DNB FINANCIAL CORP /PA/
Form 10-Q
November 13, 2017
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: September 30, 2017

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, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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) 4,268,833 (Shares Outstanding as of November 13, 2017)

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)	September 30, 2017	December 31, 2016
Assets		
Cash and due from banks	$ 19,490	$ 22,103
Cash and cash equivalents	19,490	22,103
Available-for-sale investment securities at fair value (amortized cost of $109,262 and $116,830)	108,008	115,184
Held-to-maturity investment securities (fair value of $67,229 and $66,124)	67,140	67,022
Total investment securities	175,148	182,206
Loans held for sale	350	-
Loans	819,753	817,529
Allowance for credit losses	(5,594)	(5,373)
Net loans	814,159	812,156
Restricted stock	6,371	5,381
Office property and equipment, net	8,898	9,243
Accrued interest receivable	3,791	3,567
Other real estate owned & other repossessed property	4,916	2,767
Bank owned life insurance (BOLI)	9,487	9,552
Core deposit intangible	459	537
Goodwill	15,525	15,590
Net deferred taxes	4,855	5,250
Other assets	2,234	2,333
Total assets	$ 1,065,683	$ 1,070,685
Liabilities and Stockholders’ Equity		
Liabilities		
Non-interest-bearing deposits	$ 198,399	$ 173,467
Interest-bearing deposits:		
NOW	195,455	224,219
Money market	217,870	184,783
Savings	81,030	86,176

Time	136,759	187,256
Brokered deposits	41,815	29,286
Total deposits	871,328	885,187
Federal Home Loan Bank of Pittsburgh (FHLBP) advances	51,047	55,332
Repurchase agreements	15,383	11,889
Junior subordinated debentures	9,279	9,279
Subordinated debt	9,750	9,750
Other borrowings	379	418
Total borrowings	85,838	86,668
Accrued interest payable	461	534
Other liabilities	6,172	3,456
Total liabilities	963,799	975,845
Stockholders' Equity		
Common stock, $1.00 par value;		
20,000,000 shares authorized; 4,343,616 and 4,334,352 issued, respectively; 4,262,721 and 4,240,778 outstanding, respectively	4,373	4,351
Treasury stock, at cost; 80,895 and 93,574 shares, respectively	(1,502)	(1,730)
Surplus	69,260	68,973
Retained earnings	31,763	25,520
Accumulated other comprehensive loss	(2,010)	(2,274)
Total stockholders' equity	101,884	94,840
Total liabilities and stockholders' equity	$ 1,065,683	$ 1,070,685

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Income (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except share and per share data)	2017	2016	2017	2016
Interest Income:				
Interest and fees on loans	$ 9,994	$ 5,218	$ 29,089	$ 15,377
Interest and dividends on investment securities:				
Taxable	721	716	2,175	2,150
Exempt from federal taxes	236	316	714	944
Interest on cash and cash equivalents	38	27	166	91
Total interest and dividend income	10,989	6,277	32,144	18,562
Interest Expense:				
Interest on NOW, money market and savings	606	230	1,678	588
Interest on time deposits	307	139	921	396
Interest on brokered deposits	160	81	346	214
Interest on FHLB advances	185	92	522	276
Interest on repurchase agreements	8	9	21	30
Interest on junior subordinated debentures	99	89	286	254
Interest on subordinated debt	104	104	311	311
Interest on other borrowings	14	16	42	49
Total interest expense	1,483	760	4,127	2,118
Net interest income	9,506	5,517	28,017	16,444
Provision for credit losses	375	100	1,285	630
Net interest income after provision for credit losses	9,131	5,417	26,732	15,814
Non-interest Income:				
Service charges	282	280	936	827
Wealth management	411	393	1,256	1,231
Mortgage banking	62	76	112	189
Increase in cash surrender value of BOLI	55	56	165	166
Gain on sale of investment securities, net	-	197	25	431
Gain on sale of loans	35	-	132	39
Gains from insurance proceeds	-	30	80	1,180
Other fees	426	337	1,293	1,022
Total non-interest income	1,271	1,369	3,999	5,085
Non-interest Expense:				
Salaries and employee benefits	3,926	2,817	11,291	8,636
Furniture and equipment	525	422	1,526	1,093
Occupancy	631	524	2,006	1,459
Professional and consulting	485	306	1,334	948
Advertising and marketing	135	111	575	460
Printing and supplies	47	36	183	129

FDIC insurance	161	73	506	323
PA shares tax	219	157	677	476
Telecommunications	87	63	265	185
Postage	21	28	83	70
Loss on sale or write down of OREO, net	7	160	121	164
Due diligence and merger expense	-	1,498	77	1,961
Other expenses	746	509	2,175	1,390
Total non-interest expense	6,990	6,704	20,819	17,294
Income before income tax expense	3,412	82	9,912	3,605
Income tax expense	1,001	81	2,774	939
Net income	$ 2,411	$ 1	$ 7,138	$ 2,666
Earnings per common share:				
Basic	$ 0.57	$ 0.00	$ 1.68	$ 0.94
Diluted	$ 0.56	$ 0.00	$ 1.66	$ 0.93
Cash dividends per common share	$ 0.07	$ 0.07	$ 0.21	$ 0.21
Weighted average common shares outstanding:				
Basic	4,262,165	2,853,080	4,255,520	2,844,780
Diluted	4,296,371	2,885,799	4,287,745	2,879,240

See accompanying notes to unaudited consolidated financial statements.

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DNB Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(Dollars in thousands)	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Net income	$ 2,411	$ 1	$ 7,138	$ 2,666
Other Comprehensive Income (Loss):				
Unrealized holding gains (losses) arising during the period				
Before tax amount	165	(288)	401	1,786
Tax effect	(56)	99	(136)	(607)
	109	(189)	265	1,179
Accretion of discount on AFS to HTM reclassification(1)				
Before tax amount	1	6	8	9
Tax effect(2)	-	(2)	(3)	(3)
	1	4	5	6
Less reclassification for gains on sales of AFS investment securities included in net income(3)				
Before tax amount	-	(176)	(9)	(410)
Tax effect(2)	-	59	3	139
	-	(117)	(6)	(271)
Total other comprehensive income (loss)	110	(302)	264	914
Total comprehensive income (loss)	$ 2,521	$ (301)	$ 7,402	$ 3,580

(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.
(3) Amounts are included in "Gain on sale of investment securities, net" in the consolidated statements of income.
See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Stockholders' Equity (Unaudited)

(Dollars in thousands)	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2017	$ 4,351	$ (1,730)	$ 68,973	$ 25,520	$ (2,274)	$ 94,840
Net income for nine months ended September 30, 2017	-	-	-	7,138	-	7,138
Other comprehensive income	-	-	-	-	264	264
Restricted stock compensation expense	13	-	308	-	-	321
Exercise of stock options (9,264 shares)	9	-	(9)	-	-	-
Taxes on exercise of stock options	-	-	(189)	-	-	(189)
Cash dividends - common ($0.21 per share)	-	-	-	(895)	-	(895)
Sale of treasury shares to 401(k) (8,366 shares)	-	151	62	-	-	213
Sale of treasury shares to deferred comp. plan (4,313 shares)	-	77	115	-	-	192
Balance at September 30, 2017	$ 4,373	$ (1,502)	$ 69,260	$ 31,763	$ (2,010)	$ 101,884

(Dollars in thousands)	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 nine months ended September 30, 2016	-	-	-	2,666	-	2,666
Other comprehensive income	-	-	-	-	914	914
Restricted stock compensation expense (18,079 shares vested)	36	-	765	-	-	801
Taxes on share award vest	(16)	-	(421)	-	-	(437)
Tax benefit for restricted stock vest	-	-	64	-	-	64
Cash dividends - common ($0.21 per share)	-	-	-	(598)	-	(598)
Sale of treasury shares to 401(k) (7,111 shares)	-	130	68	-	-	198
Sale of treasury shares to deferred comp. plan (4,404 shares)	-	80	41	-	-	121
Balance at September 30, 2016	$ 2,975	$ (1,805)	$ 35,614	$ 23,504	$ (1,071)	$ 59,217

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)	Nine Months Ended September 30, 2017	2016
Cash Flows From Operating Activities:		
Net income	$ 7,138	$ 2,666
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion	1,253	1,178
Provision for credit losses	1,285	630
Stock based compensation	321	801
Net gain on sale of securities	(25)	(431)
Net loss on sale or write down of OREO and other repossessed property	121	164
Gain on insurance proceeds	(80)	(1,180)
Earnings from investment in BOLI	(165)	(166)
Deferred tax expense (benefit)	260	(330)
Proceeds from sales of mortgage loans	3,698	8,200
Mortgage loans originated for sale	(3,936)	(8,011)
Mortgage banking income	(112)	(189)
Proceeds from sales of loans	2,142	525
Loans originated for sale	(2,010)	(486)
Gain on sale of loans	(132)	(39)
Increase in accrued interest receivable	(224)	(229)
Decrease (increase) in other assets	101	(6,505)
Decrease in accrued interest payable	(73)	(16)
Increase in other liabilities	2,716	1,439
Net Cash Provided By (Used In) Operating Activities	12,278	(1,979)
Cash Flows From Investing Activities:		
Activity in available-for-sale securities:		
Sales	3,030	43,913
Maturities, repayments and calls	19,318	50,660
Purchases	(15,093)	(62,646)
Activity in held-to-maturity securities:		
Sales	737	757
Maturities, repayments and calls	641	6,864
Purchases	(1,407)	(13,507)
Net increase in restricted stock	(990)	(176)
Net increase in loans	(6,074)	(27,979)
Proceeds from insurance	-	1,180
Death benefit proceeds	310	-
Purchases of property and equipment	(576)	(2,892)
Costs capitalized in OREO and other repossessed property	(15)	(954)

Proceeds from sale of OREO and other repossessed property	596	432
Net Cash Provided By (Used In) Investing Activities	477	(4,348)
Cash Flows From Financing Activities:		
Net (decrease) increase in deposits	(13,859)	39,268
Repayment of FHLBP advances	(24,133)	(10,000)
Funding of FHLBP advances	19,848	-
Net increase (decrease) in repurchase agreements	3,494	(12,933)
Repayment of other borrowings	(39)	(33)
Dividends paid	(895)	(598)
Taxes on exercise of stock options	(189)	(437)
Tax benefit for stock option exercises	-	64
Sale of treasury stock	405	319
Net Cash (Used in) Provided by Financing Activities	(15,368)	15,650
Net Change in Cash and Cash Equivalents	(2,613)	9,323
Cash and Cash Equivalents at Beginning of Period	22,103	21,119
Cash and Cash Equivalents at End of Period	$ 19,490	$ 30,442
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 4,200	$ 2,134
Income taxes	2,536	875
Supplemental Disclosure of Non-cash Flow Information:		
Net decrease in goodwill	65	-
Transfers from loans to real estate owned and other repossessed property	2,851	-

See accompanying notes to unaudited consolidated financial statements.

