

# 2016 ANNUAL REPORT



# DNB Financial Corporation

## Selected Financial Data

At or For the Year Ended December 31  
Dollars in thousands, except share data

	2016	2015	2014	2013	2012
<b>RESULTS OF OPERATIONS</b>					
Interest income	\$ 29,179	\$ 24,478	\$ 23,596	\$ 23,212	\$ 25,729
Interest expense	3,324	2,712	2,311	2,888	3,755
Net interest income	25,855	21,766	21,285	20,324	21,974
Provision for credit losses	730	1,105	1,130	2,530	1,455
Non-interest income	6,364	5,009	4,958	4,795	4,528
Non-interest expense	24,641	19,029	18,632	17,450	17,702
Income before income taxes	6,848	6,641	6,481	5,139	7,345
Income tax expense	1,869	1,503	1,677	1,220	2,106
Net income	\$ 4,979	\$ 5,138	\$ 4,804	\$ 3,919	\$ 5,239
Preferred stock dividends & accretion of discount	–	50	135	148	332
Net income available to common stockholders	\$ 4,979	\$ 5,088	\$ 4,669	\$ 3,771	\$ 4,907
<b>PER SHARE DATA</b>					
Basic earnings	\$ 1.56	\$ 1.82	\$ 1.69	\$ 1.38	\$ 1.81
Diluted earnings	1.55	1.79	1.66	1.36	1.79
Cash dividends	0.28	0.28	0.28	0.28	0.20
Book value	22.36	19.65	18.33	16.55	16.08
Tangible book value	18.56	19.58	18.26	16.47	15.98
Average common shares outstanding	3,186,079	2,801,881	2,766,723	2,742,417	2,710,819
Average diluted common shares outstanding	3,218,884	2,847,488	2,812,726	2,780,752	2,739,954
<b>PERFORMANCE RATIOS</b>					
Return on average assets	0.59 %	0.69 %	0.71 %	0.60 %	0.84 %
Return on average stockholders' equity	7.40	8.72	7.78	6.75	9.61
Return on average tangible equity	9.74	8.73	7.79	6.77	9.67
Net interest margin	3.31	3.16	3.36	3.30	3.66
Efficiency ratio	75.53	68.31	71.12	69.29	62.61
Wtd average yield on earning assets	3.72	3.51	3.67	3.76	4.26
<b>FINANCIAL CONDITION</b>					
Total assets	\$ 1,070,685	\$ 748,818	\$ 723,330	\$ 661,473	\$ 639,568
Total liabilities	975,845	693,330	659,422	602,890	582,863
Total stockholders' equity	94,840	55,488	63,908	58,583	56,705
Loans, gross	817,529	481,758	455,603	415,354	396,498
Allowance for credit losses	5,373	4,935	4,906	4,623	6,838
Investment securities	182,206	220,208	231,656	186,958	201,312
Goodwill	15,590	–	–	–	–
Intangible assets	537	66	82	111	181
Deposits	885,187	606,275	605,083	558,747	530,424
Borrowings	86,668	81,909	49,005	39,674	46,864
<b>ASSET QUALITY RATIOS</b>					
Net charge-offs to average loans	0.05 %	0.23 %	0.19 %	1.20 %	0.20 %
Non-performing loans/total loans	1.04	1.06	1.50	1.38	2.63
Non-performing assets/total assets	1.05	1.02	1.07	1.03	1.82
Allowance for credit loss/total loans	0.66	1.02	1.08	1.11	1.72
Allowance for credit loss/non-performing loans	63.20	96.91	71.59	80.70	65.54
<b>CAPITAL RATIOS</b>					
Total equity/total assets	8.86 %	7.41 %	8.84 %	8.86 %	8.87 %
Tangible equity/tangible assets	7.46	7.40	8.82	8.84	8.84
Tier 1 leverage ratio	8.42	8.94	10.55	10.61	10.50
Common equity tier 1 risk based capital ratio	9.60	10.44	10.50	10.51	10.51
Tier 1 risk based capital ratio	10.67	12.08	14.90	15.35	14.63
Total risk based capital ratio	12.50	14.78	15.92	16.40	15.88

## Dear Valued Shareholders,

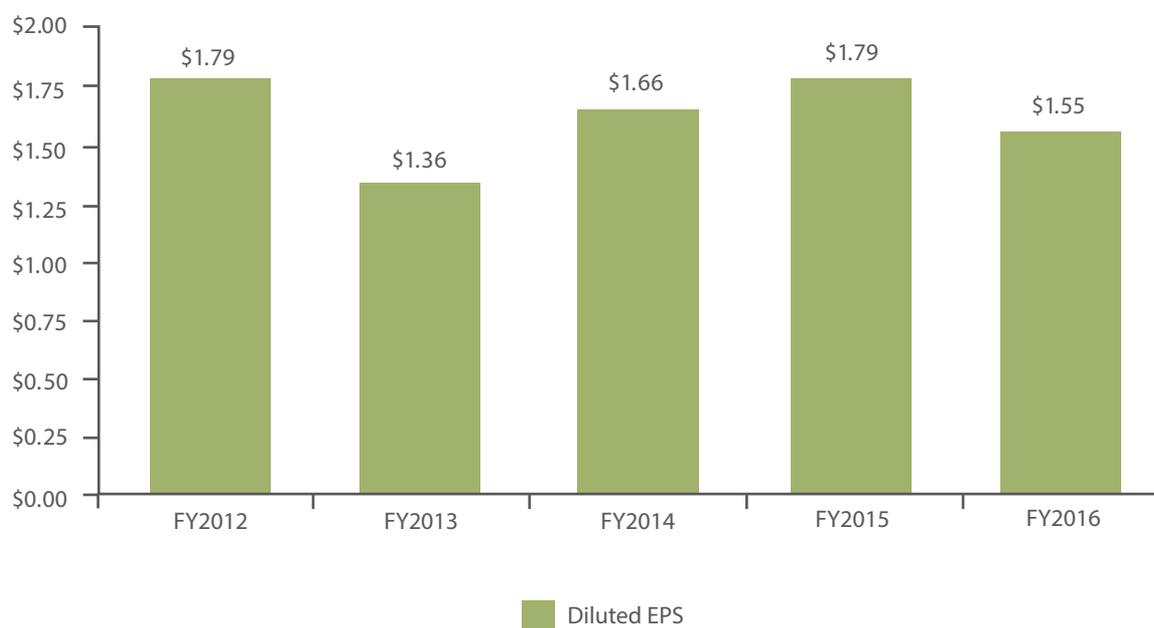
We are proud that DNB Financial achieved significant progress in 2016 and continued to build for the future. Our strong earnings were driven by disciplined loan growth, excellent credit quality, increased non-interest income, and controlled expense management. Among the highlights of the past year was the successful acquisition of East River Bank on October 1, 2016. Through East River, we added three full-service offices and expanded our customer base in the Philadelphia market area. East River's commitment to its commercial and retail customers aligns smoothly with the strategic vision and corporate values of DNB, where we have served individuals, businesses, and our local communities for over 150 years.

The East River Bank merger is an important component of our strategy to be recognized as a high-performing community bank in southeastern Pennsylvania. We believe this combination of two profitable banks enables us to offer more products and services to existing customers, and provides us with greater opportunities to grow and deliver superior financial performance. The acquisition of East River added approximately \$306 million in loans and \$227 million of deposits.

We are excited and pleased that, as part of the merger, Christopher P. McGill, former president and chief executive of East River, joined DNB as executive vice president and chief commercial lending officer. We are also delighted that John F. McGill, Jr., former chairman of East River, joined the DNB board of directors as vice chairman; and two other former members of the East River board of directors, Charles A. Murray and Daniel O'Donnell, joined the DNB board as independent directors. We thank our management and our entire employee team, who worked diligently to ensure the success of the merger.

In addition to the East River transaction, the Company had a productive year, featuring strong revenue growth and solid net income. Total revenue for fiscal 2016 was \$32.2 million, which represented an increase of \$5.4 million, or 20.3%, over fiscal 2015. Our reported 2016 net income was \$5.0 million, or \$1.55 per share. Per share figures for 2016 reflect additional shares issued in connection with the East River Bank transaction.

### CONSISTENT EARNINGS



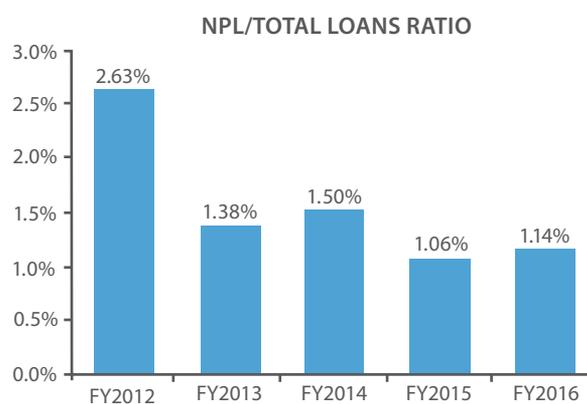
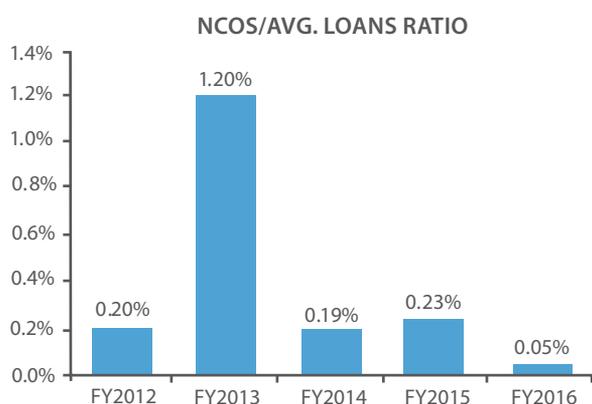
The return on average assets (“ROAA”) and average tangible equity (“ROTCE”) for 2016 were .59% and 9.74%, respectively. We remain committed to improving these profitability metrics by continuing to follow our strategic plan to drive shareholder value. This strategy focuses on: (1) providing high-quality banking products and services for our customers; (2) increasing productivity through prudent growth; (3) preserving credit discipline; (4) controlling overhead costs; and (5) expanding our fee income businesses. The sustained growth of our business lending is a key initiative, given the need of small to mid-size companies in our region for relationship banking. We are pleased to report that our determination to grow our wealth management business helped to achieve an 11.8% increase in assets under care to \$214.2 million as of December 31, 2016, from \$191.5 million as of December 31, 2015.

As of December 31, 2016, total assets were \$1.1 billion compared with \$748.8 million as of December 31, 2015. Total loans, which comprise the majority of our assets, were \$817.5 million at year-end 2016, compared with \$481.8 million at December 31, 2015. As previously noted, much of the increase was due to the East River acquisition. Organic loan growth remained prudent as the Company was challenged to grow commercial loans without sacrificing its high underwriting standards for much of the year. We believe, however, that the regional economy has started to pick up, and are excited that our lending team, which includes experienced officers from East River, will take advantage of improved lending conditions.

Net interest income, which represents the main source of revenue, increased to \$25.9 million for 2016, from \$21.8 million for the previous year, largely due to loan growth. The net interest margin improved to 3.31% for 2016 compared with 3.16% for 2015, despite historically low interest rates and the relatively flat yield curve that persisted through much of the past year. The improvement occurred in the latter part of the year and was primarily due to the acquisition of East River, which contributed to both an increase in volume and the weighted average yield on our loan portfolio.

The Company’s emphasis on relationship banking is reflected by the enviable core deposit ratio of 76%. Core deposits are prized due to their lower cost of funding and are generally less sensitive to withdrawal when interest rates fluctuate compared with certificates of deposit. Total deposits were \$885.2 million at year-end 2016, a year-over-year increase of \$278.9 million, and include the merger with East River.

Credit quality remains a fundamental strength for DNB. Our conservative underwriting standards are evidenced by the continued low level of net loan charge-offs. Net charge-offs were only 0.05% for the year ended December 31, 2016, compared with 0.23% for the previous year. Non-performing loans as a percentage of total loans remained fairly stable and were only 1.04% as of December 31, 2016, compared with 1.06% at December 31, 2015. Due largely to purchase accounting adjustments related to the East River acquisition, the allowance for credit losses as a percentage of total loans was 0.66% as of December 31, 2016, compared with 1.02% as of year-end 2015. At December 31, 2016, the allowance for credit losses as a percentage of originated loans, which represents all loans other than those acquired, was 1.04%.



We remain committed to maintaining a strong capital base in order to support our long-range business plan, reward shareholders, and satisfy bank regulators. The Company exceeded all regulatory standards to be considered “well-capitalized”. As of December 31, 2016, the Company’s Tier 1 leverage ratio was 8.4%, the Tier 1 to risk weighted assets ratio was 10.7%, and total risk-based capital ratio was 12.5%. Our quarterly dividend of \$0.07 per share, most recently paid in December 2016, represents 30 consecutive quarters of cash dividend payments. Tangible book value per share was \$18.56 at December 31, 2016.

Managing interest rate risk has been, and will continue to be, one of our top priorities. The Company’s strategy has been to seek shorter duration over yield in its lending and investing activities and lengthened duration over rate in its financing activities to reduce interest rate risk. We believe that our strong funding base, which consists primarily of core deposits, also helps to protect the Company against volatile changes in interest rates.

The Company’s strong financials are reflected in our longer term stock performance as shown below. Although our stock price declined modestly in fiscal 2016, stock price appreciation was 36.9% over the past three years, and was aligned with the appreciation for banks and thrifts in the SNL Financial Index of U.S. Banks and Thrifts.

### DNB FINANCIAL CORPORATION – PRICE CHANGE



Source: S&P Global Market Intelligence

## Outlook for Fiscal 2017

Building on the momentum of our accomplishments in 2016, we look forward to seizing the opportunities before us. In addition to our internal growth focus, we intend to watch for situations to acquire branches, banks, or other financial services firms that augment our market penetration and enhance long-term strategic value. Our goal is to manage and grow in a disciplined fashion that generates sustainable earnings growth, improved franchise value, and a higher dividend capacity for shareholders. This game plan has resulted in nearly 25 consecutive years of uninterrupted profitability and annual cash dividends.

As we enter 2017, we also recognize the challenges that lie ahead for our Company. These include the possibility of volatile interest rates, increased regulatory, accounting, and technology demands, and an uneven economic recovery across the United States, which is being impacted by the global economy. We have made, and will continue to make, investments in information technology to provide state-of-the-art customer delivery systems and to protect against the threat of cyber-attacks. Our top priority is our customers and we will do whatever it takes to ensure the security of our customers' personal information.

We are encouraged by our progress and recognize that our accomplishments reflect the confidence of our customers, the engagement of our communities, the inspiration and dedication of our employees, and the vision and judgment provided by management and the Board of Directors.

On behalf of our Board, management team, and employees, we thank you for your support. Your investment is important to us, and we appreciate your trust as we continue on the path to serve you as a high performance bank.

Sincerely,



James H. Thornton  
Chairman of the Board



William J. Hieb  
President and CEO



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended

December 31, 2016

or  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_. Commission file Number 1-34242



(Exact Name of registrant as specified in its charter)

Pennsylvania

(State or other jurisdiction of  
incorporation or organization)

23-222567

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

4 Brandywine Avenue, Downingtown, Pennsylvania

(Address of principal executive offices)

19335

(Zip Code)

Registrant's telephone number, including area code: **(610) 269-1040**

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

Title of each class

Common stock, par value \$1.00 per share

Name of each exchange on which registered

The Nasdaq Stock Market LLC

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

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of the shares of common stock of the Registrant issued and outstanding on June 30, 2016, which excludes 476,000 shares held by all directors, officers and affiliates of the Registrant as a group, was approximately \$56.0 million. This figure is based on the closing price of \$23.60 per share of the Registrant's common stock on June 30, 2016, the last business day of the Registrant's second fiscal quarter.

As of March 15, 2017, the Registrant had outstanding 4,251,664 shares of Common Stock, \$1 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement relating to the 2017 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

# DNB FINANCIAL CORPORATION

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DNB FINANCIAL CORPORATION  
FORM 10-K

**Forward-Looking Statements**

DNB Financial Corporation (the “Corporation,” “Registrant” or “DNB”), may from time to time make written or oral “forward-looking statements,” including statements contained in DNB’s filings with the Securities and Exchange Commission (including this Annual Report on Form 10-K and the exhibits hereto and thereto), in its reports to stockholders and in other communications by DNB, which are made in good faith by DNB 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 intended to 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; 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 or investment transactions; including the ability to consummate and integrate any such opportunities that are identified; 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 Form 10-K, 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 Form 10-K.

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-K, as well as any changes in risk factors that we may identify in our quarterly or other reports filed with the SEC.

## Part I

### Item 1. Business

#### General Description of Registrant's Business and Its Development

DNB Financial Corporation (the "Registrant" or "DNB"), a Pennsylvania business corporation, is a bank holding company registered with and supervised by the Board of Governors of the Federal Reserve System (Federal Reserve Board). The Registrant was incorporated on October 28, 1982 and commenced operations on July 1, 1983 upon consummation of the acquisition of all of the outstanding stock of Downingtown National Bank, now known as DNB First, National Association (the "Bank"). Since commencing operations, DNB's business has consisted primarily of managing and supervising the Bank, and its principal source of income has been derived from the Bank. At December 31, 2016, DNB had total consolidated assets, total liabilities and stockholders' equity of \$1.1 billion, \$975.8 million, and \$94.8 million, respectively.

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.

The Bank's headquarters is located at 4 Brandywine Avenue, Downingtown, Pennsylvania. As of December 31, 2016, the Bank had total assets of \$1.1 billion, total deposits of \$886.6 million and total stockholders' equity of \$111.9 million. The Bank's business is not seasonal in nature. The FDIC, to the extent provided by law, insures its deposits. On December 31, 2016, the Bank had 150 full-time employees and 16 part-time employees.

The Bank derives its income principally from interest charged on loans and, to a lesser extent, interest earned on investments, fees received in connection with the origination of loans, wealth management and other services. The Bank's principal expenses are interest expense on deposits and borrowings and operating expenses. Funds for activities are provided principally by operating revenues, deposit growth and the repayment of outstanding loans and investments.

The Bank encounters vigorous competition from a number of sources, including other commercial banks, thrift institutions, other financial institutions and financial intermediaries. In addition to commercial banks, Federal and state savings and loan associations, savings banks, credit unions and industrial savings banks actively compete in the Bank's market area to provide a wide variety of banking services. Mortgage banking firms, real estate investment trusts, finance companies, insurance companies, leasing companies and brokerage companies, financial affiliates of industrial companies and certain government agencies provide additional competition for loans and for certain financial services. The Bank also competes for interest-bearing funds with a number of other financial intermediaries, which offer a diverse range of investment alternatives, including brokerage firms and mutual fund companies.

