$ 49,582	$ 5,559		$ 486,886
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 3	$ 117	$ 57	$ -	$ 13	$ -		$ 190

(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - April 1, 2015	$ 269	$ 2,398	$ 705	$ 922	$ -	$ 224	$ 66	$ 606	$ 5,190
Charge-offs	(35)	-	(163)	(278)	-	(1)	(24)	-	(501)
Recoveries	-	-	2	-	1	-	1	-	4
Provisions	31	164	177	130	(1)	(33)	22	(75)	415
Ending balance - June 30, 2015	$ 265	$ 2,562	$ 721	$ 774	$ -	$ 190	$ 65	$ 531	$ 5,108

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(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - January 1, 2015	$ 269	$ 2,300	$ 709	$ 881	$ -	$ 189	$ 70	$ 488	$ 4,906
Charge-offs	(35)	-	(174)	(278)	-	(1)	(30)	-	(518)
Recoveries	-	-	2	-	2	-	1	-	5
Provisions	31	262	184	171	(2)	2	24	43	715
Ending balance - June 30, 2015	$ 265	$ 2,562	$ 721	$ 774	$ -	$ 190	$ 65	$ 531	$ 5,108
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 4	$ 107	$ 56	$ -	$ 13	$ -		$ 180

(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Ending balance - December 31, 2015	$ 216	$ 2,375	$ 989	$ 569	$ -	$ 195	$ 64	$ 527	$ 4,935
Ending balance: individually evaluated for impairment	$ -	$ -	$ 110	$ -	$ -	$ -	$ 4	$ -	$ 114
Ending balance: collectively evaluated for impairment	$ 216	$ 2,375	$ 879	$ 569	$ -	$ 195	$ 60	$ 527	$ 4,821
Loans receivables:									
Ending balance	$ 28,651	$ 274,132	$ 102,178	$ 20,364	$ -	$ 51,270	$ 5,163		$ 481,758
Ending balance: individually evaluated for impairment	$ 1,620	$ 1,181	$ 200	$ 1,140	$ -	$ 691	$ 189		$ 5,021
Ending balance: collectively evaluated for impairment	$ 27,031	$ 272,951	$ 101,978	$ 19,224	$ -	$ 50,579	$ 4,974		$ 476,737
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 2	$ 115	$ 58	$ -	$ 13	$ -		$ 188

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NOTE 5: EARNINGS PER SHARE

Basic earnings per share (“EPS”) is computed based on the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the treasury stock method and reflects the potential dilution that could occur from the exercise of stock options, and warrants and the amortized portion of unvested stock awards. Stock options and unvested stock awards for which the exercise or the grant price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the calculation. Treasury shares are not deemed outstanding for calculations. There were no outstanding stock warrants, no anti-dilutive stock options outstanding, and 16,595 anti-dilutive stock awards outstanding at June 30, 2016. There were no anti-dilutive stock warrants outstanding, no anti-dilutive stock options outstanding, and no anti-dilutive stock awards outstanding at June 30, 2015. The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 1,109	2,849	$ 0.39	$ 2,665	2,841	$ 0.94
Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	34	-	-	35	(0.01)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 1,109	2,883	$ 0.39	$ 2,665	2,876	$ 0.93

	Three Months Ended June 30, 2015			Six Months Ended June 30, 2015		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 1,227	2,802	$ 0.44	$ 2,453	2,794	$ 0.88

Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	46	(0.01)	-	46	(0.02)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 1,227	2,848	$ 0.43	$ 2,453	2,840	$ 0.86

NOTE 6: ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss included in stockholders' equity are as follows:

Accumulated Other Comprehensive Loss (Dollars in thousands)	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
June 30, 2016			
Net unrealized gain on AFS securities	$ 660	$ (224)	$ 436
Discount on AFS to HTM reclassification	(14)	5	(9)
Unrealized actuarial losses-pension	(1,812)	616	(1,196)
	$ (1,166)	$ 397	$ (769)
December 31, 2015			
Net unrealized loss on AFS securities	$ (1,180)	$ 402	$ (778)
Discount on AFS to HTM reclassification	(17)	6	(11)
Unrealized actuarial losses-pension	(1,812)	616	(1,196)
	$ (3,009)	$ 1,024	$ (1,985)

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NOTE 7: SUBORDINATED DEBENTURES, NOTES, AND OTHER BORROWINGS

DNB has two issuances of junior subordinated debentures (the “debentures”) as follows. The majority of the proceeds of each issuance were invested in DNB’s subsidiary, DNB First, National Association, to increase the Bank’s capital levels. The junior subordinated debentures issued in each case qualify as a component of capital for regulatory purposes. DNB Capital Trust I and II are special purpose Delaware business trusts, which are not consolidated.

DNB Capital Trust I

DNB’s first issuance of junior subordinated debentures was on July 20, 2001. These debentures are floating rate and were issued to DNB Capital Trust I, a Delaware business trust in which DNB owns all of the common equity. DNB Capital Trust I issued $5.0 million of floating rate (6 month Libor plus 3.75%, with a cap of 12%) capital preferred securities to a qualified institutional buyer. The proceeds of these securities were used by the Trust, along with DNB’s capital contribution, to purchase $5.2 million principal amount of DNB’s floating rate junior subordinated debentures. The preferred securities have been redeemable since July 25, 2006 and must be redeemed upon maturity of the debentures on July 25, 2031.

DNB Capital Trust II

DNB’s second issuance of junior subordinated debentures was on March 30, 2005. These are floating rate and were issued to DNB Capital Trust II, a Delaware business trust in which DNB owns all of the common equity. DNB Capital Trust II issued $4.0 million of floating rate (the rate was fixed at 6.56% for the first 5 years and is now adjusting at a rate of 3-month LIBOR plus 1.77%) capital preferred securities. The proceeds of these securities were used by the Trust, along with DNB’s capital contribution, to purchase $4.1 million principal amount of DNB’s floating rate junior subordinated debentures. The preferred securities have been redeemable since May 23, 2010. The preferred securities must be redeemed upon maturity of the debentures on May 23, 2035.

Subordinated Note

On March 5, 2015, DNB Financial Corporation entered into a Subordinated Note Purchase Agreement (the “Agreement”) with an accredited investor under which DNB issued a $9.75 million subordinated note (the “Note”) to the investor. The Note has a maturity date of March 6, 2025, and bears interest at a fixed rate of 4.25% per annum for the first 5 years and then will float at the Wall Street Journal Prime rate plus 1.00%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 3.0% and more than 5.75% per annum.

DNB may, at its option, beginning with the first interest payment date after March 6, 2019, and on any interest payment date thereafter, redeem the Note, in whole or in part, at par plus accrued and unpaid interest to the date of redemption. The Note is not subject to repayment at the option of the noteholder.

The Note is unsecured and ranks junior in right of payment to DNB’s senior indebtedness and to DNB’s obligations to its general creditors and qualifies as Tier 2 capital for regulatory purposes.

Repurchase Agreements Accounted for as Secured Borrowings

Repurchase agreements accounted for as secured borrowings are shown in the following table.

(Dollars in thousands)	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater than 90 days	Total
June 30, 2016					
Repurchase agreements and repurchase-to-maturity transactions	$ 17,748	$ -	$ -	$ -	$ 17,748
Gross amount of recognized liabilities for repurchase agreements in statement of condition	$ 17,748				$ 17,748
December 31, 2015					
Repurchase agreements and repurchase-to-maturity transactions	$ 32,416	$ -	$ -	$ -	$ 32,416
Gross amount of recognized liabilities for repurchase agreements in statement of condition	$ 32,416				$ 32,416

As of June 30, 2016 and December 31, 2015, DNB had $17.7 million and $32.4 million of repurchase agreements, respectively. In conjunction with these repurchase agreements, $18.1 million and $33.1 million of state and municipal securities were sold on an overnight basis as of June 30, 2016 and December 31, 2015, respectively, which represents 102% of the repurchase agreement amounts.

NOTE 8: STOCK-BASED COMPENSATION

Stock Option Plan

DNB has a Stock Option Plan for employees and directors. Under the plan, options (both qualified and non-qualified) to purchase a maximum of 793,368 (as adjusted for subsequent stock dividends) shares of DNB's common stock could be issued to employees and directors. Under the plan, option exercise prices must equal the fair market value of the shares on the date of option grant and the option exercise period may not exceed ten years. Vesting of options under the plan is determined by the Plan Committee. There were 354,090 shares available for grant at June 30, 2016. All options are immediately exercisable. During the three and six months ended June 30, 2016 and 2015, DNB had no expenses related to the plan forward looking. Stock option activity is indicated below.

	Number Outstanding	Weighted Average Exercise Price
Outstanding January 1, 2016	64,500	$ 8.67
Issued	-	-
Exercised	-	-
Forfeited	-	-
Expired	-	-
Outstanding June 30, 2016	64,500	$ 8.67

	Number Outstanding	Weighted Average Exercise Price
Outstanding January 1, 2015	163,586	$ 15.13
Issued	-	-
Exercised	95,834	19.40
Forfeited	-	-
Expired	-	-
Outstanding June 30, 2015	67,752	$ 9.09

The weighted-average price and weighted average remaining contractual life for the outstanding options are listed in the following table for the dates indicated.

June 30, 2016

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average Exercise Price	Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	64,500	64,500	$ 8.67	1.66 years	$ 963,000

December 31, 2015

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average Exercise Price	Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	64,500	64,500	$ 8.67	2.15 years	$ 1,344,000

Other Stock-Based Compensation

DNB maintains an Incentive Equity and Deferred Compensation Plan (the "Plan"). The Plan provides that up to 243,101 (as adjusted for subsequent stock dividends) shares of common stock may be granted, at the discretion of the Board, to individuals of the Corporation. Shares already granted are issuable on the earlier of three or four years (cliff vesting period) after the date of the grant or a change in control of DNB if the recipients are then employed by DNB (“Vest Date”). Upon issuance of the shares, resale of the shares is restricted for an additional one year, during which the shares may not be sold, pledged or otherwise disposed of. Prior to the Vest Date and in the event the recipient terminates association with DNB for reasons other than death, disability or change in control, the recipient forfeits all rights to the shares that would otherwise be issued under the grant.

Share awards granted by the Plan were recorded at the date of award based on the market value of shares. Awards are being amortized to expense over a three or four year cliff-vesting period. DNB records compensation expense equal to the value of the shares being amortized. For the three and six month periods ended June 30, 2016, $70,000 and $730,000 was amortized to expense, respectively. For the three and six month periods ended June 30, 2015, $78,000 and $165,000 was amortized to expense, respectively. As of June 30, 2016, there was approximately $580,000 in additional compensation that will be recognized over the remaining service period of approximately 1.89 years. At June 30, 2016, 88,169 shares were reserved for future grants under the Plan.