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 three and nine months ended September 30, 2017 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, 2016.

Subsequent Events-- Management has evaluated events and transactions occurring subsequent to September 30, 2017 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-

Accounting Developments Affecting DNB

In May 2014, the FASB issued ASU No. 2014-09, ‘‘Revenue from Contracts with Customers (Topic 606).’’ The updated standard is a new comprehensive revenue recognition model that requires revenue to be recognized in a manner that depicts the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year. During 2016 and 2017, the FASB issued ASU Nos. 2016-10, 2016-12, 2016-20, and 2017-13 that provides additional guidance related to the identification of performance obligations within a contract, assessing collectability, contract costs, and other technical corrections and improvements. ASU 2014-09 will become effective for the Company for the annual period beginning after December 15, 2017, and for interim periods within the annual period. ASU 2014-09 allows for either full retrospective or modified retrospective adoption.

DNB is determining the anticipated effects of these ASUs on the Consolidated Financial Statements and related disclosures. Interest income on the Consolidated Statement of Operations is excluded from the scope of ASU 2014-09. DNB is in the process of evaluating non-interest income on the Consolidated Statement of Operations to determine if the revenue streams are in the scope of the new standards, and to analyze the effect of any differences expected with implementation. DNB’s process of analyzing non-interest income revenue streams will include the following five steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The evaluation of non-interest income revenue streams includes service charges on deposit accounts, card fees, other charges and fees, investment banking income, trust and investment, retail investment services, and other income. The Company also continues to evaluate the related changes to disclosures that may be required, which are expected to be significant. Based on the principal versus agent guidance included within the new standards, reclassifications will be made to net certain expenses and revenue for DNB Investment Management and Trust services. These reclassifications are not expected to affect net income. Otherwise, DNB's continuing evaluation has not identified significant expected changes to the recognition of revenue at this time.

DNB plans to adopt the standards beginning January 1, 2018 and expects to use the modified retrospective method of adoption. Although the new revenue standards are not expected to have a significant impact on our prior year or ongoing net income, changes to our processes related to revenue recognition and the control activities within them will be implemented effective January 1, 2018. This includes the development of new controls based on the five-step model in the standards and gathering of information required for disclosures. DNB's revenue has been more significantly weighted towards net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new standard. DNB is continuing to assess its revenue streams and reviewing its contracts with customers that are potentially affected by the new guidance including wealth and asset management revenue, fees on deposits, gains and losses on the sale of other real estate owned, credit and debit card interchange fees.

DNB adopted ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments on a prospective basis. This amendment eliminates the requirement to account for adjustments to provisional amounts recognized in a business combination retrospectively. Instead, the acquirer will recognize the adjustments to provisional amounts during the period in which the adjustments are determined, including the effect on earnings of any amounts the acquirer would have recorded in previous periods if the accounting had been completed at the acquisition date. DNB evaluated the impact of this guidance and does not anticipate a material impact to the consolidated financial statements at this time.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities. The guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. In particular, the guidance revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. The guidance also amends certain disclosure requirements associated with fair value of financial instruments. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Entities should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. As of September 30, 2017, DNB did not hold any equity investments (excluding restricted investments in bank stocks). DNB does not expect to make significant purchases of equity investments; therefore, the adoption of this ASU is not expected to be material to DNB's consolidated financial statements.

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 has determined that upon the adoption of ASU 2016-02 we will be required to recognize a right-of-use asset and a corresponding liability based on the then present value of such obligation. DNB has not yet determined the impact ASU 2016-02 will have 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. Accordingly, effective January of 2017, DNB adopted the pronouncement. The adoption of this pronouncement was immaterial to DNB’s consolidated financial statements. During the three and nine month periods ended September 30, 2017, DNB had a $2,000 and $155,000 tax benefit for stock option exercises, respectively.

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. While DNB is currently in the process of evaluating the impact of the amended guidance on its consolidated financial statements, it currently expects the ALLL to increase upon adoption given that the allowance will be required to cover the full remaining expected life of the portfolio upon adoption, rather than the incurred loss model under current U.S. GAAP. The extent of this increase is still being evaluated and will depend on economic conditions and the composition of DNB’s loan portfolio at the time of adoption.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The amendments in this update provide guidance for eight specific cash flow classification issues for which current guidance is unclear or does not exist, thereby reducing diversity in practice. For public companies, the update is effective for annual periods beginning after December 15, 2017. DNB is currently evaluating this ASU, particularly related to cash payments for debt prepayment costs and cash proceeds received from the settlement of BOLI policies as these areas might affect DNB in the future. This ASU, however, is not expected to have a material impact on DNB's consolidated financial statements because the guidance only affects the classification within the statement of cash flows.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business. The new guidance narrows the existing definition of a business and provides a framework for evaluating whether a transaction should be accounted for as an acquisition (or disposal) of assets or a business. The guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities (collectively, the set) is not a business. To be considered a business, the set would need to include an input and a substantive process that together significantly contribute to the ability to create outputs, as defined by the ASU. The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods, and should be applied prospectively. Early adoption is permitted. DNB will apply this guidance to applicable transactions after the adoption date.

In January 2017, the Financial Accounting Standards Board (“FASB”) issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Instead, under the amendments, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value with its carrying amount. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount when measuring the goodwill impairment loss, if applicable. The update also eliminated the requirements for zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. The amendments are effective for public business entities for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. DNB will not early adopt this ASU for its annual goodwill impairment test, and will conduct a qualitative test (step zero) as of October 1, 2017. The adoption of this ASU is not expected to have a material impact on DNB's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, however, DNB has decided not to early adopt. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. ASU No. 2017-07 is not expected to have a material impact on DNB Consolidated Financial Statements because the Pension plan has been frozen to new accruals since December 31, 2003, and thus, generated no service cost in any subsequent year).

In March of 2017, the FASB issued ASU No. 2017-08, "Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities" ("ASU 2017-08"). This guidance shortens the amortization period for premiums on certain callable debt securities to the earliest call date (with an explicit, non-contingent call feature that is callable at a fixed price and on a preset dates), rather than contractual maturity date as currently required under GAAP. The ASU does not impact instruments without preset call dates such as mortgage-backed securities. For instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the ASU. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. Accordingly, effective January of 2017, DNB early adopted the pronouncement. DNB's current accounting treatment is consistent with the provisions in ASU-2017-08. As a result, there was no impact to the consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting; ("ASU 2017-09"). ASU 2017-09 provides clarity by offering guidance on the scope of modification accounting for share-based payment awards and gives direction on which changes to the terms or conditions of these awards require an entity to apply modification accounting. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The guidance is effective prospectively for all companies for annual periods beginning on or after December 15, 2017. Early adoption is permitted. DNB evaluated the impact of this guidance and does not anticipate a material impact to the consolidated financial statements at this time.

NOTE 2: INVESTMENT SECURITIES

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

	September 30, 2017			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 8,418	$ 242	$ -	$ 8,660
Government Sponsored Entities (GSE) mortgage-backed securities	525	14	-	539
Corporate bonds	14,077	286	(4)	14,359
Collateralized mortgage obligations GSE	1,580	2	(15)	1,567
State and municipal taxable	1,007	-	(18)	989
State and municipal tax-exempt	41,533	65	(483)	41,115
Total	$ 67,140	$ 609	$ (520)	$ 67,229
Available For Sale				
US Government agency obligations	$ 53,311	$ -	$ (209)	$ 53,102
GSE mortgage-backed securities	30,270	-	(498)	29,772
Collateralized mortgage obligations GSE	12,678	-	(370)	12,308
Corporate bonds	11,009	9	(114)	10,904
State and municipal tax-exempt	1,994	-	(72)	1,922
Total	$ 109,262	$ 9	$ (1,263)	$ 108,008

	December 31, 2016			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 8,224	$ 309	$ -	$ 8,533
Government Sponsored Entities (GSE) mortgage-backed securities	1,440	38	-	1,478
Corporate bonds	12,825	230	(63)	12,992
Collateralized mortgage obligations GSE	1,966	2	(22)	1,946
State and municipal taxable	1,008	6	-	1,014
State and municipal tax-exempt	41,559	8	(1,406)	40,161

Total	$ 67,022	$ 593	$ (1,491)	$ 66,124
Available For Sale				
US Government agency obligations	$ 52,428	$ 31	$ (150)	$ 52,309
GSE mortgage-backed securities	30,861	2	(723)	30,140
Collateralized mortgage obligations GSE	12,957	3	(387)	12,573
Corporate bonds	15,474	5	(299)	15,180
State and municipal tax-exempt	5,084	-	(128)	4,956
Asset-backed security	26	-	-	26
Total	$ 116,830	$ 41	$ (1,687)	$ 115,184

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 September 30, 2017 and December 31, 2016.

	September 30, 2017					
(Dollars in thousands)	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	$ 2,492	$ (4)	$ 2,492	$ (4)	$ -	$ -
Collateralized mortgage obligations GSE	895	(15)	-	-	895	(15)
State and municipal taxable	989	(18)	989	(18)	-	-
State and municipal tax-exempt	20,309	(483)	6,131	(54)	14,178	(429)
Total	$ 24,685	$ (520)	$ 9,612	$ (76)	$ 15,073	$ (444)
Available For Sale						
US Government agency obligations	$ 53,102	$ (209)	$ 33,017	$ (94)	$ 20,085	$ (115)
GSE mortgage-backed securities	29,772	(498)	12,055	(166)	17,717	(332)
Collateralized mortgage obligations GSE	12,308	(370)	3,730	(58)	8,578	(312)
Corporate bonds	9,895	(114)	3,660	(17)	6,235	(97)
State and municipal tax-exempt	1,922	(72)	293	(1)	1,629	(71)
Total	$ 106,999	$ (1,263)	$ 52,755	$ (336)	$ 54,244	$ (927)

	December 31, 2016					
(Dollars in thousands)	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	$ 5,962	$ (63)	$ 3,992	$ (39)	$ 1,970	$ (24)
Collateralized mortgage obligations GSE	1,104	(22)	1,104	(22)	-	-
State and municipal tax-exempt	32,690	(1,406)	32,690	(1,406)	-	-
Total	$ 39,756	$ (1,491)	$ 37,786	$ (1,467)	$ 1,970	$ (24)
Available For Sale						
US Government agency obligations	$ 27,270	$ (150)	$ 27,270	$ (150)	$ -	$ -
GSE mortgage-backed securities	29,145	(723)	29,145	(723)	-	-
Collateralized mortgage obligations GSE	12,116	(387)	4,868	(94)	7,248	(293)
Corporate bonds	13,031	(299)	7,593	(218)	5,438	(81)
State and municipal tax-exempt	4,956	(128)	4,956	(128)	-	-
Asset-backed security	26	-	26	-	-	-

Total	$ 86,544	$ (1,687)	$ 73,858	$ (1,313)	$ 12,686	$ (374)

As of September 30, 2017, there were eighteen collateralized mortgage obligations GSE, seventeen GSE mortgage-backed securities, eleven U.S. agency obligations, thirty-two tax-exempt municipalities, one taxable municipality, and nine 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 September 30, 2017 represents an other-than-temporary impairment (OTTI). DNB reviews its investment portfolio on a quarterly basis, reviewing 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 September 30, 2017, the following securities were reviewed:

Collateralized mortgage obligations GSE There are eighteen impaired securities classified as collateralized mortgage obligations, fifteen of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 4.84% 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 have 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 September 30, 2017 levels. Management concluded that these securities were not other-than-temporarily impaired at September 30, 2017.