## **Business Combinations**

DNB and its subsidiaries engaged in the following business combination since January 1, 2016:

Effective October 1, 2016, DNB completed its previously announced merger (the “Merger”) with East River Bank (“ERB”), a locally-managed institution, headquartered in Philadelphia, Pennsylvania. Pursuant to an Agreement and Plan of Merger (the “Merger Agreement”) dated as of April 4, 2016, at the effective time of the Merger, ERB merged with and into DNB First, N.A., a wholly owned subsidiary of DNB.

The acquisition added 3 full service branches in Philadelphia County, bringing DNB’s branch count to fifteen (15) in the Greater Philadelphia Region. In addition, the acquisition added approximately \$306.4 million in loans and \$227.2 million in deposits.

In accordance with the terms of the Merger Agreement, holders of East River Bank common shares received, in aggregate, \$6.7 million in cash and 1,368,527 shares or approximately 32% of DNB’s outstanding common stock. The transaction was valued at \$47.5 million based on DNB’s September 30, 2016 closing share price of \$25.36 as quoted on NASDAQ. The results of the combined entity’s operations have been included in DNB’s Consolidated Financial Statements from the date of acquisition.

The acquisition of ERB was accounted for as a business combination using the acquisition method of accounting, which includes estimating the fair value of assets acquired, liabilities assumed and consideration paid as of the acquisition date. These preliminary estimates were completed during the fourth quarter of 2016 and will be subject to adjustments during the up to one year measurement period after the acquisition. DNB does not expect any further adjustments to the purchase price as it was finalized as of December 31, 2016. See Note 2 — Business Combinations.

## **Supervision and Regulation — Registrant**

### **Federal Banking Laws**

The Registrant is subject to a number of complex Federal banking laws, most notably the provisions of the Bank Holding Company Act of 1956, as amended (“Bank Holding Company Act”) and the Change in Bank Control Act of 1978 (“Change in Control Act”), and to supervision by the Federal Reserve Board.

### **Bank Holding Company Act — Financial Holding Companies**

The Bank Holding Company Act requires a “company” (including the Registrant) to secure the prior approval of the Federal Reserve Board before it owns or controls, directly or indirectly, more than five percent (5%) of the voting shares or substantially all of the assets of any bank. It also prohibits acquisition by any “company” (including the Registrant) of more than five percent (5%) of the voting shares of, or interest in, or all or substantially all of the assets of, any bank located outside of the state in which a current bank subsidiary is located unless such acquisition is specifically authorized by laws of the state in which such bank is located. A “bank holding company” (including the Registrant) is prohibited from engaging in or acquiring direct or indirect control of more than five percent (5%) of the voting shares of any company engaged in non-banking activities unless the Federal Reserve Board, by order or regulation, has found such activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making this determination, the Federal Reserve Board considers whether the performance of these activities by a bank holding company would offer benefits to the public that outweigh possible adverse effects. Applications under the Bank Holding Company Act and the Change in Control Act are subject to review, based upon the record of compliance of the applicant with the Community Reinvestment Act of 1977 (“CRA”). See further discussion below.

The Registrant is required to file an annual report with the Federal Reserve Board and any additional information that the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The

Federal Reserve Board may also make examinations of the Registrant and any or all of its subsidiaries. Further, under Section 106 of the 1970 amendments to the Bank Holding Company Act and the Federal Reserve Board's regulations, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or provision of credit or provision of any property or services. The so-called "anti-tie-in" provisions state generally that a bank may not extend credit, lease, sell property or furnish any service to a customer on the condition that the customer provide additional credit or service to the bank, to its bank holding company or to any other subsidiary of its bank holding company or on the condition that the customer not obtain other credit or service from a competitor of the bank, its bank holding company or any subsidiary of its bank holding company.

**Permitted Non-Banking Activities.** The Federal Reserve Board permits bank holding companies to engage in non-banking activities so closely related to banking or managing or controlling banks as to be a proper incident thereto. A number of activities are authorized by Federal Reserve Board regulation, while other activities require prior Federal Reserve Board approval. The types of permissible activities are subject to change by the Federal Reserve Board. Revisions to the Bank Holding Company Act contained in the Gramm-Leach Bliley Act of 1999 permit certain eligible bank holding companies to qualify as "financial holding companies" and thereupon engage in a wider variety of financial services such as securities and insurance activities, and subject such companies to increased competition from a wider variety of non-banking competitors as well as banks.

**Gramm-Leach Bliley Act of 1999 ("GLB").** This law repealed certain restrictions on bank and securities firm affiliations, and allows bank holding companies to elect to be treated as a "financial holding company" that can engage in approved "financial activities," including insurance, securities underwriting and merchant banking. Banks without holding companies can engage in many of these financial activities through a "financial subsidiary." The law also mandates functional regulation of bank securities activities. Banks' exemption from broker-dealer regulation is limited to, for example, trust, safekeeping, custodian, shareholder and employee benefit plans, sweep accounts, private placements (under certain conditions), self-directed IRAs, third party networking arrangements to offer brokerage services to bank customers, and the like. It also requires banks that advise mutual funds to register as investment advisers. The legislation provides for state regulation of insurance, subject to certain specified state preemption standards. It establishes which insurance products banks and bank subsidiaries may provide as principal or underwriter, and prohibits bank underwriting of title insurance, but also preempts state laws interfering with affiliations. GLB prohibits approval of new de novo thrift charter applications by commercial entities and limits sales of existing so-called "unitary" thrifts to commercial entities. The law bars banks, savings and loans, credit unions, securities firms and insurance companies, as well as other "financial institutions," from disclosing customer account numbers or access codes to unaffiliated third parties for telemarketing or other direct marketing purposes, and enables customers of financial institutions to "opt out" of having their personal financial information shared with unaffiliated third parties, subject to exceptions related to the processing of customer transactions and joint financial services marketing arrangements with third parties, as long as the institution discloses the activity to its customers and requires the third party to keep the information confidential. It requires policies on privacy and disclosure of information to be disclosed annually, requires federal regulators to adopt comprehensive regulations for ensuring the security and confidentiality of consumers' personal information, and allows state laws to give consumers greater privacy protections. The GLB has increased the competition the Bank faces from a wider variety of non-banking competitors as well as banks.

#### **Change in Bank Control Act**

Under the Change in Control Act, no person, acting directly or indirectly or through or in concert with one or more other persons, may acquire "control" of any Federally insured depository institution unless the appropriate Federal banking agency has been given 60 days prior written notice of the proposed acquisition and within that period has not issued a notice disapproving of the proposed acquisition or has

issued written notice of its intent not to disapprove the action. The period for the agency's disapproval may be extended by the agency. Upon receiving such notice, the Federal agency is required to provide a copy to the appropriate state regulatory agency, if the institution of which control is to be acquired is state chartered, and the Federal agency is obligated to give due consideration to the views and recommendations of the state agency. Upon receiving a notice, the Federal agency is also required to conduct an investigation of each person involved in the proposed acquisition. Notice of such proposal is to be published and public comment solicited thereon. A proposal may be disapproved by the Federal agency if the proposal would have anticompetitive effects, if the proposal would jeopardize the financial stability of the institution to be acquired or prejudice the interests of its depositors, if the competence, experience or integrity of any acquiring person or proposed management personnel indicates that it would not be in the interest of depositors or the public to permit such person to control the institution, if any acquiring person fails to furnish the Federal agency with all information required by the agency, or if the Federal agency determines that the proposed transaction would result in an adverse effect on a deposit insurance fund. In addition, the Change in Control Act requires that, whenever any Federally insured depository institution makes a loan or loans secured, or to be secured, by 25% or more of the outstanding voting stock of a Federally insured depository institution, the president or chief executive officer of the lending bank must promptly report such fact to the appropriate Federal banking agency regulating the institution whose stock secures the loan or loans.

**Dodd-Frank Wall Street Reform and Consumer Protection Act.** The federal government is considering a variety of reforms related to banking and the financial industry including, without limitation, the Dodd-Frank Act. The Dodd-Frank Act is intended to promote financial stability in the U.S., reduce the risk of bailouts and protect against abusive financial services practices by improving accountability and transparency in the financial system and ending "too big to fail" institutions. It is the broadest overhaul of the U.S. financial system since the Great Depression, and much of its impact will be determined by the scope and substance of many regulations that will need to be adopted by various regulatory agencies to implement its provisions. For these reasons, the overall impact on DNB and its subsidiaries is unknown at this time.

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

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

## **Pennsylvania Banking Laws**

Under the Pennsylvania Banking Code of 1965, as amended (“PA Code”), the Registrant is permitted to control an unlimited number of banks, subject to prior approval of the Federal Reserve Board as more fully described above. The PA Code authorizes reciprocal interstate banking without any geographic limitation. Reciprocity between states exists when a foreign state’s law authorizes Pennsylvania bank holding companies to acquire banks or bank holding companies located in that state on terms and conditions substantially no more restrictive than those applicable to such an acquisition by a bank holding company located in that state. Interstate ownership of banks in Pennsylvania with banks in Delaware, Maryland, New Jersey, Ohio, New York and other states is currently authorized. Some state laws still restrict de novo formations of branches in other states, but restrictions on interstate de novo banking have been relaxed by the Dodd-Frank Act. Pennsylvania law also provides Pennsylvania state chartered institutions elective parity with the power of national banks, federal thrifts, and state-chartered institutions in other states as authorized by the Federal Deposit Insurance Corporation (“Competing Institutions”). In some cases, this may give state chartered institutions broader powers than national banks such as the Bank, and may increase competition the Bank faces from other banking institutions.

### **Supervision and Regulation — Bank**

The operations of the Bank are subject to Federal and State statutes applicable to banks chartered under the banking laws of the United States, to members of the Federal Reserve System and to banks whose deposits are insured by the FDIC. Bank operations are also subject to regulations of the Office of the Comptroller of the Currency (“OCC”), the Federal Reserve Board and the FDIC.

The primary supervisory authority of the Bank is the OCC, who regularly examines the Bank. The OCC has the authority to prevent a national bank from engaging in an unsafe or unsound practice in conducting its business.

Federal and state banking laws and regulations govern, among other things, the scope of a bank’s business, the investments a bank may make, the reserves against deposits a bank must maintain, loans a bank makes and collateral it takes, the activities of a bank with respect to mergers and consolidations and the establishment of branches. All nationally and state-chartered banks in Pennsylvania are permitted to maintain branch offices in any county of the state. National bank branches may be established only after approval by the OCC. It is the general policy of the OCC to approve applications to establish and operate domestic branches, including ATMs and other automated devices that take deposits, provided that approval would not violate applicable Federal or state laws regarding the establishment of such branches. The OCC reserves the right to deny an application or grant approval subject to conditions if (1) there are significant supervisory concerns with respect to the applicant or affiliated organizations, (2) in accordance with CRA, the applicant’s record of helping meet the credit needs of its entire community, including low and moderate income neighborhoods, consistent with safe and sound operation, is less than satisfactory, or (3) any financial or other business arrangement, direct or indirect, involving the proposed branch or device and bank “insiders” (directors, officers, employees and 10% or greater shareholders) involves terms and conditions more favorable to the insiders than would be available in a comparable transaction with unrelated parties.

The Bank, as a subsidiary of a bank holding company, is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or its subsidiaries, on investments in the stock or other securities of the bank holding company or its subsidiaries and on taking such stock or securities as collateral for loans. The Federal Reserve Act and Federal Reserve Board regulations also place certain limitations and reporting requirements on extensions of credit by a bank to principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulations may affect the terms upon which any

person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

### **Capital Adequacy**

Federal banking laws impose on banks certain minimum requirements for capital adequacy. Federal banking agencies have issued certain “risk-based capital” guidelines, and certain “leverage” requirements on member banks such as the Bank. Banking regulators have authority to require higher minimum capital ratios for an individual bank or bank holding company in view of its circumstances.

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

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

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

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

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

**Minimum Capital Ratios.** The risk-based guidelines require all banks to maintain two “risk-weighted assets” ratios. The first is a minimum ratio of total capital (“Tier 1” and “Tier 2” capital) to risk-weighted assets equal to 8.00%; the second is a minimum ratio of “Tier 1” capital to risk-weighted assets equal to 4.00%. Assets are assigned to five risk categories, with higher levels of capital being required for the categories perceived as representing greater risk. In making the calculation, certain intangible assets must be deducted from the capital base. The risk-based capital rules are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and to minimize disincentives for holding liquid assets.

The risk-based capital rules also account for interest rate risk. Institutions with interest rate risk exposure above a normal level would be required to hold extra capital in proportion to that risk. A bank’s exposure to declines in the economic value of its capital due to changes in interest rates is a factor that the banking agencies will consider in evaluating a bank’s capital adequacy. The rule does not codify an explicit minimum capital charge for interest rate risk. The Bank currently monitors and manages its assets and liabilities for interest rate risk, and management believes that the interest rate risk rules which have been implemented and proposed will not materially adversely affect our operations.

The “leverage” ratio rules require banks which are rated the highest in the composite areas of capital, asset quality, management, earnings, liquidity and sensitivity to market risk to maintain a ratio of “Tier 1” capital to “adjusted total assets” (equal to the bank’s average total assets as stated in its most recent quarterly Call Report filed with its primary federal banking regulator, minus end-of-quarter intangible assets that are deducted from Tier 1 capital) of not less than 3.00%. For banks which are not the most highly rated, the minimum “leverage” ratio will range from 4.00% to 5.00%, or higher at the discretion of the bank’s primary federal regulator, and is required to be at a level commensurate with the nature of the level of risk of the bank’s condition and activities.

For purposes of the capital requirements, “Tier 1” or “core” capital is defined to include common stockholders’ equity and certain non-cumulative perpetual preferred stock and related surplus. “Tier 2” or “qualifying supplementary” capital is defined to include a bank’s allowance for loan and lease losses up to 1.25% of risk-weighted assets, plus certain types of preferred stock and related surplus, certain “hybrid capital instruments” and certain term subordinated debt instruments.

**Prompt Corrective Action.** Federal banking law mandates certain “prompt corrective actions,” which Federal banking agencies are required to take, and certain actions which they have discretion to take, based upon the capital category into which a Federally regulated depository institution falls. Regulations have been adopted by the Federal bank regulatory agencies setting forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution that is not adequately capitalized. Under the rules, an institution will be deemed to be “adequately capitalized” or better if it exceeds the minimum Federal regulatory capital requirements. However, it will be deemed “undercapitalized” if it fails to meet the minimum capital requirements, “significantly undercapitalized” if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0%, or a leverage ratio that is less than 3.0%, and “critically undercapitalized” if the institution has a ratio of tangible equity to

total assets that is equal to or less than 2.0%. The rules require an undercapitalized institution to file a written capital restoration plan, along with a performance guaranty by its holding company or a third party. In addition, an undercapitalized institution becomes subject to certain automatic restrictions including a prohibition on the payment of dividends, a limitation on asset growth and expansion, and in certain cases, a limitation on the payment of bonuses or raises to senior executive officers, and a prohibition on the payment of certain “management fees” to any “controlling person”. Institutions that are classified as undercapitalized are also subject to certain additional supervisory actions, including increased reporting burdens and regulatory monitoring, a limitation on the institution’s ability to make acquisitions, open new branch offices, or engage in new lines of business, obligations to raise additional capital, restrictions on transactions with affiliates, and restrictions on interest rates paid by the institution on deposits. In certain cases, bank regulatory agencies may require replacement of senior executive officers or directors, or sale of the institution to a willing purchaser. If an institution is deemed to be “critically undercapitalized” and continues in that category for four quarters, the statute requires, with certain narrowly limited exceptions, that the institution be placed in receivership.

Based on management’s assessment, the Bank is “well capitalized” for regulatory capital purposes. Please see the table detailing the Bank’s compliance with minimum capital ratios, in Note 17 (“Regulatory Matters”) to DNB’s audited financial statements in this Form 10-K.

Under the Federal Deposit Insurance Act, the OCC possesses the power to prohibit institutions regulated by it, such as the Bank, from engaging in any activity that would be an unsafe and unsound banking practice and in violation of the law. Moreover, Federal law enactments have expanded the circumstances under which officers or directors of a bank may be removed by the institution’s Federal supervisory agency; unvested and further regulated lending by a bank to its executive officers, directors, principal shareholders or related interests thereof; and unvested management personnel of a bank from serving as directors or in other management positions with certain depository institutions whose assets exceed a specified amount or which have an office within a specified geographic area; and unvested management personnel from borrowing from another institution that has a correspondent relationship with their bank.

**Interstate Banking.** Federal law permits interstate bank mergers and acquisitions. Limited branch purchases are still subject to state laws. Pennsylvania law permits out-of-state banking institutions to establish branches in Pennsylvania with the approval of the Pennsylvania Department of Banking and Securities, provided the law of the state where the banking institution is located would permit a Pennsylvania banking institution to establish and maintain a branch in that state on substantially similar terms and conditions. It also permits Pennsylvania banking institutions to maintain branches in other states. The Dodd-Frank Act created a more permissive interstate branching regime by permitting banks to establish branches de novo in any state if a bank chartered by such state would have been permitted to establish the branch. Bank management anticipates that interstate banking will continue to increase competitive pressures in the Bank’s market by permitting entry of additional competitors, but management is of the opinion that this will not have a material impact upon the anticipated results of operations of the Bank.

**Bank Secrecy Act and OFAC.** Under the Bank Secrecy Act (“BSA”), the Bank is required to report to the Internal Revenue Service, currency transactions of more than \$10,000 or multiple transactions of which the Bank is aware in any one day that aggregate in excess of \$10,000. Civil and criminal penalties are provided under the BSA for failure to file a required report, for failure to supply information required by the BSA or for filing a false or fraudulent report. The Department of the Treasury’s Office of Foreign Asset Control (“OFAC”) administers and enforces economic and trade sanctions against targeted foreign countries, terrorism-sponsoring jurisdictions and organizations, and international narcotics traffickers based on U.S. foreign policy and national security goals. OFAC acts under presidential wartime and national emergency powers and authority granted by specific legislation to impose controls on transactions and freeze foreign assets under U.S. jurisdiction. Acting under authority delegated from the Secretary of

the Treasury, OFAC promulgates, develops, and administers the sanctions under its statutes and executive orders. OFAC requirements are separate and distinct from the BSA, but both OFAC requirements and the BSA share a common national security goal. Because institutions and regulators view compliance with OFAC sanctions as related to BSA compliance obligations, supervisory examination for OFAC compliance is typically connected to examination of an institution's BSA compliance. Examiners focus on a banking organization's compliance processes and evaluate the sufficiency of a banking organization's implementation of policies, procedures and systems to ensure compliance with OFAC regulations.

