DNB FINANCIAL CORP /PA/
Form 10-Q
August 06, 2018
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

____

FORM 10-Q

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended: June 30, 2018

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	(I.R.S. Employer Identification No.)

incorporation or organization)
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)	4,306,400 (Shares Outstanding as of August 6, 2018)

DNB FINANCIAL CORPORATION AND SUBSIDIARY

INDEX

PART I – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

DNB Financial Corporation and Subsidiary

Consolidated Statements of Financial Condition (Unaudited)

(Dollars in thousands, except share and per share data)	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 33,452	$ 10,917
Cash and cash equivalents	33,452	10,917
Available-for-sale investment securities at fair value (amortized cost of $106,450 and $113,555)	103,429	111,783
Held-to-maturity investment securities (fair value of $60,815 and $62,420)	62,145	62,390
Total investment securities	165,574	174,173
Loans held for sale	276	651
Loans	885,320	845,897
Allowance for credit losses	(6,188)	(5,843)
Net loans	879,132	840,054
Restricted stock	6,950	7,641
Office property and equipment, net	8,150	8,649
Accrued interest receivable	3,911	3,822
Other real estate owned & other repossessed property	5,113	5,012
Bank owned life insurance (BOLI)	9,418	9,314
Core deposit intangible	388	435
Goodwill	15,525	15,525
Net deferred taxes	3,075	2,980
Other assets	2,645	2,742
Total assets	$ 1,133,609	$ 1,081,915
Liabilities and Stockholders’ Equity		
Liabilities		
Non-interest-bearing deposits	$ 175,561	$ 176,815
Interest-bearing deposits:		
NOW	216,261	199,310
Money market	254,061	221,726
Savings	80,044	81,050

Time	114,766	140,490
Brokered deposits	93,422	41,812
Total deposits	934,115	861,203
Federal Home Loan Bank of Pittsburgh (FHLBP) advances	62,972	79,013
Repurchase agreements	5,609	12,023
Junior subordinated debentures	9,279	9,279
Subordinated debt	9,750	9,750
Other borrowings	336	2,738
Total borrowings	87,946	112,803
Accrued interest payable	561	554
Other liabilities	5,654	5,413
Total liabilities	1,028,276	979,973
Stockholders' Equity		
Common stock, $1.00 par value;		
20,000,000 shares authorized; 4,370,185 and 4,362,939 issued, respectively; 4,301,898 and 4,286,117 outstanding, respectively	4,385	4,379
Treasury stock, at cost; 68,287 and 76,822 shares, respectively	(1,276)	(1,429)
Surplus	69,268	69,110
Retained earnings	36,804	32,272
Accumulated other comprehensive loss	(3,848)	(2,390)
Total stockholders' equity	105,333	101,942
Total liabilities and stockholders' equity	$ 1,133,609	$ 1,081,915

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except share and per share data)	2018	2017	2018	2017
Interest Income:				
Interest and fees on loans	$ 10,164	$ 9,574	$ 20,046	$ 19,095
Interest and dividends on investment securities:				
Taxable	862	757	1,655	1,454
Exempt from federal taxes	218	236	435	478
Interest on cash and cash equivalents	45	94	66	128
Total interest and dividend income	11,289	10,661	22,202	21,155
Interest Expense:				
Interest on NOW, money market and savings	994	588	1,824	1,072
Interest on time deposits	333	313	658	614
Interest on brokered deposits	414	94	613	186
Interest on FHLB advances	239	168	540	337
Interest on repurchase agreements	6	7	12	13
Interest on junior subordinated debentures	113	95	218	187
Interest on subordinated debt	103	103	207	207
Interest on other borrowings	19	14	35	28
Total interest expense	2,221	1,382	4,107	2,644
Net interest income	9,068	9,279	18,095	18,511
Provision for credit losses	375	585	750	910
Net interest income after provision for credit losses	8,693	8,694	17,345	17,601
Non-interest Income:				
Service charges	261	291	574	654
Wealth management	512	471	947	845
Mortgage banking	76	14	137	50
Increase in cash surrender value of BOLI	52	55	104	110
Gain on sale of investment securities, net	-	25	-	25
Gain on sale of loans	10	97	10	97
Gains from insurance proceeds	-	-	-	80
Other fees	421	469	833	867
Total non-interest income	1,332	1,422	2,605	2,728
Non-interest Expense:				
Salaries and employee benefits	4,261	3,724	8,033	7,365
Furniture and equipment	550	505	1,039	1,001
Occupancy	634	656	1,331	1,375
Professional and consulting	424	456	827	849
Advertising and marketing	204	274	386	440
Printing and supplies	70	86	123	136

FDIC insurance	122	150	240	345
PA shares tax	243	233	485	458
Telecommunications	84	88	165	178
Postage	24	27	65	62
Loss on sale or write down of OREO, net	140	115	140	114
Due diligence and merger expense	-	26	-	77
Other expenses	784	744	1,436	1,429
Total non-interest expense	7,540	7,084	14,270	13,829
Income before income tax expense	2,485	3,032	5,680	6,500
Income tax expense	436	746	1,018	1,773
Net income	$ 2,049	$ 2,286	$ 4,662	$ 4,727
Earnings per common share:				
Basic	$ 0.48	$ 0.54	$ 1.09	$ 1.11
Diluted	$ 0.47	$ 0.53	$ 1.08	$ 1.10
Cash dividends per common share	$ 0.07	$ 0.07	$ 0.14	$ 0.14
Weighted average common shares outstanding:				
Basic	4,298,409	4,257,633	4,294,758	4,252,207
Diluted	4,314,418	4,292,411	4,311,696	4,283,424

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(Dollars in thousands)	2018	2017	2018	2017
Net income	$ 2,049	$ 2,286	$ 4,662	$ 4,727
Other Comprehensive (Loss) Income:				
Unrealized holding gains arising during the period				
Before tax amount	(235)	85	(1,249)	236
Tax effect	49	(29)	262	(80)
	(186)	56	(987)	156
Accretion of discount on AFS to HTM reclassification				
Before tax amount(1)	-	5	-	7
Tax effect(2)	-	(1)	-	(3)
	-	4	-	4
Less reclassification for gains on sales of AFS investment securities included in net income				
Before tax amount(3)	-	(9)	-	(9)
Tax effect(2)	-	3	-	3
	-	(6)	-	(6)
Total other comprehensive (loss) income	(186)	54	(987)	154
Total comprehensive income	$ 1,863	$ 2,340	$ 3,675	$ 4,881

(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 "Gains 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 Changes in Stockholders' Equity (Unaudited)

(Dollars in thousands)	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2018	$ 4,379	$ (1,429)	$ 69,110	$ 32,272	$ (2,390)	$ 101,942
Net income for six months ended June 30, 2018	-	-	-	4,662	-	4,662
Other comprehensive loss	-	-	-	-	(987)	(987)
Restricted stock compensation expense (4,908 shares vested)	8	-	196	-	-	204
Exercise of stock options (2,338 shares)	2	-	(2)	-	-	-
Taxes on exercise of stock options	(4)	-	(176)	-	-	(180)
Cash dividends - common ($0.14 per share)	-	-	-	(601)	-	(601)
Sale of treasury shares to 401(k) (5,658 shares)	-	102	92	-	-	194
Sale of treasury shares to deferred comp. plan (2,877 shares)	-	51	48	-	-	99
Adoption impact - ASU 2018-02	-	-	-	471	(471)	-
Balance at June 30, 2018	$ 4,385	$ (1,276)	$ 69,268	$ 36,804	$ (3,848)	$ 105,333

(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 six months ended June 30, 2017	-	-	-	4,727	-	4,727
Other comprehensive income	-	-	-	-	154	154
Restricted stock compensation expense	8	-	206	-	-	214
Exercise of stock options (9,132 shares)	9	-	(9)	-	-	-
Taxes on exercise of stock options	-	-	(187)	-	-	(187)
Cash dividends - common ($0.14 per share)	-	-	-	(596)	-	(596)
Sale of treasury shares to 401(k) (4,288 shares)	-	98	37	-	-	135
Sale of treasury shares to deferred comp. plan (2,566 shares)	-	50	68	-	-	118
Balance at June 30, 2017	$ 4,368	$ (1,582)	$ 69,088	$ 29,651	$ (2,120)	$ 99,405

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,			
(Dollars in thousands)	2018		2017	
Cash Flows From Operating Activities:				
Net income	$	4,662	$	4,727
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, amortization and accretion		761		846
Provision for credit losses		750		910
Stock based compensation		204		214
Net gain on sale of securities		-		(25)
Net loss on sale or write down of OREO and other repossessed property		140		114
Gain on insurance proceeds		-		(80)
Earnings from investment in BOLI		(104)		(110)
Deferred tax expense		167		289
Proceeds from sales of mortgage loans		8,620		1,657
Mortgage loans originated for sale		(8,108)		(1,607)
Gain on sale of mortgage loans		(137)		(50)
Proceeds from sales of loans		188		1,742
Loans originated for sale		(178)		(1,645)
Gain on sale of loans		(10)		(97)
(Increase) decrease in accrued interest receivable		(89)		9
Decrease in other assets		97		369
Increase in accrued interest payable		7		18
Increase (decrease) in other liabilities		241		(3)
Net Cash Provided by Operating Activities		7,211		7,278
Cash Flows From Investing Activities:				

Activity in available-for-sale securities:				
Sales		-		3,030
Maturities, repayments and calls		6,953		14,341
Purchases		-		(12,086)
Activity in held-to-maturity securities:				
Sales		-		737
Maturities, repayments and calls		304		507
Purchases		-		(1,407)
Net decrease (increase) in restricted stock		691		(1,185)
Net increase in loans		(40,102)		(2,798)
Death benefit proceeds		-		310
Purchases of property and equipment		(122)		(459)
Expenses capitalized in OREO		-		(15)
Proceeds from sale of OREO and other repossessed property		33		168
Net Cash (Used in) Provided by Investing Activities		(32,243)		1,143
Cash Flows From Financing Activities:				
Net increase in deposits		72,912		7,872
Repayment of FHLBP advances		(200,641)		(13,311)
Funding of FHLBP advances		184,600		7,848
Net (decrease) increase in repurchase agreements		(6,414)		3,811
Repayment of other borrowings		(2,402)		(25)
Dividends paid		(601)		(596)
Payment of employee taxes on stock option exercise and share award vest		(180)		(187)
Tax benefit for restricted stock vesting		-		-
Sale of treasury stock		293		253
Net Cash Provided by Financing Activities		47,567		5,665
Net Change in Cash and Cash Equivalents		22,535		14,086
Cash and Cash Equivalents at Beginning of Period		10,917		22,103
Cash and Cash Equivalents at End of Period	$	33,452	$	36,189

Supplemental Disclosure of Cash Flow Information:				
Cash paid during the period for:				
Interest	$	4,100	$	2,626
Income taxes		600		1,886
Supplemental Disclosure of Non-cash Flow Information:				
Net decrease in goodwill		-		65
Transfers from loans to real estate owned and other repossessed property		274		2,851

See accompanying notes to unaudited consolidated financial statements.