The shares awarded from the vesting resulted in an increase in shares outstanding of 18,079. There was a cash equivalent of 15,621 shares used to pay all applicable taxes on the transaction. Stock grant activity is indicated below:

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2016	77,255	$ 22.71
Granted	3,000	28.75
Forfeited	-	-
Vested	33,700	23.66
Non-vested stock awards—June 30, 2016	46,555	$ 22.42

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2015	75,930	$ 17.66
Granted	-	-
Forfeited	1,220	19.36
Vested	-	-
Non-vested stock awards—June 30, 2015	74,710	$ 17.35

NOTE 9: INCOME TAXES

As of June 30, 2016, DNB had no material unrecognized tax benefits or accrued interest and penalties. It is DNB’s policy to account for interest and penalties accrued relative to unrecognized tax benefits as a component of income tax expense. Federal and state tax years 2012 through 2015 were open for examination as of June 30, 2016.

NOTE 10: FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy based on the nature of data inputs for fair value determinations, under which DNB is required to value each asset within its scope using assumptions that market participations would utilize to value that asset. When DNB uses its own assumptions, it is required to disclose additional information about the assumptions used and the effect of the measurement on earnings or the net change in assets for the period.

The three levels of the fair value hierarchy under FASB ASC Topic 820 are as follows:

Level 1—Quoted prices in active markets for identical securities.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active and model derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3—Instruments whose significant value drivers are unobservable.

A description of the valuation methodologies used for assets measured at fair value is set forth below:

DNB's available-for-sale investment securities, which generally include U.S. government agencies and mortgage backed securities, collateralized mortgage obligations, corporate bonds and equity securities are reported at fair value. These securities are valued by an independent third party ("preparer"). The preparer's evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their evaluated pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

U.S. Government agencies are evaluated and priced using multi dimensional relational models and option adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage backed securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other securities are evaluated using a broker-quote based application, including quotes from issuers.

Impaired loans are those loans that the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

OREO assets are adjusted to fair value less estimated selling costs upon transfer of the loans to OREO establishing a new cost basis. Subsequently, OREO assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. There assets are included as Level 3 fair values.

The following table summarizes the assets at June 30, 2016 and December 31, 2015 that are recognized on DNB's statement of financial condition using fair value measurement determined based on the differing levels of input:

	June 30, 2016			
(Dollars in thousands)	Level 1	Level 2	Level 3	Fair Value
Assets Measured at Fair Value on a Recurring Basis				
AFS Investment Securities:				
US Government agency obligations	$ -	$ 54,665	$ -	$ 54,665
GSE mortgage-backed securities	-	48,714	-	48,714
Collateralized mortgage obligations GSE	-	14,698	-	14,698
Corporate bonds	-	17,877	-	17,877
State and municipal tax-exempt	-	12,351	-	12,351
Total	$ -	$ 148,305	$ -	$ 148,305
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 1,281	$ 1,281
Total	$ -	$ -	$ 1,281	$ 1,281

	December 31, 2015			
(Dollars in thousands)	Level 1	Level 2	Level 3	Fair Value
Assets Measured at Fair Value on a Recurring Basis				
AFS Investment Securities:				
US Government agency obligations	$ -	$ 58,208	$ -	$ 58,208
GSE mortgage-backed securities	-	40,351	-	40,351
Collateralized mortgage obligations GSE	-	15,806	-	15,806
Corporate bonds	-	20,571	-	20,571
State and municipal tax-exempt	-	17,443	-	17,443
Total	$ -	$ 152,379	$ -	$ 152,379
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 964	$ 964
OREO and other repossessed property	-	-	682	682
Total	$ -	$ -	$ 1,646	$ 1,646

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

June 30, 2016
Quantitative Information about Level 3 Fair Value Measurement

(Dollars in thousands)		Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)			
Impaired loans - Residential mortgage	$	741	Appraisal of	Appraisal adj. (2)	-25%	to	-25%	(-25%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Commercial term		79	Appraisal of	Appraisal adj. (2)	-72%	to	-72%	(-72%)
			collateral (1)	Disposal costs (2)	-11%	to	-11%	(-11%)
Impaired loans - Commercial construction		358	Appraisal of	Appraisal adj. (2)	-20%	to	-20%	(-20%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Consumer other		103	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loan total	$	1,281						

(1)
(2)

December 31, 2015
Quantitative Information about Level 3 Fair Value Measurement

(Dollars in thousands)		Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)			
Impaired loans - Residential mortgage	$	115	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Commercial mortgage		97	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-13%	to	-13%	(-13%)
Impaired loans - Commercial term		90	Appraisal of	Appraisal adj. (2)	-72%	to	-72%	(-72%)
			collateral (1)	Disposal costs (2)	-11%	to	-11%	(-11%)
Impaired loans - Commercial construction		559	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Consumer other		103	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loan total	$	964						
Other real estate owned	$	682		Disposal costs (2)	-8%	to	-8%	(-8%)

(1) Fair value is generally determined through independent appraisals or sales contracts of the underlying collateral, which generally include various level 3 inputs which are not identifiable.
(2) Appraisals are adjusted by management for qualitative factors and disposal costs.

Impaired loans. Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $7.5 million at June 30, 2016. Of this, $1.6 million had specific valuation allowances of $297,000, leaving a fair value of $1.3 million as of June 30, 2016. DNB did not have any impaired loans that were partially charged down during the six months ended June 30, 2016. Impaired loans had a carrying amount of $5.0 million at December 31, 2015. Of this, $307,000 had specific valuation allowances of $114,000, leaving a fair value of $193,000 at December 31, 2015. In addition, DNB had $931,000 in impaired loans that were partially charged down by $160,000, leaving $771,000 at fair value as of December 31, 2015.

Other Real Estate Owned & other repossessed property. Other real estate owned ("OREO") consists of properties acquired as a result of, or in-lieu-of, foreclosure. Properties or other assets are classified as OREO and other repossessed property are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying value or fair value, less estimated costs to sell. Costs relating to the development or improvement of the assets are capitalized and costs relating to holding the assets are charged to expense. DNB had $3.0 million of such assets at June 30, 2016, $2.8 million of which was OREO and $165,000 was in other repossessed property. DNB had $2.6 million of such assets at December 31, 2015, which consisted of $2.4 million in OREO and $165,000 in other repossessed property. Subsequent to the repossession of these assets, DNB did not write down the carrying values of OREO during the six month period ended June 30, 2016. DNB did not write down the carrying values of OREO in the six month period ended June 30, 2015.

DNB's policy is to recognize transfer between levels as of the actual date of the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and 2 for the three and six months ended June 30, 2016.

Below is management’s estimate of the fair value of all financial instruments, whether carried at cost or fair value on the Company’s consolidated balance sheet. The carrying amounts and fair values of financial instruments at June 30, 2016 and December 31, 2015 are as follows:

	June 30, 2016				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 20,146	$ 20,146	$ 20,146	$ -	$ -
AFS investment securities	148,305	148,305	-	148,305	-
HTM investment securities	74,835	76,403	-	74,403	2,000
Restricted stock	3,318	3,318	-	3,318	-
Loans, net of allowance, including impaired	489,170	476,993	-	-	476,993
Accrued interest receivable	2,390	2,390	-	2,390	-
Financial liabilities					
Deposits:					
Non-interest-bearing deposits	135,212	135,212	-	135,212	-
Interest-bearing deposits	409,623	409,623	-	409,623	-
Time deposits	73,560	73,443	-	73,443	-
Brokered deposits	23,449	23,482	-	23,482	-
Repurchase agreements	17,748	17,748	-	17,748	-
FHLBP advances	20,000	20,311	-	20,311	-
Junior subordinated debentures and other borrowings	9,279	8,284	-	8,284	-
Subordinated debt	9,750	9,406	-	9,406	-
Accrued interest payable	377	377	-	377	-
Off-balance sheet instruments	-	-	-	-	-

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	December 31, 2015				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 21,119	$ 21,119	$ 21,119	$ -	$ -
AFS investment securities	152,379	152,379	-	152,379	-
HTM investment securities	67,829	68,431	-	66,431	2,000
Restricted stock	3,447	3,447	-	3,447	-
Loans, net of allowance, including impaired	476,823	461,925	-	-	461,925
Accrued interest receivable	2,410	2,410	-	2,410	-
Financial liabilities					
Deposits:					
Non-interest-bearing deposits	125,581	125,581	-	125,581	-
Interest-bearing deposits	396,188	396,188	-	396,188	-
Time deposits	66,018	65,697	-	65,697	-
Brokered deposits	18,488	18,327	-	18,327	-
Repurchase agreements	32,416	32,416	-	32,416	-
FHLBP advances	30,000	30,210	-	30,210	-
Junior subordinated debentures and other borrowings	9,279	7,889	-	7,889	-
Subordinated debt	9,750	9,999	-	9,999	-
Accrued interest payable	345	345	-	345	-
Off-balance sheet instruments	-	-	-	-	-

The specific estimation methods and assumptions used can have a substantial impact on the resulting fair values of financial instruments. Following is a brief summary of the significant assumptions, methods, and estimates used in estimating fair value.

Limitations Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time DNB’s entire holdings of a particular financial instrument. Because no market exists for a significant portion of DNB’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Cash and Cash Equivalents, Accrued Interest Receivable and Accrued Interest Payable The carrying amounts for short-term investments (cash and cash equivalents) and accrued interest receivable and payable approximate fair value.

Investment Securities The fair value of investment securities are determined by an independent third party (“preparer”). The preparer’s evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their evaluated pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

U.S. Government agencies are evaluated and priced using multi dimensional relational models and option adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage backed securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other investments are evaluated using a broker quote based application, including quotes from issuers. The carrying amount of non-readily marketable equity securities approximates liquidation value.

Restricted Stock The carrying amount of restricted investment in Federal Home Loan Bank stock, Federal Reserve stock and ACBB stock approximates fair value, and considers the limited marketability of such securities.

Loans Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial mortgages, residential mortgages, consumer and non-accrual loans. The fair value of performing loans is calculated by discounting expected cash flows using an estimated market discount rate. Expected cash flows include both contractual cash flows and prepayments of loan balances. Prepayments on consumer loans were determined using the median of estimates of securities dealers for mortgage-backed investment pools.

The estimated discount rate considers credit and interest rate risk inherent in the loan portfolios and other factors such as liquidity premiums and incremental servicing costs to an investor. Management has made estimates of fair value discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, management has no basis to determine whether the fair value presented would be indicative of the value negotiated in an actual sale.

The fair value for non-accrual loans not based on fair value of collateral is derived through a discounted cash flow analysis, which includes the opportunity costs of carrying a non-performing asset. An estimated discount rate was used for these non-accrual loans, based on the probability of loss and the expected time to recovery.

Deposits The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts, savings accounts, and interest checking accounts approximate their fair values at the reporting date. Fair values for fixed-rate CDs and brokered deposits (all of which are CDs) are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. Of the $23.4 million in brokered deposits, $10.1 million matures in 2017, $3.2 million matures in 2018, $5.2 million matures in 2020, and $5.0 million matures in 2021.

Federal Home Loan Bank of Pittsburgh advances The fair value of the FHLBP advances is obtained from the FHLB and is calculated by discounting contractual cash flows using an estimated interest rate based on the current rates available for debt of similar remaining maturities and collateral terms.

Repurchase agreements Fair value approximates the carrying value of such liabilities due to their short-term nature.