**USA PATRIOT Act.** The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (together with its implementing regulations, the "Patriot Act"), designed to deny terrorists and others the ability to obtain access to the United States financial system, has significant implications for banks and other financial institutions. It required DNB and its subsidiary to implement new policies and procedures or amend existing policies and procedures with respect to, anti-money laundering, compliance, suspicious activity and currency transaction reporting and due diligence on customers, as well as related matters. The Patriot Act permits and in some cases requires information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, and it requires federal banking agencies to evaluate the effectiveness of an institution in combating money laundering activities, both in ongoing examinations and in connection with applications for regulatory approval.

**FDIC Insurance and Assessments.** The Bank's deposits are insured to applicable limits by the FDIC. Under the Dodd-Frank Act, the maximum deposit insurance amount was permanently increased from \$100,000 to \$250,000.

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

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

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

In addition to deposit insurance assessments, banks are subject to assessments to pay the interest on Financing Corporation bonds. The Financing Corporation was created by Congress to issue bonds to finance the resolution of failed thrift institutions. The FDIC sets the Financing Corporation assessment rate every quarter. The current annual Financing Corporation assessment rate is 56 basis points on the deposit insurance assessment base, as defined above, which we anticipate will result in an aggregate estimated FICO assessment payment by the Bank of \$55,000 in 2017.

**Other Laws and Regulations.** The Bank is subject to a variety of consumer protection laws, including the Truth in Lending Act, the Truth in Savings Act adopted as part of the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Electronic Funds Transfer Act, the Real Estate Settlement Procedures Act and the regulations adopted thereunder. In the aggregate, compliance with these consumer protection laws and regulations involves substantial expense and administrative time on the part of the Bank and DNB.

**Legislation and Regulatory Changes.** From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities and/or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, and before various bank regulatory agencies. No prediction can be made as to the likelihood of any major changes or the impact such changes might have on DNB and its subsidiary Bank.

**Effect of Government Monetary Policies.** The earnings of DNB are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States Government and its agencies (particularly the Federal Reserve Board). The monetary policies of the Federal Reserve Board have had and will likely continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The Federal Reserve Board has a major effect upon the levels of bank loans, investments and deposits through its open market operations in United States Government securities and through its regulation of, among other things, the discount rate on borrowing of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

All of DNB’s revenues are attributable to customers located in the United States, and primarily from customers located in Southeastern Pennsylvania. All of Registrant’s assets are located in the United States and in Southeastern Pennsylvania. Registrant has no activities in foreign countries and hence no risks attendant to foreign operations.

DNB files with the Securities and Exchange Commission (the “SEC”) and makes available, free of charge, through its website, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are electronically filed with the SEC. These reports can be obtained on the Corporation’s website at <http://investors.dnbfirst.com/>. The information contained on or connected to our website is not incorporated by reference into this Annual Report on Form 10-K. Further copies of these reports are located at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding our filings, at [www.sec.gov](http://www.sec.gov).

#### **Item 1A. Risk Factors**

Investment in DNB’s Common Stock involves risk and the market price of DNB’s Common Stock may fluctuate significantly in response to a number of factors, including those that follow. The following list

contains certain risks that may be unique to DNB and to the banking industry. The following list of risks should not be viewed as an all-inclusive list.

***Changes in interest rates could reduce DNB's net interest margin, net interest income, fee income and net income.*** — Interest and fees on loans and securities, net of interest paid on deposits and borrowings, account for a significant part of DNB's net income. Interest rates are key drivers of DNB's net interest margin and subject to many factors beyond DNB's control. As interest rates change, DNB's net interest income is affected. Increased interest rates in the future could result in DNB's interest expense increasing faster than interest income because of divergence in financial instrument maturities and/or competitive pressures. Because different types of assets and liabilities may react differently and at different times to market interest rate changes, changes in interest rates can increase or decrease DNB's net interest income. When interest-bearing liabilities mature or re-price more quickly than interest earning assets in a period, an increase in interest rates would reduce net interest income. Similarly, when interest earning assets mature or re-price more quickly, and because the magnitude of repricing of interest earning assets is often greater than interest bearing liabilities, falling interest rates would reduce net interest income. In addition, substantially higher interest rates generally reduce loan demand and may result in slower loan growth. Decreases or increases in interest rates could have a negative effect on the spreads between the interest rates earned on assets and the rates of interest paid on liabilities, and therefore decrease DNB's net interest income. Also, changes in interest rates might also impact the values of equity and debt securities under management and administration by DNB's wealth management business, which may have a negative impact on fee income.

***If DNB's allowance for credit losses is insufficient to absorb losses in its loan portfolio, DNB's earnings could decrease.*** — All borrowers carry the potential to default, and DNB's remedies to recover upon a default may not fully satisfy amounts previously loaned by DNB. DNB maintains an allowance for credit losses, which is a reserve established through a provision for credit losses charged to expense, which represents DNB's best estimate of probable credit losses that have been incurred within the existing portfolio of loans. The allowance, in DNB's judgment, is necessary to reserve for estimated credit losses and risks inherent in the loan portfolio. Those risks are affected by, among other things:

- the financial condition and cash flows of the borrowers and/or the projects being financed;
- the changes and uncertainties as to the future value of the collateral, in the case of collateralized loans;
- the duration of the loans in the portfolio;
- the credit history of the particular borrowers; and
- changes in economic and industry conditions.

The determination of the appropriate level of the allowance for credit losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks using existing qualitative and quantitative information, including those identified above, all of which may undergo material changes. If DNB's assumptions and estimates are incorrect, its allowance for credit losses may not be sufficient to cover losses inherent in its loan portfolio, resulting in additions to the allowance. In addition, changes in economic conditions affecting borrowers generally or certain borrowers in particular, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of DNB's control, may require an increase in the allowance for credit losses. Bank regulatory authorities periodically review DNB's allowance for credit losses and also may require us to increase the provision for credit losses or recognize additional loan charge-offs based on judgments different than DNB's. An increase in the allowance for credit losses results in a decrease in net income and may have a material adverse effect on DNB's financial condition and results of operations.

***Downgrades in U.S. Government and federal agency securities could adversely affect us.*** — In addition to causing economic and financial markets disruptions, any downgrades of U.S. Government and federal agency securities and/or failures to raise the U.S. debt limit if necessary in the future, could, among other things, materially adversely affect the market value of the U.S. and other government and governmental agency securities DNB owns, the availability of those securities for use as collateral for borrowing, and its ability to access capital markets on favorable terms, as well as have other material adverse effects on the operation of its business and financial results and condition. In particular, the impact of these events could involve increases in interest rates and disruption in payment systems, money markets and long-term or short-term fixed income markets, which could adversely affect the cost and availability of funding to us. Adverse consequences as a result of any downgrades also could extend to borrowers and, as a result, could adversely affect the borrowers' ability to repay their loans.

***DNB's financial condition and results of operations may be adversely affected by regional economic conditions and real estate values.*** — DNB's loan and deposit activities are largely based in eastern Pennsylvania. As a result, DNB's financial performance is closely tied to economic conditions in this region. This region experienced deteriorating local economic conditions during 2008 through 2011, and a continued downturn in the regional real estate market may adversely affect us because DNB's loans are concentrated in this regional area and a large percentage of its loans are secured by real property, and further declines in real estate values reduce the value of that loan collateral. This may limit the amount DNB may recover on defaulted loans by selling the underlying real estate collateral, which would adversely affect DNB's results of operations. In addition, a significant portion of DNB's loan portfolio consists of commercial real estate loans. The ability of these borrowers to repay their loans is often dependent on the borrower receiving sufficient rental payments. Economic conditions may affect the ability of tenants to make rental payments on a timely basis and/or may cause some tenants not to renew their leases, which may adversely affect a borrower's ability to make loan payments. In addition, if operating expenses, taxes and other expenses associated with commercial real estate properties increase materially, the tenant's ability to repay, and therefore the borrower's ability to make timely loan payments to us, could be adversely affected. Any of these factors could increase the amount of DNB's non-performing loans, increase its provision for credit losses and reduce its net income.

***General economic conditions and other events may adversely affect DNB's wealth management business revenues.*** — A general economic slowdown, disruptions in the financial markets, and other events and occurrences that impact the economy could decrease the value of the assets under management and administration by DNB's wealth management business, which would result in lower fee income and could cause clients to seek alternative investment opportunities with other wealth management or financial services providers, which could result in reduced revenue.

***Decreased residential mortgage origination or changes to DNB's residential mortgage related revenues and expenses as a result of actions taken by competitors and regulators could adversely affect DNB's results of operations.*** — DNB originates and sells residential mortgage loans. Changes in interest rates and pricing decisions by DNB's competitors in this market affect demand for DNB's mortgage loan products and revenue DNB realizes on the sale of mortgage loans, all of which impact DNB's net income. New regulations, increased regulatory scrutiny, changes in the structure of the secondary mortgage markets and other factors also affect DNB's mortgage loan business, and make it more difficult or costly to operate this business.

***DNB may not be able to effectively manage its growth.*** — DNB's future operating results and financial condition depend to a large extent on its ability to successfully manage its growth. DNB's growth has placed, and will continue to place, significant demands on DNB's management and operating systems and

resources. Whether through acquisitions, organic growth or a combination thereof, DNB's ability to expand its business is dependent upon its ability to:

- continue to implement and improve its processes and systems, including credit underwriting, financial, accounting and enterprise risk management;
- comply with an increasing number of new laws, rules and regulations governing its business, and changes to existing laws, rules and regulations;
- scale its information technology systems; and
- maintain appropriate staffing levels.

Addressing issues relating to DNB's growth may divert management from DNB's existing business and may require us to incur additional expenditures to expand DNB's administrative and operational infrastructure and, if DNB is unable to effectively manage and grow its banking franchise, including to the satisfaction of DNB's regulators, DNB's business could be materially and adversely affected. In addition, if DNB is unable to manage its current and future expansion in its operations, DNB may experience compliance, operational and regulatory problems and delays, have to slow its pace of growth or even stop its market and product expansion, or have to incur additional expenditures beyond current projections to support such growth, any one of which could materially and adversely affect us. If DNB experiences difficulties with the development of new business activities or the integration process of acquired businesses, the anticipated benefits of any particular acquisition may not be realized fully, or at all, or may take longer to realize than expected. Additionally, DNB may be unable to recognize synergies, operating efficiencies and/or expected benefits within expected timeframes and cost projections, or at all. DNB also may not be able to preserve the goodwill of an acquired financial institution. DNB's growth could lead to increases in its legal, audit, administrative and financial compliance costs, which could materially and adversely affect us.

***DNB may need to raise additional capital in the future and such capital may not be available when needed or at all.*** — DNB may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet its commitments and business needs. DNB's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of DNB's control, and its financial performance. DNB's customary sources of liquidity include, but are not limited to, deposits, inter-bank borrowings, repurchase agreements and borrowings from the Federal Home Loan Bank of Pittsburgh. Any occurrence that may limit DNB's access to the capital markets, such as a decline in the confidence of debt purchasers, depositors or counterparties participating in the capital markets may adversely affect DNB's capital costs and ability to raise capital and, in turn, DNB's liquidity. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on DNB's business, financial condition and results of operations.

***DNB faces strong competition for clients and this competition could affect DNB's operating results.*** — DNB operates in a highly competitive market and experiences competition in DNB's market from both banks and a variety of other financial institutions. DNB competes with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other community, super-regional, national, and international financial institutions that operate offices in DNB's primary market areas and elsewhere. DNB competes with these institutions both in attracting deposits and in making loans. Many financial service providers believe DNB's primary market is an attractive market because of its strong economic growth. As a result, DNB is experiencing particularly intense competition in DNB's primary marketplace. While DNB's strategy is to attract customers by providing personalized services and making use of the business and personal ties of DNB's management, there is no assurance DNB will keep or increase market acceptance and be able to operate profitably. Many of DNB's competitors are well-established, larger financial institutions. These institutions offer some services, such as extensive and

established branch networks, that DNB does not provide. There are also a number of other community banks in its market that share its general marketing focus. There is a risk that DNB will not be able to compete successfully with other financial institutions in its market, and that DNB may have to pay higher interest rates to attract deposits, which could result in reduced profitability. In addition, competitors that are not depository institutions are generally not subject to the extensive regulations that apply to us. All of these factors may adversely impact DNB's ability to maintain or increase profitability.

***DNB depends on its executive officers and key personnel, and DNB's ability to operate its business and implement its strategy depends significantly on DNB's ability to attract and retain individuals with experience and relationships in the markets in which DNB operates and intends to expand.*** — DNB believes that its future success, including the implementation of its strategy, will depend in large part on the skills of its executive management team and ability to motivate and retain these and other key personnel and attract and retain new personnel with expertise and relationships in the markets DNB now serves and intends to serve. The loss of service of one or more of DNB's executive officers or key personnel, its inability to replace departing personnel and/or its ability to hire new personnel to implement DNB's strategy could limit DNB's growth and could materially adversely affect DNB's business, financial condition, and results of operations. Competition for qualified candidates is intense, and DNB cannot assure you that DNB will be able to retain and recruit management and other key personnel to meet its needs.

***New lines of business or new products and services may subject us to additional risk.*** — From time to time, DNB may implement new lines of business or offer new products and services within its existing lines of business. There may be substantial risks and uncertainties associated with these efforts, particularly in instances where the markets for those new lines of business or new products or services are not yet fully developed. DNB may invest significant time and resources in developing and marketing new lines of business and/or new products and services. DNB's anticipated timetables for the development and introduction of new lines of business and/or new products or services may not be achieved, and DNB's price and profitability targets may not prove feasible. In addition, external factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact development and implementation of a new line of business and/or a new product or service. Any new line of business and/or new product or service also could have a significant impact on the effectiveness of DNB's system of internal controls. If DNB fails to successfully manage these risks in the development and implementation of new lines of business and/or new products or services, DNB's business, financial condition and results of operations could be materially adversely affected.

***The fair value of DNB's investment securities can fluctuate due to market conditions which, under some circumstances can lead to other-than-temporary impairment.*** — As of December 31, 2016, the fair value of DNB's investment securities portfolio was approximately \$181.3 million. Factors beyond DNB's control can significantly influence the fair value of DNB's investment securities and can result in adverse changes to their fair value. These factors include, but are not limited to, rating agency actions with respect to the securities, defaults by the issuer or with respect to any underlying securities, and changes in market interest rates and instability in the capital markets. These and other factors could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could have a material adverse effect on us. The process for determining whether impairment of a security is other-than-temporary typically requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

***Changes to estimates and assumptions DNB makes in preparing its financial statements could adversely affect its operating results, reported assets and liabilities, financial condition and capital levels.*** — The preparation of DNB's financial statements requires management to make certain critical accounting estimates and assumptions that could affect DNB's reported amounts of assets and liabilities and income and expense during the reporting periods. Changes to those estimates or assumptions could materially affect its operating results, reported assets and liabilities, financial condition and capital levels.

***If DNB lost a significant portion of its low-cost deposits, it would negatively impact its liquidity and profitability.*** — DNB’s profitability depends in part on DNB’s success in attracting and retaining a stable base of low-cost deposits. While DNB generally does not believe these core deposits are sensitive to interest rate fluctuations, the competition for these deposits in DNB’s markets is strong and customers are increasingly seeking investments that are safe, including the purchase of U.S. Treasury securities and other government-guaranteed obligations, as well as the establishment of accounts at the largest, most-well capitalized banks. If DNB were to lose a significant portion of its low-cost deposits, it would negatively impact its liquidity and profitability.

***Changes in accounting standards and policies can be difficult to predict and can materially affect how DNB records and reports its financial results.*** — DNB’s accounting policies and methods are fundamental to how DNB records and reports its financial condition and results of operations. The regulatory bodies that establish accounting standards, including, among others, the Financial Accounting, or FASB, and the SEC, periodically revise or issue new financial accounting and reporting standards that govern the preparation of its financial statements. These changes, and the effects of these changes, can be difficult to predict and can materially impact how DNB records and reports its financial condition and results of operations. DNB could be required to apply new or revised guidance retrospectively, which may result in the revision of prior period financial statements by material amounts. The implementation of new or revised accounting guidance could have a material adverse effect on its reported financial results.

In addition, DNB must exercise judgment in appropriately applying many of its accounting policies and methods so they comply with generally accepted accounting principles. In some cases, DNB may have to select a particular accounting policy or method from two or more alternatives. In some cases, the accounting policy or method chosen might be reasonable under the circumstances and yet might result in its reporting materially different amounts than would have been reported if DNB had selected a different policy or method. Accounting policies are critical to fairly presenting DNB’s financial condition and results of operations and may require us to make difficult, subjective or complex judgments about matters that are uncertain.

***If DNB fails to maintain an effective system of internal controls, its business could be adversely affected.*** — DNB is dependent upon maintaining an effective system of internal controls to provide reasonable assurance that transactions and activities are conducted in accordance with established policies and procedures and are all captured and reported in the financial statements. Any system of internal controls, however well designed and operated, is based in part on certain assumptions and expectations of employee conduct and can only provide reasonable, not absolute, assurance that the objectives of the system are met. Any failure to maintain an effective system of internal controls, any failure to adhere to those internal controls, or any circumvention of DNB’s controls could have a material adverse effect on its operations, net income, financial condition, reputation and compliance with laws and regulations.

***Technological systems failures, interruptions and security breaches could negatively impact DNB’s operations.*** — Communications and information systems are essential to the conduct of DNB’s business, as DNB uses such systems to manage its customer relationships, its general ledger, its deposits, and its loans. While DNB has established policies and procedures to prevent or limit the impact of systems failures, interruptions, and security breaches, DNB cannot assure you that such events will not occur or that they will be adequately addressed if they do occur. In addition, any compromise of DNB’s security systems could deter customers from using DNB’s website and DNB’s online banking service, which involve the transmission of confidential information. Although DNB relies on commonly-used security and processing systems to provide the security and authentication necessary to effect the secure transmission of data, these precautions may not protect its systems from compromises or breaches of security. In addition, DNB outsources certain of its data processing to third-party providers. If DNB’s third-party providers encounter difficulties, or if DNB has difficulty in communicating with them, DNB’s ability to adequately process and account for customer transactions could be affected, and DNB’s business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through

various other vendors and their personnel. The occurrence of any systems failure, interruption, or breach of security could damage DNB's reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to civil litigation and possible financial liability. Any of these occurrences could have a material adverse effect on DNB's financial condition and results of operations.