7

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 six months ended June 30, 2018 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, 2017.

Subsequent Events-- Management has evaluated events and transactions occurring subsequent to June 30, 2018 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 provided additional guidance related to the identification of performance obligations within a contract, assessing collectability, contract costs, and other technical corrections and improvements.

DNB adopted the new standards discussed above effective January 1, 2018 using the modified retrospective approach. A significant majority of DNB’s revenues are explicitly excluded from the scope of the new guidance including interest, dividend income, BOLI, gain/loss on sale of loans and investments on the Consolidated Statements of Income. The adoption of ASU 2014-09 did not require a cumulative adjustment to the opening balance of retained earnings as of January 1, 2018 and is not expected to have a material impact on DNB’s Consolidated Statements of Financial Condition, Comprehensive Income, Stockholders’ Equity or Cash Flows for the year ended December 31, 2018. Non-interest income components in the scope of Topic 606 continue to be recognized when DNB’s performance obligations are complete or at the time of sale after a customer’s transaction posts in the account. Disclosures required for DNB’s revenue streams in the scope of ASU 2014-09 are included in Non-Interest Income in the following table.

8

Non-interest Income Non-interest income includes revenue from contracts with customers in the scope of ASU 2014-09 as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(Dollars in thousands)	2018	2017	2018	2017
Non-interest Income:				
Service charges:				
Non-sufficient funds charges	$ 142	$ 177	$ 301	$ 365
Business analysis charges	44	39	85	81
Cycle charges	22	21	45	46
Lockbox fees	8	8	52	55
Stop payment fees	3	5	7	10
Wire transfer fees	22	23	43	44
Other service charges	20	18	41	53
Total service charges	261	291	574	654
Wealth management:				
DNB Investments & Insurance	150	144	238	246
DNB First Investment Management & Trust	362	327	709	599
Total wealth management	512	471	947	845
Other fee income:				
Cardholder interchange fees	269	257	514	488
Safe deposit box	26	25	50	50
Check printing	12	18	35	39
Merchant card processing	42	56	90	97
ATM surcharges for non-DNB customers	20	22	37	40
Other fee income	13	35	27	57
Total other fee income	382	413	753	771
Total Revenue from contracts with customers	1,155	1,175	2,274	2,270
Total Revenue not within the scope of ASC 606	177	247	331	458
Total non-interest income	$ 1,332	$ 1,422	$ 2,605	$ 2,728

Service charges on deposit accounts are recorded monthly when DNB’s performance obligations are complete. Deposit balances are disclosed in the Consolidated Statement of Condition. For transaction-based service charges such as non-sufficient funds charges, wire transfer fees, stop payment fees, ATM fees, and other transaction-based fees, revenue is recognized at the time of sale after the transaction posts in the customer’s account.

Wealth management revenue includes non-deposit products and services offered under the names “DNB Investment & Insurance” and “DNB First Investment Management & Trust”.

Through a third-party marketing agreement with Cetera Investment Services, LLC (“Cetera”), DNB Investment & Insurance offers a complete line of investment and insurance products. DNB’s performance obligation as an agent is to arrange for the sale of products by Cetera. Monthly, DNB recognizes commission fees in the amounts to which it is entitled in accordance with the terms of the marketing agreement for products sold. Shortly after a sale, the product provided remits the commission payment through Cetera to the Company, and the Company recognizes the revenue.

DNB First Investment Management & Trust offers a full line of investment and fiduciary services. DNB’s performance obligation is to manage investments, estates and trusts. Investment management and trust income is primarily comprised of fees earned from the management and administration of trusts, estates and investment agency portfolios. The Company’s performance obligation is generally satisfied over time and the resulting fees are recognized quarterly, based upon the quarter-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customers’ accounts. While managing estates and trusts, DNB contracts with a third-party tax preparation service. For tax preparation services, DNB’s obligation as an agent is to arrange for the performance of services by the third party. As tax services are rendered, DNB records revenue monthly, net of the cost of the services.

Cardholder interchange fees consist of revenue DNB is entitled per agreements with third party debit and credit card providers. DNB’s performance obligation as an agent is to arrange for cardholder services with its customers in accordance with fees and terms offered by the third-party service providers. Based on cardholder transactions reported by third party service providers, DNB recognizes fees for the amount it is contractually entitled.

DNB also contracts with third party providers for check printing, merchant card services, and ATM services. DNB’s performance obligation as an agent is to arrange for the services with its customers in accordance with fees and terms offered by the third-party service providers. Monthly, DNB recognizes fees for the amount it is contractually entitled.

DNB adopted ASU 2015-16, Business Combinations (Topic 805), in 2016: 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 it does not have a material impact to the consolidated financial statements.

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 June 30, 2018, 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. Adoption of the standard on January 1, 2018 also resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets.

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 is preparing an inventory of its leases and evaluating the impact of this ASU on these leases. Upon adoption of the guidance, DNB expects to report increased assets and increased liabilities as a result of recognizing right-of-use assets and lease liabilities on its consolidated statement of condition. DNB is currently evaluating the extent of the impact that the adoption of this ASU will have on our 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. During the three and six month periods ended June 30, 2018, DNB had $29,000 and $42,000 of tax benefits for stock option exercises and restricted stock vesting, respectively. In accordance with ASU 2016-09, forfeitures are recognized as they occur instead of applying an estimated forfeiture rate to each grant. For purposes of the determination of stock-based compensation expense for the three and six month periods ended June 30, 2018, we recognized actual forfeitures of 4,095 and 4,345 shares of restricted stock awards that were granted to officers and other employees.

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. Although early adoption is permitted for fiscal years beginning after December 15, 2018, DNB does not plan to early adopt. DNB has established a CECL Implementation Team to assess the impact of this ASU on its consolidated financial position, results of operations, and cash flows. DNB has been preserving certain historical loan information from its core processing system in anticipation of adopting the standard and will be evaluating control and process framework, data, model, and resource requirements and areas where modifications will be required. The team continues to assess the impact of the standard; however, DNB expects adopting this ASU will result in an increase in its allowance for credit losses. The amount of the increase in the allowance for credit losses upon adoption will be dependent upon the characteristics of the portfolio at the adoption date, as well as macroeconomic conditions and forecasts at that date. A cumulative effect adjustment will be made to retained earnings for the impact of the standard at the beginning of the period the standard is adopted.

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.

Accordingly, effective January 1, 2018, DNB adopted the pronouncement and it did not have a material impact to DNB's consolidated financial statements.

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 conducted a qualitative test (step zero) as of October 1, 2017 and determined that its Goodwill has not been impaired. 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 will not 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. The adoption of the ASU did not have a material 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 adopted the ASU on January 1, 2018 and the effects were immaterial.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income; (“ASU 2018-02”). This ASU allows a reclassification from accumulated other comprehensive income (“AOCI”) to retained earnings for certain income tax effects stranded in AOCI as a result of the Tax Act. Consequently, the reclassification eliminates the stranded tax effects resulting from the Tax Act and is intended to improve the usefulness of information reported to financial statement users. However, because the ASU only relates to the reclassification of the income tax effects of the Tax Act, the underlying guidance that requires the effect of a change in tax laws or rates to be included in income from continuing operations is not affected. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. DNB adopted this ASU on January 1, 2018. The amount of this reclassification is $471,000.

NOTE 2: INVESTMENT SECURITIES

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

	June 30, 2018			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 8,615	$ 56	$ -	$ 8,671
Government Sponsored Entities (GSE) mortgage-backed securities	443	-	(1)	442
Corporate bonds	13,913	136	(72)	13,977
Collateralized mortgage obligations GSE	1,291	-	(51)	1,240
State and municipal taxable	362	-	(12)	350
State and municipal tax-exempt	37,521	10	(1,396)	36,135
Total	$ 62,145	$ 202	$ (1,532)	$ 60,815
Available For Sale				
US Government agency obligations	$ 50,070	$ -	$ (621)	$ 49,449
GSE mortgage-backed securities	30,328	-	(1,348)	28,980
Collateralized mortgage obligations GSE	11,130	-	(608)	10,522
Corporate bonds	12,936	-	(275)	12,661
State and municipal tax-exempt	1,986	-	(169)	1,817
Total	$ 106,450	$ -	$ (3,021)	$ 103,429

	December 31, 2017			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 8,483	$ 163	$ -	$ 8,646
Government Sponsored Entities (GSE) mortgage-backed securities	496	9	-	505
Corporate bonds	14,047	243	(2)	14,288
Collateralized mortgage obligations GSE	1,471	-	(29)	1,442

State and municipal taxable	363	-	(8)	355
State and municipal tax-exempt	37,530	59	(405)	37,184
Total	$ 62,390	$ 474	$ (444)	$ 62,420
Available For Sale				
US Government agency obligations	$ 53,279	$ -	$ (386)	$ 52,893
GSE mortgage-backed securities	33,203	-	(715)	32,488
Collateralized mortgage obligations GSE	12,101	-	(447)	11,654
Corporate bonds	12,981	12	(173)	12,820
State and municipal tax-exempt	1,991	-	(63)	1,928
Total	$ 113,555	$ 12	$ (1,784)	$ 111,783

Included in unrealized losses are market losses on securities that have been in a continuous unrealized loss position for twelve months or more and those securities that have been in a continuous unrealized loss position for less than twelve months. The following table details the aggregate unrealized losses and aggregate fair value of the underlying securities whose fair values are below their amortized cost at June 30, 2018 and December 31, 2017.