Junior subordinated debentures The fair value for subordinated debentures is calculated using discounted cash flows based upon current market spreads to LIBOR for debt of similar remaining maturities and collateral terms.

Subordinated debt The fair value of the subordinated debt was estimated using either a discounted cash flow analysis based on current market interest rates for debt with similar maturities and credit quality or estimated using market quotes.

Accrued Interest Receivable and Payable The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Off-balance-sheet Instruments (Disclosed at Cost) Off-balance-sheet instruments are primarily comprised of loan commitments, which are generally priced at market at the time of funding. Fees on commitments to extend credit and stand-by letters of credit are deemed to be immaterial and these instruments are expected to be settled at face value or expire unused. It is impractical to assign any fair value to these instruments. At June 30, 2016, un-funded loan commitments totaled $117.8 million and stand-by letters of credit totaled $2.6 million. At December 31, 2015, un-funded loan commitments totaled $116.4 million and stand-by letters of credit totaled $3.2 million.

NOTE 11: STOCKHOLDERS’ EQUITY

In July 2013, the Board of Governors of the Federal Reserve approved the Basel III interim final rule (Basel III), which is intended to strengthen the quality and increase the required level of regulatory capital for a more stable and resilient banking system. The changes include (1) a new regulatory capital measure, Common Equity Tier 1 (CET1), which is limited to capital elements of the highest quality, (2) a new definition and increase of tier 1 capital which is now comprised of CET1 and Additional Tier 1, (3) changes in calculation of some risk-weighted assets and off-balance sheet exposure, and (4) a capital conservation buffer that will limit capital distributions, stock redemptions, and certain discretionary bonus payments if the institution does not maintain capital in excess of the minimum capital requirements. These new capital rules took effect for our Bank on January 1, 2015 and reporting began for the period ended March 31, 2015.

On August 4, 2011, DNB entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which DNB issued and sold to the Treasury 13,000 shares of its Non-Cumulative Perpetual Preferred Stock, Series 2011A ("Series 2011A Preferred Stock"), having a liquidation preference of $1,000 per share for aggregate proceeds of $13.0 million. The Securities Purchase Agreement was entered into, and the Series 2011A Preferred Stock was issued, pursuant to the Treasury's Small Business Lending Fund program ("SBLF"), a $30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion. The securities sold in this transaction were exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as a transaction by DNB not involving a public offering. Of the $13.0 million in aggregate proceeds, $11,879,000 was used on August 4, 2011 to repurchase all shares issued and sold in 2009 to the United States Department of the Treasury in connection with the U. S. Treasury Capital Purchase Program (“CPP Shares”) ($11,750,000 was paid in principal and $128,900 in dividends related to the CPP Shares) held by the Treasury as described above. As of December 31, 2015, DNB had redeemed all of the Series 2011A Preferred Stock issued to the U.S. Treasury.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

DNB Financial Corporation (the “Corporation” or "DNB"), may from time to time make written or oral “forward-looking statements,” including statements contained in the Corporation’s filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q and the exhibits hereto and thereto), in its reports to stockholders and in other communications by the Corporation, which are made in good faith by the Corporation pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended.

These forward-looking statements include statements with respect to the Corporation’s beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond the Corporation’s control). The words “may,” “could,” “should,” “would,”"will," “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan” and similar expressions are i identify forward-looking statements. The following factors, among others, could cause the Corporation’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Corporation conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; the downgrade, and any future downgrades, in the credit rating of the U.S. Government and federal agencies; inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Corporation and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors’ products and services; the willingness of users to substitute competitors’ products and services for the Corporation’s products and services; the success of the Corporation in gaining regulatory approval of its products and services, when required; the impact of changes in laws and regulations applicable to financial institutions (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; changes in consumer spending and saving habits; the nature, extent, and timing of governmental actions and reforms the implementation of Basel III, which may be changed unilaterally and retroactively by legislative or regulatory actions; and the success of the Corporation at managing the risks involved in the foregoing.

The Corporation cautions that the foregoing list of important factors is not exclusive. Readers are also cautioned not to place undue reliance on these forward-looking statements, which reflect management’s analysis only as of the date of this report, even if subsequently made available by the Corporation on its website or otherwise. The Corporation does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Corporation to reflect events or circumstances occurring after the date of this report.

For a complete discussion of the assumptions, risks and uncertainties related to our business, you are encouraged to review our filings with the Securities and Exchange Commission, including this Form 10-Q, as well as any changes in risk factors or other risks that we may identify in our quarterly or other reports subsequently filed with the SEC.

DESCRIPTION OF DNB'S BUSINESS AND BUSINESS STRATEGY

DNB is a bank holding company whose bank subsidiary, DNB First, National Association (the "Bank") is a nationally chartered commercial bank with trust powers, and a member of the FDIC. DNB provides a broad range of banking services to individual and corporate customers through its twelve community offices located throughout Chester and Delaware Counties, Pennsylvania. DNB is a community banking organization that focuses its lending and other services on businesses and consumers in the local market area. DNB funds all these activities with retail and business deposits and borrowings. Through its DNB First Investment Management & Trust division, the Bank provides investment management and trust administration services to individuals and non-profit organizations. The Bank and its subsidiary, DNB Investments & Insurance, provide brokerage, retirement and insurance services.

DNB earns revenues and generates cash flows by lending funds to commercial and consumer customers in its marketplace. DNB generates its largest source of interest income through its lending function. A secondary source of interest income is DNB's investment portfolio, which provides liquidity and cash flows for future lending needs.

In addition to interest earned on loans and investments, DNB earns revenues from fees it charges customers for non-lending services. These products and services include trust administration, estate settlement, investment management, annuities, insurance and brokerage; cash management services; banking and ATM services; as well as safekeeping and other depository services.

To ensure we remain well positioned to meet the growing needs of our customers and communities and to meet the challenges of the 21st century, we’ve worked to build awareness of our full-service capabilities and ability to meet the needs of a wide range of customers. This served to not only retain our existing, customer base, but to position ourselves as an attractive financial institution on which younger individuals and families can build their dreams. To that end, DNB continues to make appropriate investments in all areas of our business, including people, technology, facilities and marketing.

Comprehensive 5-Year Plan. During the third quarter of 2015, management updated the 5-year strategic plan that was designed to reposition its balance sheet and improve core earnings. Through the plan, management will endeavor to expand its loan portfolio through new originations, increased loan participations, as well as strategic loan purchases. Management also plans to reduce the absolute level of borrowings with cash flows from existing loans and investments as well as from new deposit growth. A discussion on DNB’s Key Strategies follows below:

•Focus on penetrating existing markets to maximize profitability;

•Grow loans and diversify the mix;

•Improve asset quality;

•Focus on profitable customer segments;

•Grow and diversify non-interest income, primarily wealth management and mortgage banking;

•Continue to grow core deposits to maintain low funding costs;

•Focus on cost containment and improving operational efficiencies; and

•Continue to engage employees to help them become more effective and successful.

Strategic Plan Update. DNB reported net income available to common stockholders of $1.1 million, or $0.39 per diluted share, for the quarter ending June 30, 2016, compared with $1.2 million, or $0.43 per diluted share, for the same quarter, last year. Results for the three months ended June 30, 2016 included merger-related costs of $275,000 ($235,000 net of taxes) associated with East River Bank.

On a year-over-year basis, the net interest margin remained relatively stable despite continuing pressure due to the flattening yield curve. The net interest margin was 3.08% for the second quarter of 2016, compared with 3.11% for the same quarter, last year. On a sequential quarter basis, however, the net interest margin slipped seven basis points from 3.15% for the three months ending March 31, 2016. The linked-quarter decrease was primarily due to a three basis point decrease in the weighted average yield on total average loans to 4.21% and the previously mentioned three basis point increase of the weighted average cost of funds.

On a sequential quarter basis, total loans increased $5.1 million, or 1.0% (not annualized), to $494.4 million as of June 30, 2016. As of the same date, total loans were 64.7% of total assets. Loan growth has been prudent; and DNB remains challenged to grow commercial-oriented loans in a competitive market, while maintaining its conservative underwriting standards. As part of DNB's risk management strategy, certain loan payoffs occurred during the second quarter of 2016, which better positioned the loan portfolio from a credit quality perspective.

Net charge-offs were 0.10% of total average loans for the quarter ending June 30, 2016, compared with 0.08% for the quarter ending March 31, 2016, and 0.43% for the quarter ending June 30, 2015. Total non-performing assets, including loans and other real estate property, were $10.5 million as of June 30, 2016, compared with $7.8 million as of March 31, 2016 and $7.7 million as of December 31, 2015. The ratio of non-performing assets to total assets was 1.38% as of June 30, 2016 and 1.02% as of March 31, 2016. The increase in non-performing assets at June 30, 2016 was largely due to one commercial credit amounting to $2.1 million, which management believes will be fully recoverable

Total deposits were $641.8 million as of June 30, 2016, compared with $606.3 million as of December 31, 2015. On a sequential quarter basis, total core deposits remained relatively flat and were 84.9% of total deposits as of June 30, 2016.

Total non-interest income for the second quarter of 2016 was $1.4 million, compared with $2.3 million for the prior quarter and $1.3 million for the quarter ended June 30, 2015. Total non-interest income for the first quarter of 2016 included a $1.15 million net gain from the insurance proceeds associated with the fire at our West Chester location. Excluding this gain, non-interest income was approximately $1.2 million, or 17% of total revenue, for the quarter ending March 31, 2016. Wealth management fees were $440,000 for the second quarter of 2016 compared with $397,000 for the first quarter of 2016 and $422,000 for the quarter ending June 30, 2015. Wealth management fees represented approximately one-third of total fee income. Gains from the sale of investment securities were $203,000 for the three months ending June 30, 2016, compared with $31,000 for the quarter ending March 31, 2016, and $11,000 for the same quarter, last year.

Management has made a concerted effort to improve the measurement and tracking of business lines and overall corporate performance levels. Improved information systems have increased DNB's ability to track key indicators and enhance corporate performance levels. Better measurement against goals and objectives and increased accountability will be integral in attaining desired loan, deposit and fee income production.

MATERIAL CHALLENGES, RISKS AND OPPORTUNITIES

The following is a summary of material challenges, risks and opportunities DNB has faced during the six month period ended June 30, 2016:

Interest Rate Risk Management. Interest rate risk is the exposure to adverse changes in net interest income due to changes in interest rates. DNB considers interest rate risk the predominant risk in terms of its potential impact on earnings. Interest rate risk can occur for any one or more of the following reasons: (a) assets and liabilities may mature or re-price at different times; (b) short-term or long-term market rates may change by different amounts; or (c) the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change.

The principal objective of the Bank’s interest rate risk management is to evaluate the interest rate risk included in certain on and off-balance sheet accounts, determine the level of risk appropriate given the Bank’s business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with management’s approved guidelines. Through such management, DNB seeks to reduce the vulnerability of its operations to changes in interest rates. The Bank’s Asset Liability Committee (the “ALCO”) is responsible for reviewing the Bank’s asset/liability policies and interest rate risk position and making decisions involving asset liability considerations. The ALCO meets on a monthly basis and reports trends and the Bank’s interest rate risk position to the Board of Directors. The extent of the movement of interest rates is an uncertainty that could have a negative impact on the earnings of the Bank.