GSE mortgage-backed securities There are seventeen impaired securities classified as GSE mortgage-backed securities, ten of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 2.29% of its book value. These securities were issued and insured by FNMA, FHLMC or GNMA. DNB receives monthly principal and interest payments on these securities on a timely basis and none of these have 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 September 30, 2017 levels. Management concluded that these securities were not other-than-temporarily impaired at September 30, 2017.

US Government agency obligations There are eleven impaired securities classified as agencies, two of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 1.30% of its book value. All of these securities were issued and insured by FHLB, FNMA, or FHLMC. DNB has received timely interest payments on all of these securities and none of these agencies have ever defaulted on their bonds. DNB anticipates a recovery in the market value as the securities approach their maturity dates. Management concluded that these securities were not other-than-temporarily impaired at September 30, 2017.

State and municipal tax-exempt There are thirty-two impaired securities in this category, which are comprised of intermediate to long-term municipal bonds, twenty-one of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 4.29% of its book value. All of the issues carry a “BBB-” 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 thirty-two municipal securities, there are eleven insured school districts, ten uninsured school districts, four insured townships, and seven uninsured townships, all of which have strong underlying ratings. Management concluded that these securities were not other-than-temporarily impaired at September 30, 2017.

State and municipal taxable There is one impaired security in this category, which has been impaired for less than 12 months. The unrealized loss of this security is 1.81% of its book value. This security is an insured township and carries a “BBB+” underlying credit. It is performing and is expected to continue to perform in accordance with its contractual terms and conditions. There have not been disruptions of any payments associated with this municipal security. Management concluded that this security was not other-than-temporarily impaired at September 30, 2017.

Corporate bonds There are nine impaired bonds classified as corporate bonds, four of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 2.45% 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 September 30, 2017 levels. Management concluded that these securities were not other-than-temporarily impaired at September 30, 2017.

The amortized cost and fair value of investment securities as of September 30, 2017, 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	$ -	$ -	$ 14,220	$ 14,200
Due after one year through five years	26,118	26,573	43,350	43,153
Due after five years through ten years	28,381	28,346	11,564	11,408
Due after ten years	12,641	12,310	40,128	39,247
Total investment securities	$ 67,140	$ 67,229	$ 109,262	$ 108,008

The HTM securities sold during the nine months ended September 30, 2017 and September 30, 2016 were sold in accordance with GAAP, as DNB collected greater than 85% of the original recorded investment on the HTM security prior to the sale. As a result, it is appropriate to continue to carry the remaining HTM portfolio as currently classified. Gains and losses resulting from investment sales, redemptions or calls were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2017	2016	2017	2016
Gross realized gains-AFS	$ -	$ 176	$ 10	$ 440
Gross realized gains-HTM	-	21	16	21
Gross realized losses-AFS	-	-	(1)	(30)
Net realized gain	$ -	$ 197	$ 25	$ 431

At September 30, 2017 and December 31, 2016, investment securities with a carrying value of approximately $113.1 million and $116.7 million, respectively, were pledged to secure public funds, repurchase agreements and for other purposes as required by law.

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NOTE 3: LOANS

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

(Dollars in thousands)	September 30, 2017	December 31, 2016
Residential mortgage	$ 88,249	$ 87,581
Commercial mortgage	461,012	465,486
Commercial:		
Commercial term	120,786	123,175
Commercial construction	84,428	72,755
Consumer:		
Home equity	59,433	62,560
Other	5,845	5,972
Total loans	$ 819,753	$ 817,529
Less allowance for credit losses	(5,594)	(5,373)
Net loans	$ 814,159	$ 812,156

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

			Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
(Dollars in thousands)	September 30, 2017	December 31, 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	$ 2,070	$ 1,770	$ 23	$ -	$ 23	$ 65	$ -	$ 65
Commercial mortgage	2,311	4,593	33	-	33	110	-	110
Commercial:								
Commercial term	1,506	198	27	-	27	93	-	93

Commercial construction	447	1,242	46	-	46	137	-	137
Consumer:								
Home equity	468	442	5	-	5	17	-	17
Other	308	256	9	-	9	21	-	21
Total non-accrual loans	$ 7,110	$ 8,501	$ 143	$ -	$ 143	$ 443	$ -	$ 443
Loans 90 days past due and accruing	-	-	-	-	-	-	-	-
Total non-performing loans	$ 7,110	$ 8,501	$ 143	$ -	$ 143	$ 443	$ -	$ 443

		Three Months Ended September 30, 2016			Nine Months Ended September 30, 2016		
(Dollars in thousands)	September 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	$ 1,759	$ 15	$ -	$ 15	$ 51	$ -	$ 51
Commercial mortgage	3,061	74	-	74	139	-	139
Commercial:							
Commercial term	202	3	-	3	9	-	9
Commercial construction	1,217	46	-	46	134	-	134
Consumer:							
Home equity	492	7	-	7	23	-	23
Other	221	5	-	5	14	-	14
Total non-accrual loans	$ 6,952	$ 150	$ -	$ 150	$ 370	$ -	$ 370
Loans 90 days past due and accruing	-	-	-	-	2	2	-
Total non-performing loans	$ 6,952	$ 150	$ -	$ 150	$ 372	$ 2	$ 370

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 September 30, 2017 and December 31, 2016.

Age Analysis of Past Due Loans Receivable

September 30, 2017

(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 (less acquired with credit deterioration)	$ 428	$ -	$ 1,289	$ 1,717	$ 86,521	$ 88,238	$ -
Acquired residential mortgage with credit deterioration	-	-	11	11	-	11	-
Commercial mortgage (less acquired with credit deterioration)	107	178	949	1,234	459,159	460,393	-
Acquired commercial mortgage with credit deterioration	-	58	561	619	-	619	-
Commercial:							
Commercial term	465	-	1,378	1,843	118,943	120,786	-
Commercial construction	-	-	447	447	83,981	84,428	-
Consumer:							
Home equity	257	-	386	643	58,790	59,433	-
Other	165	35	171	371	5,474	5,845	-
Total	$ 1,422	$ 271	$ 5,192	$ 6,885	$ 812,868	$ 819,753	$ -

December 31, 2016

30-59	60-89	Loans Receivable

(Dollars in thousands)	Days Past Due	Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	> 90 Days and Accruing
Residential mortgage (less acquired with credit deterioration)	$ 728	$ 374	$ 491	$ 1,593	$ 85,977	$ 87,570	$ -
Acquired residential mortgage with credit deterioration	-	-	11	11	-	11	-
Commercial mortgage (less acquired with credit deterioration)	1,202	762	2,169	4,133	459,679	463,812	-
Acquired commercial mortgage with credit deterioration	389	83	673	1,145	529	1,674	-
Commercial:							
Commercial term	747	377	23	1,147	122,028	123,175	-
Commercial construction	112	-	1,242	1,354	71,401	72,755	-
Consumer:							
Home equity	263	-	300	563	61,997	62,560	-
Other	27	65	151	243	5,729	5,972	-
Total	$ 3,468	$ 1,661	$ 5,060	$ 10,189	$ 807,340	$ 817,529	$ -

DNB had $642,000 of residential mortgage loans in the process of foreclosure and $74,000 of residential mortgage loans in other real estate owned as of September 30, 2017. DNB had no residential mortgage loans in the process of foreclosure and $170,000 of residential mortgage loans in other real estate owned as of December 31, 2016.

The following tables summarize information in regards to impaired loans by loan portfolio class as of and for the three and nine months ended September 30, 2017 and 2016 and as of December 31, 2016.

Impaired Loans

	September 30, 2017			December 31, 2016		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential mortgage	$ 1,921	$ 2,220	$ -	$ 653	$ 680	$ -
Acquired residential mortgage with credit deterioration	-	-	-	11	11	
Commercial mortgage	2,666	2,894	-	2,919	3,330	-
Acquired commercial mortgage with credit deterioration	1,141	1,141	-	1,674	1,680	
Commercial:						
Commercial term	1,506	1,943	-	22	24	-
Commercial construction	447	2,833	-	795	795	-
Consumer:						
Home equity	616	635	-	544	595	-
Other	112	112	-	114	122	-
Total	$ 8,409	$ 11,778	$ -	$ 6,732	$ 7,237	$ -
With allowance recorded:						
Residential mortgage	138	138	38	1,107	1,368	143
Acquired residential mortgage with credit deterioration	11	11	7	-	-	-
Commercial mortgage	22	96	22	-	-	-
Commercial:						
Commercial term	-	-	-	176	196	97
Commercial construction	-	-	-	447	2,833	89
Consumer:						
Other	196	196	28	142	142	5
Total	$ 367	$ 441	$ 95	$ 1,872	$ 4,539	$ 334
Total:						
Residential mortgage	2,059	2,358	38	1,760	2,048	143
Acquired residential mortgage with credit deterioration	11	11	7	11	11	-
Commercial mortgage	2,688	2,990	22	2,919	3,330	-
Acquired commercial mortgage with credit deterioration	1,141	1,141	-	1,674	1,680	-
Commercial:						
Commercial term	1,506	1,943	-	198	220	97

Commercial construction	447	2,833	-	1,242	3,628	89
Consumer:						
Home equity	616	635	-	544	595	-
Other	308	308	28	256	264	5
Total	$ 8,776	$ 12,219	$ 95	$ 8,604	$ 11,776	$ 334

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	Three Months Ended September 30, 2017		Three Months Ended September 30, 2016		Nine Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
(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	$ 1,758	$ -	$ 880	$ -	$ 1,448	$ -	$ 1,254	$ -
Acquired residential mortgage with credit deterioration	6	-	-	-	8		-	-
Commercial mortgage	2,210	3	3,101	-	2,023	3	2,102	-
Acquired commercial mortgage with credit deterioration	1,141	-	-	-	1,272		-	-
Commercial:								
Commercial term	1,508	-	24	-	978	-	18	-
Commercial construction	447	-	924	-	734	-	944	-
Consumer:								
Home equity	584	3	631	1	580	7	657	3
Other	94	-	116	-	103	-	101	-
Total	$ 7,748	$ 6	$ 5,676	$ 1	$ 7,146	$ 10	$ 5,076	$ 3
With allowance recorded:								
Residential mortgage	174	-	886	-	416	-	479	-
Acquired residential mortgage with credit deterioration	6		-	-	3		-	-
Commercial mortgage	11	-	-	-	6	-	-	-
Acquired commercial mortgage with credit deterioration	-		-	-	-		-	-
Commercial:								
Commercial term	-	-	181	-	322	-	187	-
Commercial construction	-	-	447	-	112	-	335	-
Consumer:								
Other	216	-	106	-	179	-	107	-
Total	$ 407	$ -	$ 1,620	$ -	$ 1,038	$ -	$ 1,108	$ -
Total:								
Residential mortgage	1,932	-	1,766	-	1,864	-	1,733	-
Acquired residential mortgage with credit deterioration	12	-	-	-	11	-	-	-
Commercial mortgage	2,221	3	3,101	-	2,029	3	2,102	-
Acquired commercial mortgage with credit deterioration	1,141	-	-	-	1,272	-	-	-
Commercial:								
Commercial term	1,508	-	205	-	1,300	-	205	-
Commercial construction	447	-	1,371	-	846	-	1,279	-

Consumer:								
Home equity	584	3	631	1	580	7	657	3
Other	310	-	222	-	282	-	208	-
Total	$ 8,155	$ 6	$ 7,296	$ 1	$ 8,184	$ 10	$ 6,184	$ 3

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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 September 30, 2017 and December 31, 2016.