(Dollars in thousands)	June 30, 2018 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						
GSE mortgage-backed securities	$ 442	$ (1)	$ 442	$ (1)	$ -	$ -
Corporate bonds	4,192	(72)	4,192	(72)	-	-
Collateralized mortgage obligations GSE	1,241	(51)	531	(16)	710	(35)
State and municipal taxable	350	(12)	350	(12)	-	-
State and municipal tax-exempt	26,416	(1,396)	13,130	(339)	13,286	(1,057)
Total	$ 32,641	$ (1,532)	$ 18,645	$ (440)	$ 13,996	$ (1,092)
Available For Sale						
US Government agency obligations	$ 49,449	$ (621)	$ 15,625	$ (297)	$ 33,824	$ (324)
GSE mortgage-backed securities	28,980	(1,348)	3,798	(131)	25,182	(1,217)
Collateralized mortgage obligations GSE	10,522	(608)	201	(7)	10,321	(601)
Corporate bonds	12,661	(275)	6,520	(128)	6,141	(147)
State and municipal tax-exempt	1,817	(169)	284	(1)	1,533	(168)
Total	$ 103,429	$ (3,021)	$ 26,428	$ (564)	$ 77,001	$ (2,457)

(Dollars in thousands)	December 31, 2017 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	$ 498	$ (2)	$ 498	$ (2)	$ -	$ -
Collateralized mortgage obligations GSE	1,442	(29)	620	(5)	822	(24)
State and municipal taxable	355	(8)	355	(8)	-	-
State and municipal tax-exempt	20,240	(405)	6,775	(67)	13,465	(338)
Total	$ 22,535	$ (444)	$ 8,248	$ (82)	$ 14,287	$ (362)
Available For Sale						
US Government agency obligations	$ 52,893	$ (386)	$ 30,894	$ (185)	$ 21,999	$ (201)
GSE mortgage-backed securities	32,488	(715)	9,055	(133)	23,433	(582)
Collateralized mortgage obligations GSE	11,654	(447)	2,132	(56)	9,522	(391)
Corporate bonds	10,759	(173)	4,572	(43)	6,187	(130)

State and municipal tax-exempt	1,928	(63)	288	(2)	1,640	(61)
Total	$ 109,722	$ (1,784)	$ 46,941	$ (419)	$ 62,781	$ (1,365)

As of June 30, 2018, there were nineteen collateralized mortgage obligations GSE, twenty GSE mortgage-backed securities, nine U.S. agency obligations, forty-three tax-exempt municipalities, one taxable municipality, and twelve 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 their cost basis. Management has reviewed all of these securities and believes that DNB will collect all principal and interest that is due on debt securities on a timely basis. Management does not believe any individual unrealized loss as of June 30, 2018 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 June 30, 2018, the following securities were reviewed:

Collateralized mortgage obligations GSE There are nineteen impaired securities classified as collateralized mortgage obligations, seventeen of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 7.59% of its carrying 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 June 30, 2018 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2018.

GSE mortgage-backed securities There are twenty impaired securities classified as GSE mortgage-backed securities, seventeen of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 5.35% of its carrying 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 June 30, 2018 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2018.

US Government agency obligations There are nine impaired securities classified as agencies, five of which have been impaired for more than 12 months. The largest unrealized loss of a security in this group is 5.36% of its carrying 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 June 30, 2018.

State and municipal tax-exempt There are forty-three 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 11.13% of its carrying 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 forty-three municipal securities, there are seventeen insured school districts, fifteen 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 June 30, 2018.

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 3.36% of its carrying 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 June 30, 2018.

Corporate bonds There are twelve 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 5.54% of its carrying value. The bonds are investment grade and the value decline is related to the changes in interest rates that occurred since the time of purchase and subsequent changes in spreads affecting the market prices. All of the issues carry a "BBB+" or better underlying credit support and were evaluated on the basis on their underlying fundamentals; included but not limited to annual financial reports, rating agency reports, capital strength and debt ratios. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from June 30, 2018 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2018.

The amortized cost and fair value of investment securities as of June 30, 2018, 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	$ 1,000	$ 1,000	$ 34,760	$ 34,531
Due after one year through five years	21,516	21,604	22,809	22,419
Due after five years through ten years	28,528	27,867	23,062	22,069
Due after ten years	11,101	10,344	25,819	24,410
Total investment securities	$ 62,145	$ 60,815	$ 106,450	$ 103,429

The HTM security sold during the six months ended June 30, 2017 was 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 June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2018	2017	2018	2017
Gross realized gains-AFS	$ -	$ 10	$ -	$ 10
Gross realized gains-HTM	-	16	-	16
Gross realized losses-AFS	-	(1)	-	(1)
Net realized gain	$ -	$ 25	$ -	$ 25

At June 30, 2018 and December 31, 2017, investment securities with a carrying value of approximately $92.5 million and $105.9 million, respectively, were pledged to secure public funds, repurchase agreements and for other purposes as required by law.

NOTE 3: LOANS

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

(Dollars in thousands)	June 30, 2018	December 31, 2017
Residential mortgage	$ 98,858	$ 93,959
Commercial mortgage	516,772	484,868
Commercial:		
Commercial term	130,565	129,535
Commercial construction	80,594	75,014
Consumer:		
Home equity	53,173	56,844
Other	5,358	5,677
Total loans	$ 885,320	$ 845,897
Less allowance for credit losses	(6,188)	(5,843)
Net loans	$ 879,132	$ 840,054

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

			Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
(Dollars in thousands)	June 30, 2018	December 31, 2017	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	$ 1,344	$ 1,915	$ 18	$ -	$ 18	$ 43	$ -	$ 43
Commercial mortgage	1,593	2,259	28	-	28	58	-	58
Commercial:								
Commercial term	2,583	2,100	46	-	46	90	-	90

Commercial construction	488	514	9	-	9	20	-	20
Consumer:								
Home equity	498	466	3	-	3	8	-	8
Other	215	245	3	-	3	11	-	11
Total non-accrual loans	$ 6,721	$ 7,499	$ 107	$ -	$ 107	$ 230	$ -	$ 230
Loans 90 days past due and accruing	23	54	1	1	-	1	1	-
Total non-performing loans	$ 6,744	$ 7,553	$ 108	$ 1	$ 107	$ 231	$ 1	$ 230

		Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
(Dollars in thousands)	June 30, 2017	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	$ 1,815	$ 21	$ -	$ 21	$ 42	$ -	$ 42
Commercial mortgage	2,375	36	-	36	77	-	77
Commercial:							
Commercial term	1,510	28	-	28	66	-	66
Commercial construction	447	46	-	46	91	-	91
Consumer:							
Home equity	404	6	-	6	12	-	12
Other	311	7	-	7	12	-	12
Total non-accrual loans	$ 6,862	$ 144	$ -	$ 144	$ 300	$ -	$ 300
Loans 90 days past due and accruing	-	-	-	-	-	-	-
Total non-performing loans	$ 6,862	$ 144	$ -	$ 144	$ 300	$ -	$ 300

NOTE 4: ALLOWANCE FOR CREDIT LOSSES

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a scheduled payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of June 30, 2018 and December 31, 2017.

Age Analysis of Past Due Loans Receivable

	June 30, 2018						
(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	$ 883	$ -	$ 1,146	$ 2,029	$ 96,829	$ 98,858	$ -
Commercial mortgage (less acquired with credit deterioration)	947	-	960	1,907	514,052	515,959	-
Acquired commercial mortgage with credit deterioration	-	-	-	-	813	813	-
Commercial:							
Commercial term	77	-	2,370	2,447	128,118	130,565	23
Commercial construction	-	488	-	488	80,106	80,594	-
Consumer:							
Home equity	382	160	355	897	52,276	53,173	-
Other	54	-	150	204	5,154	5,358	-
Total	$ 2,343	$ 648	$ 4,981	$ 7,972	$ 877,348	$ 885,320	$ 23

	December 31, 2017						
(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total	Current	Total Loans Receivable	Loans Receivable > 90 Days and Accruing

				Past Due			
Residential mortgage (less acquired with credit deterioration)	$ 887	$ 349	$ 1,148	$ 2,384	$ 91,568	$ 93,952	$ -
Acquired residential mortgage with credit deterioration	-	-	7	7	-	7	-
Commercial mortgage (less acquired with credit deterioration)	221	-	1,126	1,347	483,105	484,452	-
Acquired commercial mortgage with credit deterioration	-	-	416	416	-	416	-
Commercial:							
Commercial term	381	13	1,654	2,048	127,487	129,535	-
Commercial construction	514	-	-	514	74,500	75,014	-
Consumer:							
Home equity	15	-	386	401	56,443	56,844	-
Other	13	139	156	308	5,369	5,677	54
Total	$ 2,031	$ 501	$ 4,893	$ 7,425	$ 838,472	$ 845,897	$ 54

DNB had $793,000 of residential mortgage loans in the process of foreclosure and $74,000 of residential mortgage loans in other real estate owned as of June 30, 2018. DNB had $638,000 residential mortgage loans in the process of foreclosure and $149,000 of residential mortgage loans in other real estate owned as of December 31, 2017.

The following tables summarize information in regards to impaired loans by loan portfolio class as of June 30, 2018 and December 31, 2017, and for the three and six months ended June 30, 2018 and 2017.

Impaired Loans

	June 30, 2018			December 31, 2017		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential mortgage	$ 1,922	$ 2,244	$ -	$ 1,908	$ 2,210	$ -
Commercial mortgage	2,486	2,804	-	2,809	3,207	-
Acquired commercial mortgage with credit deterioration	522	535	-	936	950	
Commercial:						
Commercial term	1,957	2,456	-	1,743	2,253	-
Commercial construction	488	514	-	514	514	-
Consumer:						
Home equity	641	641	-	612	632	-
Other	204	263	-	117	117	-
Total	$ 8,220	$ 9,457	$ -	$ 8,639	$ 9,883	$ -
With allowance recorded:						
Residential mortgage	74	74	1	-	-	-
Acquired residential mortgage with credit deterioration	-	-	-	7	26	3
Commercial mortgage	79	156	19	19	93	19
Commercial:						
Commercial term	626	709	171	337	343	123
Consumer:						
Other	42	42	3	128	129	12
Total	$ 821	$ 981	$ 194	$ 491	$ 591	$ 157
Total:						
Residential mortgage	1,996	2,318	1	1,908	2,210	-
Acquired residential mortgage with credit deterioration	-	-	-	7	26	3
Commercial mortgage	2,565	2,960	19	2,828	3,300	19
Acquired commercial mortgage with credit deterioration	522	535	-	936	950	-
Commercial:						
Commercial term	2,583	3,165	171	2,080	2,596	123
Commercial construction	488	514	-	514	514	-
Consumer:						
Home equity	641	641	-	612	632	-