The largest component of DNB’s total income is net interest income, and the majority of DNB’s financial instruments are comprised of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the re-pricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. The ALCO actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities. One measure of interest rate risk is net interest income simulation analysis. The ALCO utilizes simulation analysis, whereby the model estimates the variance in net interest income with a change in interest rates of plus or minus 200 and 300 basis points in addition to four yield curve twists over a twelve-month period.

Liquidity and Market Risk Management Liquidity is the ability to meet current and future financial obligations. The Bank further defines liquidity as the ability to respond to deposit outflows as well as maintain flexibility to take advantage of lending and investment opportunities. The Bank’s primary sources of funds are operating earnings, deposits, repurchase agreements, principal and interest payments on loans, proceeds from loan sales, principal and interest payments on mortgage backed securities, sales of investment securities, and advances from the FHLB. The Bank uses the funds generated to support its lending and investment activities as well as any other demands for liquidity such as deposit outflows. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows, mortgage prepayments, loan and security sales and the exercise of call features are greatly influenced by general interest rates, economic conditions and competition.

The objective of DNB’s asset/liability management function is to maintain consistent growth in net interest income within DNB’s policy limits. This objective is accomplished through the management of liquidity and interest rate risk, as well as customer offerings of various loan and deposit products. DNB maintains adequate liquidity to meet daily funding requirements, anticipated deposit withdrawals, or asset opportunities in a timely manner. Liquidity is also necessary to meet obligations during unusual, extraordinary or adverse operating circumstances, while avoiding a significant loss or cost. DNB’s foundation for liquidity is a stable deposit base as well as a marketable investment portfolio that provides cash flow through regular maturities or that can be used for collateral to secure funding in an emergency. As part of its liquidity management, DNB maintains assets, which comprise its primary liquidity (Federal funds sold, investments and cash and due from banks, less pledged securities).

Credit Risk Management. DNB defines credit risk as the risk of default by a customer or counter-party. The objective of DNB's credit risk management strategy is to quantify and manage credit risk on an aggregate portfolio basis as well as to limit the risk of loss resulting from an individual customer default. Credit risk is managed through a combination of underwriting, documentation and collection standards. DNB's credit risk management strategy calls for regular credit examinations and quarterly management reviews of large credit exposures and credits that are experiencing credit quality deterioration. DNB's loan review procedures provide assessments of the quality of underwriting, documentation, risk grading and charge-off procedures, as well as an assessment of the allowance for credit loss reserve analysis process.

Competition. In addition to the challenges related to the interest rate environment, community banks in Chester and Delaware Counties have been experiencing increased competition from large regional and international banks entering DNB's marketplace through mergers and acquisitions. Competition for loans and deposits may negatively affect DNB's net interest margin. To compensate for the increased competition, DNB has targeted customers who have been disenfranchised by these mergers. To attract these customers, DNB has introduced new products and services, such as Mobile Money and Mobile Deposit, Popmoney and instant issue debit cards.

FDIC Insurance and Assessments. The Bank's deposits are insured to applicable limits by the FDIC. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the maximum deposit insurance amount was permanently increased from $100,000 to $250,000.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Within its risk category, an institution is assigned an initial base assessment which is then adjusted to determine its final assessment rate based on its level of brokered deposits, secured liabilities and unsecured debt.

The Dodd-Frank Act required the FDIC to take such steps as necessary to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020. In setting the assessments, the FDIC is required to offset the effect of the higher reserve ratio against insured depository institutions with total consolidated assets of less than $10 billion. The Dodd-Frank Act also broadened the base for FDIC insurance assessments so that assessments will be based on the average consolidated total assets less average tangible equity capital of a financial institution rather than on its insured deposits. The FDIC has adopted a restoration plan to increase the reserve ratio to 1.15% by September 30, 2020 with additional rulemaking scheduled regarding the method to be used to achieve a 1.35% reserve ratio by that date and offset the effect on institutions with less than $10 billion in assets.

Pursuant to these requirements, the FDIC adopted new assessment regulations effective April 1, 2011 that redefined the assessment base as average consolidated assets less average tangible equity. Insured banks with more than $1.0 billion in assets must calculate quarterly average assets based on daily balances while smaller banks and newly chartered banks may use weekly averages. Average assets would be reduced by goodwill and other intangibles. Average tangible equity equals Tier 1 capital. For institutions with more than $1.0 billion in assets, average tangible equity is calculated on a weekly basis while smaller institutions may use the quarter-end balance. The base assessment rate for insured institutions in Risk Category I will range between 5 to 9 basis points and for institutions in Risk Categories II, III, and IV will be 14, 23 and 35 basis points. An institution's assessment rate will be reduced based on the amount of its outstanding unsecured long-term debt and for institutions in Risk Categories II, III and IV may be increased based on their brokered deposits.

In addition to deposit insurance assessments, banks are subject to assessments to pay the interest on Financing Corporation bonds. The Financing Corporation was created by Congress to issue bonds to finance the resolution of failed thrift institutions. The FDIC sets the Financing Corporation assessment rate every quarter. The current annual Financing Corporation assessment rate is 56 basis points on the deposit insurance assessment base, as defined above, which we anticipate will result in an aggregate estimated FICO assessment payment by the Bank of $37,000 in 2016.

Merger Agreement. On April 04, 2016, DNB entered into an Agreement and Plan of Merger, dated as of April 4, 2016 (the "merger agreement"), by and between DNB Financial Corporation and East River Bank, which, among other matters, provides for: (i) the merger of East River Bank with and into DNB First, N.A., a wholly owned subsidiary of DNB, with DNB First, N.A., as the surviving entity, and (ii) upon consummation of the merger, the exchange of each outstanding share of ERB common stock (other than shares the holders of which perfect dissenters' rights of appraisal), subject to the election, proration and adjustment procedures provided in the merger agreement, for 0.6562 of a share of DNB common stock or $18.65 in cash.

The Merger Agreement was approved by the Board of Directors of DNB and ERB. ERB shareholders may seek appraisal rights as dissenting shareholders under Pennsylvania law.

The merger is subject to customary closing conditions enumerated in the merger agreement, including receipt of regulatory approvals and the approval of both DNB’s and ERB’s shareholders. It is anticipated that the transaction will close during the fourth quarter of 2016.

Material Trends and Uncertainties.

DNB reported net income available to common stockholders of $1.1 million, or $0.39 per diluted share, for the quarter ending June 30, 2016, compared with $1.2 million, or $0.43 per diluted share, for the same quarter, last year. Results for the three months ended June 30, 2016 included merger-related costs of $275,000 ($235,000 net of taxes) associated with East River Bank. Even though DNB’s quarterly earnings have increased (absent net merger related costs), there are many aspects of the economy and the Federal Reserve’s monetary policy that hinder DNB’s ability to grow revenues and net income. One of the most significant factors is that the global and U.S. economies have experienced reduced business activity as a result of disruptions in the financial system during the past seven years. The United States, Europe, China and many other countries across the globe are struggling with too much debt and weaker streams of revenues as a result of recessionary pressures and high unemployment. Overall economic growth continues to be slow at a time when national and regional unemployment rates have improved, however participation rates remain at historically low levels. The risks associated with our business remain acute in periods of slow wage and economic growth. Moreover, financial institutions continue to be affected by a sluggish real estate market. While we are continuing to take steps to decrease and limit our exposure to problem loans, we nonetheless retain direct exposure to the residential and commercial real estate markets, and we are affected by these events.

The April 13, 2016 Beige Book indicated that aggregate business activity in the Third District continued at a modest pace of growth during the July 13, 2016 Beige Book period. Employment trends remained the same, with most of the Federal Reserve’s contacts reporting a modest pace of hiring, staffing firms continuing to be more bullish, and manufacturing firms reporting further job declines. On balance, prices continued to rise slightly over the July 13, 2016 Beige Book period; home prices, which had been essentially flat over the June 1, 2016 Beige Book period, also rose slightly. The Federal Reserve’s contacts appeared to be in more agreement than June 1, 2016 Beige Book period that current wage pressures had remained modest. On balance, firms continued to expect modest growth over the next six months.

Overall, Third District homebuilders reported that economic activity continued to rise slightly. Demand for new single family homes remains soft, and the lack of affordable land for lots hampers new development in suburban markets, while urban locations are attracting infill and redevelopment to meet greater demand for rental properties, ranging from affordable to upscale units. The Federal Reserve’s contacts noted some cost pressures for labor and as a consequence of new building codes in New Jersey; material costs pressures were less pronounced.

The Federal Reserve’s nonresidential real estate contacts, predominately in the Greater Philadelphia area, reported little change in the ongoing modest gains in construction activity and in leasing activity. The City of Philadelphia office market also continues to tighten as vacancy rates continue to drop.

Third District financial firms continued to report moderate growth of total loan volumes over the July 13, 2016 Beige Book period. Volumes within all lending categories have grown since the prior period, except for home equity loans. All categories except home equities and automobile loans grew at a faster pace than during the same period one year ago. The strongest growth during the July 13, 2016 Beige Book period was for credit cards and automobile loans. Commercial real estate, commercial and industrial loans, mortgages, and other consumer lending grew modestly or slightly this year after declining slightly over the same period last year.

Third District manufacturers reported that overall activity has climbed into slightly positive territory since the June 1, 2016 Beige Book period; however, reports of shipments and new orders remained slightly negative. Firms also reported that the number of employees and the average employee workweek continued to fall. The makers of lumber products, fabricated metal products, and industrial machinery noted overall gains in activity from the June 1, 2016 Beige Book, while the makers of paper, primary metals, and electronic products noted weaker activity. However, these trends may be seasonal in nature, as they are similar to what these sectors noted during the same time period last year. Overall, the Federal Reserve’s contacts expressed somewhat lower expectations of growth during the next six months than during the June 1, 2016 Beige Book period. The change in outlook was driven, in part, by lower percentages of firms expecting increases in shipments and new orders and higher percentages expecting a decrease in general activity than during the prior period. Expectations of future capital expenditures also fell, with fewer firms expecting increases and more expecting decreases.

Although DNB’s earnings have been impacted by the general economic conditions, the impact has not been as severe as it has been in many parts of the nation, largely due to a relatively healthier economic climate in the Third Federal Reserve District and specifically Chester County. DNB’s franchise spans both Chester and Delaware counties in southeastern Pennsylvania. The majority of loans have been made to businesses and individuals in Chester County and the majority of deposits are from businesses and individuals within the County. According to census data, Chester County’s population has grown at approximately 15%, compared to

13% for the nation and 3% for the Commonwealth of Pennsylvania. The median household income in Chester County is $85,373 and the County ranks 14th nationally in disposable income. The unemployment rate for Chester County stood at 3.8% as of March 2016, compared to a Pennsylvania unemployment rate of 5.3% and a national unemployment rate of 5.1%. Traditionally, the unemployment rate has been the lowest in the surrounding five-county area and it ranks among the lowest unemployment rates in the Commonwealth. Chester County has a civilian labor force of 266,900, with manufacturing jobs representing 23.1% of the workforce and retail shopping comprising 13.8% of the total employment. During the last few years, the County has been able to keep most of its major employers; however some of them have downsized in order to remain competitive. Chester County is home to several Fortune 500 companies. Thirteen Chester County employers have 1,000 employees or more. Of these 13 companies, two companies have more than 5,000 employees.