Credit Quality Indicators

	September 30, 2017				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 86,114	$ -	$ 2,135	$ -	$ 88,249
Commercial mortgage	447,639	7,821	5,552	-	461,012
Commercial:					
Commercial term	116,490	1,399	2,897	-	120,786
Commercial construction	76,759	6,601	1,068	-	84,428
Consumer:					
Home equity	58,668	-	765	-	59,433
Other	5,537	-	308	-	5,845
Total	$ 791,207	$ 15,821	$ 12,725	$ -	$ 819,753

	December 31, 2016				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 85,259	$ -	$ 2,322	$ -	$ 87,581
Commercial mortgage	450,124	3,763	11,599	-	465,486
Commercial:					
Commercial term	116,522	591	6,062	-	123,175
Commercial construction	71,400	-	1,355	-	72,755
Consumer:					
Home equity	61,782	-	778	-	62,560
Other	5,716	-	256	-	5,972
Total	$ 790,803	$ 4,354	$ 22,372	$ -	$ 817,529

Troubled Debt Restructurings Loans whose terms are modified are classified as troubled debt restructurings ("TDR") if DNB grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. During the three and nine month periods ended September 30, 2017, DNB classified three commercial mortgage loans totaling $987,000 as TDRs, all of which had rate changes and extensions to their maturity dates, but their balances were unmodified. Loans classified as troubled debt restructurings are designated as impaired. The recorded investments in troubled debt restructured loans at September 30, 2017 and December 31, 2016 are as follows:

	September 30, 2017		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 754	$ 883	$ 699
Commercial mortgage	992	992	987
Consumer:			
Home equity	148	148	147
Other	40	42	39
Total	$ 1,934	$ 2,065	$ 1,872

	December 31, 2016		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 754	$ 883	$ 726
Consumer:			
Home equity	148	148	148
Other	40	42	40
Total	$ 942	$ 1,073	$ 914

At September 30, 2017, DNB had eight TDRs with recorded investment totaling $1,872,000, five of which, totaling $1,134,000, are accruing loans in compliance with the terms of the modification. The remaining $738,000 represents three loans that were nonaccrual impaired loans and resulted in collateral evaluations. As a result of the evaluations, specific reserves and charge-offs have been taken where appropriate. DNB recognized partial charge-offs totaling $151,000 on two residential loans prior to their restructuring and $2,000 on one consumer installment loan after its restructuring. As of September 30, 2017, there were no defaulted TDRs as all TDRs were current with respect to their associated forbearance agreements. There were no defaults on TDRs during the nine months ended September 30, 2017.

At December 31, 2016, DNB had five TDRs with recorded investment totaling $914,000, one of which totaled $102,000, represented an accruing impaired home equity loan in compliance with the terms of the modification. The remaining $812,000 represents four loans that were nonaccrual impaired loans and resulted in collateral evaluations. As a result of the evaluations, specific reserves and charge-offs have been taken where appropriate. As of December 31, 2016, DNB recognized partial charge-offs totaling $151,000 on two residential loans prior to their restructuring and $2,000 on one consumer installment loan after its restructuring. DNB did not recognize any charge-off on the last remaining TDR. As of December 31, 2016, there were no defaulted TDRs as all TDRs were current with respect to their associated forbearance agreements. There were no defaults on TDRs within twelve months of restructure during the nine months ended September 30, 2016.

The following tables set forth the composition of DNB's allowance for credit losses as of September 30, 2017 and December 31, 2016, the activity for the three and nine months ended September 30, 2017 and 2016 and as of and for the year ended December 31, 2016.

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 - July 1, 2017	$ 245	$ 2,634	$ 625	$ 1,208	$ -	$ 189	$ 84	$ 282	$ 5,267
Charge-offs	-	(36)	(14)	-	-	-	-	-	(50)
Recoveries	-	-	1	-	-	-	1	-	2
Provisions	1	200	36	(102)	-	(3)	(4)	247	375
Ending balance - September 30, 2017	$ 246	$ 2,798	$ 648	$ 1,106	$ -	$ 186	$ 81	$ 529	$ 5,594

(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, 2017	$ 349	$ 2,531	$ 709	$ 969	$ -	$ 196	$ 61	$ 558	$ 5,373
Charge-offs	-	(519)	(610)	-	-	-	(10)	-	(1,139)
Recoveries	2	50	20	-	1	-	2	-	75
Provisions	(105)	736	529	137	(1)	(10)	28	(29)	1,285
Ending balance - September 30, 2017	$ 246	$ 2,798	$ 648	$ 1,106	$ -	$ 186	$ 81	$ 529	$ 5,594
Ending balance: individually evaluated for impairment	$ 45	$ 22	$ -	$ -	$ -	$ -	$ 28	$ -	$ 95
Ending balance: collectively evaluated for impairment	$ 201	$ 2,776	$ 648	$ 1,106	$ -	$ 186	$ 53	$ 529	$ 5,499
Loans receivables:									
Ending balance	$ 88,249	$ 461,012	$ 120,786	$ 84,428	$ -	$ 59,433	$ 5,845		$ 819,753
Ending balance: individually evaluated for impairment	$ 2,059	$ 2,688	$ 1,506	$ 447	$ -	$ 616	$ 308		$ 7,624
Ending balance: acquired with credit deterioration	$ 11	$ 1,141	$ -	$ -	$ -	$ -	$ -		$ 1,152
Ending balance: collectively evaluated for impairment	$ 86,179	$ 457,183	$ 119,280	$ 83,981	$ -	$ 58,817	$ 5,537		$ 810,977
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 3	$ 150	$ 139	$ -	$ 17	$ -		$ 309

(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 - July 1, 2016	$ 314	$ 2,370	$ 891	$ 866	$ -	$ 191	$ 64	$ 551	$ 5,247
Charge-offs	-	(39)	(8)	-	-	-	-	-	(47)
Recoveries	2	-	-	-	1	-	-	-	3
Provisions	87	141	(90)	7	(1)	11	(2)	(53)	100
Ending balance - September 30, 2016	$ 403	$ 2,472	$ 793	$ 873	$ -	$ 202	$ 62	$ 498	$ 5,303

(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)	(39)	(32)	-	-	-	-	-	(277)
Recoveries	10	-	1	1	2	-	1	-	15
Provisions	383	136	(165)	303	(2)	7	(3)	(29)	630
Ending balance - September 30, 2016	$ 403	$ 2,472	$ 793	$ 873	$ -	$ 202	$ 62	$ 498	$ 5,303
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 3	$ 119	$ 64	$ -	$ 13	$ -		$ 199

	Residential	Commercial	Commercial	Commercial	Lease	Consumer	Consumer		
(Dollars in thousands)	Mortgage	Mortgage	Term	Construction	Financing		Other	Unallocated	Total

						Home Equity			
Allowance for credit losses:									
Ending balance - December 31, 2016	$ 349	$ 2,531	$ 709	$ 969	$ -	$ 196	$ 61	$ 558	$ 5,373
Ending balance: individually evaluated for impairment	$ 143	$ -	$ 97	$ 89	$ -	$ -	$ 5	$ -	$ 334
Ending balance: collectively evaluated for impairment	$ 206	$ 2,531	$ 612	$ 880	$ -	$ 196	$ 56	$ 558	$ 5,039
Loans receivables:									
Ending balance	$ 87,581	$ 465,486	$ 123,175	$ 72,755	$ -	$ 62,560	$ 5,972		$ 817,529
Ending balance: individually evaluated for impairment	$ 1,760	$ 2,919	$ 198	$ 1,242	$ -	$ 544	$ 256		$ 6,919
Ending balance: acquired with credit deterioration	$ 11	$ 1,674	$ -	$ -	$ -	$ -	$ -		$ 1,685
Ending balance: collectively evaluated for impairment	$ 85,810	$ 460,893	$ 122,977	$ 71,513	$ -	$ 62,016	$ 5,716		$ 808,925
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 4	$ 135	$ 190	$ -	$ 16	$ -		$ 345

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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 no anti-dilutive stock awards outstanding at September 30, 2017. There were no outstanding stock warrants, no anti-dilutive stock options outstanding, and 16,595 anti-dilutive stock awards outstanding at September 30, 2016. The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 2,411	4,262	$ 0.57	$ 7,138	4,256	$ 1.68
Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	34	(0.01)	-	32	(0.02)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 2,411	4,296	$ 0.56	$ 7,138	4,288	$ 1.66

	Three Months Ended September 30, 2016			Nine Months Ended September 30, 2016		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 1	2,853	$ 0.00	$ 2,666	2,845	$ 0.94

Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	33	(0.00)	-	34	(0.01)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 1	2,886	$ 0.00	$ 2,666	2,879	$ 0.93

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
September 30, 2017			
Net unrealized loss on AFS securities	$ (1,254)	$ 427	$ (827)
Unrealized actuarial losses-pension	(1,792)	609	(1,183)
	$ (3,046)	$ 1,036	$ (2,010)
December 31, 2016			
Net unrealized loss on AFS securities	$ (1,646)	$ 560	$ (1,086)
Discount on AFS to HTM reclassification	(8)	3	(5)
Unrealized actuarial losses-pension	(1,792)	609	(1,183)
	$ (3,446)	$ 1,172	$ (2,274)

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
September 30, 2017					
Repurchase agreements and repurchase-to-maturity transactions	$ 15,383	$ -	$ -	$ -	$ 15,383
Gross amount of recognized liabilities for repurchase agreements in statement of condition	$ 15,383				$ 15,383
December 31, 2016					
Repurchase agreements and repurchase-to-maturity transactions	$ 11,889	$ -	$ -	$ -	$ 11,889
Gross amount of recognized liabilities for repurchase agreements in statement of condition	$ 11,889				$ 11,889

As of September 30, 2017 and December 31, 2016, DNB had $15.4 million and $11.9 million of repurchase agreements, respectively. In conjunction with these repurchase agreements, $15.7 million and $12.1 million of state and municipal securities were sold on an overnight basis as of September 30, 2017 and December 31, 2016, 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 September 30, 2017. All options are immediately exercisable. During the three and nine months ended September 30, 2017 and 2016, DNB had no expenses related to the plan. DNB has no anticipated additional expense related to the plan. Under the Stock Option Plan, 19,150 shares were exercised during the nine months ended September 30, 2017. The shares awarded from the NQ cashless exercises resulted in an increase in shares outstanding of 9,264 shares. There was a cash equivalent of 9,886 shares used to pay all applicable taxes on the transactions. Stock option activity is indicated below.