Other	246	305	3	245	246	12
Total	$ 9,041	$ 10,438	$ 194	$ 9,130	$ 10,474	$ 157

17

(Dollars in thousands)	Three Months Ended June 30, 2018 Average Recorded Investment	Three Months Ended June 30, 2018 Interest Income Recognized	Three Months Ended June 30, 2017 Average Recorded Investment	Three Months Ended June 30, 2017 Interest Income Recognized	Six Months Ended June 30, 2018 Average Recorded Investment	Six Months Ended June 30, 2018 Interest Income Recognized	Six Months Ended June 30, 2017 Average Recorded Investment	Six Months Ended June 30, 2017 Interest Income Recognized
With no related allowance recorded:								
Residential mortgage	$ 2,109	$ 5	$ 1,610	$ -	$ 2,042	$ 6	$ 1,291	$ -
Acquired residential mortgage with credit deterioration	-	-	11	-	-	-	11	-
Commercial mortgage	2,597	12	1,253	-	2,668	24	1,808	-
Acquired commercial mortgage with credit deterioration	654	8	1,137	-	748	15	1,316	-
Commercial:								
Commercial term	2,024	-	1,192	-	1,931	-	802	-
Commercial construction	493	-	848	-	500	-	830	-
Consumer:								
Home equity	624	2	580	2	620	4	568	4
Other	207	-	94	-	177	-	100	-
Total	$ 8,708	$ 27	$ 6,725	$ 2	$ 8,686	$ 49	$ 6,726	$ 4
With allowance recorded:								
Residential mortgage	37	-	210	-	25	-	509	-
Acquired residential mortgage with credit deterioration	-	-	-	-	2	-	-	-
Commercial mortgage	81	-	-	-	60	-	-	-
Acquired commercial mortgage with credit deterioration	-	-	-	-	-	-	-	-
Commercial:								
Commercial term	774	-	557	-	628	-	430	-
Commercial construction	-	-	-	-	-	-	149	-
Consumer:								
Other	71	-	189	-	90	-	173	-
Total	$ 963	$ -	$ 956	$ -	$ 805	$ -	$ 1,261	$ -
Total:								
Residential mortgage	2,146	5	1,820	-	2,067	6	1,800	-
Acquired residential mortgage with credit deterioration	-	-	11	-	2	-	11	-
Commercial mortgage	2,678	12	1,253	-	2,728	24	1,808	-
Acquired commercial mortgage with credit deterioration	654	8	1,137	-	748	15	1,316	-
Commercial:								

Commercial term	2,798	-	1,749	-	2,559	-	1,232	-
Commercial construction	493	-	848	-	500	-	979	-
Consumer:								
Home equity	624	2	580	2	620	4	568	4
Other	278	-	283	-	267	-	273	-
Total	$ 9,671	$ 27	$ 7,681	$ 2	$ 9,491	$ 49	$ 7,987	$ 4

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within DNB's internal risk rating system as of June 30, 2018 and December 31, 2017.

Credit Quality Indicators

	June 30, 2018				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 97,501	$ -	$ 1,357	$ -	$ 98,858
Commercial mortgage	509,378	2,383	5,011	-	516,772
Commercial:					
Commercial term	126,773	544	3,248	-	130,565
Commercial construction	78,429	1,643	522	-	80,594
Consumer:					
Home equity	52,361	144	668	-	53,173
Other	5,143	-	215	-	5,358
Total	$ 869,585	$ 4,714	$ 11,021	$ -	$ 885,320

	December 31, 2017				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 91,993	$ -	$ 1,966	$ -	$ 93,959
Commercial mortgage	479,308	125	5,435	-	484,868
Commercial:					
Commercial term	125,926	115	3,494	-	129,535
Commercial construction	73,902	-	1,112	-	75,014
Consumer:					
Home equity	56,085	-	759	-	56,844
Other	5,432	-	245	-	5,677
Total	$ 832,646	$ 240	$ 13,011	$ -	$ 845,897

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 six month period ended June 30, 2018 DNB classified one residential mortgage loan totaling $73,000 as TDR. The loan's rate was changed but the term was not extended. During the six month period ended June 30, 2017, DNB did not classify any loans as TDRs. Loans classified as troubled debt restructurings are designated as impaired. The recorded investments in troubled debt restructured loans at June 30, 2018 and December 31, 2017 are as follows:

	June 30, 2018		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 676	$ 805	$ 652
Commercial mortgage	992	992	972
Consumer:			
Home equity	148	148	143
Other	40	42	30
Total	$ 1,856	$ 1,987	$ 1,797

	December 31, 2017		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 603	$ 732	$ 690
Commercial mortgage	992	992	982
Consumer:			
Home equity	148	148	146
Other	40	42	39
Total	$ 1,783	$ 1,914	$ 1,857

At June 30, 2018, DNB had nine TDRs with recorded investment totaling $1,797,000, all of which are accruing loans in compliance with the terms of the modifications. As a result of collateral 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 June 30, 2018, 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 six months ended June 30, 2018.

At December 31, 2017, DNB had eight TDRs with recorded investment totaling $1,857,000, five of which, totaling $1,128,000, were accruing loans in compliance with the terms of the modifications. The remaining $729,000 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. As of December 31, 2017, 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 December 31, 2017, 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 2017. DNB classified three commercial mortgage loans totaling $992,000 as TDRs during the year ended December 31, 2017.

The following tables set forth the composition of DNB’s allowance for credit losses as of June 30, 2018 and December 31, 2017, the activity for the three and six months ended June 30, 2018 and 2017 and as of and for the year ended December 31, 2017.

Allowance for Credit Losses and Recorded Investment in Loans Receivables

	Residential	Commercial	Commercial	Commercial	Lease	Consumer	Consumer		
(Dollars in thousands)	Mortgage	Mortgage	Term	Construction	Financing	Home Equity	Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - April 1, 2018	$ 226	$ 2,987	$ 904	$ 1,219	$ -	$ 176	$ 55	$ 578	$ 6,145
Charge-offs	(103)	(171)	(47)	-	-	-	(37)	-	(358)
Recoveries	25	-	-	-	-	-	1	-	26
Provisions	59	260	32	136	-	20	30	(162)	375
Ending balance - June 30, 2018	$ 207	$ 3,076	$ 889	$ 1,355	$ -	$ 196	$ 49	$ 416	$ 6,188

(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, 2018	$ 221	$ 2,856	$ 845	$ 1,128	$ -	$ 183	$ 63	$ 547	$ 5,843
Charge-offs	(137)	(184)	(64)	-	-	-	(49)	-	(434)
Recoveries	26	-	2	-	-	-	1	-	29
Provisions	97	404	106	227	-	13	34	(131)	750
Ending balance - June 30, 2018	$ 207	$ 3,076	$ 889	$ 1,355	$ -	$ 196	$ 49	$ 416	$ 6,188
Ending balance: individually evaluated for impairment	$ 1	$ 19	$ 171	$ -	$ -	$ -	$ 3	$ -	$ 194
Ending balance: collectively evaluated for impairment	$ 206	$ 3,057	$ 718	$ 1,355	$ -	$ 196	$ 46	$ 416	$ 5,994
Loans receivables:									
Ending balance	$ 98,858	$ 516,772	$ 130,565	$ 80,594	$ -	$ 53,173	$ 5,358		$ 885,320
Ending balance: individually evaluated for impairment	$ 1,996	$ 2,565	$ 2,583	$ 488	$ -	$ 641	$ 246		$ 8,519
Ending balance: acquired with credit deterioration	$ -	$ 522	$ -	$ -	$ -	$ -	$ -		$ 522
Ending balance: collectively evaluated for impairment	$ 96,862	$ 513,685	$ 127,982	$ 80,106	$ -	$ 52,532	$ 5,112		$ 876,279
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 3	$ 183	$ 201	$ -	$ 21	$ -		$ 408

20

(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - April 1, 2017	$ 247	$ 2,597	$ 774	$ 1,059	$ -	$ 196	$ 63	$ 482	$ 5,418
Charge-offs	-	(249)	(491)	-	-	-	-	-	(740)
Recoveries	-	-	3	-	-	-	1	-	4
Provisions	(2)	286	339	149	-	(7)	20	(200)	585
Ending balance - June 30, 2017	$ 245	$ 2,634	$ 625	$ 1,208	$ -	$ 189	$ 84	$ 282	$ 5,267

(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	-	(483)	(596)	-	-	-	(10)	-	(1,089)
Recoveries	2	50	19	-	1	-	1	-	73
Provisions	(106)	536	493	239	(1)	(7)	32	(276)	910
Ending balance - June 30, 2017	$ 245	$ 2,634	$ 625	$ 1,208	$ -	$ 189	$ 84	$ 282	$ 5,267
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 9	$ 140	$ 173	$ -	$ 18	$ -		$ 340

Residential	Commercial	Commercial	Commercial	Lease	Consumer	Consumer

(Dollars in thousands)	Mortgage	Mortgage	Term	Construction	Financing	Home Equity	Other	Unallocated	Total
Allowance for credit losses:									
Ending balance - December 31, 2017	$ 221	$ 2,856	$ 845	$ 1,128	$ -	$ 183	$ 63	$ 547	$ 5,843
Ending balance: individually evaluated for impairment	$ 3	$ 19	$ 123	$ -	$ -	$ -	$ 12	$ -	$ 157
Ending balance: collectively evaluated for impairment	$ 218	$ 2,837	$ 722	$ 1,128	$ -	$ 183	$ 51	$ 547	$ 5,686
Loans receivables:									
Ending balance	$ 93,959	$ 484,868	$ 129,535	$ 75,014	$ -	$ 56,844	$ 5,677		$ 845,897
Ending balance: individually evaluated for impairment	$ 1,908	$ 2,828	$ 2,080	$ 514	$ -	$ 612	$ 245		$ 8,187
Ending balance: acquired with credit deterioration	$ 7	$ 936	$ -	$ -	$ -	$ -	$ -		$ 943
Ending balance: collectively evaluated for impairment	$ 92,044	$ 481,104	$ 127,455	$ 74,500	$ -	$ 56,232	$ 5,432		$ 836,767
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 2	$ 155	$ 173	$ -	$ 18	$ -		$ 348

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 June 30, 2018 and June 30, 2017. The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 2,049	4,298	$ 0.48	$ 4,662	4,295	$ 1.09
Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	16	(0.01)	-	17	(0.01)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 2,049	4,314	$ 0.47	$ 4,662	4,312	$ 1.08

	Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 2,286	4,258	$ 0.54	$ 4,727	4,252	$ 1.11
	-	34	(0.01)	-	31	(0.01)

Effect of potential dilutive common stock equivalents – stock options and restricted shares						
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 2,286	4,292	$ 0.53	$ 4,727	4,283	$ 1.10

NOTE 6: ACCUMULATED OTHER COMPREHENSIVE LOSS

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

Accumulated Other Comprehensive Loss (Dollars in thousands)	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
June 30, 2018			
Net unrealized loss on AFS securities	$ (3,021)	$ 634	$ (2,387)
Unrealized actuarial losses-pension	(1,849)	388	(1,461)
	$ (4,870)	$ 1,022	$ (3,848)
December 31, 2017			
Net unrealized loss on AFS securities	$ (1,772)	$ 603	$ (1,169)
Unrealized actuarial losses-pension	(1,849)	628	(1,221)
	$ (3,621)	$ 1,231	$ (2,390)

NOTE 7: SUBORDINATED DEBENTURES, NOTES, AND OTHER BORROWINGS

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

DNB Capital Trust I

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

DNB Capital Trust II

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

Subordinated Note

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

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

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

Repurchase Agreements Accounted for as Secured Borrowings

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

(Dollars in thousands)	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater than 90 days	Total
June 30, 2018					
Repurchase agreements and repurchase-to-maturity transactions	$ 5,609	$ -	$ -	$ -	$ 5,609
Gross amount of recognized liabilities for repurchase agreements in statement of financial condition	$ 5,609				$ 5,609
December 31, 2017					
Repurchase agreements and repurchase-to-maturity transactions	$ 12,023	$ -	$ -	$ -	$ 12,023
Gross amount of recognized liabilities for repurchase agreements in statement of financial condition	$ 12,023				$ 12,023

As of June 30, 2018 and December 31, 2017, DNB had $5.6 million and $12.0 million of repurchase agreements, respectively. In conjunction with these repurchase agreements, $5.7 million and $12.3 million of state and municipal securities were sold on an overnight basis as of June 30, 2018 and December 31, 2017, respectively, which represents 102% of the repurchase agreement amounts.