These and other factors have impacted our operations. We continue to focus on the consistency and stability of core earnings and balance sheet strength which are critical success factors in today's challenging economic environment.

Regulatory Initiatives Related to Our Industry. The federal government continues to consider a variety of reforms related to banking and the financial industry including, without limitation, the Dodd-Frank Act. The Dodd-Frank Act is intended to promote financial stability in the U.S., reduce the risk of bailouts and protect against abusive financial services practices by improving accountability and transparency in the financial system and ending "too big to fail" institutions. It is the broadest overhaul of the U.S. financial system since the Great Depression, and although enacted more than five years ago, much of its impact will be determined by the scope and substance of many regulations that still need to be adopted by various regulatory agencies to implement its provisions. For these reasons, the overall impact on DNB and its subsidiaries remains unknown at this time.

The Dodd-Frank Act delegates to various federal agencies, including the Consumer Financial Protection Bureau, the task of implementing its many provisions through regulation. While some regulations have been adopted, hundreds of new federal regulations, studies and reports addressing all of the major areas of the new law, including the regulation of banks and their holding companies, will be required, ensuring that federal rules and policies in this area will be further developing for months and years to come. Based on the provisions of the Dodd-Frank Act and adopted and anticipated implementing regulations, it is highly likely that banks and thrifts as well as their holding companies will be subject to significantly increased regulation and compliance obligations.

The Dodd-Frank Act could require us to make material expenditures, in particular personnel training costs and additional compliance expenses, or otherwise adversely affect our business or financial results. It could also require us to change certain of our business practices, adversely affect our ability to pursue business opportunities we might otherwise consider engaging in, cause business disruptions and/or have other impacts that are as-of-yet unknown to DNB and the Bank. Failure to comply with these laws or regulations, even if inadvertent, could result in negative publicity, fines or additional licensing expenses, any of which could have an adverse effect on our cash flow and results of operations. For example, a provision of the Dodd-Frank Act precludes bank holding companies from treating future trust preferred securities issuances as Tier 1 capital for regulatory capital adequacy purposes. This provision may narrow the number of possible capital raising opportunities DNB and other bank holding companies might have in the future. Further, the new rules issued by the Consumer Financial Protection Bureau may materially affect the methods and costs of compliance by the Bank in connection with future consumer-related transactions.

Capital Rules. On July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Corporation and the Bank. The FDIC and the OCC have subsequently approved these rules. The final rules were adopted following the issuance of proposed rules by the Federal Reserve in June 2012, and implement the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. “Basel III” refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

The rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and refine the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation and the Bank under the final rules effective as of January 1, 2015: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a “capital conservation buffer” above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The final rules implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The final rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including the Bank, if their capital levels begin to show signs of weakness. These revisions took effect January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions are required to meet the following increased capital level requirements in order to qualify as “well capitalized:” (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The final rules set forth certain changes for the calculation of risk-weighted assets, which have been required to utilize since January 1, 2015. The standardized approach final rule utilizes an increased number of credit risk exposure categories and risk weights, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with $50 billion or more in total assets that are not subject to the “advance approach rules” that apply to banks with greater than $250 billion in consolidated assets. Based on our current capital composition and levels, we believe that we are in compliance with the requirements as set forth in the final rules presently in effect.

Other Material Challenges, Risks and Opportunities. As a financial institution, DNB's earnings are significantly affected by general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the United States economy and local economies in which we operate. As mentioned above in Material Trends and Uncertainties, the economic downturn, increased unemployment, and other events negatively impact household and/or corporate incomes and could decrease the demand for DNB's loan and non-loan products and services and increase the number of customers who fail to pay interest or principal on their loans. Geopolitical conditions can also affect DNB's earnings. Acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and our military conflicts, could impact business conditions in the United States.

CRITICAL ACCOUNTING POLICIES

The following discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principals. Generally accepted accounting principles are complex and require management to apply significant judgment to various accounting, reporting and disclosure matters. Management must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. Actual results may differ from these estimates under different assumptions or conditions.

In management's opinion, the most critical accounting policies and estimates impacting DNB's consolidated financial statements are listed below. These policies are critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. For a complete discussion of DNB's significant accounting policies, see the notes to the Consolidated Financial Statements included in DNB's 10-K for the year ended December 31, 2015.

Determination of the allowance for credit losses. Credit loss allowance policies involve significant judgments, estimates and assumptions by management which may have a material impact on the carrying value of net loans and, potentially, on the net income recognized by DNB from period to period. The allowance for credit losses is based on management's ongoing evaluation of the loan portfolio and reflects an amount considered by management to be its best estimate of the amount necessary to absorb known and inherent losses in the portfolio. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the portfolios, delinquency statistics, results of loan review and related classifications, and historic loss rates. In addition, certain individual loans which management has identified as problematic are specifically provided for, based upon an evaluation of the borrower's perceived ability to pay, the estimated adequacy of the underlying collateral and other relevant factors. In addition, regulatory authorities, as an integral part of their examinations, periodically review the allowance for credit losses. They may require additions to the allowance based upon their judgments about information available to them at the time of examination. Although provisions have been established and segmented by type of loan, based upon management's assessment of their differing inherent loss characteristics, the entire allowance for credit losses is available to absorb further losses in any category.

Management uses significant estimates to determine the allowance for credit losses. Because the allowance for credit losses is dependent, to a great extent, on conditions that may be beyond DNB's control, management's estimate of the amount necessary to absorb credit losses and actual credit losses could differ. DNB's current judgment is that the allowance for credit losses remains appropriate at June 30, 2016. For a description of DNB's accounting policies in connection with its allowance for credit losses, see, "Allowance for Credit Losses" in Management's Discussion and Analysis.

The notes to DNB's most recent Consolidated Financial Statements as set forth in DNB's Annual Report 10-K identify other significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of DNB and its results of operations.

FINANCIAL CONDITION

DNB's total assets were $764.2 million at June 30, 2016, compared to $748.8 million at December 31, 2015. The $15.4 million increase in total assets was primarily attributable to a $12.7 million increase in loans before allowance for credit losses, a $2.9 million increase in investment securities and a $1.8 million increase in office property and equipment, offset by a decrease of $973,000 in cash and cash equivalents and a $312,000 increase in allowance for credit losses.

Investment Securities. Investment securities, including restricted stock, at June 30, 2016 were $226.5 million, compared to $223.7 million at December 31, 2015. The $2.8 million increase in investment securities and restricted stock was primarily due to $64.1 million in purchases of investment securities and a $1.8 million change in fair value, offset by $62.9 million in sales, principal pay-downs, calls and maturities and a $129,000 net decrease in restricted stock.

Gross Loans. DNB's loans increased $12.7 million to $494.4 million at June 30, 2016, compared to $481.8 million at December 31, 2015. Total commercial loans increased $14.8 million while residential loans and consumer loans decreased $1.7 million, and $404,000, respectively.

Deposits. Deposits were $641.8 million at June 30, 2016, compared to $606.3 million at December 31, 2015. Deposits increased $35.6 million or 5.87% during the six-month period ended June 30, 2016. Core deposits, which are comprised of demand, NOW, money markets and savings accounts, increased by $23.1 million, time deposits increased by $7.5 million and brokered deposits increased by $5.0 million.

Borrowings. Borrowings were $57.2 million at June 30, 2016, compared to $81.9 million at December 31, 2015. The decrease of $24.7 million or 30.1% was primarily due to a $14.7 million decrease in repurchase agreements and a $10.0 million decrease in FHLBP advances.

Stockholders' Equity. Stockholders' equity was $59.5 million at June 30, 2016, compared to $55.5 million at December 31, 2015. The increase in stockholders' equity was primarily a result of year-to-date earnings of $2.7 million and $1.2 million of other comprehensive income, and restricted stock compensation expense of $730,000. These additions to stockholders' equity were partially offset by taxes on share award vesting of $436,000 and $398,000 of dividends paid on DNB's common stock.

RESULTS OF OPERATIONS

SUMMARY

Net income for the three and six-month periods ended June 30, 2016 was $1.1 million and $2.7 million compared to $1.2 million and $2.5 million for the same periods in 2015. Diluted earnings per share for the three and six-month periods ended June 30, 2016 were $0.39 and $0.93 compared to $0.43 and $0.86 for the same periods in 2015. The $126,000 decrease in net income during the most recent three-month period was primarily attributable to a $448,000 increase in non-interest expense, offset by a $215,000 decrease in the provision for credit losses, a $49,000 increase in non-interest income a $39,000 decrease in income tax expense, and a $19,000 increase in net interest income. The $178,000 increase during the six-month period was primarily attributable to a $1.0 million increase in non-interest income, a $185,000 decrease in the provision for credit losses, and an $84,000 increase in net interest income, offset by a $1.0 million increase in non-interest expense and a $92,000 increase in income tax expense.

NET INTEREST INCOME

DNB's earnings performance is primarily dependent upon its level of net interest income, which is the excess of interest income over interest expense. Interest income includes interest earned on loans, investments and federal funds sold and interest-earning cash, as well as loan fees and dividend income earned on investment securities. Interest expense includes interest on deposits, Federal Home Loan Bank of Pittsburgh ("FHLBP") advances, repurchase agreements, Federal funds purchased, subordinated debentures and notes, and other borrowings.

Net interest income for the three and six-month periods ended June 30, 2016 was $5.5 million and $10.9 million, compared to $5.5 million and $10.8 million for the same periods in 2015. Interest income for the three and six-month periods ended June 30, 2016 was $6.2 million and $12.3 million, compared to $6.1 million and $12.1 million for the same periods in 2015. Interest expense for the three and six-month periods ended June 30, 2016 was $708,000 and $1.4 million, compared to $678,000 and $1.3 million for the same periods in 2015. The composite cost of funds for the three and six-month periods ended June 30, 2016 was 0.41% and 0.40%, compared to 0.40% and 0.38% for the same periods in 2015. The net interest margin for the three and six-month periods ended June 30, 2016 was 3.08% and 3.12%, compared to 3.11% and 3.13% for the same periods in 2015.

Interest on loans was $5.1 million and $10.2 million for the three and six-month periods ended June 30, 2016, compared to $5.0 million and $9.9 million for the same periods in 2015. The average balance of loans was $488.4 million with an average yield of 4.21% for the second quarter of 2016, compared to $459.5 million with an average yield of 4.36% for the same period in 2015. The average balance of loans was $485.8 million with an average yield of 4.22% for the six months ended June 30, 2016, compared to $460.0 million with an average yield of 4.34% for the same period in 2015.