	Number Outstanding	Weighted Average Exercise Price
Outstanding January 1, 2017	49,700	$ 9.18
Issued	-	-
Exercised	19,150	7.39
Forfeited	-	-
Expired	-	-
Outstanding September 30, 2017	30,550	$ 10.31

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

Forfeited	-	-
Expired	-	-
Outstanding September 30, 2016	64,500	$ 8.67

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

September 30, 2017

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Exercise Price	Average Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	30,550	30,550	$ 10.31	1.20 years	$ 768,000

December 31, 2016

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Exercise Price	Average Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	49,700	49,700	$ 9.18	1.40 years	$ 955,000

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 nine month period ended September 30, 2017, $106,000 and $321,000 was amortized to expense. For the three and nine month period ended September 30, 2016, $71,000 and $801,000 was amortized to expense.

DNB issued 3,000 restricted stock awards during the first quarter of 2016 and 26,595 restricted stock awards in December 2015 that required the award recipient to hold the shares for one additional year after vesting. These awards cliff vest in three years. For these shares, DNB adopted the Chaffe Model to measure the fair value by applying a 9.1% discount due to the lack of marketability when these transactions took place. The input assumptions used and resulting fair values were an expected life of 5 years, volatility of 19.37%, annual rate of quarterly dividends of 1.01%, and bond equivalent yield of 1.742%.

As of September 30, 2017, there was approximately $706,000 in additional compensation that will be recognized over the remaining service period of approximately 1.50 years. At September 30, 2017, 64,659 shares were reserved for future grants under the Plan.

During the nine months ended September 30, 2016, 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 transactions. There were no such transactions during the nine months ended September 30, 2017. Stock grant activity is indicated below:

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2017	55,775	$ 25.63
Granted	500	34.00
Forfeited	230	22.92
Vested	-	-
Non-vested stock awards—September 30, 2017	56,045	$ 25.71

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2016	77,255	$ 22.71
Granted	3,540	28.33

Forfeited	-		-
Vested	33,700		23.66
Non-vested stock awards—September 30, 2016	47,095	$	22.46

NOTE 9: INCOME TAXES

As of September 30, 2017, 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 2013 through 2016 were open for examination as of September 30, 2017.

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.

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The following table summarizes the assets at September 30, 2017 and December 31, 2016 that are recognized on DNB's statement of financial condition using fair value measurement determined based on the differing levels of input:

	September 30, 2017			
(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	$ -	$ 53,102	$ -	$ 53,102
GSE mortgage-backed securities	-	29,772	-	29,772
Collateralized mortgage obligations GSE	-	12,308	-	12,308
Corporate bonds	-	10,904	-	10,904
State and municipal tax-exempt	-	1,922	-	1,922
Total	$ -	$ 108,008	$ -	$ 108,008
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 1,803	$ 1,803
OREO and other repossessed property	-	-	817	817
Total	$ -	$ -	$ 2,620	$ 2,620

	December 31, 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	$ -	$ 52,309	$ -	$ 52,309
GSE mortgage-backed securities	-	30,140	-	30,140
Collateralized mortgage obligations GSE	-	12,573	-	12,573
Corporate bonds	-	15,180	-	15,180
State and municipal tax-exempt	-	4,956	-	4,956
Asset-backed security	-	26	-	26
Total	$ -	$ 115,184	$ -	$ 115,184
Assets Measured at Fair Value on a Nonrecurring Basis				

Impaired loans	$ -	$ -	$ 1,538	$ 1,538
OREO and other repossessed property	-	-	2,485	2,485
Total	$ -	$ -	$ 4,023	$ 4,023

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:

September 30, 2017
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	$ 104	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
		collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Commercial mortgage	46	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
		collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Commercial term	1,485	Appraisal of	Appraisal adj. (2)	0%	to	-50%	(-7%)
		collateral (1)	Disposal costs (2)	0%	to	-9%	(-8%)
Impaired loans - Consumer other	168	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
		collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loan total	$ 1,803						
Other real estate owned	$ 817		Disposal costs (2)	8%	to	8%	(-8%)

(1)
(2)

December 31, 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	$ 964	Appraisal of	Appraisal adj. (2)	0%	to	-25%	(-22%)
		collateral (1)	Disposal costs (2)	-8%	to	-12%	(-9%)
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)	0%	to	0%	(0%)
		collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Consumer other	137	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
		collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loan total	$ 1,538						
Other real estate owned	$ 2,485		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 $8.8 million at September 30, 2017. Of this, $367,000 had specific valuation allowances of $95,000, leaving a fair value of $272,000 as of September 30, 2017. In addition, DNB had $1,973,000 in impaired loans that were partially charged down by $442,000, leaving $1,531,000 at fair value as of September 30, 2017. Impaired loans had a carrying amount of $8.6 million at December 31, 2016. Of this, $1.9 million had specific valuation allowances of $334,000, leaving a fair value of $1.5 million at December 31, 2016. DNB did not have any impaired loans that were partially charged down during the year ended December 31, 2016.

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 $4.9 million of such assets at September 30, 2017, $4.8 million of which was OREO and $81,000 was in other repossessed property. DNB had $2.8 million of such assets at December 31, 2016, which consisted of $2.6 million in OREO and

$191,000 in other repossessed property. Subsequent to the repossession of these assets, DNB wrote down the carrying value of two OREO properties by $121,000 to $817,000 during the nine month period ended September 30, 2017. DNB did not write down the carrying values of OREO during the nine month period ended September 30, 2016.

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 nine months ended September 30, 2017.

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 September 30, 2017 and December 31, 2016 are as follows:

	September 30, 2017				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 19,490	$ 19,490	$ 19,490	$ -	$ -
AFS investment securities	108,008	108,008	-	108,008	-
HTM investment securities	67,140	67,229	-	65,229	2,000
Restricted stock	6,371	6,371	-	6,371	-
Loans, net of allowance, including impaired	814,159	802,324	-	-	802,324
Accrued interest receivable	3,791	3,791	-	3,791	-
Financial liabilities					
Deposits:					
Non-interest-bearing deposits	198,399	198,399	-	198,399	-
Interest-bearing deposits	494,355	494,355	-	494,355	-
Time deposits	136,759	136,106	-	136,106	-
Brokered deposits	41,815	42,786	-	42,786	-
Repurchase agreements	15,383	15,383	-	15,383	-
FHLBP advances	51,047	50,843	-	50,843	-
Junior subordinated debentures and other borrowings	9,279	9,037	-	9,037	-
Subordinated debt	9,750	11,295	-	11,295	-
Accrued interest payable	461	461	-	461	-
Off-balance sheet instruments	-	-	-	-	-

	December 31, 2016				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 22,103	$ 22,103	$ 22,103	$ -	$ -
AFS investment securities	115,184	115,184	-	115,184	-
HTM investment securities	67,022	66,124	-	64,124	2,000
Restricted stock	5,381	5,381	-	5,381	-
Loans, net of allowance, including impaired	812,156	792,190	-	-	792,190
Accrued interest receivable	3,567	3,567	-	3,567	-
Financial liabilities					
Deposits:					
Non-interest-bearing deposits	173,467	173,467	-	173,467	-
Interest-bearing deposits	495,178	495,178	-	495,178	-
Time deposits	187,256	186,012	-	186,012	-
Brokered deposits	29,286	28,873	-	28,873	-
Repurchase agreements	11,889	11,889	-	11,889	-
FHLBP advances	55,332	54,734	-	54,734	-
Junior subordinated debentures and other borrowings	9,279	8,637	-	8,637	-
Subordinated debt	9,750	10,493	-	10,493	-
Accrued interest payable	534	534	-	534	-
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 Held-for-Sale (Carried at Lower of Cost or Fair Value) The fair value of loans held-for-sale is determined, when possible, using quoted secondary-market prices. If no such quotes prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan.

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 $41.8 million in brokered deposits at September 30, 2017, $4.0 million matures in 2018, $5.9 million matures in 2019, $21.9 million matures in 2020, $5.0 million matures in 2021, and $5.0 million matures in 2022.

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 September 30, 2017, un-funded loan commitments totaled $164.0 million and stand-by letters of credit totaled $3.4 million. At December 31, 2016, un-funded loan commitments totaled $185.8 million and stand-by letters of credit totaled $2.8 million.

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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 ir 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 Financial Corporation (the “Registrant” or “DNB”), a Pennsylvania business corporation, is a bank holding company registered with and supervised by the Board of Governors of the Federal Reserve System (Federal Reserve Board). The Registrant was incorporated on October 28, 1982 and commenced operations on July 1, 1983 upon consummation of the acquisition of all of the outstanding stock of Downingtown National Bank, now known as DNB First, National Association (the “Bank”). Since commencing operations, DNB’s business has consisted primarily of managing and supervising the Bank, and its principal source of income has been derived from the Bank.

The Bank was organized in 1860. The Bank is a national banking association that is a member of the Federal Reserve System, the deposits of which are insured by the Federal Deposit Insurance Corporation (“FDIC”). The Bank is a full service commercial bank providing a wide range of services to individuals and small to medium sized businesses in the southeastern Pennsylvania market area, including accepting time, demand, and savings deposits and making secured and unsecured commercial, real estate and consumer loans. In addition, the Bank has fifteen (15) full service branches and a full-service wealth management group known as “DNB First Wealth Management”. The Bank’s financial subsidiary, DNB Financial Services, Inc., (also known as “DNB Investments & Insurance”) is a Pennsylvania licensed insurance agency, which, through a third party marketing agreement with Cetera Investment Services, LLC, sells a broad variety of insurance and investment products. The Bank’s other subsidiaries are Downco, Inc. and DN Acquisition Company, Inc. which were incorporated in December 1995 and December 2008, respectively, for the purpose of acquiring and holding Other Real Estate Owned acquired through foreclosure or deed in-lieu-of foreclosure, as well as Bank-occupied real estate.

On April 4, 2016, the Corporation entered into an Agreement and Plan of Merger (the “Merger Agreement”) with East River Bank (“ERB”). Under the transaction, ERB merged with and into the Bank. The merger was consummated on October 1, 2016. The acquisition was an opportunity for DNB to strengthen its competitive position as one of the premier community banks headquartered in Southeastern Pennsylvania. Additionally, the ERB acquisition enhanced DNB's footprint in Southeastern Pennsylvania.