Additionally, financial products and services have become increasingly technology-driven. DNB's ability to meet the needs of its customers competitively, and in a cost-efficient manner, is dependent on DNB's ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of DNB's competitors have greater resources to invest in technology than DNB does and may be better equipped to market new technology-driven products and services. If DNB fails to keep pace with technological change, it could have a material adverse impact on DNB's business.

***Loss of, or failure to adequately safeguard, confidential or proprietary information may adversely affect DNB's operations, financial performance or reputation.*** — DNB regularly collects, processes, transmits and stores significant amounts of confidential information regarding its customers, employees and others. This information is necessary for DNB to conduct its business activities, including the ongoing maintenance of deposit, loan, investment management and other account relationships for DNB's customers, and receiving instructions and completing transactions for DNB's customers and other users of DNB's products and services. In addition, DNB compiles, processes, transmits and stores proprietary, non-public information concerning its business, operations, plans and strategies. In some cases, this confidential or proprietary information is collected, compiled, processed, transmitted or stored by third parties on DNB's behalf. Information security risks have generally increased in recent years because of the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. A failure in or breach of DNB's operational or information security systems, or those of DNB's service providers, as a result of cyber-attacks, information security breaches or otherwise could adversely affect its business, result in the disclosure or misuse of confidential or proprietary information, damage DNB's reputation, increase DNB's costs and/or cause losses. If this confidential or proprietary information were to be mishandled, misused, improperly disclosed or lost, DNB could be exposed to significant regulatory consequences, reputational damage, civil litigation and financial loss. Although DNB employs a variety of safeguards to protect this confidential and proprietary information from mishandling, misuse, improper disclosure or loss, DNB cannot assure you that these safeguards will be effective in every instance, or that if mishandling, misuse, improper disclosure or loss of the information did occur, those events would be promptly detected and addressed. Additionally, as information security risks and cyber threats continue to evolve, DNB may be required to expend additional resources to continue to enhance its information security measures and/or to investigate and remediate any information security vulnerabilities.

***Employee errors or misconduct could subject us to financial losses or regulatory sanctions and seriously harm DNB's reputation.*** — Errors or misconduct by DNB's employees could adversely impact DNB's business. Employee misconduct could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions DNB takes to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence. Although DNB maintains a system of internal controls and insurance coverage to mitigate operational risks, including employee errors and customer or employee fraud, should those internal controls fail to prevent or detect errors or improper actions, or if any resulting loss is not insured or exceeds applicable insurance limits, DNB's business and reputation could be adversely affected.

***Environmental risks associated with DNB's lending activities could adversely affect its financial condition and results of operations.*** — A significant portion of DNB's loan portfolio is secured by real property. In the course of its business, DNB may own or foreclose on and take title to real estate, which could result in DNB's being subject to environmental liabilities with respect to these properties. DNB may become responsible to a governmental agency or third parties for property damage, personal injury, investigation

and clean-up costs incurred by those parties in connection with environmental contamination, or DNB may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with environmental investigation or remediation activities could be substantial. If DNB were to become subject to significant environmental liabilities, it could have a material adverse effect on DNB's financial condition and results of operations.

***Severe weather, natural disasters, acts of war or terrorism and other external events could adversely affect DNB's business.*** — A variety of events over which DNB has no control, including severe weather, natural disasters, acts of war or terrorism and others could have a significant adverse effect on its business. Events such as these could affect the stability of its deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant damage to properties funded by DNB's loans, result in loss of revenue and/or cause us to incur additional expenses.

***Potential additional acquisitions in the future may disrupt DNB's business and dilute shareholder value.*** — DNB may pursue additional acquisitions of other financial institutions in the future as part of its growth strategy. As a result, DNB may engage in negotiations or discussions that, if they were to result in a transaction, could have a material effect on its business, operating results and financial condition. In any acquisition, DNB may pay for the acquisition through the payment of cash, the issuance of its common stock or other securities, or a combination thereof. Depending on the size of the acquisition, the amount DNB pays may be material. Using cash in connection with any acquisition could materially affect DNB's cash resources or require us to incur indebtedness. Using shares of common stock as payment could dilute the ownership interest of current shareholders. In addition, the required accounting treatment for certain acquisitions could result in us having to recognize a charge against earnings, which could materially and adversely affect DNB's results of operations during the period in which the charge is recognized. In addition, if goodwill recorded in connection with our prior or potential future acquisitions were determined to be impaired, then we would be required to recognize a charge against our earnings, which could materially and adversely affect our results of operations during the period in which the impairment was recognized. Any potential charges for impairment related to goodwill would not directly impact cash flow or tangible capital.

Acquisition activities generally involve a number of additional risks and potential effects on us and DNB's business, including:

- the time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, including the diversion of management resources from the operation of DNB's existing business;
- the time and expense necessary to integrate the operations and personnel of the acquired company; and
- difficulties relating to the conversion of operational, financial, accounting and customer data of the acquired company onto its systems.

DNB may not be successful in addressing the risks and inherent challenges in completing acquisitions. DNB may lose key employees, experience disruption of DNB's business and customer relationships, incur unexpected costs and face a variety of other unanticipated challenges, any of which could result in not achieving the anticipated benefits of an acquisition. If DNB is not able to successfully identify and address the risks and challenges associated with acquisitions, its business may be harmed and its financial position and results of operations could be materially and adversely affected.

***Attractive acquisition opportunities may not be available to us in the future, which could limit the growth of DNB's business.*** — DNB's future growth may depend, in part, on its ability to expand its business through additional acquisitions of other financial institutions in the future. DNB expects that other banking and financial service companies, many of which have significantly greater resources than us, will compete with us in seeking to complete such acquisitions. This could decrease our chances of growing through

acquisitions and increase prices for potential acquisition opportunities that DNB believes are attractive. Also, DNB's acquisitions are subject to various regulatory approvals. If DNB fails to receive the appropriate regulatory approvals for a proposed acquisition, DNB will not be able to complete a transaction which DNB believes to be in its best interests. DNB's regulators consider its capital, liquidity, profitability, regulatory compliance and levels of goodwill and intangibles, among other factors, when considering DNB's acquisition and expansion proposals. If DNB is unable to pursue and complete acquisitions, its ability to grow its business could be adversely affected.

***DNB operates in a highly regulated environment, and the laws and regulations that govern its operations, changes in those laws and regulations, or its failure to comply with applicable laws and regulations, could materially and adversely affect us.*** — DNB is subject to extensive regulation, supervision, and legislation that govern almost all aspects of its operations. These are intended to protect customers, depositors and the FDIC's Deposit Insurance Fund and not shareholders. Among other things, these laws and regulations prescribe minimum capital requirements, impose limitations on its business activities, limit the dividends or distributions that DNB can pay, restrict the ability of DNB First to engage in transactions with DNB, and impose certain specific accounting requirements on us that may be more restrictive and may result in greater or earlier charges to earnings or reductions in its capital than GAAP. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional compliance costs, and may make certain business practices or products impermissible or uneconomic. DNB's failure to comply with these laws and regulations, even if the failure follows good faith effort or reflects a difference in interpretation, could subject us to restrictions on its business activities, reputational harm, fines and other penalties, any of which could materially and adversely affect us. Further, any new laws, rules and regulations could make compliance more difficult or expensive and also materially and adversely affect us.

***Previously-enacted and potential future legislation, including legislation to reform the U.S. financial regulatory system, could adversely affect DNB's business.*** — Market conditions have resulted in the creation of various programs by the U.S. Congress, the Treasury Department, the Federal Reserve and the FDIC that were designed to enhance market liquidity and bank capital. As these programs expire, are withdrawn or reduced, the impact on the financial markets, and banks in general and their customers is unknown. This could have the effect of, among other things, reducing liquidity, raising interest rates, reducing fee revenue, limiting the ability to raise capital, all of which could have an adverse impact on DNB's financial condition. Additionally, the federal government has passed a variety of other reforms related to banking and the financial services industry, including the Dodd-Frank Act. The Dodd-Frank Act imposes significant regulatory and compliance changes. Effects of the Dodd-Frank Act on its business include:

- changes to regulatory capital requirements;
- exclusion of hybrid securities, including trust preferred securities, issued on or after May 19, 2010 from Tier 1 capital;
- creation of new government regulatory agencies, such as the Financial Stability Oversight Council and the Consumer Financial Protection Bureau;
- potential limitations on federal preemption;
- changes to deposit insurance assessments;
- regulation of debit interchange fees DNB earns;
- changes in retail banking regulations, including potential limitations on certain fees DNB may charge; and
- changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds, commonly referred to as the Volker Rule. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, will require regulations to be promulgated by various federal agencies in order to be implemented, some of which have been proposed by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until implementation. The changes resulting from the Dodd-Frank Act could limit DNB's business activities, require changes to certain of its business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise materially and adversely affect us. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements could also materially and adversely affect us.

***New capital rules that were recently issued generally require insured depository institutions and certain holding companies to hold more capital. The impact of the new rules on DNB's financial condition and operations is uncertain.*** — In July 2013, U.S. federal bank regulatory agencies issued final rules that substantially amended the regulatory risk-based capital rules applicable to DNB and DNB First. The new rules revise, among other things, risk-based capital requirements and the method for calculating risk weighted assets to make those standards consistent with agreements that were reached by Basel III and certain provisions of the Dodd-Frank Act. Certain requirements of the rule began to phase in on January 1, 2015 and the remaining requirements of the rule will be phased by January 1, 2019. The new rules include certain new and higher risk-based capital and leverage requirements than those currently in place. In addition, in order to avoid restrictions on capital distributions (including dividends) or discretionary bonus payments to executives, a covered banking organization must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. The capital conservation buffer will be phased in incrementally over time, becoming fully effective on January 1, 2019. Furthermore, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if DNB were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in modifications to its business strategy and could limit its ability to make distributions, including paying dividends or repurchasing its shares.

***The FDIC's restoration plan and the related increased assessment rate could materially and adversely affect us.*** — The FDIC insures deposits at FDIC-insured depository institutions, including DNB First, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on certain factors, including capital levels and the level of supervisory concern regulators believe the institution poses. Market developments have significantly depleted the FDIC Deposit Insurance Fund, or DIF, and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, the FDIC has increased the deposit insurance assessment rates and thus raised deposit insurance premiums for insured depository institutions. If these increases are insufficient for the DIF to meet its funding requirements, there may need to be further special assessments or increases in deposit insurance premiums. DNB is generally unable to control the amount of premiums that DNB is required to pay for FDIC insurance. If there are additional bank or financial institution failures, DNB may be required to pay even higher FDIC premiums than the recently

increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums may materially and adversely affect us, including by reducing DNB's profitability or limiting its ability to pursue certain business opportunities.

***The Consumer Financial Protection Bureau may reshape consumer financial laws through rulemaking and enforcement of unfair, deceptive or abusive practices, which may directly impact DNB's business practices relating to consumer financial products or services.*** — The Consumer Financial Protection Bureau, or CFPB, has broad rulemaking authority to administer and carry out the purposes and objectives of the “Federal consumer financial laws, and to prevent evasions thereof,” with respect to all financial institutions that offer financial products and services to consumers. The CFPB is also authorized to prescribe rules applicable to any covered person or service provider identifying and prohibiting acts or practices that are “unfair, deceptive, or abusive” in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service (“UDAP authority”). The potential reach of the CFPB's broad new rulemaking powers and UDAP authority on the operations of financial institutions offering consumer financial products or services, including us, is currently unknown.

***DNB First is subject to federal and state and fair lending laws and failure to comply with these laws could lead to material penalties.*** — Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB, and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to DNB First's performance under the fair lending laws and regulations could adversely impact DNB First's rating under the Community Reinvestment Act and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact DNB's reputation, business, financial condition and results of operations.

***DNB faces a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.*** — The Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “PATRIOT Act”) and other laws and regulations require financial institutions, including us, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements, and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the Justice Department, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control (the “OFAC”). If its policies, procedures and systems are deemed deficient, DNB would be subject to liability, including fines and regulatory actions, including possible restrictions on DNB's ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of its business plan, which could materially and adversely affect us. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

***DNB's share price may change for a variety of reasons, some of which are beyond DNB's control.*** — DNB's share price can fluctuate in response to a variety of factors, some of which are not under DNB's control. These factors could cause the share price to decrease regardless of DNB's operating results. These factors include:

- DNB's financial condition, performance, creditworthiness and prospects;
- DNB's past and future dividend practice;

- operating results that vary from the expectations of management, securities analysts and investors;
- quarterly variations in DNB's operating results or in the quality of DNB's assets;
- operating results and securities price performance of companies that investors believe are comparable to us;
- the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and developments with respect to financial institutions generally;
- future sales of DNB's equity or equity-related securities; and
- changes in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stock, commodity or real estate valuations or volatility and other geopolitical, regulatory or judicial events.

In addition, DNB's share price can be affected by the level of trading in its common stock. The trading volume for the common stock has historically been less than that of larger financial services companies. In light of the relatively low trading volume, significant sales of its common stock in the public market, or the perception that those sales may occur, could cause the trading price of the common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

***DNB may sell additional shares of its common stock or other securities that are convertible into or exchangeable for its common stock, which may adversely affect the market price of DNB's common stock.*** — DNB is not restricted from issuing additional shares of common stock or other securities, including securities that may be convertible into or exchangeable for shares of its common stock. Some of these securities may have distribution rights in connection with liquidation or other rights, including dividend and voting rights, senior to the rights of DNB's common stock. The future issuance of shares of common stock or other securities could have a dilutive effect on the holders of DNB's common stock. Additionally, the market value of DNB's common stock could decline as a result of sales by us of a large number of shares of common stock or other securities or the perception that such sales could occur.

***Provisions in DNB's articles of incorporation and bylaws may inhibit a takeover of us, which could discourage transactions that would otherwise be in the best interests of DNB's shareholders and could entrench management.*** — Provisions of DNB's amended and restated articles of incorporation and amended and restated bylaws, and applicable provisions of Pennsylvania law may delay, inhibit or prevent someone from gaining control of its business through a tender offer, business combination, proxy contest or some other method even though some shareholders might believe a change in control is desirable.

***DNB relies on dividends from DNB First for most of DNB's revenue.*** — DNB is a bank holding company and its operations are conducted by DNB's subsidiaries from which DNB receives dividends. The ability of DNB's subsidiaries to pay dividends is subject to legal and regulatory limitations, profitability, financial condition, capital expenditures and other cash flow requirements. The ability of DNB First to pay cash dividends to DNB is limited by its obligation to maintain sufficient capital and by other restrictions on its cash dividends that are applicable to banks. If DNB First is not permitted to pay cash dividends to DNB, it is unlikely that DNB would be able to pay cash dividends on its common stock.

***Combining the two companies may be more difficult, costly or time-consuming than expected and the anticipated benefits and cost savings of the merger may not be realized.*** — The challenges involved in combining the operations of DNB and ERB include, among other things, integrating personnel with diverse business backgrounds, combining different corporate cultures, and retaining key employees. It is possible that the integration process could result in the loss of key employees or disruption of each company's ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect DNB's ability to maintain relationships with customers and employees or to achieve the anticipated benefits of the merger. The integration of the two companies will require the experience and expertise of certain key employees of ERB who are expected to be retained by DNB. DNB may not be successful in retaining these

employees for the time period necessary to successfully integrate ERB's operations with those of DNB. In addition, as with any merger of banking institutions, there also may be business disruptions that cause us to lose customers or cause customers to take their deposits out of DNB. The success of the combined company following the merger may depend in large part on the ability to integrate the two businesses, business models and cultures. DNB may not be able to successfully achieve the level of cost savings, revenue enhancements, and other anticipated synergies, and may not be able to capitalize upon the existing customer relationships of ERB to the extent anticipated, or it may take longer, or be more difficult or expensive than expected to achieve these goals. If DNB is not able to integrate the companies' operations successfully and in a timely manner, the expected benefits of the merger may not be realized, and this could have an adverse effect on DNB's business, results of operation and stock price.

***Goodwill Impairment may adversely impact our results of operations.*** — Impairment of goodwill or other intangible assets could require charges to earnings, which could result in a negative impact on our results of operations. Under current accounting standards, goodwill and certain other intangible assets with indeterminate lives are no longer amortized but, instead, are evaluated for impairment periodically or when impairment indicators are present. Evaluation of goodwill and such other intangible assets could result in circumstances where the applicable intangible asset is deemed to be impaired for accounting purposes. Under such circumstances, the intangible asset's impairment would be reflected as a charge to earnings in the period during which such impairment is identified. Management evaluated the goodwill using an analysis of required measures of value, including the current stock price as an indicator of minority interest value, change of control multiples as a measure of controlling interest value and discounted cash flow analysis as a measure of going concern value and applied a weighting based on appraisal standards to arrive at a valuation conclusion that indicated no impairment at December 31, 2016.

There is no assurance that we will be successful in overcoming these risks or any other problems encountered in connection with pending or potential acquisitions. Our inability to overcome these risks could have an adverse effect on our levels of reported net income, ROE and ROA, and our ability to achieve our business strategy and maintain our market value.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

The main office of the Bank, which the Bank owns, is located at 4 Brandywine Avenue, Downingtown, Pennsylvania 19335. DNB's registered office is also at this location, and DNB pays no rent or other form of consideration for the use of the Bank's main office as its principal executive office. The Bank leases its operations center located at 104 Brandywine Avenue Downingtown, PA. The Bank had a net book value of \$7.0 million for all branches owned plus leasehold improvements on offices leased at December 31, 2016. The Bank's DNB Investments & Insurance and DNB First Investment Management & Trust units, operating under the name, "DNB First Wealth Management," have offices adjacent to the Bank's Exton Office.