NOTE 8: STOCK-BASED COMPENSATION

Stock Option Plan

DNB has a Stock Option Plan for employees and directors. Under the plan, options (both qualified and non-qualified) to purchase a maximum of 793,368 (as adjusted for subsequent stock dividends) shares of DNB's common stock could be issued to employees and directors. Under the plan, option exercise prices must equal the fair market value of the shares on the date of option grant and the option exercise period may not exceed ten years. Vesting of options under the plan is determined by the Plan Committee. There were 354,090 shares available for grant at June 30, 2018. All options are immediately exercisable. During the three and six months ended June 30, 2018 and 2017, DNB had no expenses related to the plan and anticipates no additional expense related to the plan. Under the Stock Option Plan, 5,300 shares were exercised during the six months ended June 30, 2018. The shares awarded from the non-qualified cashless exercises resulted in an increase in shares outstanding of 2,338 shares. There was a cash equivalent of 2,962 shares used to pay all applicable taxes on the transactions. Under the Stock Option Plan, 18,850 shares were exercised during the six months ended June 30, 2017. The shares awarded from the non-qualified cashless exercises resulted in an increase in shares outstanding of 9,132 shares. There was a cash equivalent of 9,718 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, 2018	16,450	$ 10.31
Issued	-	-
Exercised	5,300	10.31
Forfeited	-	-
Expired	-	-
Outstanding June 30, 2018	11,150	$ 10.31

	Number Outstanding	Weighted Average Exercise Price
Outstanding January 1, 2017	49,700	$ 9.18

Issued	-	-
Exercised	18,850	7.34
Forfeited	-	-
Expired	-	-
Outstanding June 30, 2017	30,850	$ 10.31

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

June 30, 2018

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Exercise Price	Average Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	11,150	11,150	$ 10.31	0.45 years	$ 276,000

December 31, 2017

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Exercise Price	Average Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	16,450	16,450	$ 10.31	0.95 years	$ 385,000

Other Stock-Based Compensation

DNB maintains an Incentive Equity and Deferred Compensation Plan (the "Plan"). The Plan provides that up to 493,101 (as adjusted for subsequent stock dividends) shares of common stock may be granted, at the discretion of the Board, to individuals of the Corporation. Shares already granted are issuable on the earlier of three or four years (cliff vesting period) after the date of the grant or a change in control of DNB if the recipients are then employed by DNB ("Vest Date"). Upon issuance of the shares, resale of the shares is restricted for an additional one year, during which the shares may not be sold, pledged or otherwise disposed of. Prior to the Vest Date and in the event the recipient terminates association with DNB for reasons other than death, disability or change in control, the recipient forfeits all rights to the shares that would otherwise be issued under the grant.

Share awards granted by the Plan were recorded at the date of award based on the market value of shares. Awards are being amortized to expense over a three or four year cliff-vesting period. DNB records compensation expense equal to the value of the shares being amortized. For the three and six month periods ended June 30, 2018, $108,000 and $204,000 was amortized to expense. For the three and six month periods ended June 30, 2017, $107,000 and $214,000 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 Chaffee 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 June 30, 2018, there was approximately $439,000 in additional compensation that will be recognized over the remaining service period of approximately 1.49 years. At June 30, 2018, 308,254 shares were reserved for future grants under the Plan.

There were 8,500 restricted shares that vested during the six months ended June 30, 2018. The shares awarded from the cashless exercises resulted in an increase in shares outstanding of 4,908 shares. There was a cash equivalent of 3,492 shares used to pay all applicable taxes on the transactions. There were no such transaction during the six months ended June 30, 2017. Stock grant activity is indicated below:

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2018	31,130	$ 26.53
Granted	10,750	33.98
Forfeited	4,345	28.92
Vested	8,500	26.69
Non-vested stock awards—June 30, 2018	29,035	$ 28.88

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2017	55,775	$ 25.63
Granted	500	34.00
Forfeited	90	23.99
Vested	-	-
Non-vested stock awards—June 30, 2017	56,185	$ 25.70

NOTE 9: INCOME TAXES

As of June 30, 2018, 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 2015 through 2017 were open for examination as of June 30, 2018.

NOTE 10: FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. 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. These assets are included as Level 3 fair values.

The following tables present assets measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017:

	June 30, 2018			
(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	$ -	$ 49,449	$ -	$ 49,449
GSE mortgage-backed securities	-	28,980	-	28,980
Collateralized mortgage obligations GSE	-	10,522	-	10,522
Corporate bonds	-	12,661	-	12,661
State and municipal tax-exempt	-	1,817	-	1,817
Total	$ -	$ 103,429	$ -	$ 103,429
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 1,961	$ 1,961
OREO and other repossessed property	-	-	1,167	1,167
Total	$ -	$ -	$ 3,128	$ 3,128

	December 31, 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	$ -	$ 52,893	$ -	$ 52,893
GSE mortgage-backed securities	-	32,488	-	32,488
Collateralized mortgage obligations GSE	-	11,654	-	11,654
Corporate bonds	-	12,820	-	12,820
State and municipal tax-exempt	-	1,928	-	1,928
Total	$ -	$ 111,783	$ -	$ 111,783
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 1,814	$ 1,814

OREO and other repossessed property	-	-	817	817
Total	$ -	$ -	$ 2,631	$ 2,631

27

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

June 30, 2018
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	$	73	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loans - Commercial mortgage		796	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-7%	to	-8%	(-8%)
Impaired loans - Commercial term		1,014	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-7%	to	-31%	(-17%)
Impaired loans - Consumer other		78	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loan total	$	1,961						
Other real estate owned	$	1,167		Disposal costs (2)	8%	to	8%	(-8%)

(1)
(2)

December 31, 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	$	4	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		1,648	Appraisal of	Appraisal adj. (2)	0%	to	-50%	(-6%)
			collateral (1)	Disposal costs (2)	0%	to	-9%	(-8%)
Impaired loans - Consumer other		116	Appraisal of	Appraisal adj. (2)	0%	to	0%	(0%)
			collateral (1)	Disposal costs (2)	-8%	to	-8%	(-8%)
Impaired loan total	$	1,814						
Other real estate owned	$	817		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 $9.0 million at June 30, 2018. Of this, $821,000 had specific valuation allowances of $194,000, leaving a fair value of $627,000 as of June 30, 2018. In addition, DNB had $1.5 million in impaired loans that were partially charged down by $117,000, leaving $1.3 million at fair value as of June 30, 2018. The total fair value of impaired loans at June 30, 2018 was $2.0 million. Impaired loans had a carrying amount of $9.1 million at December 31, 2017. Of this, $491,000 had specific valuation allowances of $157,000, leaving a fair value of $334,000 at December 31, 2017. In addition, DNB had $1.9 million in impaired loans that were partially charged down by $442,000, leaving $1.5 million at fair value as of December 31, 2017. The total fair value of impaired loans at December 31, 2017 was $1.8 million.

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 $5.1 million of such assets at June 30, 2018, $4.9 million of which was OREO and $187,000 was in other repossessed property. DNB had $5.0 million of such assets at December 31, 2017, which consisted of $4.8 million in OREO and $177,000 in other repossessed property. DNB wrote down the carrying values of one OREO property by $140,000 during the six month period ended June 30, 2018. DNB wrote down the carrying value of one OREO property by $102,000 to $1.2 million during the six month period ended June 30, 2017.

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 six months ended June 30, 2018.

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 statement of financial condition. The carrying amounts and fair values of financial instruments at June 30, 2018 and December 31, 2017 are as follows:

	June 30, 2018				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 33,452	$ 33,452	$ 33,452	$ -	$ -
AFS investment securities	103,429	103,429	-	103,429	-
HTM investment securities	62,145	60,815	-	58,815	2,000
Restricted stock	6,950	6,950	-	6,950	-
Loans held-for-sale	276	280	-	-	280
Loans, net of allowance, including impaired	879,132	864,770	-	-	864,770
Accrued interest receivable	3,911	3,911	-	3,911	-
Financial liabilities					
Deposits:					
Non-interest-bearing	175,561	175,561	-	175,561	-
NOW, Money market, and Savings	550,366	550,366	-	550,366	-
Time	114,766	113,523	-	113,523	-
Brokered	93,422	91,892	-	91,892	-
Repurchase agreements	5,609	5,609	-	5,609	-
FHLBP advances	62,972	62,229	-	62,229	-
Junior subordinated debentures and other borrowings	9,279	9,902	-	9,902	-
Subordinated debt	9,750	9,531	-	9,531	-
Accrued interest payable	561	561	-	561	-
Off-balance sheet instruments	-	-	-	-	-

29

	December 31, 2017				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 10,917	$ 10,917	$ 10,917	$ -	$ -
AFS investment securities	111,783	111,783	-	111,783	-
HTM investment securities	62,390	62,420	-	60,420	2,000
Restricted stock	7,641	7,641	-	7,641	-
Loans held-for-sale	651	657	-	-	657
Loans, net of allowance, including impaired	840,054	821,672	-	-	821,672
Accrued interest receivable	3,822	3,822	-	3,822	-
Financial liabilities					
Deposits:					
Non-interest-bearing	176,815	176,815	-	176,815	-
NOW, Money market, and Savings	502,086	502,086	-	502,086	-
Time	140,490	139,406	-	139,406	-
Brokered	41,812	42,304	-	42,304	-
Repurchase agreements	12,023	12,023	-	12,023	-
FHLBP advances	79,013	78,531	-	78,531	-
Junior subordinated debentures and other borrowings	9,279	9,373	-	9,373	-
Subordinated debt	9,750	9,577	-	9,577	-
Accrued interest payable	554	554	-	554	-
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 $93.4 million in brokered deposits at June 30, 2018, $20.9 million matures in 2018, $25.9 million matures in 2019, $28.4 million matures in 2020, $13.2 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 June 30, 2018, un-funded loan commitments totaled $195.1 million and stand-by letters of credit totaled $3.0 million. At December 31, 2017, un-funded loan commitments totaled $176.6 million and stand-by letters of credit totaled $4.6 million.