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. 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 2017, 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 and lease purchases. Management also plans to reduce the absolute level of borrowings and brokered deposits with cash flows from existing loans and investments as well as from new core deposit growth. A discussion on DNB's Key Strategies follows:

- 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, origination and sales of SBA guaranteed loans 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. Net income was $2.4 million, or $0.56 per diluted share, for the quarter ending September 30, 2017, compared with $1,000, or less than a penny per share, for the same quarter, last year. Earnings for the three month period ending September 30, 2016 included merger-related expenses of $1.5 million. For the nine months ending September 30, 2017, net income was $7.1 million, or $1.66 per diluted share, compared with $2.7 million, or $0.93 per diluted share, for the same period, last year. Interest income for the third quarter of 2017 included $409,000 of purchase accounting adjustments recognized due to the pay-off of certain loans acquired from East River. For the third quarter of 2017, the weighted average yield on total interest-earning assets was 4.30%, which included purchase accounting adjustments. The net interest margin was 3.42% for the third quarter of 2017 compared with 3.39% for the second quarter of 2017, when excluding purchase accounting marks.

The weighted average rate paid for interest-bearing liabilities was 0.61% and 0.43% for the quarters ending September 30, 2017 and September 30, 2016, respectively. The increase in the composite cost of funds was due largely to the acquisition of East River Bank in the fourth quarter of 2016, coupled with a 75 basis points increase in the federal funds rate, which has impacted the rates DNB pays on the majority of non-maturity deposit accounts. The allowance for credit losses at September 30, 2017 was $5.6 million compared to $5.4 million at December 31, 2016. The allowance as a percentage of total loans and leases was 0.68% at September 30, 2017, compared to 0.66% at December 31, 2016. Asset quality remained strong as annualized net charge-offs decreased to 0.02% of total average loans for the quarter ending September 30, 2017, from 0.36% for the quarter ending June 30, 2017, and 0.03% for the quarter ending September 30, 2016. Total non-performing assets, including loans and other real estate property, were $12.0 million as of September 30, 2017, compared with $11.3 million as of December 31, 2016. The ratio of non-performing loans to total loans was 0.87% as of September 30, 2017, versus 1.04% as of December 31, 2016.

DNB's most significant revenue source continues to be net interest income, defined as total interest income less total interest expense, which accounted for approximately 88% of total revenue during the third quarter of 2017. To produce net interest income and consistent earnings growth over the long-term, DNB must generate loan and deposit growth at acceptable economic spreads within its market area. To generate and grow loans and deposits, DNB must focus on a number of areas including, but not limited to, the economy, branch expansion, sales practices, customer satisfaction and retention, competition, customer behavior, technology, product innovation and credit performance of its customers.

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 nine month period ended September 30, 2017:

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, 300, and 400 basis points in addition to four yield curve twists over a twenty-four-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 the amount of securities required to be pledged for certain liabilities).

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, Philadelphia 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 has negatively affected DNB's net interest margin. To compensate for the increased competition, DNB, along with other area community banks, has aggressively sought and marketed customers who have been disenfranchised by these mergers.

To attract these customers, DNB offers deposit products and services, such as Choice Checking relationship products with ATM surcharge rebates, and Online Banking with bill payment, external transfer and account aggregation functionality. DNB also offers a complete package of cash management services including automated clearing house services, remote deposit, payroll services, and merchant services and account payment solutions. Our broad range of Business Checking products provides solutions to meet the needs of a variety of businesses and non-profit organizations.

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 54 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 $53,000 in 2017.

Material Trends and Uncertainties.

DNB reported net income available to common shareholders of $2.4 million, or $0.56 per diluted share, for the quarter ending September 30, 2017, compared with $1,000, or less than a penny per share, for the same quarter, last year. Earnings for the three month period ending September 30, 2016 included merger-related expenses of $1.5 million.

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 nine 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, falling oil prices and high unemployment. Overall economic growth continues to be slow at a time when national and regional unemployment rates have improved, however labor participation rates remain at historically low levels. The risks associated with our business remain acute in periods of slow economic growth. 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.

Aggregate business activity in the Third District continued at a modest pace of growth during the October 18, 2017 Beige Book period. Manufacturing, nonfinancial services, new home sales, and tourism grew modestly; nonresidential construction and leasing appeared to grow slightly and non-auto retail sales and new home construction activity exhibited little change. Auto sales, which had declined modestly in the September 6, 2017 Beige Book period, showed modest growth in the October 18, 2017 period. On balance, wages and prices continued to grow at a modest pace, but employment flattened out. Overall, firms appear to anticipate continued modest growth over the next six months, with a larger percentage of firms expecting growth.

Homebuilders generally reported little change during the October 18, 2017 Beige Book period, similar to the September 6, 2017 period. The current period covered weeks that are typically slow for traffic and contract signings and some of the Federal Reserve Bank's builder contacts reported no real pickup at the end of September following the expected slow period. Brokers in most major Third District housing markets continued to report modest growth of existing home sales, but no increase of inventories.

The Federal Reserve's nonresidential real estate contacts continued to report slight growth in construction and leasing activity. Contractors reported that despite a slight softening over the summer, overall, labor hours have picked up in September, suggesting more new construction activity. This year has been the second most active year in the past five years (behind 2016), and the Federal Reserve's contacts expect activity to keep up in 2018.

Third District financial firms reported modest growth of overall loan volumes (excluding credit cards), which is similar to the September 6, 2017 Beige Book period. Loan volumes grew modestly in most categories, including auto loans and other consumer loans, while commercial real estate loans grew slightly. Commercial and industrial loan volumes improved over the period, posting modest growth following declines over the September 6, 2017 Beige Book period. Credit card volumes, which are highly seasonal, continued to grow at a modest rate over the most recent period but outpaced growth in the comparable year-ago period. In general, the Federal Reserve's banking contacts tended to describe economic growth as slow and steady.

Third District manufacturing activity, on balance, continued at a modest pace of growth and showed signs of improvement. Higher percentages of firms reported increases in new orders and shipments compared with the September 6, 2017 Beige Book period. Firms in most sectors continued to note gains in both new orders and shipments, including makers of paper products, chemicals, fabricated metal products, industrial machinery, and electronic products. Generally, the Federal Reserve's manufacturing contacts continued to expect growth over the next six months. The percentage of firms expecting future increases for general activity rose, while it held mostly steady for future increases in capital expenditures and employment.

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. DNB's franchise spans Chester, Philadelphia and Delaware counties in southeastern Pennsylvania and the majority of the loan and deposits relationships are with businesses and individuals within the Third Federal Reserve District.

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 was 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 implemented 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 no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provided that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) were able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 until they redeem such instruments or until the instruments mature.

The final rules also contained 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 be utilized 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 preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Statements of Financial Condition, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Amounts subject to significant estimates are items such as the allowance for credit losses and lending related commitments, the fair value of repossessed assets, pension and post-retirement obligations, the fair value of financial instruments, other-than-temporary impairments of investment securities, the valuation of assets acquired and liabilities assumed in business combinations, and the valuations of goodwill for impairment. Among other effects, such changes could result in future impairments of investment securities, and establishment of allowances for credit losses and lending related commitments as well as increased benefit plans' expenses. The comparability of the results of operations for the periods ended September 30, 2017 compared to September 30, 2016, in general, have been impacted by the acquisition of ERB on October 1, 2016. The assets and liabilities of ERB were recorded on the consolidated statement of financial condition at their established fair value as of October 1, 2016, and their results of operations have been included in the consolidated income statement since that date

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 $1.07 billion at September 30, 2017, compared to $1.07 billion at December 31, 2016. The $5.0 million decrease in total assets was primarily attributable to a $7.1 million decrease in investment securities and a $2.6 million decrease in cash and cash equivalents, offset by a $2.1 million increase in other real estate owned and other repossessed property and a $2.0 million increase in net loans.

Investment Securities. Investment securities, including restricted stock, at September 30, 2017 were $181.5 million, compared to $187.6 million at December 31, 2016. The $6.1 million decrease in investment securities and restricted stock was primarily due to $23.7 million in sales, principal pay-downs, calls and maturities, offset by $16.5 million in purchases of investment securities and $990,000 increase in restricted stock.

Gross Loans. DNB’s loans increased $2.3 million to $819.8 million at September 30, 2017, compared to $817.5 million at December 31, 2016. Total commercial loans increased $4.8 million and residential loans increased $668,000, while consumer loans decreased $3.3 million.

Deposits. Deposits were $871.3 million at September 30, 2017, compared to $885.2 million at December 31, 2016. Deposits decreased $13.9 million or 1.57% during the nine month period ended September 30, 2017. Core deposits, which are comprised of demand, NOW, money markets and savings accounts, increased by $24.1 million, while time deposits decreased by $50.5 million and brokered deposits increased by $12.5 million.

Borrowings. Borrowings were $85.8 million at September 30, 2017, compared to $86.7 million at December 31, 2016. The decrease of $830,000 or 0.96% was primarily due to a $4.3 million decrease in FHLBP advances offset by a $3.5 million increase in repurchase agreements.

Stockholders’ Equity. Stockholders' equity was $101.9 million at September 30, 2017, compared to $94.8 million at December 31, 2016. The increase in stockholders’ equity was primarily a result of year-to-date earnings of $7.1 million, sales of treasury shares totaling $405,000, restricted stock compensation expense of $321,000, and $264,000 of other comprehensive income. These additions to stockholders’ equity were partially offset by taxes on the exercise of stock options of $189,000 and $895,000 of dividends paid on DNB’s common stock.

RESULTS OF OPERATIONS

SUMMARY

Net income for the three and nine month periods ended September 30, 2017 was $2.4 million and $7.1 million compared to $1,000 and $2.7 million for the same periods in 2016. The comparability of the results of operations for the nine month period ended September 31, 2017 compared to the same period in 2016, in general, have been impacted by the acquisition of ERB on October 1, 2016. Diluted earnings per share for the three and nine month periods ended September 30, 2017 were $0.56 and $1.66 compared to $0.00 and $0.93 for the same periods in 2016. The $2.4 million increase in net income in the third quarter of 2017 compared to the third quarter of 2016 was primarily attributable to a $3.7 million increase in net interest income after provision (primarily due to interest and fees on loans), offset by a $98,000 decrease in non-interest income, a $286,000 increase in non-interest expense (primarily due to salary and employee benefits), and a $920,000 increase in income tax expense. The $4.5 million increase in net income during the nine month period ended September 30, 2017, compared to the nine month period ended September 30, 2016, was primarily attributable to a $10.9 million increase in net interest income after provision (primarily due to interest and fees on loans), offset by a $1.8 million increase in income tax expense, a $1.1 million decrease in non-interest income (primarily due to significantly higher gains on insurance proceeds in 2016), and a $3.5 million increase in non-interest expense (primarily due to salary and employee benefits).