The Bank has fifteen branch offices located in Chester, Delaware, and Philadelphia Counties, Pennsylvania. In addition to the main office discussed above, they are:

<b>Office</b>	<b>Office Location</b>	<b>Owned/Leased</b>
Boothwyn	3915 Chichester Avenue, Boothwyn	Owned
Caln	1835 East Lincoln Highway, Coatesville	Owned
Chadds Ford	300 Oakland Road, West Chester	Leased
East End	701 East Lancaster Avenue, Downingtown	Owned
East Falls	4341 Ridge Avenue , Philadelphia	Leased
Exton	410 Exton Square Parkway, Exton	Leased
Kennett Square	215 East Cypress Street, Kennett Square	Owned
Lionville	891 Pottstown Pike, Exton	Owned
Little Washington	104 Culbertson Run Road, Downingtown	Owned
Ludwig's Corner	1030 North Pottstown Pike, Chester Springs	Owned
Old City	36 North 3rd Street, Philadelphia	Leased
Roxborough	6137 Ridge Avenue, Philadelphia	Leased
West Chester	124 West Market Street, West Chester	Leased
West Goshen	1115 West Chester Pike, West Chester	Leased

**Item 3. Legal Proceedings**

None.

**Item 4. Mine Safety Disclosures**

Not Applicable.

## Part II

### Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### (a) Market Price of and Dividends on Registrant’s Common Equity

DNB Financial Corporation’s common stock, par value \$1.00 per share, is listed for trading on Nasdaq’s Capital Market under the symbol DNB. Current price information is available from account executives at most brokerage firms as well as the firms listed at the back of this report who are market makers of DNB’s common stock. There were approximately 700 shareholders who owned 4.2 million shares of common stock outstanding at March 15, 2017. Quarterly high and low sales prices are set forth in the following table:

	High	2016 Low	Dividend	High	2015 Low	Dividend
First quarter	\$29.40	\$27.95	\$0.07	\$28.67	\$21.13	\$0.07
Second quarter	29.50	23.05	0.07	26.93	24.44	0.07
Third quarter	26.47	23.71	0.07	27.85	25.10	0.07
Fourth quarter	28.95	25.01	0.07	29.87	26.07	0.07

The information required with respect to the frequency and amount of DNB’s cash dividends declared on each class of its common equity for the two most recent fiscal years is set forth in the section of this report titled, “Item 6 — Selected Financial Data” on page 27, and incorporated herein by reference.

See also the discussion under “5. Certain Regulatory Matters” at page 54 of “Management’s Discussion and Analysis of Results of Operations” for further information regarding limitations on our ability to pay dividends.

The information required with respect to securities authorized for issuance under DNB’s equity compensation plans is set forth in “Item 12 — Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” on page 113, and incorporated herein by reference.

#### (b) Recent Sales of Unregistered Securities

None.

#### (c) Purchases of Equity Securities by DNB and Affiliated Purchasers

The following table provides information on repurchases by or on behalf of DNB or any “affiliated purchaser” (as defined in Regulation 10b-18(a) (3)) of its common stock in each month of the quarter ended December 31, 2016.

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2016 – October 31, 2016	—	\$—	—	63,016
November 1, 2016 – November 30, 2016	—	—	—	63,016
December 1, 2016 – December 31, 2016	—	—	—	63,016
<b>Total</b>	—	\$—	—	63,016

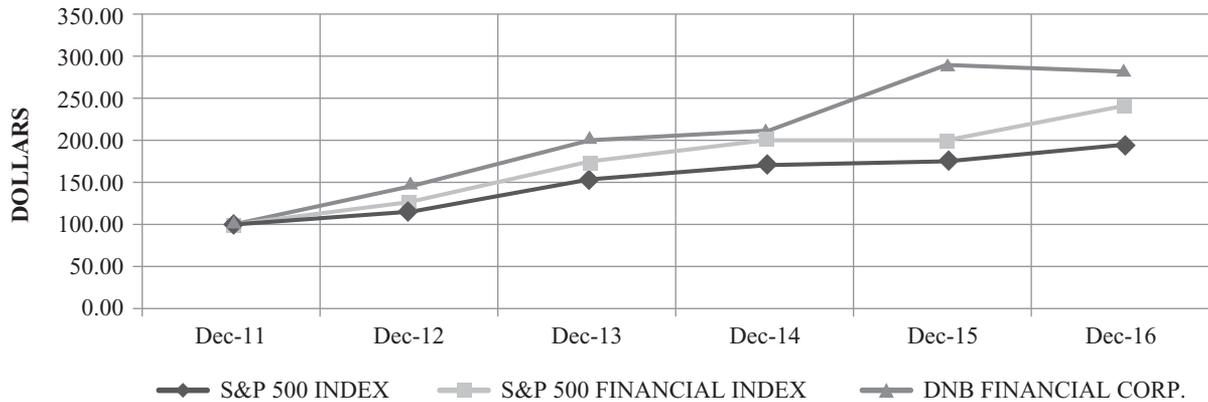
On July 25, 2001, DNB authorized the buyback of up to 175,000 shares of its common stock over an indefinite period. On August 27, 2004, DNB increased the buyback from 175,000 to 325,000 shares of its common stock over an indefinite period.

As more fully discussed beginning on page 6 in the “Supervision and Regulation” section of Item 1. “Business” of this Annual Report on Form 10-K, DNB’s ability to repurchase its common stock was limited by the terms of the Securities Purchase Agreement between DNB and the U.S. Treasury regarding its participation in the Treasury’s Small Business Lending Fund (SBLF). Under the SBLF, effective August 4, 2011, so long as any share of Series 2011A Preferred Stock remained outstanding, DNB was permitted to repurchase or redeem any shares of Capital Stock, only if, after giving effect to such dividend, repurchase or redemption, DNB’s Tier 1 capital would be at least equal to the Tier 1 Dividend Threshold, as specified in the agreement and that the dividends on such stock have all been contemporaneously declared and paid. During 2015, DNB redeemed all remaining shares issued to the U.S. Treasury.

(d) Corporation Performance Graph

The following graph presents the 5 year cumulative total return on DNB Financial Corporation’s common stock, compared to the S&P 500 Index and the S&P 500 Financial Index for the 5 year period ended December 31, 2016. The comparison assumes that \$100 was invested in DNB’s common stock and each of the foregoing indices and that all dividends have been reinvested.

**CORPORATION PERFORMANCE**  
**COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN**  
**AMONG DNB FINANCIAL CORP., the S&P 500 INDEX and the S&P 500 FINANCIAL INDEX**



## Item 6. Selected Financial Data

The selected financial data set forth below is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements and Notes thereto, contained elsewhere herein.

	At or For the Year Ended December 31 (Dollars in thousands, except share data)				
	2016	2015	2014	2013	2012
<b>RESULTS OF OPERATIONS</b>					
Interest income	\$ 29,179	\$ 24,478	\$ 23,596	\$ 23,212	\$ 25,729
Interest expense	3,324	2,712	2,311	2,888	3,755
Net interest income	25,855	21,766	21,285	20,324	21,974
Provision for credit losses	730	1,105	1,130	2,530	1,455
Non-interest income	6,364	5,009	4,958	4,795	4,528
Non-interest expense	24,641	19,029	18,632	17,450	17,702
Income before income taxes	6,848	6,641	6,481	5,139	7,345
Income tax expense	1,869	1,503	1,677	1,220	2,106
Net income	\$ 4,979	\$ 5,138	\$ 4,804	\$ 3,919	\$ 5,239
Preferred stock dividends & accretion of discount	—	50	135	148	332
Net income available to common stockholders	\$ 4,979	\$ 5,088	\$ 4,669	\$ 3,771	\$ 4,907
<b>PER SHARE DATA</b>					
Basic earnings	\$ 1.56	\$ 1.82	\$ 1.69	\$ 1.38	\$ 1.81
Diluted earnings	1.55	1.79	1.66	1.36	1.79
Cash dividends	0.28	0.28	0.28	0.28	0.20
Book value	22.36	19.65	18.33	16.55	16.08
Tangible book value	18.56	19.58	18.26	16.47	15.98
Average common shares outstanding	3,186,079	2,801,881	2,766,723	2,742,417	2,710,819
Average diluted common shares outstanding	3,218,884	2,847,488	2,812,726	2,780,752	2,739,954
<b>PERFORMANCE RATIOS</b>					
Return on average assets	0.59%	0.69%	0.71%	0.60%	0.84%
Return on average stockholders' equity	7.40	8.72	7.78	6.75	9.61
Return on average tangible equity	9.74	8.73	7.79	6.77	9.67
Net interest margin	3.31	3.16	3.36	3.30	3.66
Efficiency ratio	75.53	68.31	71.12	69.29	62.61
Wtd average yield on earning assets	3.72	3.51	3.67	3.76	4.26
<b>FINANCIAL CONDITION</b>					
Total assets	\$1,070,685	\$ 748,818	\$ 723,330	\$ 661,473	\$ 639,568
Total liabilities	975,845	693,330	659,422	602,890	582,863
Total stockholders' equity	94,840	55,488	63,908	58,583	56,705
Loans, gross	817,529	481,758	455,603	415,354	396,498
Allowance for credit losses	5,373	4,935	4,906	4,623	6,838
Investment securities	182,206	220,208	231,656	186,958	201,312
Goodwill	15,590	—	—	—	—
Intangible assets	537	66	82	111	181
Deposits	885,187	606,275	605,083	558,747	530,424
Borrowings	86,668	81,909	49,005	39,674	46,864
<b>ASSET QUALITY RATIOS</b>					
Net charge-offs to average loans	0.05%	0.23%	0.19%	1.20%	0.20%
Non-performing loans/total loans	1.04	1.06	1.50	1.38	2.63
Non-performing assets/total assets	1.05	1.02	1.07	1.03	1.82
Allowance for credit loss/total loans	0.66	1.02	1.08	1.11	1.72
Allowance for credit loss/non-performing loans	63.20	96.91	71.59	80.70	65.54
<b>CAPITAL RATIOS</b>					
Total equity/total assets	8.86%	7.41%	8.84%	8.86%	8.87%
Tangible equity/tangible assets	7.46	7.40	8.82	8.84	8.84
Tier 1 leverage ratio	8.42	8.94	10.55	10.61	10.50
Common equity tier 1 risk based capital ratio	9.60	10.44	10.50	10.51	10.51
Tier 1 risk based capital ratio	10.67	12.08	14.90	15.35	14.63
Total risk based capital ratio	12.50	14.78	15.92	16.40	15.88

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

### **I. Introductory Overview**

DNB is a bank holding company whose bank subsidiary, the Bank, is a nationally chartered commercial bank with trust powers, and a member of the FDIC. DNB provides a broad range of banking services to individual and corporate customers through its fifteen community offices located throughout Chester, Delaware, and Philadelphia Counties, Pennsylvania. DNB is a community banking organization that focuses its lending and other services on businesses and consumers in the local market area. DNB funds all these activities with retail and business deposits and borrowings. Through its Wealth Management Group, the Bank provides wealth management and trust services to individuals, businesses and non-profit organizations. The Bank and its subsidiary, DNB Investments and Insurance, make available certain non-depository products and services, such as securities brokerage, mutual funds, life insurance and annuities.

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

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

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

#### **Non-GAAP Based Financial Measures**

Our selected financial data contains a non-GAAP financial measure calculated using non-GAAP amounts. This measure is tangible book value per common share. Tangible book value per share adjusts the numerator by the amount of Goodwill and Other Intangible Assets (reduction of Shareholders' Equity). Management uses non-GAAP measures to present historical periods comparable to the current period presentation. In addition, management believes the use of non-GAAP measures provides additional clarity when assessing our financial results and use of equity. Disclosures of this type should not be viewed as substitutes for results determined to be in accordance with U.S. GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other entities.

Highlights of DNB's results for the year-end December 31, 2016 include:

- DNB completed its acquisition of East River Bank on October 1, 2016. The comparability of the financial condition of DNB as of December 31, 2016 compared to December 31, 2015, and the results of operations for the year ended 2016 compared to 2015, in general, have been impacted by the acquisition of ERB on October 1, 2016. The assets and liabilities of ERB were recorded on the consolidated balance sheet at their established fair value as of October 1, 2016, and their results of operations have been included in the consolidated income statement since that date. The acquisition added 3 full service branches in Philadelphia County, bringing DNB's branch count to fifteen (15) in the Greater Philadelphia Region. In addition, the acquisition added approximately \$306.4 million in loans and \$227.2 million in deposits.

- For the year ending December 31, 2016, net income available to common shareholders was \$5.0 million, or \$1.55 per share, compared with \$5.1 million, or \$1.79 per share for the corresponding prior year period. 2016's results include the operations of the former East River Bank for the fourth quarter of 2016 and include \$2.2 million of due diligence and merger related costs associated with its acquisition of East River Bank.
- Asset quality remained solid as non-performing assets, including loans and other real estate property, were \$11.3 million as of December 31, 2016, or 1.05% of total assets, compared with \$7.7 million as of December 31, 2015, or 1.02% of total assets. The total amount of non-performing assets increased due to loans and other assets acquired with the East River acquisition.
- DNB continued its focus on growing fee-based income. Wealth Management recorded a strong growth in total assets under care, which increased 11.8% to \$214.2 million as of December 31, 2016, from \$191.5 million as of December 31, 2015. This growth contributed to a \$149,000 or 10.0% increase in Wealth Management fee income. In addition, mortgage banking revenue increased \$111,000 or 85.9% to \$282,000 in 2016.
- Capital ratios continue to exceed minimum regulatory standards for well-capitalized institutions. As of December 31, 2016, the tier 1 leverage ratio was 8.42%, the tier 1 risk-based capital was 10.67%, the common equity tier 1 risk-based capital ratio was 9.60% and the total risk-based capital ratio was 12.50%. As of the same date, the tangible common equity-to-tangible assets ratio was 7.46%.

DNB is particularly exposed to downturns in the greater Philadelphia region as well as the global and U.S. economies. Starting in the 2007-2008 time period, a weak economy, coupled with declines in the housing market and elevated unemployment negatively impacted the credit performance of mortgage, construction and other loans and resulted in significant write-downs by many financial institutions across the U.S. In addition, the values of real estate collateral supporting many loans declined. While certain economic conditions in the U.S. have shown some improvement over the last eight years, economic growth has been slow and uneven as consumers continue to recover from previously high unemployment rates and lower housing valuations. In addition, high levels of U.S. government debt, as well as economic and political conditions in the global markets may impact DNB's borrowers negatively. Unfavorable general economic trends, reduced availability of commercial credit and a sustained low Labor Force Participation rate, can negatively impact the credit performance of both consumer and commercial credits, resulting in increased write-downs. A worsening of these conditions, such as an economic slowdown or recession, would likely worsen the adverse effects of these difficult market conditions on DNB and other financial institutions. As a result of a historically low rate of loan charge-offs in 2016 (0.05%), coupled with DNB's continued aggressive management of troubled assets, DNB was able to reduce its provision in 2016 to \$730,000, a \$375,000 reduction from the \$1.1 million provision made in 2015.

In addition, DNB's net interest margin has been impacted by these changes in the economy. Management has been aggressive in managing DNB's cost of funds during the year by implementing carefully planned pricing strategies, designed to offset the decline in rates on earning assets, while matching liquidity needs. Our composite cost of funds for 2016 was 0.53%, compared to 0.48% in 2015. DNB's net interest margin increased slightly to 3.31% in 2016 from 3.16% in 2015. The increased net interest margin was primarily caused by the higher volume and higher yield of interest-earning assets in 2016, over 2015.

**Earnings.** For the year ended December 31, 2016, DNB reported net income available to common shareholders of \$5.0 million, a decrease of \$109,000 from \$5.1 million reported for the year ended December 31, 2015, or \$1.55 per share versus \$1.79 per share, respectively, on a fully diluted basis. DNB's 2016 results include the operations of the former East River Bank for the fourth quarter of 2016, a \$1.2 million gain from insurance proceeds associated with a fire at one of DNB's offices during the second quarter of 2015, as well as \$2.2 million of due diligence and merger related costs associated with its acquisition of East River Bank.

**Asset Quality.** Non-performing assets were \$11.3 million at December 31, 2016 compared to \$7.7 million at December 31, 2015. Non-performing assets as of December 31, 2016 were comprised of \$8.5 million of non-accrual loans, as well as \$2.6 million of Other Real Estate Owned (“OREO”) and \$191,000 in other repossessed property. As of December 31, 2016, the non-performing loans to total loans ratio decreased to 1.04% compared to 1.06% at December 31, 2015. The non-performing assets to total assets ratio increased to 1.05% at December 31, 2016, compared to 1.02% at December 31, 2015. The allowance for credit losses was \$5.4 million at December 31, 2016, compared to \$4.9 million at December 31, 2015. The allowance to total loans was 0.66% at December 31, 2016 compared to 1.02% at December 31, 2015. Loans acquired in connection with the purchase of East River have been recorded at fair value based on an initial estimate of expected cash flows, including a reduction for estimated credit losses, and without carryover of the respective portfolio’s historical allowance for loan losses. At December 31, 2016, the allowance for credit losses as a percentage of originated loans (a non-GAAP measure), which represents all loans other than those acquired, was 1.04%. DNB’s delinquency ratio (the total of all delinquent loans plus loans greater than 90 days and still accruing, divided by total loans) was 1.60% at December 31, 2016, up from 1.32% at December 31, 2015.

## **II. Overview of Financial Condition — Major Changes and Trends**

At December 31, 2016, DNB had consolidated assets of \$1.1 billion and a Tier I/Leverage Capital Ratio of 8.42%. Loans comprise 79.6% of earning assets, while investments and overnight funds constitute the remainder. Assets increased \$321.9 million to \$1.1 billion at December 31, 2016, compared to \$748.8 million at December 31, 2015. During the same period, investment securities decreased \$38.0 million to \$182.2 million, while the loan portfolio increased \$335.8 million, or 69.70%, to \$817.5 million. Deposits increased \$278.9 million to \$885.2 million at December 31, 2016. DNB’s liabilities are comprised of a high level of core deposits with a low cost of funds in addition to a moderate level of brokered deposits and borrowings with costs that are more volatile than core deposits.

**Comprehensive 5-Year Plan.** During the fourth quarter of 2016, 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.** During the fourth quarter of 2016, DNB completed the acquisition of East River Bank. The acquisition made DNB one of only six institutions with assets over \$1 billion, headquartered in Southeastern, PA. The acquisition increased DNB’s assets to \$1.1 billion and deposits to \$885.2 million at December 31, 2016. The acquisition and integration of East River Bank contributed significantly to DNB’s goal of increasing shareholder value. DNB’s gross loans to assets ratio increased to 76.4% at December 31,

2016 from 64.3% at December 31, 2015. During the same period, DNB's investment securities to assets ratio decreased to 17.0% at December 31, 2016 from 29.4% at December 31, 2015. The shift in these ratios factored heavily in a 15 basis point increase in DNB's net interest margin during the year (3.31% for the year ended December 31, 2016, compared to 3.16% in 2015). The acquisition also provides DNB with a proven and successful Philadelphia based lending staff poised to continue loan growth in Philadelphia County. In addition to the greater economies of scale and improved efficiencies created by the merger, the combination provides the possibility of further margin expansion as DNB replaces higher costing deposits and borrowings acquired in the merger with core deposits during 2017. The acquisition will also open up the Philadelphia market to DNB's Wealth Management, Cash Management and Mortgage Banking products and services.