Interest and dividends on investment securities was $1.0 million and $2.1 million for the three and six-month periods ended June 30, 2016, compared to $1.1 million and $2.2 million for the same periods in 2015. The average balance of investment securities was $207.9 million with a tax equivalent average yield of 2.18% for the second quarter of 2016, compared to $234.3 million with a tax equivalent average yield of 2.10% for the same period in 2015. The average balance of investment securities was $209.2 million with a tax equivalent average yield 2.20% for the six months ended June 30, 2016, compared to $233.5 million with a tax equivalent average yield of 2.08% for the same period in 2015.

Interest on deposits was $405,000 and $748,000 for the three and six-month periods ended June 30, 2016, compared to $277,000 and $559,000 for the same periods in 2015. The average balance of deposits was $637.8 million with an average rate of 0.25% for the second quarter of 2016, compared to $623.5 million with an average rate of 0.24% for the same period in 2015. The average balance of deposits was $626.5 million with an average rate of 0.24% for the six months ended June 30, 2016, compared to $620.4 million with an average rate of 0.18% for the same period in 2015.

Interest on borrowings was $303,000 and $610,000 for the three and six-month periods ended June 30, 2016, compared to $401,000 and $725,000 for the same periods in 2015. The average balance of borrowings was $58.6 million with an average rate of 2.07% for the second quarter of 2016, compared to $60.2 million with an average rate of 2.67% for the same period in 2015. The average balance of borrowings was $62.6 million with an average rate of 1.95% for the six months ended June 30, 2016, compared to $55.6 million with an average rate of 2.62% for the same period in 2015.

PROVISION FOR CREDIT LOSSES

To provide for known and inherent losses in the loan portfolios, DNB maintains an allowance for credit losses. Provisions for credit losses are charged against income to increase the allowance when necessary. Loan losses are charged directly against the allowance and recoveries on previously charged-off loans are added to the allowance. In establishing its allowance for credit losses, management considers the size and risk exposure of each segment of the loan portfolio, past loss experience, present indicators of risk such as delinquency rates, levels of non-accruals, the potential for losses in future periods, and other relevant factors. Management's evaluation of criticized and classified loans generally includes reviews of borrowers of $100,000 or greater. Consideration is also given to examinations performed by regulatory agencies, primarily the Office of the Comptroller of the Currency ("OCC").

Management reviews and establishes the adequacy of the allowance for credit losses in accordance with U.S. generally accepted accounting principles, guidance provided by the Securities and Exchange Commission and as prescribed in OCC Bulletin 2006-47. Its methodology for assessing the appropriateness of the allowance consists of several key elements which include: specific allowances for identified impaired loans; and allowances by loan type for pooled homogenous loans. In considering national and local economic trends, we review a variety of information including Federal Reserve publications, general economic statistics, foreclosure rates and housing statistics published by third parties. We believe this improves the measure of inherent loss over a complete economic cycle and reduces the impact for qualitative adjustments. The unallocated portion of the allowance is intended to provide for probable losses not otherwise accounted for in management's other elements of its overall estimate. An unallocated component is maintained to cover uncertainties such as changes in the national and local economy, concentrations of credit, expansion into new markets and other factors that could affect management'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 portfolio.

In addition, DNB reviews historical loss experience for the residential mortgage, commercial mortgage, commercial term, commercial construction, home equity and consumer installment loan pools to determine a historical loss factor. The historical loss factors are then applied to the current portfolio balances to determine the required reserve percentage for each loan pool. A historical loss ratio is determined for each group over a five year period. The five year average loss ratio by type is then used to calculate the estimated loss based on the current balance of each group. This five year time period is appropriate given DNB's historical level of losses and, more importantly, represents the current economic environment.

This analysis is intended to assess the potential for loss within the loan portfolio and to substantiate the adequacy of the allowance. Should the analysis indicate that the allowance is not adequate, management will recommend a provision expense be made in an amount equal to the shortfall derived. In establishing and reviewing the allowance for adequacy, emphasis has been placed on utilizing the methodology prescribed in OCC Bulletin 2006-47. Management believes that the following factors create a comprehensive system of controls in which management can monitor the quality of the loan portfolio. Consideration has been given to the following factors and variables which may influence the risk of loss within the loan portfolio:

•Changes in the nature and volume of the portfolio and in the terms of loans;

•Changes in the volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans;

•The existence and effect of any concentrations of credit, and changes in the level of such concentrations;

•Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;

•Changes in the experience, ability, and depth of lending management and other relevant staff;

•Changes in Loan Review Methodology and Degree of Oversight by Bank’s Board of Directors;

•Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;

•The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution’s existing portfolio; and

•Changes in the value of underlying collateral for collateral dependent loans.

Portfolio risk includes the levels and trends in delinquencies, impaired loans, changes in the loan rating matrix and trends in volume and terms of loans. Management is satisfied with the stability of the past due and non-performing loans and believes there has been no further decline in the quality of the loan portfolio due to any trend in delinquent or adversely classified loans. In addition to ordering new appraisals and creating specific reserves on impaired loans, the allowance allocation rates were increased, reflective of delinquency trends which have been caused by continued weakness in the housing markets, falling home equity values, and rising unemployment. New appraisal values we have obtained for existing loans have generally been consistent with trends indicated by Case-Schiller and other indices.

Given the contraction in real estate values, DNB closely monitors the loan to value ratios of all classified assets and requires periodic current appraisals to monitor underlying collateral values. Management also reviews borrower, sponsorship and guarantor’s financial strength along with their ability and willingness to provide financial support of their obligations on an immediate and continuing basis.

There was a $200,000 and $530,000 provision made during the three and six months ended June 30, 2016, compared to $415,000 and $715,000 for the same periods in 2015. DNB’s percentage of allowance for credit losses to total loans was 1.06% at June 30, 2016 compared to 1.02% and 1.08% at December 31, 2015 and June 30, 2015, respectively. Net charge-offs were $218,000, $1.1 million, and $513,000 during the six months ended June 30, 2016, year ended December 31, 2015, and six months ended June 30, 2015, respectively. The percentage of net charge-offs to total average loans were 0.04%, 0.23%, and 0.11% for those same respective periods. Management believes that the allowance for credit losses is adequate, but continues to monitor it along with other performance metrics including those ratios related to non-performing loans. Management is not aware of any potential problem loans, which were accruing and current at June 30, 2016, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to DNB. Non-performing loans increased $2.5 million during the six month period ended June 30, 2016. The ratio of the allowance for credit losses as a percentage of loans reflects management's estimate of the level of inherent losses in the portfolio, which has been impacted by a slow economy, a weakened housing market and deterioration in income-producing properties.

We typically establish a general valuation allowance on classified loans which are not individually impaired. In establishing the general valuation allowance, we segregate these loans by category. The categories used by DNB include "doubtful," "substandard," "special mention," "watch list" and "pass." For commercial mortgage, commercial and construction loans, the determination of the category for each loan is based on periodic reviews of each loan by our lending and credit officers as well as an independent, third-party consultant. The reviews include a consideration of such factors as recent payment history, current financial data, cash flow, financial projections, collateral evaluations, guarantor or sponsorship financial strength and current economic and business conditions. Categories for residential mortgage and consumer loans are determined through a similar review. Classification of a loan within a category is based on identified weaknesses that increase the credit risk of loss on the loan. Each category carries a loss factor for the allowance percentage to be assigned to the loans within that category. The allowance percentage, is determined based on inherent losses associated with each type of lending as determined through consideration of our loss history with each type of loan, trends in credit quality and collateral values, and an evaluation of current economic and business conditions.

We establish a general allowance on non-classified loans to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem loans. This general valuation allowance is determined by segregating the loans by loan category and assigning allowance percentages to each category. An evaluation of each category is made to determine the need to further segregate the loans within each category by type. For our residential mortgage and consumer loan portfolios, we identify similar characteristics throughout the portfolio including credit scores, loan-to-value ratios and collateral. For our commercial mortgage and construction loan portfolios, a further analysis is made in which we segregated the loans by type based on the purpose of the loan and the collateral properties securing the loan. Various risk factors for each type of loan are considered, including the impact of general economic and business conditions, collateral value trends, credit quality trends and historical loss experience.

As of June 30, 2016, DNB had $10.5 million of non-performing assets, which included $7.5 million of non-performing loans and $3.0 million of OREO and other repossessed assets. This compares to $7.7 million of non-performing assets at December 31, 2015 which included $5.1 million of non-performing or impaired loans and $2.6 million of OREO and other repossessed assets. Loans are reviewed for impairment in accordance with FASB ASC 310-10-35. Impaired loans can either be secured or unsecured, not including large groups of smaller balance loans that are collectively evaluated. Impairment is measured by the difference between the loan amount and the present value of the future cash flow discounted at the loan’s effective interest rate. Management measures loans for impairment by using the fair value of collateral for collateral dependent loans. In general, management reduces the amount of the appraisal by the estimated cost of acquisition and disposition of the underlying collateral and compares that adjusted value with DNB’s carrying value. DNB establishes a specific valuation allowance on impaired loans that have a collateral shortfall and/or statement cashflow shortfalls, including estimated costs to sell in comparison to the carrying value of the loan. Of the $7.5 million of impaired loans at June 30, 2016, $1.6 million had valuation allowances of $297,000 and $6.0 million had no specific allowance. Of the $5.0 million of impaired loans at December 31, 2015, $307,000 had valuation allowances of $114,000 and $4.7 million had no specific allowance. For those impaired loans that management determined that no specific valuation allowance was necessary, management has reviewed the present value of the future cash flows or the appraisal for each loan and determined that there is no shortfall in the collateral. During the quarter ended June 30, 2016, DNB recognized $133,000 in total charge-offs, $122,000 of which related to impaired loans. An impaired loan may not represent an expected loss.

We typically order new third-party appraisals or collateral valuations when a loan becomes impaired or is transferred to Other Real Estate Owned ("OREO"). This is done within two weeks of a loan becoming impaired or a loan moving to OREO. It generally takes two to eight weeks to receive the appraisals, depending on the type of property being appraised. We recognize any provision or related charge-off within two weeks of receiving the appraisal after the appraisal has been reviewed by DNB. We generally order a new appraisal for all impaired real estate loans having a balance of $100,000 or higher, every twelve months, unless management determines more frequent appraisals are necessary. We use updated valuations when time constraints do not permit a full appraisal process, to reflect rapidly changing market conditions. Because appraisals and updated valuations utilize historical data in reaching valuation conclusions, the appraised or updated value may or may not reflect the actual sales price that we will receive at the time of sale. Management uses the qualitative factor “Changes in the value of underlying collateral for collateral-dependent loans” to calculate any required reserve to mitigate this risk.

Real estate appraisals typically include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost approach. Not all appraisals utilize all three approaches to value. Depending on the nature of the collateral and market conditions, the appraiser may emphasize one approach over another in determining the fair value of collateral.

Appraisals may also contain different estimates of value based on the level of occupancy or future improvements. “As-is” valuations represent an estimate of value based on current market conditions with no changes to the collateral’s use or condition. “As-stabilized” or “as-completed” valuations assume that the collateral is improved to a stated standard or achieves its highest and best use in terms of occupancy. “As-stabilized” valuations may be subject to a present value adjustment for market conditions or the schedule for improvements.