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

FORWARD-LOOKING STATEMENTS

DNB Financial Corporation (the "Registrant", "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 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, 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.

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 $2.0 million, or $0.47 per diluted share, for the quarter ending June 30, 2018, compared with $2.3 million, or $0.53 per share, for the same quarter, last year. For the six months ending June 30, 2018, DNB reported net income of $4.7 million, or $1.08 per share, compared with $4.7 million, or $1.10 per share, for the same period last year. Non-interest expense for the second quarter of 2018 included a one-time severance payment of $434,000 and other related costs of $79,000 associated with an internal restructuring, as well as a $140,000 write-down of an OREO property.

- As of June 30, 2018, total assets were $1.1 billion. Since December 31, 2017, total assets increased $51.7 million, or 4.8% (not annualized) primarily due to loan growth of $39.4 million, or 4.7% (not annualized). Total deposits increased $72.9 million, or 8.5% (not annualized) since December 31, 2017, mainly due to growth in money market and brokered deposits. As of June 30, 2018, total shareholders' equity was $105.3 million, compared with $101.9 million as of December 31, 2017. Tangible book value per share was $20.79 as of June 30, 2018, compared with $20.06 as of December 31, 2017.

- Gross loans held for investment were $885.3 million, or 78.1% of total assets, as of June 30, 2018. As of June 30, 2018, commercial loans – a key strategic emphasis - totaled $727.9 million and represented 82% of total loans. Over the past 3 months, total commercial loans increased $19.4 million, or 2.7% (not annualized). Commercial mortgage loans increased $18.3 million, or 3.7%, commercial business loans decreased $579,000, or less than 1%, and commercial construction loans increased $1.7 million, or 2.2%.

·

On a sequential quarter basis, core deposits increased $11.0 million, or 1.5% (not annualized), and were 77.8% of total deposits as of June 30, 2018. As of the same date, noninterest-bearing deposits were 18.8% of total deposits. Core deposit growth in the first quarter of 2018 was primarily attributable to an increase in NOW accounts. The amount of time deposits was relatively stable through the second quarter of 2018 as DNB used brokered deposits to help fund loan growth due to their more favorable rates and maturities compared with other non-core funding sources.

- Asset quality remained strong as net charge-offs were 0.15% (annualized) of total average loans for the quarter ending June 30, 2018. Total non-performing assets, including loans and other real estate property, were $11.9 million as of June 30, 2018, compared with $13.4 million as of March 31, 2018, and $12.6 million as of December 31, 2017. The ratio of non-performing loans to total loans was 0.76% compared with 0.97% as of March 31, 2018 and 0.89% as of December 31, 2017.

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 87% of total revenue during the second quarter of 2018. 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 six month period ended June 30, 2018:

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. Simulation model results continue to show moderate liability sensitivity to rising rates in 100, 200, 300 and 400 basis point shock scenarios over a 12 month period. Rate changes ramped in over 24 months also show moderate liability sensitivity.

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, 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, 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 32 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 $34,000 in 2018.

Material Trends and Uncertainties.

DNB reported net income available to common shareholders of $2.0 million, or $0.47 per diluted share, for the quarter ending June 30, 2018, compared with $2.3 million, or $0.53 per share, for the same quarter, last year. For the six months ending June 30, 2018, the Company reported net income of $4.7 million, or $1.08 per share, compared with $4.7 million, or $1.10 per share, for the same period last year.

There are many aspects of the economy and the Federal Reserve's monetary policy that influence DNB's ability to grow revenues and net income. In general, the U.S. economy is growing at a moderate pace. Average monthly job growth for the first six months of 2018 was approximately 215,000 based on preliminary estimates, while the national unemployment rate remained low at 4.0% as of June 30, 2018. Activity in the housing market continues at a moderate pace. Short-term interest rates are expected to continue to gradually rise. One of the most significant factors is that US economic growth is strengthening to about 3%, largely due to a substantial fiscal boost. Employment growth remains robust which, coupled with buoyant asset prices and strong consumer confidence, is sustaining income and consumption growth. Business investment is projected to strengthen as a result of major tax reform and supportive financial conditions. A pick-up in the world economy is underpinning export growth, although tensions have emerged on how best to reduce barriers to trade.

Although the national and international economies influence DNB's Results, economic conditions in southeastern Pennsylvania are more germane, as the majority of DNB's loan and deposits relationships are with businesses and individuals within the Third Federal Reserve District. The Federal Reserve's July 18, 2018 Beige Book summarizes the economic climate which impacts DNB's operating environment.

Aggregate business activity in the Third District continued at a modest pace of growth during the July 18, 2018 Beige Book period. Employment also continued at a modest pace; but with hiring constrained by a tightening labor market, wage increases have become more widespread and accelerated to a moderate pace. Despite rising labor costs, most of the Federal Reserve's contacts are not yet concerned that inflation will exceed its current modest pace. While manufacturing activity and nonfinancial services maintained a moderate pace of growth, most retail sectors continued at a modest pace. The construction and real estate sectors tended to be flat or declining. In particular, nonresidential construction activity has begun to decline from its previously high levels and represented the only sector with a significant shift in activity during the July 18, 2018 Beige Book period. The growth outlook over the next six months remained positive, with over half of all firms anticipating increases in general activity.

Homebuilders reported no change in sales and construction activity. In most major Third District markets, sales of existing homes continued to be down moderately compared with the same period last year. According to brokers, inventories remain at very low levels throughout the District.

The Federal Reserve's nonresidential real estate contacts reported no change in the modest growth in leasing activity. However, as several major projects reach or near completion in Philadelphia, there has been a slow and steady decline in labor hours from previously high levels of construction activity.

Third District financial firms reported modest growth in overall loan volumes (excluding credit cards)--a somewhat faster pace than the May 30, 2018 Beige Book period. Volumes grew moderately in mortgages and in commercial and industrial lending and grew slightly in commercial real estate lending. However, these gains were offset by slight declines in home equity lines, auto loans, and in other consumer loans. Compared with one year earlier, loans grew modestly in all categories, except for home equity lines. During the current period, credit card lending grew at a moderate pace, however slow by comparison to the same period last year for this highly seasonal measure. Over the year, credit card lending has grown modestly. The Federal Reserve's banking contacts continued to note competitive pressure to raise deposit rates but flagged few concerns about credit standards and no issues with credit quality. Bankers remained generally confident about future economic prospects.

Third District manufacturing activity maintained a moderate pace of growth. About 40 percent of the firms reported an increase in shipments and new orders; however, this percentage was closer to 50 percent for new orders during the May 30, 2018 Beige Book period. The makers of chemical products, paper products, fabricated metal products, and electronic equipment tended to note gains in new orders and shipments, while the makers of lumber products, primary metals, and industrial machinery reported mixed results. On balance, the Federal Reserve's manufacturing contacts continued to expect general activity to increase over the next six months and the percentage of firms expecting future increases remained just below 50 percent. About 40 percent of the firms expected increases in future employment and future capital expenditures, which represented an improved outlook for capital expenditures since the May 30, 2018 Beige Book period, but a lower expectation for employment.

These and other factors have impacted DNB's 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 Reform and Legislation. From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of DNB in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. DNB cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on its financial condition or results of operations. A change in statutes, regulations or regulatory policies applicable to DNB or our subsidiaries could have a material effect on our business, financial condition and results of operations.

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 principles. 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 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 $1.13 billion at June 30, 2018, compared to $1.08 billion at December 31, 2017. The $51.7 million increase in total assets was primarily attributable to a $39.1 million increase in net loans and a $22.5 million increase in cash and cash equivalents, offset by an $8.6 million decrease in investment securities.

Investment Securities. Investment securities, including restricted stock, at June 30, 2018 were $172.5 million, compared to $181.8 million at December 31, 2017. The $9.3 million decrease in investment securities and restricted stock was primarily due to $7.3 million in principal pay-downs, calls and maturities, a $691,000 decrease in restricted stock, and a $1.2 million increase in unrealized loss of the AFS portfolio.

Gross Loans. DNB’s loans held for investment increased $39.4 million to $885.3 million at June 30, 2018, compared to $845.9 million at December 31, 2017. Total commercial loans increased $38.5 million and residential loans increased $4.9 million, while consumer loans decreased $4.0 million.

Deposits. Deposits were $934.1 million at June 30, 2018, compared to $861.2 million at December 31, 2017. Deposits increased $72.9 million or 8.47% during the six month period ended June 30, 2018. Core deposits, which are comprised of demand, NOW, money markets and savings accounts, increased by $47.0 million, while time deposits decreased by $25.7 million and brokered deposits increased by $51.6 million.

Borrowings. Borrowings were $87.9 million at June 30, 2018, compared to $112.8 million at December 31, 2017. The decrease of $24.9 million or 22.04% was primarily due to a $16.0 million decrease in FHLBP advances, a $6.4 million decrease in repurchase agreements, and a $2.4 million decrease in other borrowings.

Stockholders’ Equity. Stockholders' equity was $105.3 million at June 30, 2018, compared to $101.9 million at December 31, 2017. The increase in stockholders’ equity was primarily a result of year-to-date earnings of $4.7 million, sales of treasury shares totaling $293,000, and restricted stock compensation expense of $204,000. These additions to stockholders’ equity were partially offset by other comprehensive loss of $987,000, taxes on the exercise of stock options of $180,000 and $601,000 of dividends paid on DNB’s common stock.

RESULTS OF OPERATIONS

SUMMARY

Net income for the three and six month periods ended June 30, 2018 was $2.0 million and $4.7 million, respectively, compared to $2.3 million and $4.7 million for the same periods in 2017. Diluted earnings per share for the three and six month periods ended June 30, 2018 was $0.48 and $1.08, compared to $0.53 and $1.10 for the same periods in 2017. The $237,000 decrease in net income in the second quarter of 2018 compared to the second quarter of 2017 was primarily attributable to a $456,000 increase in non-interest expense (primarily due to increased salaries and employee benefits expense from a previously disclosed one-time internal restructuring expense), a $211,000 decrease in net interest income before provision (primarily due to increased interest expense on deposits), a $90,000 decrease in non-interest income (primarily due to a reduction in gains on sales of loans and securities), offset by a $310,000 decrease in income tax expense (primarily due to decreased effective tax rate as a result of the Tax Cuts and Jobs Act of 2017) and a $210,000 decrease in provision for credit losses. The $65,000 decrease in net income during the six month period ended June 30, 2018 compared to the six month period ended June 30, 2017 was primarily attributable to a $441,000 increase in non-interest expense (primarily due to increased salaries and employee benefits), a $416,000 decrease in net interest income before provision (primarily due to increased interest expense on deposits), and a $123,000 decrease in non-interest income (primarily due to decreased gains on sales of loans, securities, and insurance proceeds), offset by a $755,000 decrease in income tax expense (primarily due to decreased effective tax rate as a result of the Tax Cuts and Jobs Act of 2017) and a $160,000 decrease in provision for credit losses.