DNB's most significant revenue source continues to be net interest income, defined as total interest income less total interest expense, which in 2016 accounted for approximately 80.2% of total revenue. 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.

### **III. DNB's Principal Products and Services**

**Loans and Lending Services.** DNB's primary source of earnings and cash flows is derived from its lending function. The commercial loan portfolio amounted to \$661.4 million or 80.9% of total loans as of December 31, 2016. DNB focuses on providing these products to small to mid-size businesses throughout Chester, Delaware, and Philadelphia Counties. In keeping with DNB's goal to match customer business initiatives with products designed to meet their needs, DNB offers a wide variety of fixed and variable rate loans that are priced competitively. DNB serves this market by providing funds for the purchase of business property or ventures, working capital lines, Small Business Administration loans, lease financing for equipment and for a variety of other purposes.

As a community bank, DNB also serves consumers by providing home equity and home mortgages, as well as term loans for the purchase of consumer goods. Residential mortgage and consumer loans increased \$71.0 million in 2016 compared to 2015, primarily in the residential mortgage portfolio. In addition to providing funds to customers, DNB also provides a variety of services to its commercial customers. These services, such as cash management, remote capture, commercial sweep accounts, internet banking, letters of credit and other lending services are designed to meet our customer needs and help them become successful. DNB provides these services to assist its customers in obtaining financing, securing business opportunities, providing access to new resources and managing cash flows.

**Deposit Products and Services.** DNB's primary source of funds is derived from customer deposits, which are typically generated by DNB's fifteen branch offices. DNB's deposit base, while highly concentrated in central Chester County, extends to southern Chester County and into parts of Delaware, Lancaster, and Philadelphia Counties. In addition, a growing amount of new deposits are being generated through expanded government service offerings and as a part of comprehensive loan or wealth management relationships. DNB also has access to wholesale brokered deposits which amounted to \$29.3 million at December 31, 2016.

The majority of DNB's deposit mix consists of low costing core deposits, (demand, NOW and savings accounts). The remaining deposits are comprised of rate-sensitive money market and time products. DNB offers tiered savings and money market accounts, designed to attract high dollar, less volatile funds. Certificates of deposit and IRAs are traditionally offered with interest rates commensurate with their terms.

**Non-Deposit Products and Services.** DNB offers non-deposit products and services under the names "DNB Investments & Insurance" and "DNB First Investment Management & Trust." Revenues from these entities were \$1.6 million and \$1.5 million for 2016 and 2015, respectively.

**DNB Investments & Insurance.** Through a third party marketing agreement with Cetera Investment Services, LLC, DNB Investments & Insurance offers a complete line of investment and insurance products, which include the following:

- Fixed & Variable Annuities
- 401(k) Rollovers
- Self-Directed and Managed IRAs
- Mutual Funds
- Long Term Care Insurance
- Life Insurance
- Disability Insurance
- 401(k) plans
- Stocks
- Bonds
- Full Services Brokerage/Cash Management
- 529 College Savings Plans
- Separately Managed Investment Accounts (SMA)
- Self Employed Pension (SEP)

**DNB First Investment Management & Trust.** DNB First Investment Management & Trust offers a full line of investment and fiduciary services, which includes the following:

- Investment Management
- Estate Settlement
- Custody Services
- Corporate Trustee / Trust Administration
- Investment Advisory
- Client Bill Paying
- Financial Planning
- Power of Attorney and Guardian of the Estate Capacities

#### **IV. Material Challenges, Risks and Opportunities**

##### ***A. 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 a 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 DNB'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 DNB's business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with approved guidelines. Through such management, DNB seeks to reduce the vulnerability of its operations to changes in interest rates. DNB's Asset Liability Committee (the "ALCO") is responsible for reviewing DNB'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 DNB's interest rate risk position to the Board of Directors on a quarterly basis. The extent of the movement of interest rates is an uncertainty that could have a negative impact on DNB's earnings. (See additional discussion in Item 7a. Quantitative and Qualitative Disclosures About Market Risk on page 56 of this Form 10-K.)

1. *Net Interest Margin*

DNB's net interest margin is the ratio of net interest income to average interest-earning assets. Unlike the interest rate spread, which measures the difference between the rates on earning assets and interest paying liabilities, the net interest margin measures that spread plus the effect of net free funding sources. This is a more meaningful measure of profitability because a bank can have a narrow spread but a high level of equity and non-interest-bearing deposits, resulting in a higher net interest margin. One of the most critical challenges DNB faced over the last several years was the impact of historically low interest rates and a narrower spread between short-term rates and long-term rates as noted in the following tables.

	<b>December 31</b>					
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Prime	<b>3.75%</b>	3.50%	3.25%	3.25%	3.25%	3.25%
Federal Funds Sold ("FFS")	<b>0.75</b>	0.50	0.25	0.25	0.25	0.25
6 month US Treasury	<b>0.61</b>	0.48	0.11	0.10	0.12	0.05

	<b>Historical Yield Spread December 31</b>					
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
FFS to 5 year US Treasury	<b>1.21%</b>	1.21%	1.64%	1.58%	0.70%	0.64%
FFS to 10 year US Treasury	<b>1.74</b>	1.75	2.21	2.90	1.72	1.73

In general, financial institutions price their fixed rate loans off of 5 and 10 year treasuries and price their deposits off of shorter indices, like the Federal Funds Sold rate. As you can see in the table above, the spread between the Federal Funds Sold rate and the 5 year treasury has ranged from 1.64% to 0.64% during the last 6 years. The spread between the Federal Funds Sold rate and the 10 year treasury has ranged from 2.90% to 1.72% during the last 6 years. As a result of the compression between long and short term rates, many banks, including DNB, have seen their net interest margin fluctuate during the last 6 years.

The following table provides, for the periods indicated, information regarding: (i) DNB's average balance sheet; (ii) the total dollar amounts of interest income from interest-earning assets and the resulting average yields (tax-exempt yields have been adjusted to a tax equivalent basis using a 34% tax rate); (iii) the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs; (iv) net interest income; (v) net interest rate spread; and (vi) net interest margin. Average balances were calculated based on daily balances. Non-accrual loan balances are included in total loans. Loan fees and costs are included in interest on total loans.

*Average Balances, Rates, and Interest Income and Expense*  
(Dollars in thousands)

	2016			Year Ended December 31 2015			2014		
	Average Balance	Interest*	Yield/ Rate	Average Balance	Interest*	Yield/ Rate	Average Balance	Interest*	Yield/ Rate
<b>ASSETS</b>									
Interest-earning assets:									
Investment securities:									
Taxable	\$154,827	\$ 2,896	1.87%	\$177,213	\$ 2,955	1.67%	\$156,402	\$ 2,850	1.82%
Tax-exempt	53,430	1,825	3.42	54,578	2,112	3.87	41,934	1,685	4.02
Total securities	208,257	4,721	2.27	231,791	5,067	2.19	198,336	4,535	2.29
Cash and cash equivalents	30,391	129	0.42	21,075	42	0.20	21,247	42	0.20
Total loans	571,432	25,310	4.43	465,944	20,348	4.37	435,816	19,733	4.53
Total interest-earning assets	810,080	30,160	3.72	718,810	25,457	3.54	655,399	24,310	3.71
Non-interest-earning assets	28,427			22,542			21,457		
<b>Total assets</b>	<b>\$838,507</b>			<b>\$741,352</b>			<b>\$676,856</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest-bearing liabilities:									
NOW, money market, and savings	\$428,143	\$ 1,004	0.23%	\$414,920	\$ 590	0.14%	\$376,568	\$ 541	0.14%
Time	101,268	706	0.70	67,487	396	0.59	81,546	697	0.85
Brokered	22,491	301	1.34	14,803	179	1.21	5,590	53	0.95
Total interest-bearing deposits	551,902	2,011	0.36	497,210	1,165	0.23	463,704	1,291	0.28
Federal funds purchased	442	3	0.72	204	1	0.51	276	2	0.64
Repurchase agreements	19,878	40	0.20	25,574	51	0.20	19,531	39	0.20
Subordinated debt	9,750	414	4.25	8,067	341	4.22	—	—	—
FHLBP advances	31,965	451	1.41	20,603	787	3.82	10,986	613	5.58
Other interest-bearing accounts	9,722	405	4.16	9,765	367	3.76	9,802	366	3.73
Total interest-bearing liabilities	623,659	3,324	0.53	561,423	2,712	0.48	504,299	2,311	0.46
Demand deposits	142,569			115,901			106,604		
Other liabilities	5,179			5,115			4,190		
Stockholders' equity	67,100			58,913			61,763		
<b>Total liabilities and stockholders' equity</b>	<b>\$838,507</b>			<b>\$741,352</b>			<b>\$676,856</b>		
Net interest income		\$26,836			\$22,745			\$21,999	
Interest rate spread			3.19%			3.09%			3.25%
Net interest margin			3.31%			3.16%			3.36%

\* All amounts are reported on a tax equivalent basis computed using the statutory federal income tax rate, exclusive of the alternative minimum tax rate and nondeductible interest expense. The tax equivalent adjustment amounts used in the above table to compute yields aggregated \$981,000 in 2016, \$979,000 in 2015 and \$714,000 in 2014.

2. Rate / Volume Analysis

In the fourth quarter of 2016, DNB recognized purchase accounting accretion and amortization related to the acquisition of ERB which totaled \$761,000 in additional net interest income, affecting interest income on loans, and interest expense on time deposits and borrowings. During 2016, net interest income increased \$4.1 million or 17.99% on a tax equivalent basis. As shown in the following Rate/Volume Analysis table, DNB benefited by \$3.7 million in favorable volume changes and by \$427,000 in favorable rate changes. The favorable change in net interest income due to volume changes is mostly attributable to increased average balances of loans of \$105.5 million (affecting net interest income favorably by \$4.7 million), increased average balances of cash and cash equivalents of \$9.3 million (favorable change \$40,000), and decreased average balances of repurchase agreements of \$5.7 million (favorable change \$11,000), offset by decreased average balances of investment securities of \$23.5 million (unfavorable

change \$458,000), increased average balances of interest-bearing deposits of \$54.7 million (unfavorable change \$369,000), increased average balances of FHLBP advances of \$11.4 million (unfavorable change \$160,000), and increased average balances of subordinated debt of \$1.7 million (unfavorable change \$71,000). The favorable impact of increased yields on interest-earning assets outweighed the unfavorable impact of increased rates on interest-bearing liabilities, resulting in a \$427,000 favorable difference. The favorable change due to rate earned on loans was \$290,000 (an average rate earned of 4.43% in 2016, compared to 4.37% in 2015). The favorable change due to rate earned on investments was \$112,000 (an average rate earned of 2.27% in 2016, compared to 2.19% in 2015). The favorable change due to rate paid on FHLBP advances was \$496,000 (an average rate paid of 1.41% in 2016, compared to 3.82% in 2015). These favorable changes due to increased yields on loans and investments and decreased yields on FHLBP advances were partially offset by higher rates paid on interest-bearing deposits and other interest-bearing liabilities. The unfavorable change due to rate on interest-bearing deposits was \$477,000 (an average rate paid of 0.36% in 2016, compared to 0.23% in 2015). The unfavorable change due to rate on other interest-bearing accounts was \$39,000 (an average rate paid of 4.16% in 2016, compared to 3.76% in 2015). DNB's composite cost of funds was 0.53% in 2016 compared to 0.48% in 2015.

The following table sets forth, among other things, the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense for the periods noted (tax-exempt yields have been adjusted to a tax equivalent basis using a 34% tax rate). For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to (i) changes in rate (change in rate multiplied by old volume) and (ii) changes in volume (change in volume multiplied by new rate). The net change attributable to the combined impact of rate and volume has been allocated proportionately to the change due to rate and the change due to volume.

**Rate / Volume Analysis**  
(Dollars in thousands)

	2016 Versus 2015 Change Due To			2015 Versus 2014 Change Due To		
	Rate	Volume	Total	Rate	Volume	Total
<b>Interest-earning assets:</b>						
Loans	\$ 290	\$4,672	\$4,962	\$ (701)	\$1,316	\$ 615
Investment securities:						
Taxable	360	(419)	(59)	(242)	347	105
Tax-exempt	(248)	(39)	(287)	(62)	489	427
Cash and cash equivalents	47	40	87	1	(1)	—
Total	449	4,254	4,703	(1,004)	2,151	1,147
<b>Interest-bearing liabilities:</b>						
NOW, money market, and savings	384	30	414	(5)	54	49
Time	74	236	310	(219)	(82)	(301)
Brokered	19	103	122	14	112	126
Federal funds purchased	—	2	2	—	(1)	(1)
Repurchase agreements	—	(11)	(11)	—	12	12
Subordinated notes	2	71	73	—	341	341
FHLBP advances	(496)	160	(336)	(193)	367	174
Other interest-bearing accounts	39	(1)	38	2	(1)	1
Total	22	590	612	(401)	802	401
Net interest income	\$ 427	\$3,664	\$4,091	\$ (603)	\$1,349	\$ 746

### 3. Interest Rate Sensitivity Analysis

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 Asset/Liability Committee ("ALCO") actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

ALCO continually evaluates interest rate risk management opportunities, including the use of derivative financial instruments. Management believes that hedging instruments currently available are not cost-effective, and therefore, has focused its efforts on increasing DNB's spread by attracting lower-costing retail deposits and in some instances, borrowing from the FHLB of Pittsburgh.

DNB reports its callable agency investments (\$23.1 million at December 31, 2016) at their Option Adjusted Spread ("OAS") effective duration date, as opposed to the call or maturity date. In management's opinion, using effective duration dates on callable securities and advances provides a better estimate of the option exercise date under any interest rate environment. The OAS methodology is an approach whereby the likelihood of option exercise takes into account the coupon on the security, the distance to the call date, the maturity date and current interest rate volatility. In addition, prepayment assumptions derived from historical data have been applied to mortgage-related securities, which are included in investments. (See additional discussion in Item 7a. Quantitative and Qualitative Disclosures About Market Risk on page 56 of this Form 10-K.)

#### ***B. 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, sales and maturities of mortgage-backed and investment securities, and FHLBP advances. 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 liquidity (Federal funds sold, investments and interest-bearing cash balances, less pledged securities).

#### ***C. 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 experiencing credit quality deterioration. DNB's loan review procedures provide objective 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. As the U.S. economy moves through a period of recession, it is possible that delinquencies and non-performing assets may rise as the value of homes decline and DNB's borrowers experience financial difficulty due to corporate downsizing, reduced sales and income levels, or other negative events which will impact their ability to meet their contractual loan payments. To minimize the impact on DNB's earnings and maintain sound credit quality, management continues to aggressively monitor credit and credit relationships that may be impacted by such adverse factors.

#### ***D. Competition***

In addition to the challenges related to the interest rate environment, community banks in Chester, Philadelphia and Delaware Counties have been experiencing increased competition from large regional and international banks entering DNB's marketplace through mergers and acquisitions. Competition for loans and deposits has negatively affected DNB's net interest margin. To compensate for the increased competition, DNB, along with other area community banks, has aggressively sought and marketed customers who have been disenfranchised by these mergers.

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

#### **V. Critical Accounting Policies and Estimates**

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 U.S. 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 management's opinion, the most critical accounting policies and estimates impacting DNB's consolidated financial statements are in Note 1. These policies are critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. For a complete discussion of DNB's significant accounting policies, see the Notes to the Consolidated Financial Statements and discussion throughout this Form 10-K.

#### **VI. 2016 Financial Results**

##### ***A. Liquidity***

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. Primary liquidity includes investments, Federal funds sold, and interest-bearing cash balances, less

pledged securities. 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 has available credit of approximately \$516.3 million at December 31, 2016. Management believes that DNB has adequate resources to meet its short-term and long-term funding requirements.

As of December 31, 2016, deposits totaled \$885.2 million, up \$278.9 million from \$606.3 million at December 31, 2015. There are \$159.0 million in certificates of deposit (including IRAs) scheduled to mature during 2017. 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. At December 31, 2016, DNB had \$185.8 million in un-funded loan commitments. In addition, there were \$2.8 million in un-funded letters of credit. Management anticipates the majority of these commitments will be funded by means of normal cash flows. Included in interest bearing deposits are time and brokered deposits issued in amounts of \$100,000 or more and their remaining maturities at December 31, 2016 were as follows:

*(Dollars in thousands)*

	<b>December 31, 2016</b>		
	<b>Time Deposits</b>	<b>Brokered Deposits</b>	<b>Total</b>
Three months or less	\$ 24,192	\$ 1,000	\$ 25,192
Over three through six months	48,677	5,263	53,940
Over six through twelve months	28,496	2,536	31,032
Over one year through two years	9,635	876	10,511
Over two years	12,601	1,494	14,095
<b>Total</b>	<b>\$123,601</b>	<b>\$11,169</b>	<b>\$134,770</b>

The following table sets forth the composition of DNB's deposits at the dates indicated.

***Deposits By Major Classification***

*(Dollars in thousands)*

	<b>December 31</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Non-interest-bearing deposits	\$173,467	\$125,581	\$102,107	\$101,853	\$ 85,055
Interest-bearing deposits:					
NOW	224,219	185,973	205,816	170,427	161,844
Money market	184,783	137,555	143,483	130,835	122,953
Savings	86,176	72,660	66,634	60,090	58,256
Certificates	166,565	55,180	62,747	75,856	81,637
IRA	20,691	10,838	14,058	19,686	20,679
Brokered	29,286	18,488	10,238	—	—
<b>Total deposits</b>	<b>\$885,187</b>	<b>\$606,275</b>	<b>\$605,083</b>	<b>\$558,747</b>	<b>\$530,424</b>

For detailed information regarding the maturity of our time deposits and certificates of deposit, see Note 7 to our Consolidated Financial Statements.

***Capital Resources and Adequacy***

Stockholders' equity was \$94.8 million at December 31, 2016 compared to \$55.5 million at December 31, 2015. The increase in stockholders' equity was primarily a result of the issuance of

\$34.7 million of common stock related to DNB's merger with ERB and 2016 earnings of \$5.0 million. These increases were partially offset by \$895,000 of dividends paid on DNB's common stock, \$568,000 of taxes on share awards vesting, and \$289,000 of other comprehensive loss. We have modeled our ratios under the finalized Basel III rules and we do not expect that we will be required to raise additional capital as a result of these rules.