In connection with the valuation process, we will typically develop an exit strategy for the collateral by assessing overall market conditions, the current condition and use of the asset and its highest and best use. For most income-producing real estate, investors value most highly a stable income stream from the asset; consequently, we conduct a comparative evaluation to determine whether conducting a sale on an “as-is” basis or on an “as-stabilized” basis is most likely to produce the highest net realizable value and compare these values with the costs incurred and the holding period necessary to achieve the “as stabilized” value.

Our estimates of the net realizable value of collateral include a deduction for the expected costs to sell the collateral or such other deductions as deemed appropriate. For most real estate collateral, we apply a seven to ten percent deduction to the value of real estate collateral to determine its expected costs to sell the asset.

Analysis of Allowance for Credit Losses

(Dollars in thousands)

	Six Months Ended June 30, 2016	Year Ended December 31, 2015	Six Months Ended June 30, 2015
Beginning balance	$ 4,935	$ 4,906	$ 4,906
Provisions	530	1,105	715
Loans charged off:			
Residential mortgage	(206)	(194)	(35)
Commercial mortgage	-	(105)	-
Commercial:			
Commercial term	(24)	(200)	(174)
Commercial construction	-	(581)	(278)
Lease financing	-	-	-
Consumer:			
Home equity	-	(11)	(1)
Other	-	(63)	(30)
Total charged off	(230)	(1,154)	(518)
Recoveries:			
Residential mortgage	8	4	-
Commercial mortgage	-	-	-
Commercial:			
Commercial term	1	13	2
Commercial construction	1	10	-
Lease financing	1	49	2
Consumer:			
Home Equity	-	-	-
Other	1	2	1
Total recoveries	12	78	5
Ending balance	$ 5,247	$ 4,935	$ 5,108
Reserve for unfunded loan commitments	$ 190	$ 188	$ 180

The following table sets forth the composition of DNB’s allowance for credit losses for the dates indicated.

Composition of Allowance for Credit Losses

(Dollars in thousands)

	June 30, 2016		December 31, 2015		June 30, 2015	
	Amount	Percent of Loan Type to Total Loans	Amount	Percent of Loan Type to Total Loans	Amount	Percent of Loan Type to Total Loans
Residential mortgage	$ 314	6 %	$ 216	6 %	$ 265	6 %
Commercial mortgage	2,370	56	2,375	57	2,562	58
Commercial:						
Commercial term	891	21	989	21	721	18
Commercial construction	866	6	569	4	774	6
Consumer:						
Home equity	191	10	195	11	190	11
Other	64	1	64	1	65	1
Unallocated	551	-	527	-	531	-
Total	$ 5,247	100 %	$ 4,935	100 %	$ 5,108	100 %
Reserve for unfunded loan commitments	$ 190		$ 188		$ 180	

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NON-INTEREST INCOME

Non-interest income includes service charges on deposit products; fees received in connection with the sale of non-depository products and services, including fiduciary and investment advisory services offered through DNB First Investment Management and Trust; securities brokerage products and services and insurance products and services offered through DNB Investments & Insurance; and other sources of income such as increases in the cash surrender value of Bank Owned Life Insurance (“BOLI”), net gains on sales of investment securities, SBA loans and OREO properties. In addition, DNB receives fees for cash management, mortgage banking, remote capture, merchant services, debit cards, safe deposit box rentals and similar activities.

Non-interest income for the three and six-month periods ended June 30, 2016 was $1.4 million and $3.7 million, compared to $1.3 million and $2.7 million for the same periods in 2015. The $49,000 increase during the three months ended June 30, 2016 was mainly attributable to increases of $192,000 in gains on sale of investments, $30,000 in mortgage banking, $26,000 in other fees (mostly servicing fee income), and $19,000 in wealth management. These increases were offset by decreases of $185,000 in gains on sale of loans and $32,000 in service charges (mostly NSF fees and business analysis charges). The $1.0 million increase during the six months ended June 30, 2016 was mainly attributable to increases of $1.2 million in gains from insurance proceeds, $170,000 in gain on sale of investments, $64,000 in wealth management, $34,000 in other fees (mostly servicing fee income, Visa debit interchange, and merchant card processing), and $24,000 in mortgage banking.

NON-INTEREST EXPENSE

Non-interest expense for the three and six-month periods ended June 30, 2016 was $5.2 million and $10.6 million, compared to $4.7 million and $9.5 million for the same periods in 2015. During the three months ended June 30, 2016, total non-interest expense increased by $448,000. The increase was primarily due to increases of $275,000 in due diligence and merger expense, $72,000 in professional and consulting, $55,000 in salary and employee benefits, $39,000 in furniture and equipment, and $21,000 in printing and supplies. These increases were partially offset by decreases of $18,000 in other expenses (mostly provision for unfunded and contribution expense). During the six months ended June 30, 2016, total non-interest expense increased $1.0 million. The increase was primarily due to increases of $537,000 in salary and employee benefits (restricted stock vestings, normal merit increases, and higher commissions), $463,000 in due diligence and merger expenses, $66,000 in furniture and equipment, $53,000 in professional and consulting, $18,000 in PA shares tax, $18,000 in other expenses (mostly director’s fees), and $10,000 in advertising and marketing.

INCOME TAXES

Income tax expense for the three and six-month periods ended June 30, 2016 was $378,000 and $858,000, compared to $417,000 and $766,000 for the same periods in 2015. The effective tax rate for the three and six-month periods ended June 30, 2016 was 25.4% and 24.4% compared to 25.2% and 23.5% for the same periods in 2015. Income tax expense for each period differs from the amount determined at the statutory rate of 34.0% due to tax-exempt income on loans and investment securities, DNB's ownership of BOLI policies, and tax credits recognized on a low-income housing limited partnership.

ASSET QUALITY

DNB continues to work diligently to improve asset quality by adhering to strict underwriting standards and improving lending policies and procedures. Non-performing assets totaled $10.5 million at June 30, 2016 compared to $7.7 million at December 31, 2015 and $6.6 million at June 30, 2015. The non-performing loans to total loans ratio was 1.54% at June 30, 2016, 1.06% at December 31, 2015 and 0.98% at June 30, 2015. The non-performing assets to total assets ratio was 1.38% at June 30, 2016, 1.02% at December 31, 2015, and 0.88% at June 30, 2015. The allowance to non-performing loans ratio was 69.1% at June 30, 2016, 96.9% at December 31, 2015 and 110.3% at June 30, 2015. Non-performing assets have, and will continue to have, an impact on earnings; therefore management intends to continue working aggressively to reduce the level of such assets.

Non-performing assets are comprised of non-accrual loans, loans delinquent over ninety days and still accruing, as well as OREO and other repossessed assets. Non-accrual loans are loans for which the accrual of interest ceases when the collection of principal or interest payments is determined to be doubtful by management. It is the policy of DNB to discontinue the accrual of interest when principal or interest payments are delinquent 90 days or more (unless the loan principal and interest are determined by management to be fully secured and in the process of collection), or earlier if considered prudent. Interest received on such loans is applied to the principal balance, or may, in some instances, be recognized as income on a cash basis. A non-accrual loan may be restored to accrual status when management expects to collect all contractual principal and interest due and the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms. OREO consists of real estate acquired by foreclosure or deed-in-lieu of foreclosure. Other repossessed assets are primarily assets from DNB’s consumer purchased chattel portfolio that were repossessed. OREO and other repossessed assets are carried at the lower of carrying value or estimated fair value, less estimated disposition costs. Any significant change in the level of non-performing assets is dependent, to a large extent, on the economic climate within DNB’s market area.

DNB’s Credit Policy Committee monitors the performance of the loan portfolio to identify potential problem assets on a timely basis. Committee members meet to design, implement and review asset recovery strategies, which serve to maximize the recovery of each troubled asset. As of June 30, 2016, DNB had $24.0 million of substandard loans. Of the $24.0 million, $16.2 million are performing and are believed to require increased supervision and review; and may, depending on the economic environment and other factors, become non-performing assets in future periods. The amount of performing substandard loans at December 31, 2015 was $14.6 million. The majority of the loans are secured by commercial real estate, with lesser amounts being secured by residential real estate, inventory and receivables.

The following table sets forth those assets that are: (i) placed on non-accrual status, (ii) contractually delinquent by 90 days or more and still accruing, and (iii) OREO as a result of foreclosure or voluntary transfer to DNB as well as other repossessed assets. In addition, the table sets forth DNB's asset quality and allowance coverage ratios at the dates indicated:

Non-Performing Assets

(Dollars in thousands)

	June 30, 2016	December 31, 2015	June 30, 2015
Non-accrual loans:			
Residential mortgage	$ 1,772	$ 1,619	$ 1,671
Commercial mortgage	3,140	1,048	1,251
Commercial:			
Commercial term	207	188	193
Commercial construction	1,524	1,028	749
Consumer:			
Home equity	564	563	431
Other	222	189	169
Total non-accrual loans	7,429	4,635	4,464
Loans 90 days past due and still accruing	162	457	168
Total non-performing loans	7,591	5,092	4,632
Other real estate owned & other repossessed property	2,952	2,581	2,002
Total non-performing assets	$ 10,543	$ 7,673	$ 6,634
Asset quality ratios:			
Non-performing loans to total loans	1.54 %	1.06 %	0.98 %
Non-performing assets to total assets	1.38	1.02	0.88
Allowance for credit losses to:			
Total loans	1.06	1.02	1.08
Non-performing loans	69.1	96.9	110.3

As of June 30, 2016, DNB had no commercial mortgages classified as a TDR, compared to no commercial mortgages classified as a TDR at December 31, 2015, and one commercial mortgage classified as a TDR totaling $2,222,000 at June 30, 2015. This loan paid off during the third quarter of 2015. The rate on this loan was modified and the terms of the loans were changed to interest only while the project was being built out. The loan commenced normal principal and interest payments in June 2014. The loan was extended and there was no reduction of principal. The balance of the loan prior to modification was $2,272,000 and the balance after the modification was $2,272,000. During the six months ended June 30, 2015, there were no defaults on any terms of this loan.

As of June 30, 2016, DNB had one consumer home equity loan classified as a TDR totaling $102,000, compared to one consumer home equity loan classified as a TDR totaling $102,000 (the same loan) at December 31, 2015, and one consumer home equity loan classified as a TDR totaling $102,000 (the same loan) at June 30, 2015. The monthly payment on this loan was reduced for 36 months and the borrower will resume making contractual payments at the end of this period. The loan was extended and there was no reduction of principal. This loan was classified a TDR in June of 2014. The balance of the loan prior to modification was $102,000 and the balance after the modification was $102,000. During the three months ended March 31, 2016 and 2015, there were no defaults on any terms of this loan.

As of June 30, 2016, DNB had one consumer installment loan classified as a TDR totaling $40,000 compared to one consumer installment loan classified as a TDR totaling $40,000 (the same loan) at December 31, 2015, and no such loans at June 30, 2015. The interest rate on the loan was reduced. The loan was extended and there was no reduction of principal. This loan was classified as a TDR in December of 2015. The balance of the loan prior to modification was $42,000 and the balance after the modification was $42,000. DNB recognized a partial charge-off on the loan in the amount of $2,000. During the six months ended June 30, 2016 and 2015, there were no defaults on any terms of this loan.