NET INTEREST INCOME

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

Net interest income for the three and six month periods ended June 30, 2018 was $9.1 million and $18.1 million, compared to $9.3 million and $18.5 million for the same periods in 2017. Interest income for the three and six month periods ended June 30, 2018 was $11.3 million and $22.2 million, compared to $10.7 million and $21.2 million for the same periods in 2017. The $628,000 increase in interest income in the second quarter of 2018, compared to the second quarter of 2017, was primarily due to increases of $590,000 in interest and fees on loans and $87,000 in interest and dividends on investment securities, offset by a decrease of $49,000 in interest on cash and cash equivalents. The $1.0 million increase in interest income in the six month period ended June 30, 2018, compared to the six month period ended June 30, 2017, was primarily due to increases of $951,000 in interest and fees on loans and $158,000 in interest and dividends on investment securities, offset by a decrease of $62,000 in interest on cash and cash equivalents. The weighted average yield on total interest-earning assets was 4.28% and 4.26% for the three and six month periods ended June 30, 2018, compared to 4.12% and 4.14% for the same periods in 2017. Interest expense for the three and six month periods ended June 30, 2018 was $2.2 million and $4.1 million, compared to $1.4 million and $2.6 million for the same periods in 2017. The $839,000 increase in interest expense in the second quarter of 2018, compared to the second quarter of 2017, was primarily due to increases of $746,000 in interest on deposits and $93,000 in interest on borrowings. The $1.5 million increase in interest expense in the six month period ended June 30, 2018, compared to the six month period ended June 30, 2017, was primarily due to increases of $1.2 million in interest on deposits and $240,000 in interest on borrowings. The composite cost of funds for the three and six month periods ended June 30, 2018 was 0.90% and 0.84%, compared to 0.56% and 0.54% for the same periods in 2017.

Interest on loans was $10.2 million and $20.0 million for the three and six month periods ended June 30, 2018, compared to $9.6 million and $19.1 million for the same periods in 2017. The average balance of loans was $869.2 million, with a tax equivalent average yield of 4.70% (a non-GAAP measure) for the second quarter of 2018, compared to $817.1 million, with a tax equivalent average yield of 4.68% (a non-GAAP measure) for the same period in 2017. The average balance of loans was $860.4 million, with a tax equivalent average yield of 4.71% (a non-GAAP measure) for the six month period ended June 30, 2018, compared to $816.1 million, with a tax equivalent average yield of 4.69% (a non-GAAP measure) for the same period in 2017. See the following table for a reconciliation of the non-GAAP measure “tax equivalent average yield on loans.”

Tax equivalent average yield on loans (Non-GAAP)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2018	2017	2018	2017
Interest and fees on loans (GAAP)	$ 10,164	$ 9,574	$ 20,046	$ 19,095
Tax adjustment	27	66	57	132
Tax equivalent interest and fees on loans (Non-GAAP)	$ 10,191	$ 9,640	$ 20,103	$ 19,227
Average balance of loans	$ 869,166	$ 817,148	$ 860,443	$ 816,094
Tax equivalent average yield on loans (Non-GAAP)	4.70 %	4.68 %	4.71 %	4.69 %

Interest and dividends on investment securities was $1.1 million and $2.1 million for the three and six month periods ended June 30, 2018, compared to $993,000 and $1.9 million for the same periods in 2017. The average balance of investment securities was $178.6 million with a tax equivalent average yield of 2.53% (a non-GAAP measure) for the second quarter of 2018, compared to $183.4 million with a tax equivalent average yield of 2.42% (a non-GAAP measure) for the same period in 2017. The average balance of investment securities was $180.6 million with a tax equivalent average yield of 2.44% (a non-GAAP measure) for the six month period ended June 30, 2018, compared to $185.3 million with a tax equivalent average yield of 2.36% (a non-GAAP measure) for the same period in 2017. See the following table for a reconciliation of the non-GAAP measure “tax equivalent average yield on investment securities.”

Tax equivalent average yield on investment securities (Non-GAAP)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2018	2017	2018	2017
Interest on tax exempt investment securities (GAAP)	$ 1,080	$ 993	$ 2,090	$ 1,932
Tax adjustment	52	115	110	240
Tax equivalent interest on tax-exempt investment securities (Non-GAAP)	$ 1,132	$ 1,108	$ 2,200	$ 2,172
Average balance of investment securities	$ 178,644	$ 183,360	$ 180,638	$ 185,274
Tax equivalent average yield on investment securities (Non-GAAP)	2.53 %	2.42 %	2.44 %	2.36 %

Interest on deposits was $1.7 million and $3.1 million for the three and six month periods ended June 30, 2018, compared to $995,000 and $1.9 million for the same periods in 2017. The average balance of deposits was $907.8 million, with an average rate of 0.77% for the second quarter of 2018, compared to $903.5 million, with an average rate of 0.44% for the same period in 2017. The average balance of deposits was $890.4 million, with an average rate of 0.70% for the six month period ended June 30, 2018, compared to $893.5 million, with an average rate of 0.42% for the same period in 2017. The increases in average rate were attributable to a 75 basis points increase in the federal funds rate, which has impacted the rates DNB pays on the majority of interest-bearing deposit accounts.

Interest on borrowings was $480,000 and $1.0 million for the three and six month periods ended June 30, 2018, compared to $387,000 and $772,000 for the same periods in 2017. The average balance of borrowings was $87.7 million, with an average rate of 2.20% for the second quarter of 2018, compared to $82.6 million, with an average rate of 1.87% for the same period in 2017. The average balance of borrowings was $97.8 million, with an average rate of 2.08% for the six month period ended June 30, 2018, compared to $85.2 million, with an average rate of 1.82% for the same period in 2017.

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

40

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.

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 $750,000 provision made during the three and six months periods ended June 30, 2018, compared to $585,000 and $910,000 for the same periods in 2017. DNB's percentage of allowance for credit losses to total loans was 0.70% at June 30, 2018 compared to 0.69% and 0.65% at December 31, 2017 and June 30, 2017, respectively. Net charge-offs were $405,000, $1.2 million, and $1.0 million during the six months ended June 30, 2018, year ended December 31, 2017, and six months ended June 30, 2017, respectively. The percentage of net charge-offs to total average loans were 0.05%, 0.15%, and 0.12% for those same respective periods. Management believes that the allowance for credit losses is adequate, but continues to monitor it along with other performance metrics including those ratios related to non-performing loans. Management is not aware of any potential problem loans, which were accruing and current at June 30, 2018, 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 $809,000 during the six month period ended June 30, 2018. 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.

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

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

As of June 30, 2018, DNB had $11.9 million of non-performing assets, which included $6.7 million of non-performing loans and $5.1 million of OREO and other repossessed assets. This compares to $12.6 million of non-performing assets at December 31, 2017 which included $7.6 million of non-performing loans and $5.0 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 $9.0 million of impaired loans ($6.7 million of non-performing loans, $1.8 million of performing TDRs, and a $522,000 performing ASC 310-30 loan) at June 30, 2018, $821,000 had valuation allowances of $194,000 and $8.2 million had no specific allowance. Of the $9.1 million of impaired loans ($7.6 million of non-performing loans, $1.0 million of performing TDRs, and a $520,000 performing ASC 310-30 loan) at December 31, 2017, $491,000 had valuation allowances of $157,000 and $8.6 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 June 30, 2018, DNB recognized $358,000 in total charge-offs, $350,000 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 $250,000 or higher, every twelve to twenty-four months, dependent upon management's assessment of trends in relevant markets and property types. 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)

	Six Months Ended June 30, 2018	Year Ended December 31, 2017	Six Months Ended June 30, 2017
Beginning balance	$ 5,843	$ 5,373	$ 5,373
Provisions	750	1,660	910
Loans charged off:			
Residential mortgage	(137)	(85)	-
Commercial mortgage	(184)	(519)	(483)
Commercial:			
Commercial term	(64)	(683)	(596)

Commercial construction	-	-	-
Lease financing	-	-	-
Consumer:			
Home equity	-	-	-
Other	(49)	(38)	(10)
Total charged off	(434)	(1,325)	(1,089)
Recoveries:			
Residential mortgage	26	16	2
Commercial mortgage	-	51	50
Commercial:			
Commercial term	2	23	19
Commercial construction	-	42	-
Lease financing	-	1	1
Consumer:			
Home Equity	-	-	-
Other	1	2	1
Total recoveries	29	135	73
Ending balance	$ 6,188	$ 5,843	$ 5,267

42

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

Composition of Allowance for Credit Losses

(Dollars in thousands)

	June 30, 2018		December 31, 2017		June 30, 2017	
	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	$ 207	11 %	$ 221	11 %	$ 245	11 %
Commercial mortgage	3,076	58	2,856	57	2,634	56
Commercial:						
Commercial term	889	15	845	15	625	14
Commercial construction	1,355	9	1,128	9	1,208	11
Lease financing	-	-	-	-	-	-
Consumer:						
Home equity	196	6	183	7	189	7
Other	49	1	63	1	84	1
Unallocated	416	-	547	-	282	-
Total	$ 6,188	100 %	$ 5,843	100 %	$ 5,267	100 %
Reserve for unfunded loan commitments	$ 408		$ 348		$ 340	

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 six month periods ended June 30, 2018 was $1.3 million and $2.6 million, compared to $1.4 million and $2.7 million for the same periods in 2017. The $90,000 decrease during the three months ended June 30, 2018 was mainly attributable to decreases of $87,000 in gains from sale of loans, $48,000 in other fees (mostly servicing fees), $30,000 in service charges (mostly NSF fees and business analysis charges), and

$25,000 in gain on sale of investment securities. These decreases were offset by increases of $62,000 in mortgage banking and $41,000 in wealth management. The $123,000 decrease during the six months ended June 30, 2018 was mainly attributable to decreases of $87,000 in gain on sale of loans, $80,000 in gains from insurance proceeds, $80,000 in service charges (mostly NSF fees and business analysis charges), $34,000 in other fees (mostly servicing fees), and $25,000 in gain on sale of investment securities. These decreases were offset by increases of $102,000 in wealth management and $87,000 in mortgage banking.