On August 4, 2011, DNB entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which DNB issued and sold to the Treasury 13,000 shares of its Series 2011A Preferred Stock, having a liquidation preference of \$1,000 per share for aggregate proceeds of \$13,000,000. The Securities Purchase Agreement was entered into, and the Series 2011A Preferred Stock was issued, pursuant to the Treasury's SBLF, a \$30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion. Of the \$13 million in aggregate proceeds, \$11,879,000 was used to repurchase all CPP Shares (\$11,750,000 was paid in principal and \$128,900 in accrued, unpaid dividends related to the CPP Shares) previously held by the Treasury. The securities sold in this transaction were exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as a transaction by DNB not involving a public offering.

On March 6, 2015, DNB redeemed 9,750 of the 13,000 shares of the Corporation's Series 2011A Preferred Stock that had been issued to the United States Department of the Treasury in connection with the Corporation's participation in the SBLF program. The shares were redeemed at their liquidation value of \$1,000 per share plus accrued dividends for a total redemption price of \$9,767,604. DNB redeemed the remaining 3,250 shares on December 31, 2015. The shares were redeemed at their liquidation value of \$1,000 per share plus accrued dividends for a total redemption price of \$3,258,125.

Based on management's assessment, DNB and the Bank have each met the definition of "well capitalized" for regulatory purposes on December 31, 2016. The Bank's capital category is determined for the purposes of applying the bank regulators' "prompt corrective action" regulations and for determining levels of deposit insurance assessments and may not constitute an accurate representation of DNB's or the Bank's overall financial condition or prospects. DNB's capital exceeds the Federal Reserve Bank's ("FRB's") minimum leverage ratio requirements for bank holding companies (see additional discussion in Regulatory Matters — Note 17 to DNB's Consolidated Financial Statements).

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.

## ***B. Results of Operations***

### ***1. Summary of Performance***

#### **(a) Summary of Results**

For the year ended December 31, 2016, DNB reported net income available to common shareholders of \$5.0 million, a decrease of \$109,000 from \$5.1 million reported for the year ended December 31, 2015, or \$1.55 per share versus \$1.79 per share, respectively, on a fully diluted basis. DNB's 2016 results include the operations of the former East River Bank for the fourth quarter of 2016, a \$1.2 million gain from insurance proceeds associated with a fire at one of DNB's offices during the second quarter of 2015, as well as \$2.2 million of due diligence and merger related costs associated with its acquisition of East River Bank.

There are many aspects of the economy and the Federal Reserve's monetary policy that hinder DNB's ability to grow revenues and net income. One of the most significant factors is that the global and U.S. economies have experienced reduced business activity as a result of disruptions in the financial system during the past nine years. The United States, Europe, China and many other countries across the globe

are struggling with too much debt and weaker streams of revenues as a result of recessionary pressures, falling oil prices and high unemployment. Overall economic growth continues to be slow at a time when national and regional unemployment rates have improved, however participation rates remain at historically low levels. The risks associated with our business remain acute in periods of slow economic growth. While we are continuing to take steps to decrease and limit our exposure to problem loans, we nonetheless retain direct exposure to the residential and commercial real estate markets, and we are affected by these events.

The January 18, 2017 Beige Book indicated that aggregate business activity in the Third District grew at a modest pace during the January 18, 2017 Beige Book reporting period, a bit faster than the November 30, 2016 period. Notable shifts in activity included nonfinancial services and existing home sales, which improved to a moderate pace of growth. Four sectors: non-auto consumer spending, manufacturing, nonresidential construction and leasing, improved to a modest pace of growth. Employment growth also picked up to a modest pace. This pickup included manufacturing firms, which had been reporting job losses for much of the year. The Federal Reserve's contacts continued to report that wages rose modestly as the labor market continued to tighten. On balance, general prices also continued to grow at a modest pace. Overall, firms continued to expect moderate growth over the next six months.

Overall, Third District homebuilders continued to report little change in activity. However, reports were mixed: Pennsylvania builders of mid-priced homes noted a pause in activity, while a South Jersey builder of higher-priced homes reported a pickup at year-end with strong backlogs going into January. Brokers in most major Third District housing markets reported an upsurge in home sales to a moderate pace but noted that this season accounts for a relatively low percentage of annual sales volume. Moreover, sales continued to be constrained by very low inventory levels.

The Federal Reserve's nonresidential real estate contacts reported that slow, steady incremental growth was supporting leasing (and pre-leasing) activity, falling vacancy rates, rising rents, and new construction. Industrial/warehouse space is in greatest demand throughout the District. The market for office space is tightest in Philadelphia's central business district, while most suburban office markets are still strengthening.

Third District financial firms reported modest growth of total loan volume, a bit off the moderate pace of the November 30, 2016 Beige Book period. However, the significant seasonal increase in credit card volumes anticipated for the recent holiday period was much larger in 2016 than in 2015. Commercial real estate loans and commercial and industrial loans continued to be two of the fastest growing loan categories; however, both grew at a slower pace than during the same period one year ago. Volumes of home mortgages, home equity loans, auto loans, and other consumer loans were mostly unchanged over the November 30, 2016 Beige Book period. On balance, the Federal Reserve Bank of Philadelphia's banking contacts continued to report healthy loan portfolios and improving customer credit quality. Overall, banking contacts continued to express cautious optimism for slow, steady growth, and are not yet convinced of potentially greater growth.

Third District manufacturing firms reported modest growth, noting improvements in general activity and shipments, for which over one-third of the firms reported increases. New orders also continued to grow, but with somewhat fewer firms noting increases compared with the November 30, 2016 period. The makers of paper products, chemicals, and primary metal products noted overall gains in activity from the November 30, 2016 period, while the makers of lumber products noted weaker activity. Fabricated metals, industrial machinery, and electronics firms reported mixed results. More than half of the Federal Reserve Bank of Philadelphia's manufacturing contacts were optimistic that orders, shipping, and general activity would grow over the next six months. Firms also expressed broader optimism for future capital expenditures and employment.

Although DNB's earnings have been impacted by the general economic conditions, the impact has not been as severe as it has been in many parts of the nation, largely due to a relatively healthier economic

climate in the Third Federal Reserve District, compared to other areas of the country. DNB's franchise spans Chester, Philadelphia and Delaware counties in southeastern Pennsylvania and the majority of loans and deposits relationships are with businesses and individuals within the Third Federal Reserve District.

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

**(b) Significant Events, Transactions and Economic Changes Affecting Results**

Some of DNB's significant events during 2016 include:

- DNB completed its acquisition of East River Bank on October 1, 2016. The acquisition added 3 full service branches in Philadelphia County, bringing DNB's branch count to fifteen (15) in the Greater Philadelphia Region. In addition, the acquisition added approximately \$306.4 million in loans and \$227.2 million in deposits.
- There was a fire at the West Chester branch in 2015 that resulted in an insurance related gain of \$1.2 million in 2016.
- William S. Latoff, DNB's former Chairman and CEO passed away on January 11, 2016. The death of Mr. Latoff resulted in a net expense of \$445,000 in 2016 related to restricted stock owned by him and his SERP.

**(c) Trends and Uncertainties**

Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Introductory Overview on page 28 of this Form 10-K.

**(d) Material Changes in Results**

Please refer to the discussion above in the section titled "Significant Events, Transactions and Economic Changes Affecting Results."

**(e) Effect of Inflation and Changing Rates**

For detailed discussion of the effects of inflation and changes in rates on DNB's results, refer to the following discussion on "Net Interest Income."

**2. 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 (net of interest reversals on non-performing loans), investments and Federal funds sold, as well as net loan fee amortization and dividend income. Interest expense includes the interest cost for deposits, FHLBP advances, repurchase agreements, corporate debentures, Federal funds purchased and other borrowings.

During the year ended December 31, 2016, management focused on growing the loan portfolio, controlling our composite cost of funds, increasing penetration of new and existing households, as well as maintaining strong asset quality. Due primarily to the acquisition of East River Bank, total loans increased \$335.8 million or 70.4% on a year-over year basis, while our composite cost of funds for the year ended December 31, 2016 was 0.53%, compared to 0.48% in 2015. The net interest margin for the year ended December 31, 2016 was 3.31% compared to 3.16% in 2015. The increased net interest margin was primarily caused by the higher volume and higher yield of interest-earning assets in 2016, over 2015.

Interest on loans was \$24.9 million for 2016, compared to \$20.1 million for 2015. The average balance of loans was \$571.4 million with an average tax equivalent yield of 4.43% in 2016, compared to \$465.9 million with an average tax equivalent yield of 4.37% in 2015.

Interest and dividends on investment securities was \$4.1 million for 2016 compared to \$4.4 million for 2015. The average balance of investment securities was \$208.3 million with an average tax equivalent yield of 2.27% in 2016 compared to \$231.8 million with an average tax equivalent yield of 2.19% in 2015. Total investment securities decreased \$38.0 million from December 31, 2015 to December 31, 2016, primarily due to \$113.5 million in sales, principal pay-downs, calls and maturities, and a change in unrealized loss of \$466,000, offset by \$76.2 million in purchases. Interest and dividends decreased \$248,000, primarily due the lower average volume of the portfolio during the year.

Interest on deposits was \$2.0 million for 2016 compared to \$1.2 million for 2015. The average balance of interest-bearing deposits was \$551.9 million with an average rate of 0.36% for 2016 compared to \$497.2 million with an average rate of 0.23% for 2015.

Interest on FHLBP advances was \$451,000 for 2016 compared to \$787,000 for 2015. The average balance on FHLBP advances was \$32.0 million with an average rate of 1.41% for 2016 compared to \$20.6 million with an average rate of 3.82% for 2015. The decrease in rate was primarily due to a \$10.0 million FHLBP advance with a yield of 5.86% that matured in December of 2015.

Interest on repurchase agreements was \$40,000 for 2016 compared to \$51,000 for 2015. The average balance on repurchase agreements was \$19.9 million with an average rate of 0.20% for 2016 compared to \$25.6 million with an average rate of 0.20% for 2015. The decrease in interest expense was primarily the result of the lower volume of these accounts.

Interest on subordinated debt was \$414,000 for 2016 compared to \$341,000 for 2015. The average balance on subordinated debt was \$9.8 million with an average rate of 4.25% for 2016 compared to \$8.1 million with an average rate of 4.22% for 2015. The increase in interest expense was primarily the result of the higher average balance, year over year.

### 3. Provision for Credit Losses

To provide for known and inherent losses in the loan and lease portfolio, DNB maintains an allowance for credit losses. There was a \$730,000 provision made in 2016 compared to \$1.1 million in 2015. For a detailed discussion on DNB's reserve methodology, refer to "Item 1 — Determination of the allowance for credit losses" which can be found under "Critical Accounting Policies and Estimates".

### 4. 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; non-depository 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 and loans. In addition, DNB receives fees for cash management, remote capture, merchant services, debit cards, safe deposit box rentals and similar activities.

Non-interest income was \$6.4 million for 2016 compared to \$5.0 million for 2015. The \$1.4 million increase was primarily due to increases of \$1.1 million in gain from insurance proceeds associated with a fire at one of the Bank's locations, a \$353,000 increase in gain on sale of investment securities, a \$149,000 increase in Wealth Management, a \$114,000 increase in other fees, a \$111,000 increase in mortgage banking, and a \$15,000 increase in service charges on deposits. These increases were offset by a decrease of \$445,000 in gains on sale of loans.

## 5. Non-Interest Expense

Non-interest expense includes salaries & employee benefits, furniture & equipment, occupancy, professional & consulting fees as well as marketing, printing & supplies, FDIC insurance, PA shares tax, telecommunications, write-downs on other real estate owned (“OREO”) and other repossessed property and other less significant expense items. Non-interest expenses increased during 2016 by \$5.6 million or 29.5% compared to 2015. The \$5.6 million increase was largely due to the addition of former East River staff, offices and equipment as well as related due diligence and merger expense and the write down of OREO property.

*Salary and employee benefits.* Salary and employee benefits were \$12.3 million for 2016 compared to \$10.6 million for 2015. The \$1.7 million increase was primarily attributable to the addition of East River staff in the fourth quarter of 2016, higher level of full-time equivalent employees year over year, higher levels of restricted stock grants expense (primarily due to the death of the former Chairman and CEO), as well as a higher level of incentive and commission based compensation paid to various revenue producers.

*Furniture and equipment.* Furniture and equipment expense was \$1.5 million for 2016 compared to \$1.2 million for 2015. The \$254,000 increase was mainly attributable to an increase in maintenance agreements required in conjunction with acquiring East River Bank.

*Occupancy.* Occupancy expense was \$2.1 million for 2016 compared to \$1.9 million for 2015. The \$164,000 increase was mainly attributable to an increase in office building rental expense for our West Chester branch and loan operations office due to the fire during the second quarter of 2015 and the acquisition of three East River branch offices in the fourth quarter of 2016.

*Professional and Consulting.* Professional and consulting expense was \$1.3 million for 2016 compared to \$1.2 million for 2015. The \$154,000 increase was mainly attributable to increases in legal fees of \$59,000, consulting expenses of \$46,000 related to recruitment and placement fees of new employees, third party services of \$27,000, and audit and accounting fees of \$22,000.

*Loss on sale or write-down of OREO and other repossessed property.* During 2016, DNB had \$644,000 of net loss on the sale/write-downs of OREO properties compared to \$134,000 in 2015. At December 31, 2016, DNB held \$2.8 million of such assets, compared to \$2.6 million at December 31, 2015.

*Due diligence and merger expense.* Merger and acquisition expenses in connection with the acquisition of East River Bank totaled \$2.2 million for 2016. DNB estimates it will recognize \$35,000 of East River Bank merger related expenses in 2017 related to legal expenses and maintenance agreements.

*Other expenses.* Other expenses were \$2.2 million for 2016 compared to \$1.9 million for 2015. The \$341,000 increase was primarily due to increases in OREO expenses, director’s fees, Visa card charge-offs and bank service charges.

## 6. Income Taxes

Income tax expense was \$1.9 million and \$1.5 million for the years ended December 31, 2016 and 2015, respectively. Income tax expense for each period primarily differs from the amount determined at the statutory rate of 34.0% due to tax-exempt income on loans and investment securities, DNB’s ownership of BOLI policies and tax credits recognized on a low-income housing limited partnership. The effective tax rates for 2016 and 2015 were 27.3% and 22.6%, respectively. The increase in effective tax rate for 2016 as compared to 2015 was related to the non-tax-deductibility of certain due diligence and merger-related expenses incurred during 2016. For more information related to income taxes, refer to Note 12 in the Notes to Consolidated Financial Statements.

## **Financial Condition Analysis**

### *1. Investment Securities*

DNB's investment portfolio consists of U.S. agency securities, mortgage-backed securities and collateralized mortgage obligations issued by U.S. Government agencies state and municipal securities, bank stocks, and other bonds and notes. In addition to generating revenue, DNB maintains the investment portfolio to manage interest rate risk, provide liquidity, provide collateral for borrowings and to diversify the credit risk of earning assets. The portfolio is structured to maximize DNB's net interest income given changes in the economic environment, liquidity position and balance sheet mix.

Given the nature of the portfolio, and its generally high credit quality, management normally expects to realize all of its investment upon the maturity of such instruments. Management determines the appropriate classification of securities at the time of purchase. Investment securities are classified as: (a) securities held to maturity ("HTM") based on management's intent and ability to hold them to maturity; (b) trading account ("TA") securities that are bought and held principally for the purpose of selling them in the near term; and (c) securities available for sale ("AFS"). DNB does not currently maintain a trading account portfolio.

Securities classified as AFS include securities that may be sold in response to changes in interest rates, changes in prepayment assumptions, the need to increase regulatory capital or other similar requirements. DNB does not necessarily intend to sell such securities, but has classified them as AFS to provide flexibility to respond to liquidity needs.

DNB's investment portfolio (HTM and AFS securities) totaled \$182.2 million at December 31, 2016, down \$38.0 million or 17.3% from \$220.2 million at December 31, 2015. The \$38.0 million decrease in investment securities was primarily due to \$113.5 million in sales, principal pay-downs, calls and maturities, and a change in unrealized loss of \$466,000, offset by \$76.2 million in purchases.

At December 31, 2016, approximately 63% of DNB's investments were in the AFS portfolio and 37% were in the HTM portfolio. Investments consist mainly of mortgage-backed securities and Agency notes backed by government sponsored enterprises, such as FHLMC, FNMA and FHLB. Management regularly reviews its investment portfolio to determine whether any securities are other than temporarily impaired. DNB did not invest in securities backed by sub-prime mortgages. At December 31, 2016, the combined AFS and HTM portfolios had an unrealized pretax gain of \$634,000 and an unrealized pretax loss of \$3.2 million. At December 31, 2015, the combined AFS and HTM portfolios had an unrealized pretax gain of \$1.1 million and an unrealized pretax loss of \$1.7 million. There were no other than temporarily impaired securities.

The following tables set forth information regarding the composition, stated maturity and average yield of DNB's investment security portfolio as of the dates indicated (tax-exempt yields have been adjusted to a tax equivalent basis using a 34% tax rate). The first two tables do not include amortization or anticipated prepayments on mortgage-backed securities. Callable securities are included at their stated maturity dates.