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 nine month periods ended September 30, 2017 was $9.5 million and $28.0 million, compared to $5.5 million and $16.4 million for the same periods in 2016. Interest income for the three and nine month period ended September 30, 2017 was $11.0 million and $32.1 million, compared to $6.3 million and $18.6 million for the same periods in 2016. The $4.7 million increase in interest income in the third quarter of 2017 compared to the third quarter of 2016 was primarily due to a 64.2% increase in total average loans and a 0.66% increase in the net interest margin to 3.72% for the three month period ended September 30, 2017, compared to 3.06% for the same period in 2016. The $13.6 million increase in the nine months ended September 30, 2017 compared the same period in 2016 was primarily due to a 66.7% increase in total average loans and a 0.56% increase in the net interest margin to 3.66% for the nine month period ended September 30, 2017, compared to 3.10% for the same period in 2016. The main driver for the increase in both volume and rate was the ERB acquisition, which took place October 1, 2016. For the three and nine month period ended September 30, 2017, the weighted average yield on total interest-earning assets was 4.30% and 4.20%, which included the accretable portion of purchase accounting fair value marks of $754,000 and $1.9 million, respectively. Both the three and nine months ended September 30, 2017 include $409,000 of income attributable to fair value marks accreted into income, related to the pay-off of certain loans acquired from ERB. Interest expense for the three and nine month periods ended September 30, 2017 was $1.5 million and $4.1 million, compared to $760,000 and $2.1 million for the same periods in 2016. The composite cost of funds for the three and nine month period ended September 30, 2017 was 0.61% and 0.57%, compared to 0.43% and 0.41% for the same periods in 2016.

Interest on loans was $10.0 million and $29.1 million for the three and nine month periods ended September 30, 2017, compared to $5.2 million and $15.4 million for the same periods in 2016. The average balance of loans was $818.8 million with an average yield of 4.82% for the third quarter of 2017, compared to $498.6 million with an average yield of 4.18% for the same period in 2016. The average balance of loans was $817.0 million with an average yield of 4.73% for the nine months ended September 30, 2017, compared to $490.1 million with an average yield of 4.21% for the same period in 2016. The increases in average balance and average yield were attributable to the acquisition of ERB effective October 1, 2016.

Interest and dividends on investment securities was $957,000 and $2.9 million for the three and nine month periods ended September 30, 2017, compared to $1.0 million and $3.1 million for the same periods in 2016. The average balance of investment securities was $184.1 million with a tax equivalent average yield of 2.33% for the third quarter of 2017, compared to $215.0 million with a tax equivalent average yield of 2.19% for the same period in 2016. The average balance of investment securities was $184.9 million with a tax equivalent average yield of 2.37% for the nine month period ended September 30, 2017, compared to $213.3 million with a tax equivalent average yield of 2.24% for the same period in 2016.

Interest on deposits was $1.1 million and $2.9 million for the three and nine month periods ended September 30, 2017, compared to $450,000 and $1.2 million for the same periods in 2016. The average balance of deposits was $872.9 million with an average rate of 0.49% for the third quarter of 2017, compared to $640.8 million with an average rate of 0.28% for the same period in 2016. The average balance of deposits was $886.6 million with an average rate of 0.44% for the nine months ended September 30, 2017, compared to $631.3 million with an average rate of 0.25% for the same period in 2016. The increases in average balance and average rate were attributable to the acquisition of ERB on October 1, 2016, coupled with a 75 basis points increase in the federal funds rate, which has impacted the rates DNB pays on the majority of non-maturity deposit accounts.

Interest on borrowings was $410,000 and $1.2 million for the three and nine month periods ended September 30, 2017, compared to $310,000 and $920,000 for the same periods in 2016. The average balance of borrowings was $86.6 million with an average rate of 1.88% for the third quarter of 2017, compared to $58.5 million with an average rate of 2.10% for the same period in 2016. The average balance of borrowings was $85.7 million with an average rate of 1.84% for the nine months ended September 30, 2017, compared to $61.2 million with an average rate of 2.00% for the same period in 2016.

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"). Based on reviews and analyses by regulators, additional allowances may be required in the future.

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 DNB'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 $375,000 and $1.3 million provision made during the three and nine months periods ended September 30, 2017, compared to $100,000 and $630,000 for the same periods in 2016. DNB's percentage of allowance for credit losses to total loans was 0.68% at September 30, 2017 compared to 0.66% and 1.04% at December 31, 2016 and September 30, 2016, respectively. The decline in this ratio from 1.04% at September 30, 2016 to 0.68% at September 30, 2017, was primarily due to the acquisition of ERB. Loans acquired in connection with the purchase of ERB have been recorded at fair value, in accordance with GAAP, and are based on an initial estimate of the expected cash flows, including a reduction for estimated credit losses, and without carryover of the respective portfolio's historical allowance for credit losses. DNB will continually evaluate the loans acquired from ERB for additional impairment as part of our normal allowance review process. Net charge-offs were $1.1 million, $292,000, and $262,000 during the nine months ended September 30, 2017, year ended December 31, 2016, and nine months ended September 30, 2016, respectively. The percentage of net charge-offs to total average loans were 0.13%, 0.05%, and 0.05% 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 September 30, 2017, 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 decreased $1.4 million during the nine month period ended September 30, 2017. 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 September 30, 2017, DNB had $12.0 million of non-performing assets, which included $7.1 million of non-performing loans and $4.9 million of OREO and other repossessed assets. This compares to $11.3 million of non-performing assets at December 31, 2016 which included $8.5 million of non-performing loans and $2.8 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 cashflow shortfalls, including estimated costs to sell in comparison to the carrying value of the loan. Of the $8.8 million of impaired loans ($7.1 million of non-performing loans, $1.1 million of performing TDRs, and a $522,000 performing ASC310-30 loan) at September 30, 2017, $367,000 had valuation allowances of $95,000 and $8.4 million had no specific allowance. Of the $8.6 million of impaired loans at December 31, 2016, $1.9 million had valuation allowances of $334,000 and $6.7 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 no valuation was necessary. During the quarter ended September 30, 2017, DNB recognized $50,000 in total charge-offs, $36,000 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 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 our expected costs to sell the asset.

Analysis of Allowance for Credit Losses

(Dollars in thousands)

	Nine Months Ended September 30, 2017	Year Ended December 31, 2016	Nine Months Ended September 30, 2016
Beginning balance	$ 5,373	$ 4,935	$ 4,935
Provisions	1,285	730	630
Loans charged off:			
Residential mortgage	-	(206)	(206)
Commercial mortgage	(519)	(39)	(39)
Commercial:			
Commercial term	(610)	(45)	(32)
Commercial construction	-	-	-
Lease financing	-	-	-
Consumer:			
Home equity	-	-	-
Other	(10)	(21)	-
Total charged off	(1,139)	(311)	(277)
Recoveries:			
Residential mortgage	2	13	10
Commercial mortgage	50	-	-
Commercial:			
Commercial term	20	1	1
Commercial construction	-	1	1
Lease financing	1	3	2
Consumer:			
Home Equity	-	-	-
Other	2	1	1
Total recoveries	75	19	15
Ending balance	$ 5,594	$ 5,373	$ 5,303

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)

	September 30, 2017			December 31, 2016			September 30, 2016		
	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	$ 246	11	%	$ 349	11	%	$ 403	6	%
Commercial mortgage	2,798	56		2,531	57		2,472	56	
Commercial:									
Commercial term	648	15		709	15		793	21	
Commercial construction	1,106	10		969	9		873	6	
Consumer:									
Home equity	186	7		196	7		202	10	
Other	81	1		61	1		62	1	
Unallocated	529	-		558	-		498	-	
Total	$ 5,594	100	%	$ 5,373	100	%	$ 5,303	100	%
Reserve for unfunded loan commitments	$ 309			$ 345			$ 199		

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, mortgage loans, 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 nine month periods ended September 30, 2017 was $1.3 million and $4.0 million, compared to $1.4 million and $5.1 million for the same periods in 2016. The $98,000 decrease during the three months ended September 30, 2017 was mainly attributable to decreases of $197,000 in gain on sale of investment securities, $30,000 in gains from insurance proceeds, and $14,000 in mortgage banking. These decreases were offset by increases of $89,000 in other fees (mostly servicing fee income), $35,000 in gain on sale of loans, and $18,000 in wealth management. The $1.1 million decrease during the nine months ended September 30, 2017 was mainly attributable to decreases of $1.1 million in gains on insurance proceeds (DNB received $1.18 million in gains on insurance proceeds in 2016 as a result of a fire at our West Chester offices that occurred during the second quarter of 2015), $406,000 in gain on sale of investment securities, and $77,000 in mortgage banking. These decreases were offset by increases of $271,000 in other fees (mostly servicing fee income), $109,000 in service charges on deposits (mostly NSF fees and business analysis charges), $93,000 in gain on sale of loans, and $25,000 in wealth management.

NON-INTEREST EXPENSE

Non-interest expense for the three and nine month periods ended September 30, 2017 was $7.0 million and $20.8 million, compared to $6.7 million and $17.3 million for the same periods in 2016. During the three months ended September 30, 2017, total non-interest expense increased by $286,000. Compared to the three month period ended September 30, 2016, the increase in non-interest expense was largely due to the addition of ERB staff, offices and equipment as well as Core deposit intangible amortization expense. The increase was primarily due to increases of $1.1 million in salary and employee benefits, $237,000 in other expenses (mostly OREO expense, officer & employee expense, amortization of core deposit intangible, insurance expense, and bank service charges), $179,000 in professional and consulting (mostly professional services and 3rd party services), $107,000 in occupancy (mostly office building rental expense and repairs and maintenance), $103,000 in furniture and equipment (mostly maintenance agreements and depreciation), $88,000 in FDIC insurance, $62,000 in PA shares tax, $24,000 in advertising and marketing, $24,000 in telecommunications, and $11,000 in printing and supplies. These increases were partially offset by decreases of $1.5 million in due diligence and merger expense, $153,000 in loss on sale or write down of OREO, and $7,000 in postage. During the nine months ended September 30, 2017, total non-interest expense increased by $3.5 million. Compared to the nine month period ended September 30, 2016, the increase in non-interest expense was largely due to the addition of ERB staff, offices and equipment as well as Core deposit intangible amortization expense. The increase was primarily due to increases of $2.6 million in salary and employee benefits, $785,000 in other expenses (mostly OREO expense, officer & employee expense, Visa debit charge-off expense, amortization of core deposit intangible, insurance expense, and bank service charges), $547,000 in occupancy (mostly office building rental expense and repairs and maintenance), $433,000 in furniture and equipment (mostly maintenance agreements and depreciation), $386,000 in professional and consulting (mostly audit and accounting fees, professional services, and 3rd party services), $201,000 in PA shares tax, $183,000 in FDIC insurance, $115,000 in advertising and marketing, $80,000 in telecommunications, $54,000 in printing and supplies, and $13,000 in postage. These increases were partially offset by decreases of $1.9 million in due diligence and merger expense and $43,000 in loss on sale or write down of OREO.