Impaired loans are measured for impairment using the fair value of the collateral for collateral dependent loans. Information regarding impaired loans is presented as follows:

(Dollars in thousands)	At and For the Six Months Ended June 30, 2016	At and For the Year Ended December 31, 2015	At and For the Six Months Ended June 30, 2015
Total recorded investment	$ 7,531	$ 5,021	$ 7,013
Impaired loans with a specific allowance	1,578	307	1,014
Impaired loans without a specific allowance	5,953	4,714	5,999
Average recorded investment	5,895	6,891	8,442
Specific allowance allocation	297	114	317
Total principal and interest collected	101	2,878	473
Interest income recorded	2	96	59

LIQUIDITY AND CAPITAL RESOURCES

Management maintains liquidity to meet depositors' needs for funds, to satisfy or fund loan commitments, and for other operating purposes. DNB's foundation for liquidity is a stable and loyal customer deposit base, cash and cash equivalents, and a marketable investment portfolio that provides periodic cash flow through regular maturities and amortization, or that can be used as collateral to secure funding. As part of its liquidity management, DNB maintains assets that comprise its primary liquidity, which totaled $112.7 million at June 30, 2016 compared to $96.8 million at December 31, 2015. Primary liquidity includes investments and restricted stock, Federal funds sold and cash and due from banks, less pledged securities of $133.9 million. DNB also anticipates scheduled payments and prepayments on its loan and mortgage-backed securities portfolios.

In addition, DNB maintains borrowing arrangements with various correspondent banks, the Federal Home Loan Bank of Pittsburgh and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB had available credit of approximately $311.4 million at June 30, 2016. As a member of the FHLB, we are eligible to borrow up to a specific credit limit which is determined by the amount of our residential mortgages, commercial mortgages and other loans that have been pledged as collateral. As of June 30, 2016, our Maximum Borrowing Capacity with the FHLB was $265.4 million. At June 30, 2016, DNB had borrowed $20.0 million and the FHLB had issued letters of credit, on DNB's behalf, totaling $45.0 million against its available credit lines. At June 30, 2016, we also had available $46.0 million of unsecured federal funds lines of credit with other financial institutions as well as $23.9 million of available short or long term funding through the Certificate of Deposit

Account Registry Service (CDARS) program and $106.3 million of available short or long term funding through Raymond James' brokered CDs agreement. Management believes that DNB has adequate resources to meet its short-term and long-term funding requirements.

On August 5, 2011, Standard & Poor's downgraded the credit rating of the U.S. Government and federal agencies, including the FHLB, from AAA to AA+, with a negative outlook. Any future downgrades in the credit ratings of the U.S. Government and the FHLB could likely increase the borrowing costs of the FHLB and possibly have a negative impact on its operations and long-term performance. It is possible this could have an adverse effect on the value of the Corporation's investment in FHLB stock.

At June 30, 2016, DNB had $117.8 million in un-funded loan commitments. Management anticipates these commitments will be funded by means of normal cash flows. Certificates of deposit greater than or equal to $250,000 scheduled to mature in one year or less from June 30, 2016 totaled $40.6 million. Management believes that the majority of such deposits will be reinvested with DNB and that certificates that are not renewed will be funded by a reduction in cash and cash equivalents or by pay-downs and maturities of loans and investments.

The Corporation and the Bank have each met the definition of "well capitalized" for regulatory purposes on June 30, 2016. The Bank's capital category is determined for the purposes of applying the bank regulators' "prompt corrective action" regulations and for determining levels of deposit insurance assessments and may not constitute an accurate representation of the Corporation's or the Bank's overall financial condition or prospects. The Corporation's capital exceeds the FRB's minimum leverage ratio requirements for bank holding companies (see additional discussion included in Note 16 of DNB's December 31, 2015 Form 10-K).

Under federal banking laws and regulations, DNB and the Bank are required to maintain minimum capital as determined by certain regulatory ratios. Capital adequacy for regulatory purposes, and the capital category assigned to an institution by its regulators, may be determinative of an institution's overall financial condition. Under the final capital rules that became effective on January 1, 2015, there was a requirement for a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement is being phased in over three years beginning in 2016. DNB must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%.

The following table summarizes data and ratios pertaining to the Corporation and the Bank's capital structure.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
DNB Financial Corporation						
June 30, 2016						
Total risk-based capital	$ 84,458	15.2 %	$ 48,050	8.625 %	N/A	N/A
Common Equity Tier 1 capital	60,271	10.8	28,551	5.125	N/A	N/A
Tier 1 risk-based capital	69,271	12.4	36,908	6.625	N/A	N/A
Tier 1 (leverage) capital	69,271	9.1	30,405	4.000	N/A	N/A
December 31, 2015						
Total risk-based capital	$ 81,321	14.8 %	$ 44,003	8.0 %	N/A	N/A
Common equity tier 1 capital	57,448	10.4	24,752	4.5	N/A	N/A
Tier 1 risk-based capital	66,448	12.1	33,002	6.0	N/A	N/A
Tier 1 (leverage) capital	66,448	8.9	29,717	4.0	N/A	N/A
DNB First, N.A.						
June 30, 2016						
Total risk-based capital	$ 83,309	15.0 %	$ 47,923	8.625 %	$ 55,563	10.0 %
Common Equity Tier 1 capital	77,872	14.0	28,476	5.125	36,116	6.5
Tier 1 risk-based capital	77,872	14.0	36,810	6.625	44,450	8.0
Tier 1 (leverage) capital	77,872	10.3	30,355	4.000	37,944	5.0
December 31, 2015						
Total risk-based capital	$ 80,286	14.6 %	$ 43,904	8.0 %	$ 54,880	10.0 %
Common equity tier 1 capital	75,163	13.7	24,696	4.5	35,672	6.5
Tier 1 risk-based capital	75,163	13.7	32,928	6.0	43,904	8.0
Tier 1 (leverage) capital	75,163	10.1	29,670	4.0	37,087	5.0

In addition, the Federal Reserve Bank (the "FRB") leverage ratio rules require bank holding companies to maintain a minimum level of "primary capital" to total assets of 5.5% and a minimum level of "total capital" to total assets of

6%. For this purpose, (i) "primary capital" includes, among other items, common stock, certain perpetual debt instruments such as eligible Trust preferred securities, contingency and other capital reserves, and the allowance for loan losses, (ii) "total capital" includes, among other things, certain subordinated debt, and "total assets" is increased by the allowance for loan losses. DNB's primary capital ratio and its total capital ratio are both well in excess of FRB requirements.

REGULATORY MATTERS

Dividends payable to the Corporation by the Bank are subject to certain regulatory limitations. Under normal circumstances, the payment of dividends in any year without regulatory permission is limited to the net profits (as defined for regulatory purposes) for that year, plus the retained net profits for the preceding two calendar years.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

To measure the impacts of longer-term asset and liability mismatches beyond two years, DNB utilizes an Economic Value of Equity ("EVE") model. The EVE model measures the potential price risk of equity to changes in interest rates and factors in the optionality included on the balance sheet. EVE analysis is used to dynamically model the present value of asset and liability cash flows, with rates ranging up or down 200 basis points. The EVE is likely to be different if rates change. Results falling outside prescribed ranges may require action by management. At June 30, 2016 and December 31, 2015, DNB's variance in the EVE as a percentage of assets with an instantaneous and sustained parallel shift of 200 basis points was within its negative 3% guideline, as shown in the following table. The change as a percentage of the present value of equity with a 200 basis point increase was within DNB's negative 25% guideline at June 30, 2016 and December 31, 2015.

(Dollars in thousands)	June 30, 2016			December 31, 2015		
Change in rates	Flat	-200bp	+200bp	Flat	-200bp	+200bp
EVE	$ 66,975	$ 74,277	$ 66,611	$ 68,118	$ 58,298	$ 58,936
Change		7,302	(364)		(9,820)	(9,182)
Change as % of assets		1.0%	(0.0%)		(1.3%)	(1.2%)
Change as % of PV equity		10.9%	(0.5%)		(14.4%)	(13.5%)

ITEM 4- CONTROLS AND PROCEDURES

DNB’s Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of June 30, 2016, the end of the period covered by this report, in accordance with the requirements of Exchange Act Rule 240.13a-15(b). Based on that evaluation, Management has concluded that DNB’s current disclosure controls and procedures are effective.

Management of DNB is responsible for establishing and maintaining adequate internal control over financial reporting for DNB, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. There was no change in DNB’s “internal control over financial reporting” (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2016, that has materially affected, or is reasonably likely to materially affect, DNB’s internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Neither DNB nor any of its subsidiaries is a party to, nor is any of their property the subject of, any material legal proceedings other than ordinary routine litigation incident to their businesses.

ITEM 1A. RISK FACTORS

Not applicable

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered sales of equity securities during the quarter ended June 30, 2016. The following table provides information on repurchases by DNB of its common stock in each month of the quarter ended June 30, 2016:

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (a)
April 1, 2016 – April 30, 2016	-	$ -	-	$ 63,016
May 1, 2016 – May 31, 2016	-	-	-	$ 63,016
June 1, 2016 – June 30, 2016	-	-	-	$ 63,016
Total	-	$ -	-	$ 63,016

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On July 25, 2001, DNB authorized the buyback of up to 175,000 shares of its common stock over an indefinite period. On August 27, 2004, DNB increased the buyback from 175,000 to 325,000 shares of its common stock over an indefinite period.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

a) The following exhibits are filed or furnished herewith:

Exhibit Number	Description
2.1	Agreement and Plan of Merger by and between DNB Financial Corporation and East River Bank, dated as of April 4, 2016, filed as Exhibit 2.1 to Form 8-K (No. 1-34242) on April 5, 2016 and incorporated herein by reference.
3.1	Amended and Restated Articles of Incorporation, as amended effective December 8, 2008, filed March 31, 2009 as item 3(i) to Form 10-K for the fiscal year-ended December 31, 2008 (No. 1-34242) and incorporated herein by reference.
3.2	Bylaws of the Registrant as amended December 8, 2008, filed March 31, 2009 as item 3(ii) to Form 10-K for the fiscal year-ended December 31, 2008 (No. 1-34242) and incorporated herein by reference.
3.3	

	Certificate of Designations of Fixed Rate Cumulative Preferred Stock, Series 2008A of DNB Financial Corporation, filed as Exhibit 4.3 to Form 8-K (No. 1-34242) on January 26, 2009 and incorporated herein by reference.
31.1	Rule 13a-14(a)/15d-14 (a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14 (a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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

overmber

		DNB FINANCIAL CORPORATION
August 12, 2016	BY:	/s/ William J. Hieb
		William J. Hieb, Chief Executive Officer, President and Director
August 12, 2016	BY:	/s/ Gerald F. Sopp
		Gerald F. Sopp, Chief Financial Officer and Executive Vice President

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Exhibit Index

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