NON-INTEREST EXPENSE

Non-interest expense for the three and six month periods ended June 30, 2018 was $7.5 million and $14.3 million, compared to $5.2 million and $10.6 million for the same periods in 2017. During the three months ended June 30, 2018, total non-interest expense increased by $456,000. The increase was primarily due to increases of $537,000 in salaries and employee benefits (compensation expense for the second quarter of 2018 included a one-time severance payment of $434,000 and other related costs of $79,000 associated with an internal restructuring), $45,000 in furniture and equipment (increased maintenance agreement expenses), $40,000 in other expenses (increased provision for unfunded commitments), $25,000 in loss on sale or write down of OREO, and $10,000 in PA shares tax. These increases were partially offset by decreases of $70,000 in advertising and marketing, $32,000 in professional and consulting (mostly 3rd party expenses), $28,000 in FDIC insurance (assessment rate decreased due to improved leverage ratio and increase in income over the last 12 months), $26,000 in due diligence and merger expense (no expense in 2018), $22,000 in occupancy (mostly repairs and maintenance), and $16,000 in printing and supplies. During the six months ended June 30, 2018, total non-interest expense increased by $441,000. The increase was primarily due to increases of $668,000 in salaries and employee benefits (internal restructuring costs noted above), $38,000 in furniture and equipment (increased maintenance agreement expenses), $27,000 in PA shares tax, and $26,000 in loss on sale or write down of OREO. These increases were partially offset by decreases of $105,000 in FDIC insurance (assessment rate decreased due to improved leverage ratio and increase in income over the last 12 months), $77,000 in due diligence and merger expense (no expense in 2018), $54,000 in advertising and marketing, $44,000 in occupancy (mostly repairs and maintenance), $22,000 in professional and consulting (mostly 3rd party expenses), $13,000 in printing and supplies, and $13,000 in telecommunications.

INCOME TAXES

Income tax expense for the three and six month periods ended June 30, 2018 was $436,000 and $1.0 million, respectively, compared to $746,000 and $1.8 million for the same periods in 2017. The effective tax rate for the three and six month periods ended June 30, 2018 was 17.5% and 17.9% compared to 24.6% and 27.3% for the same periods in 2017. The decrease in effective tax rate was mainly attributable to adoption of the Tax Cuts and Jobs Act of 2017 which reduced the statutory rate from 34% to 21%. Income tax expense for each period differs from the amount determined at the statutory rate, due to tax-exempt income on loans and investment securities and DNB's ownership of BOLI policies.

ASSET QUALITY

DNB works diligently to improve asset quality by adhering to strict underwriting standards and improving lending policies and procedures. Non-performing assets totaled $11.9 million at June 30, 2018 compared to $12.6 million at December 31, 2017 and $12.2 million at June 30, 2017. 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 June 30, 2018, DNB had $11.0 million of substandard loans. Of the $11.0 million, $3.9 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, 2017 was $4.5 million. DNB had $4.7 million of special mention loans at June 30, 2018 compared to $240,000 at December 31, 2017. The increase in special mention loans during the six months ended June 30, 2018 was primarily due to rating downgrades in the portfolio, specifically $2.3 million of commercial mortgages, $1.6 million of commercial construction loans, $429,000 in commercial term loans, and $144,000 in home equity 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)

	June 30, 2018	December 31, 2017	June 30, 2017
Non-accrual loans:			
Residential mortgage	$ 1,344	$ 1,915	$ 1,815
Commercial mortgage	1,593	2,259	2,375
Commercial:			
Commercial term	2,583	2,100	1,510
Commercial construction	488	514	447
Consumer:			
Home equity	498	466	404
Other	215	245	311
Total non-accrual loans	6,721	7,499	6,862
Loans 90 days past due and still accruing	23	54	-
Total non-performing loans	6,744	7,553	6,862
Other real estate owned & other repossessed property	5,113	5,012	5,351
Total non-performing assets	$ 11,857	$ 12,565	$ 12,213
Asset quality ratios:			
Non-performing loans to total loans	0.76 %	0.89 %	0.84 %
Non-performing assets to total assets	1.05	1.16	1.13
Allowance for credit losses to:			
Total loans	0.70	0.69	0.65
Non-performing loans	91.8	77.4	76.8

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 June 30, 2018 and December 31, 2017 are as follows:

	June 30, 2018		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 676	$ 805	$ 652
Commercial mortgage	992	992	972
Consumer:			
Home equity	148	148	143
Other	40	42	30
Total	$ 1,856	$ 1,987	$ 1,797

	December 31, 2017		
(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Residential mortgage	$ 603	$ 732	$ 690
Commercial mortgage	992	992	982
Consumer:			
Home equity	148	148	146
Other	40	42	39
Total	$ 1,783	$ 1,914	$ 1,857

At June 30, 2018, DNB had nine TDRs with recorded investment totaling $1,797,000, all of which are accruing loans in compliance with the terms of the modifications. As a result of collateral 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 June 30, 2018, 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 six months ended June 30, 2018.

At December 31, 2017, DNB had eight TDRs with recorded investment totaling $1,857,000, five of which, totaling $1,128,000, were accruing loans in compliance with the terms of the modifications. The remaining $729,000 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. As of December 31, 2017, 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 December 31, 2017, 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 2017. DNB classified three commercial mortgage loans totaling $992,000 as TDRs during the year ended December 31, 2017.

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

(Dollars in thousands)	At and For the Six Months Ended June 30, 2018	At and For the Year Ended December 31, 2017	At and For the Six Months Ended June 30, 2017
Total recorded investment	$ 9,041	$ 9,130	$ 7,528
Impaired loans with a specific allowance	821	491	445
Impaired loans without a specific allowance	8,220	8,639	7,083
Average recorded investment	9,491	8,373	7,987
Specific allowance allocation	194	157	67
Total principal and interest collected	318	1,409	331
Interest income recorded	49	24	4

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 $115.8 million at June 30, 2018 compared to $109.3 million at December 31, 2017. 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 $553.4 million at June 30, 2018. As a member of the FHLB, we are eligible to borrow up to a specific credit limit which is determined by the amount of our residential mortgages, commercial mortgages and other loans that have been pledged as collateral. As of June 30, 2018, DNB's Maximum Borrowing Capacity with the FHLBP was $493.4 million. At June 30, 2018, DNB had borrowed $63.0 million and the FHLB had issued letters of credit, on DNB's behalf, totaling $45.0 million against its available credit lines. At June 30, 2018, DNB also had available $60.0 million of unsecured federal funds lines of credit with other financial institutions as well as $482.7 million of available short or long term funding through several agreements and programs with brokers. Management believes that DNB has adequate resources to meet its short-term and long-term funding requirements.

At June 30, 2018, DNB had $195.1 million in un-funded loan commitments. Management anticipates these commitments will be funded by means of normal cash flows. Certificates of deposit greater than or equal to $250,000 scheduled to mature in one year or less from June 30, 2018 totaled $30.2 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 Bank has met the definition of "well capitalized" for regulatory purposes on June 30, 2018. 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 and meets other requirements to be considered "well capitalized" (see additional discussion included in Note 18 of DNB's December 31, 2017 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 1.875% and 1.25% for 2018 and 2017, respectively.

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

	Actual			For Capital Adequacy Purposes*			To Be Well Capitalized Under Prompt Corrective Action Provisions		
(Dollars in thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
DNB Financial Corporation									
June 30, 2018									
Total risk-based capital	$ 118,614	13.59	%	$ 69,817	8.00	%	N/A	N/A	
Common Equity Tier 1 capital	993,268	10.69		39,272	4.50		N/A	N/A	
Tier 1 risk-based capital	102,268	11.72		52,363	6.00		N/A	N/A	
Tier 1 (leverage) capital	102,268	9.35		43,771	4.00		N/A	N/A	
December 31, 2017									
Total risk-based capital	$ 113,400	13.73	%	$ 66,083	8.00	%	N/A	N/A	
Common equity tier 1 capital	88,459	10.71		37,172	4.50		N/A	N/A	
Tier 1 risk-based capital	97,459	11.80		49,562	6.00		N/A	N/A	
Tier 1 (leverage) capital	97,459	9.19		42,426	4.00		N/A	N/A	
DNB First, N.A.									
June 30, 2018									
Total risk-based capital	$ 117,005	13.43	%	$ 69,683	8.00	%	$ 87,103	10.00	%
Common Equity Tier 1 capital	110,409	12.68		39,197	4.50		56,617	6.50	
Tier 1 risk-based capital	110,409	12.68		52,262	6.00		69,683	8.00	
Tier 1 (leverage) capital	110,409	10.10		43,719	4.00		54,649	5.00	
December 31, 2017									
Total risk-based capital	$ 112,050	13.59	%	$ 65,953	8.00	%	$ 82,441	10.00	%
Common equity tier 1 capital	105,859	12.84		37,098	4.50		53,587	6.50	
Tier 1 risk-based capital	105,859	12.84		49,465	6.00		65,953	8.00	
Tier 1 (leverage) capital	105,859	9.99		42,378	4.00		52,972	5.00	

*Does not include capital conservation buffer of 1.875% and 1.25% for June 30, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017, DNB's variance in the EVE as a percentage of assets with an instantaneous and sustained parallel shift of 200 basis points was within its negative 3% guideline, as shown in the following table. The change as a percentage of the present value of equity with a 200 basis point increase was within DNB's negative 25% guideline at June 30, 2018 and December 31, 2017.

(Dollars in thousands)	June 30, 2018			December 31, 2017		
Change in rates	Flat	-200bp	+200bp	Flat	-200bp	+200bp
EVE	$ 155,742	$ 149,719	$ 150,142	$ 129,535	$ 120,945	$ 123,710
Change		(6,023)	(5,600)		(8,590)	(5,825)
Change as % of assets		(0.5%)	(0.5%)		(0.8%)	(0.5%)
Change as % of PV equity		(3.9%)	(3.6%)		(6.6%)	(4.5%)

ITEM 4- CONTROLS AND PROCEDURES

DNB’s Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of June 30, 2018, the end of the period covered by this report, in accordance with the requirements of Exchange Act Rule 240.13a-15(b). Based on that evaluation, Management has concluded that DNB’s current disclosure controls and procedures are effective.

Management of DNB is responsible for establishing and maintaining adequate internal control over financial reporting for DNB, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. There was no change in DNB’s “internal control over financial reporting” (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2018, 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 2017 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 June 30, 2018. The following table provides information on repurchases by DNB of its common stock in each month of the quarter ended June 30, 2018:

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (a)
April 1, 2018 – April 30, 2018	-	$ -	-	$ 63,016
May 1, 2018 – May 31, 2018	-	-	-	$ 63,016
June 1, 2018 – June 30, 2018	-	-	-	$ 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.

48

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
August 6, 2018	BY:	/s/ William J. Hieb
		William J. Hieb, Chief Executive Officer, President and Director
August 6, 2018	BY:	/s/ Gerald F. Sopp
		Gerald F. Sopp, Chief Financial Officer and Executive Vice President

50

Exhibit Index

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