INCOME TAXES

Income tax expense for the three and nine month periods ended September 30, 2017 was $1.0 million and $2.8 million, compared to $81,000 and $939,000 for the same periods in 2016. The effective tax rate for the three and nine month periods ended September 30, 2017 was 29.3% and 28.0% compared to 99.1% and 26.0% for the same periods in 2016. The effective tax rate for the three months ended September 30, 2016 was 99.1% primarily due to an increased taxable adjustment in the quarter for non-deductible due diligence and merger expense of $313,000. The effective tax rate for the nine months ended September 30, 2016 was 26.0% due to non-deductible due-diligence and merger expense of $673,000. 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 $12.0 million at September 30, 2017 compared to $11.3 million at December 31, 2016 and $9.9 million at September 30, 2016. The non-performing loans to total loans ratio was 0.87% at September 30, 2017, 1.04% at December 31, 2016, and 1.36% at September 30, 2016. The non-performing assets to total assets ratio was 1.13% at September 30, 2017, 1.05% at December 31, 2016, and 1.28% at September 30, 2016. The allowance to non-performing loans ratio was 78.7% at September 30, 2017, 63.2% at December 31, 2016, and 76.3% at September 30, 2016. Loans acquired in connection with the purchase of ERB have been recorded at fair value, in accordance with GAAP, and are based on an initial estimate of the expected cash flows, including a reduction for estimated credit losses, and without carryover of the respective portfolio's historical allowance for credit losses. DNB will continually evaluate the loans acquired from ERB for additional impairment as part of our normal allowance review process. 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 September 30, 2017, DNB had $12.7 million of substandard loans. Of the $12.7 million, $5.0 million are performing and are believed to require supervision and review greater than loans rated pass or special mention; 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, 2016 was $13.5 million. The decrease in substandard loans during the nine months ended September 30, 2017 was primarily due to payoffs, charge-offs, and rating upgrades in the portfolio, specifically $6.0 million of commercial mortgages and $3.2 million of commercial term loans. The increase in special mention loans during the nine months ended September 30, 2017 was primarily due to rating downgrades in the portfolio, specifically $4.1 million of commercial mortgages and $6.6 million of commercial construction loans. 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)

	September 30, 2017	December 31, 2016	September 30, 2016

Non-accrual loans:			
Residential mortgage	$ 2,070	$ 1,770	$ 1,759
Commercial mortgage	2,311	4,593	3,061
Commercial:			
Commercial term	1,506	198	202
Commercial construction	447	1,242	1,217
Consumer:			
Home equity	468	442	492
Other	308	256	221
Total non-accrual loans	7,110	8,501	6,952
Loans 90 days past due and still accruing	-	-	-
Total non-performing loans	7,110	8,501	6,952
Other real estate owned & other repossessed property	4,916	2,767	2,939
Total non-performing assets	$ 12,026	$ 11,268	$ 9,891
Asset quality ratios:			
Non-performing loans to total loans	0.87 %	1.04 %	1.36 %
Non-performing assets to total assets	1.13	1.05	1.28
Allowance for credit losses to:			
Total loans	0.68	0.66	1.04
Non-performing loans	78.7	63.2	76.3

Troubled Debt Restructurings Loans whose terms are modified are classified as troubled debt restructurings ("TDR") if DNB grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired. The recorded investments in troubled debt restructured loans at September, 2017 and December 31, 2016 are as follows:

	September 30, 2017		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 754	$ 883	$ 699
Commercial mortgage	992	992	987
Consumer:			
Home equity	148	148	147
Other	40	42	39
Total	$ 1,934	$ 2,065	$ 1,872

	December 31, 2016		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 754	$ 883	$ 726
Consumer:			
Home equity	148	148	148
Other	40	42	40
Total	$ 942	$ 1,073	$ 914

At September 30, 2017, DNB had eight TDRs with recorded investment totaling $1,872,000, five of which, totaling $1,134,000, are accruing loans in compliance with the terms of the modification. The remaining $738,000 represents three loans that were nonaccrual impaired loans and resulted in collateral evaluations. As a result of the evaluations, specific reserves and charge-offs have been taken where appropriate. DNB recognized partial charge-offs totaling $151,000 on two residential loans prior to their restructuring and $2,000 on one consumer installment loan after its restructuring. As of September 30, 2017, there were no defaulted TDRs as all TDRs were current with respect to their associated forbearance agreements. There were no defaults on TDRs during the nine months ended September 30, 2017.

At December 31, 2016, DNB had five TDRs with recorded investment totaling $914,000, one of which totaled $102,000, represented an accruing impaired home equity loan in compliance with the terms of the modification. The remaining $812,000 represents four loans that were nonaccrual impaired loans and resulted in collateral evaluations. As a result of the evaluations, specific reserves and charge-offs have been taken where appropriate. As of December 31, 2016, DNB recognized partial charge-offs totaling $151,000 on two residential loans prior to their restructuring and $2,000 on one consumer installment loan after its restructuring. DNB did not recognize any charge-off on the last remaining TDR. As of December 31, 2016, there were no defaulted TDRs as all TDRs were current with respect to their associated forbearance agreements. There were no defaults on TDRs within twelve months of restructure during the nine months ended September 30, 2016.

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 Nine Months Ended September 30, 2017	At and For the Year Ended December 31, 2016	At and For the Nine Months Ended September 30, 2016
Total recorded investment	$ 8,776	$ 8,604	$ 7,055
Impaired loans with a specific allowance	367	1,872	1,662
Impaired loans without a specific allowance	8,409	6,732	5,393
Average recorded investment	8,184	6,669	6,184
Specific allowance allocation	95	334	386
Total principal and interest collected	427	852	772
Interest income recorded	10	4	3

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 liquidity, which totaled $105.4 million at September 30, 2017 compared to $101.4 million at December 31, 2016. Liquidity includes investments and restricted stock, Federal funds sold and cash and due from banks, less the amount of securities required to be pledged for certain liabilities. 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 $510.8 million at September 30, 2017. 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 September 30, 2017, DNB's Maximum Borrowing Capacity with the FHLBP was $450.8 million. At September 30, 2017, DNB had borrowed $51.0 million and the FHLB had issued letters of credit, on DNB's behalf, totaling $50.0 million against its available credit lines. At September 30, 2017, DNB also had available $60.0 million of unsecured federal funds lines of credit with other financial institutions as well as $162.6 million of available short or long term funding through the Certificate of Deposit Account Registry Service (CDARS) program and $174.3 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.

At September 30, 2017, DNB had $164.0 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 September 30, 2017 totaled $40.1 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 September 30, 2017. 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 17 of DNB's December 31, 2016 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% to 2.50% by 2019. The capital conservation buffer is 1.25% and 0.625% for 2017 and 2016, respectively.

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

(Dollars in thousands)	Actual Amount	Actual Ratio	For Capital Adequacy Purposes* Amount	For Capital Adequacy Purposes* Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
DNB Financial Corporation						
September 30, 2017						
Total risk-based capital	$ 112,654	13.79 %	$ 75,544	9.250 %	N/A	N/A
Common Equity Tier 1 capital	88,001	10.78	46,959	5.750	N/A	N/A
Tier 1 risk-based capital	97,001	11.88	59,210	7.250	N/A	N/A
Tier 1 (leverage) capital	97,001	9.22	42,069	4.000	N/A	N/A
December 31, 2016						
Total risk-based capital	$ 105,669	12.50 %	$ 72,924	8.625 %	N/A	N/A
Common equity tier 1 capital	81,201	9.60	43,332	5.125	N/A	N/A
Tier 1 risk-based capital	90,201	10.67	56,014	6.625	N/A	N/A
Tier 1 (leverage) capital	90,201	8.42	42,864	4.000	N/A	N/A
DNB First, N.A.						
September 30, 2017						
Total risk-based capital	$ 110,998	13.62 %	$ 75,391	9.250 %	$ 91,692	11.25 %
Common Equity Tier 1 capital	105,095	12.89	46,865	5.750	63,165	7.75
Tier 1 risk-based capital	105,095	12.89	59,090	7.250	75,391	9.25
Tier 1 (leverage) capital	105,095	10.00	42,017	4.000	52,522	5.00
December 31, 2016						
Total risk-based capital	$ 103,094	12.22 %	$ 72,785	8.625 %	$ 84,388	10.00 %
Common equity tier 1 capital	97,376	11.54	43,249	5.125	54,852	6.50
Tier 1 risk-based capital	97,376	11.54	55,907	6.625	67,511	8.00
Tier 1 (leverage) capital	97,376	9.09	42,830	4.000	53,537	5.00

*Capital conversion buffer of 1.25% and 0.625% included for September 30, 2017 and December 31, 2016, respectively.

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 September 30, 2017 and December 31, 2016, 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 September 30, 2017 and December 31, 2016.

(Dollars in thousands)	September 30, 2017			December 31, 2016		
Change in rates	Flat	-200bp	+200bp	Flat	-200bp	+200bp
EVE	$ 134,102	$ 116,470	$ 135,091	$ 118,298	$ 111,279	$ 114,771
Change		(17,632)	989		(7,019)	(3,527)
Change as % of assets		(1.7%)	0.1%		(0.7%)	(0.3%)
Change as % of PV equity		(13.1%)	0.7%		(5.9%)	(3.0%)

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, 2017, 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 September 30, 2017, 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

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in“Risk Factors” included within the 2016 Form 10-K. The risks described therein are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently believe to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

There were no unregistered sales of equity securities during the quarter ended September 30, 2017. The following table provides information on repurchases by DNB of its common stock in each month of the quarter ended September 30, 2017:

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)
July 1, 2017 – July 31, 2017	-	$ -	-	$ 63,016
August 1, 2017 – August 31, 2017	-	-	-	$ 63,016
September 1, 2017 – September 30, 2017	-	-	-	$ 63,016
Total	-	$ -	-	$ 63,016

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 on April 5, 2016 and incorporated herein by reference.
3.1	Amended and Restated Articles of Incorporation, as amended effective June 30, 2017, filed as Exhibit 3.1 to Form 8-K on July 3, 2017 and incorporated herein by reference.
3.2	Bylaws of the Registrant as amended January 27, 2016, filed as Exhibit 3.1 to Form 8-K on January 29, 2016 and incorporated herein by reference.
31.1	Rule 13a-14(a)/15d-14 (a) Certification of Chief Executive Officer, filed herewith.
31.2	Rule 13a-14(a)/15d-14 (a) Certification of Chief Financial Officer, filed herewith.
32.1	Section 1350 Certification of Chief Executive Officer, filed herewith.
32.2	Section 1350 Certification of Chief Financial Officer, filed herewith.
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
November 13, 2017	BY:	/s/ William J. Hieb
		William J. Hieb, Chief Executive Officer, President and Director
November 13, 2017	BY:	/s/ Gerald F. Sopp
		Gerald F. Sopp, Chief Financial Officer and Executive Vice President

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101.DEF	XBRL Taxonomy Extension Definition Linkbase Document