**Investment Maturity Schedule, Including Weighted Average Yield**  
(Dollars in thousands)

Held to Maturity	December 31, 2016					Total	Yield
	Less than 1 Year	1-5 Years	5-10 Years	Over 10 Years	No Stated Maturity		
US Government agency obligations	\$—	\$ 8,224	\$ —	\$ —	\$—	\$ 8,224	3.13%
GSE mortgage-backed securities	—	—	1,440	—	—	1,440	2.84
Corporate bonds	—	6,327	6,498	—	—	12,825	4.54
Collateralized mortgage obligations GSE	—	—	—	1,966	—	1,966	2.06
State and municipal taxable	—	—	1,008	—	—	1,008	2.70
State and municipal tax-exempt	—	9,311	18,950	13,298	—	41,559	3.26
<b>Total</b>	<b>\$—</b>	<b>\$23,862</b>	<b>\$27,896</b>	<b>\$15,264</b>	<b>\$—</b>	<b>\$67,022</b>	<b>3.44%</b>
Percent of portfolio	—%	35%	42%	23%	—%	100%	
Weighted average yield	—%	3.09%	3.85%	3.23%	—%	3.44%	

Available for Sale	December 31, 2016					Total	Yield
	Less than 1 Year	1-5 Years	5-10 Years	Over 10 Years	No Stated Maturity		
US Government agency obligations	\$12,021	\$40,288	\$ —	\$ —	\$—	\$ 52,309	1.15%
GSE mortgage-backed securities	—	—	4,714	25,426	—	30,140	1.70
Collateralized mortgage obligations GSE	—	—	1,810	10,763	—	12,573	1.55
Corporate bonds	4,620	8,800	1,760	—	—	15,180	2.09
State and municipal tax-exempt	3,079	—	298	1,579	—	4,956	1.93
Asset-backed security	—	—	26	—	—	26	1.39
<b>Total</b>	<b>\$19,720</b>	<b>\$49,088</b>	<b>\$8,608</b>	<b>\$37,768</b>	<b>\$—</b>	<b>\$115,184</b>	<b>1.49%</b>
Percent of portfolio	17%	43%	7%	33%	—%	100%	
Weighted average yield	1.33%	1.32%	1.78%	1.75%	—%	1.49%	

**Composition of Investment Securities**  
(Dollars in thousands)

Held to Maturity	December 31					
	2016		2015		2014	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Government agency obligations	\$ 8,224	\$ 8,533	\$ 7,973	\$ 8,293	\$ 7,730	\$ 8,073
GSE mortgage-backed securities	1,440	1,478	2,759	2,842	3,579	3,712
Corporate bonds	12,825	12,992	11,518	11,710	3,951	4,275
Collateralized mortgage obligations GSE	1,966	1,946	2,623	2,606	3,605	3,579
State and municipal taxable	1,008	1,014	2,623	2,606	3,605	3,579
State and municipal tax-exempt	41,559	40,161	42,956	42,980	40,589	40,460
<b>Total</b>	<b>\$67,022</b>	<b>\$66,124</b>	<b>\$67,829</b>	<b>\$68,431</b>	<b>\$59,454</b>	<b>\$60,099</b>

Available for Sale	2016		December 31 2015		2014	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
US Government agency obligations	\$ 52,428	\$ 52,309	\$ 58,460	\$ 58,208	\$ 61,547	\$ 61,354
GSE mortgage-backed securities	30,861	30,140	40,663	40,351	66,669	66,723
Collateralized mortgage obligations						
GSE	12,957	12,573	16,241	15,806	20,499	20,011
Corporate bonds	15,474	15,180	20,921	20,571	13,208	13,102
State and municipal tax-exempt	5,084	4,956	17,274	17,443	10,917	10,994
Asset-backed securities	26	26	—	—	—	—
Equity security	—	—	—	—	27	18
<b>Total</b>	<b>\$116,830</b>	<b>\$115,184</b>	<b>\$153,559</b>	<b>\$152,379</b>	<b>\$172,867</b>	<b>\$172,202</b>

## 2. Loan and Lease Portfolio

DNB's loan and lease portfolio consists primarily of commercial and residential real estate loans, commercial loans and lines of credit (including commercial construction), commercial leases and consumer loans. The portfolio provides a stable source of interest income, monthly amortization of principal and, in the case of adjustable rate loans, re-pricing opportunities.

Total loans were \$817.5 million at December 31, 2016, up \$335.8 million or 69.7% from 2015. Gross loans funded during 2016 were \$146.1 million, compared to \$145.9 million in 2015. DNB acquired \$306.4 million in loans from the acquisition of ERB. Paydowns on loans were \$116.7 million, down 2.5% from \$119.7 million in 2015. Commercial mortgage loans grew \$191.4 million or 69.8% to \$465.5 million, commercial loans grew by \$73.4 million or 59.9% to \$195.9 million, residential loans grew \$58.9 million or 205.7% to \$87.6 million, and consumer loans grew \$12.1 million or 21.4% to \$68.5 million.

The following table sets forth information concerning the composition of total loans outstanding, net of unearned income and fees and the allowance for credit losses, as of the dates indicated.

### ***Total Loans Outstanding, Net of Allowance for Credit Losses*** *(Dollars in thousands)*

	December 31				
	2016	2015	2014	2013	2012
Residential mortgage	\$ 87,581	\$ 28,651	\$ 25,993	\$ 24,677	\$ 25,835
Commercial mortgage	465,486	274,132	257,310	234,599	234,202
Commercial:					
Commercial term	123,175	102,178	80,819	89,279	81,888
Commercial construction	72,755	20,364	35,534	19,117	12,247
Lease financing	—	—	—	2	67
Consumer:					
Home equity	62,560	51,270	50,192	41,418	35,322
Other	5,972	5,163	5,755	6,262	6,937
<b>Total loans</b>	<b>817,529</b>	<b>481,758</b>	<b>455,603</b>	<b>415,354</b>	<b>396,498</b>
Less allowance for credit losses	(5,373)	(4,935)	(4,906)	(4,623)	(6,838)
<b>Net loans</b>	<b>\$812,156</b>	<b>\$476,823</b>	<b>\$450,697</b>	<b>\$410,731</b>	<b>\$389,660</b>

The following table sets forth information concerning the contractual maturities of the loan portfolio, net of unearned income and fees. For amortizing loans, scheduled repayments for the maturity category in which the payment is due are not reflected below, because such information is not readily available.

**Loan Maturities**  
(Dollars in thousands)

	Less than 1 Year	December 31, 2016		
		1-5 Years	Over 5 Years	Total
Residential mortgage	\$12,699	\$ 243	\$ 74,639	\$ 87,581
Commercial mortgage	17,686	138,974	308,826	465,486
Commercial:				
Commercial term	11,571	23,937	87,667	123,175
Commercial construction	46,164	22,829	3,762	72,755
Consumer:				
Home equity	28	3,383	59,149	62,560
Other	18	756	5,198	5,972
<b>Total loans</b>	<b>88,166</b>	<b>190,122</b>	<b>539,241</b>	<b>817,529</b>
Loans with fixed interest rates	23,229	144,094	238,634	405,957
Loans with variable interest rates	64,937	46,028	300,607	411,572
<b>Total loans</b>	<b>\$88,166</b>	<b>\$190,122</b>	<b>\$539,241</b>	<b>\$817,529</b>

3. *Non-Performing Assets*

Total non-performing assets increased \$3.6 million to \$11.3 million at December 31, 2016, compared to \$7.7 million at December 31, 2015. The \$3.6 million increase was attributable to a \$3.9 million increase in non-accrual loans (primarily due to the acquisition of ERB's non-accrual loans) and a \$186,000 increase in other real estate owned & other repossessed property, offset by a \$457,000 decrease in loans 90 days past due and still accruing. As a result of the increase in non-performing loans and a \$335.8 million net increase in gross loans, the non-performing loans to total loans ratio decreased to 1.04% at December 31, 2016, from 1.06% at December 31, 2015. The non-performing assets to total assets ratio increased to 1.05% at December 31, 2016 from 1.02% at December 31, 2015. The allowance to non-performing loans ratio decreased to 63.2% at December 31, 2016 from 96.9% at December 31, 2015. DNB continues to work diligently to improve asset quality by adhering to strict underwriting standards and improving lending policies and procedures. Non-performing assets have had, 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 or lease 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 commercial lease 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 and lease 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 December 31, 2016, DNB had \$22.4 million of loans classified as substandard. Of the \$22.4 million, \$13.5 million are performing and are believed to require increased supervision and review; and may, depending on the economic environment and other factors, become non-performing assets in future periods. The majority of these loans are secured by commercial real estate, with lesser amounts being secured by residential real estate, inventory and receivables. The amount of performing substandard loans at December 31, 2015 was \$14.6 million.

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)

	<b>December 31</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Non-accrual loans:					
Residential mortgage	<b>\$ 1,770</b>	\$1,619	\$2,457	\$2,250	\$ 2,196
Commercial mortgage	<b>4,593</b>	1,048	1,294	266	2,804
Commercial:					
Commercial term	<b>198</b>	188	198	—	—
Commercial construction	<b>1,242</b>	1,028	2,043	2,554	4,326
Lease financing	—	—	—	—	28
Consumer:					
Home equity	<b>442</b>	563	432	434	64
Other	<b>256</b>	189	95	82	147
Total non-accrual loans	<b>8,501</b>	4,635	6,519	5,586	9,565
Loans 90 days past due and still accruing	—	457	334	141	869
Total non-performing loans	<b>8,501</b>	5,092	6,853	5,727	10,434
Other real estate owned & other repossessed property	<b>2,767</b>	2,581	901	1,096	1,237
Total non-performing assets	<b>\$11,268</b>	\$7,673	\$7,754	\$6,823	\$11,671
Asset quality ratios:					
Non-performing loans to total loans	<b>1.04%</b>	1.06%	1.50%	1.38%	2.63%
Non-performing assets to total assets	<b>1.05</b>	1.02	1.07	1.03	1.82
Allowance for credit losses to:					
Total loans	<b>0.66</b>	1.02	1.08	1.11	1.72
Non-performing loans	<b>63.20</b>	96.91	71.59	80.70	65.54

If contractual interest income had been recorded on non-accrual loans, interest would have been increased as shown in the following tables:

***Non-accrual Loans-Contractual Interest Income***  
(Dollars in thousands)

	Year Ended December 31, 2016			
	December 31, 2016 Amount	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	\$1,770	\$ 74	\$—	\$ 74
Commercial mortgage	4,593	277	—	277
Commercial:				
Commercial term	198	11	—	11
Commercial construction	1,242	180	—	180
Consumer:				
Home equity	442	28	—	28
Other	256	20	—	20
Total non-accrual loans	8,501	590	—	590
Loans 90 days past due and still accruing	—	2	2	—
Total non-performing loans	\$8,501	\$592	\$ 2	\$590

	Year Ended December 31, 2015			
	December 31, 2015 Amount	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:				
Residential mortgage	\$1,619	\$ 69	\$—	\$ 69
Commercial mortgage	1,048	86	—	86
Commercial:				
Commercial term	188	9	—	9
Commercial construction	1,028	268	—	268
Consumer:				
Home equity	563	26	—	26
Other	189	15	—	15
Total non-accrual loans	4,635	473	—	473
Loans 90 days past due and still accruing	457	3	3	—
Total non-performing loans	\$5,092	\$476	\$ 3	\$473

4. Allowance for Credit Losses

To provide for known and inherent losses in the loan and lease portfolios, DNB maintains an allowance for credit losses. Provisions for credit losses are charged against income to increase the allowance when necessary. Loan and lease 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 and lease 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 OCC.

Management reviews and establishes the adequacy of the allowance for credit losses in accordance with U.S. generally accepted accounting principles, guidance provided by the Securities and Exchange Commission and as prescribed in OCC Bulletin 2006-47. Its methodology for assessing the appropriateness of the allowance consists of several key elements which include: specific allowances for identified impaired

loans; and allowances by loan type for pooled homogenous loans. In considering national and local economic trends, we review a variety of information including Federal Reserve publications, general economic statistics, foreclosure rates and housing statistics published by third parties. We believe this improves the measure of inherent loss over a complete economic cycle and reduces the impact for qualitative adjustments. An 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 also 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 commercial real estate, commercial, residential real estate, home equity and consumer installment loan pools to determine historical loss factors. The historical loss factors are then applied to the current portfolio balances to determine the required reserve percentage for each loan pool based on risk rating. Historical losses are segregated into risk-similar groups and a 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 the Loan Review Methodology and Degree of Oversight by Bank's Board of Directors.
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio
- 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 decline in the quality of the loan portfolio due to any trend in delinquent or adversely classified loans. In determining the adequacy of the allowance, management considers any deterioration of asset quality in DNB's commercial mortgage and residential first mortgage portfolios. 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.

The provision decreased to \$730,000 in 2016 compared to \$1.1 million in 2015. DNB's percentage of allowance for credit losses to total loans was 0.66% at December 31, 2016 compared to 1.02%, 1.08%, 1.11%, and 1.72% as of December 31, 2015, 2014, 2013, and 2012, respectively. The decline in this ratio from 1.02% in 2015 to 0.66% in 2016 was primarily due to the acquisition of ERB. Loans acquired in connection with the purchase of ERB have been recorded at fair value, in accordance with GAAP, and are based on an initial estimate of the expected cash flows, including a reduction for estimated credit losses, and without carryover of the respective portfolio's historical allowance for credit losses. DNB will continually evaluate the loans acquired from ERB for additional impairment as part of our normal allowance review process. The decline between 2013 and 2012 was a result of management partially charging off the carrying balance of four large non-performing loans by \$4.0 million during 2013. Prior to the partial charge-offs during 2013, DNB had specific reserves in the allowance of \$1.9 million on these loans. Net charge-offs were \$292,000 in 2016, compared to \$1.1 million, \$847,000, \$4.7 million, \$781,000, and \$1.2 million in 2015, 2014, 2013, and 2012, respectively. The percentage of net charge-offs to total average loans was 0.05%, 0.23%, 0.19%, 1.20%, and 0.20% during the five years ending December 31, 2016, 2015, 2014, 2013, and 2012, respectively. Management is not aware of any potential problem loans, which were accruing and current at December 31, 2016, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to DNB.

We typically establish a general valuation allowance on classified loans which are not impaired. In establishing the general valuation allowance, we segregate these loans by loan type. For 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 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. 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 treat them as homogeneous pools. For our commercial real estate 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 December 31, 2016, DNB had \$11.3 million of non-performing assets, which included \$8.5 million of non-performing loans and \$2.8 million of OREO and other repossessed property. 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, including estimated costs to sell in comparison to the carrying value of the loan. Of the \$8.6 million of impaired loans at December 31, 2016, \$1.9 million had a valuation allowance of \$334,000 and \$6.7 million had no specific allowance. For those impaired loans that management determined that no specific valuation allowance was necessary, management has reviewed the appraisal for each loan and determined that there is no shortfall in the collateral. During the year ended December 31, 2016, DNB recognized \$311,000 in total charge-offs, \$245,000 of which related to impaired loans.

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

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

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

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

Our estimates of the net realizable value of collateral include a deduction for the expected costs to sell the collateral or such other deductions as deemed appropriate. For most real estate collateral, we apply a seven to ten percent deduction to the value of real estate collateral to determine its expected costs to sell the asset. This estimate generally includes real estate commissions, one year of real estate taxes and miscellaneous repair and closing costs. If we receive a purchase offer that requires unbudgeted repairs, or if the expected holding period for the asset exceeds one year, then we include the additional real estate taxes and repairs or other holding costs in the expected costs to sell the collateral on a case-by-case basis.

*Analysis of Allowance for Credit Losses*  
(Dollars in thousands)

	Year Ended December 31				
	2016	2015	2014	2013	2012
Beginning balance	<b>\$4,935</b>	\$ 4,906	\$4,623	\$ 6,838	\$ 6,164
Provisions	<b>730</b>	1,105	1,130	2,530	1,455
Loans charged off:					
Residential mortgage	<b>(206)</b>	(194)	(326)	(183)	(99)
Commercial mortgage	<b>(39)</b>	(105)	(8)	(716)	—
Commercial:					
Commercial term	<b>(45)</b>	(200)	(47)	(247)	(38)
Commercial construction	<b>—</b>	(581)	(511)	(3,648)	(848)
Lease financing	<b>—</b>	—	(1)	(26)	(1)
Consumer:					
Home equity	<b>—</b>	(11)	—	—	—
Other	<b>(21)</b>	(63)	(82)	(70)	(31)
Total charged off	<b>(311)</b>	(1,154)	(975)	(4,890)	(1,017)
Recoveries:					
Residential mortgage	<b>13</b>	4	5	80	21
Commercial mortgage	<b>—</b>	—	—	—	—
Commercial:					
Commercial term	<b>1</b>	13	3	5	115
Commercial construction	<b>1</b>	10	103	—	—
Lease financing	<b>3</b>	49	8	59	72
Consumer:					
Home equity	<b>—</b>	—	—	—	—
Other	<b>1</b>	2	9	1	28
Total recoveries	<b>19</b>	78	128	145	236
Net charge-offs	<b>(292)</b>	(1,076)	(847)	(4,745)	(781)
Ending balance	<b>\$5,373</b>	\$ 4,935	\$4,906	\$ 4,623	\$ 6,838
Reserve for unfunded loan commitments	<b>\$ 345</b>	\$ 188	\$ 166	\$ 143	\$ 125
Ratio of net charge-offs to average loans	<b>0.05%</b>	0.23%	0.19%	1.20%	0.20%

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

**Composition of Allowance for Credit Losses**  
(Dollars in thousands)

	December 31									
	2016		2015		2014		2013		2012	
	Amount	Percent of Loan Type to Total Loans	Amount	Percent of Loan Type to Total Loans	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	\$ 349	11%	\$ 216	6%	\$ 269	6%	\$ 285	6%	\$ 306	6%
Commercial mortgage	2,531	57	2,375	57	2,300	56	2,010	56	3,094	59
Commercial:										
Commercial term	709	15	989	21	709	18	621	21	506	21
Commercial construction	969	9	569	4	881	8	1,073	5	1,536	3
Lease financing	—	—	—	—	—	—	—	—	3	—
Consumer:										
Home equity	196	7	195	11	189	11	156	10	178	9
Other	61	1	64	1	70	1	78	2	86	2
Unallocated	558	—	527	—	488	—	440	—	1,129	—
<b>Total</b>	<b>\$5,373</b>	<b>100%</b>	<b>\$4,935</b>	<b>100%</b>	<b>\$4,906</b>	<b>100%</b>	<b>\$4,623</b>	<b>100%</b>	<b>\$6,838</b>	<b>100%</b>
Reserve for unfunded loan commitments (other liability)	\$ 345		\$ 188		\$ 166		\$ 143		\$ 125	

5. Certain Regulatory Matters

Dividends payable to DNB 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. The sum of these items amounted to \$2.8 million for the year ended December 31, 2016. During 2015, the Bank paid \$8.95 million to DNB in connection with the acquisition of East River Bank. The OCC approved a special dividend request for \$10.0 million on August 16, 2016.

The FDIC has authority to assess and change federal deposit insurance assessment rates based on average consolidated assets, less tangible equity capital of the Bank. For further information, please refer to the discussion of FDIC deposit insurance assessments under Part I, Item 1 (“Business”), section (c) (“Narrative Description of Business”) — “Supervision and Regulation — Bank” under the heading “FDIC Insurance and Assessments” on page 6 of this report. DNB's FDIC insurance expense was \$507,000 in 2016.

DNB was well capitalized at December 31, 2016 and met all regulatory capital requirements. Please refer to Note 17 to the Consolidated Financial Statements for a table that summarizes required capital ratios and the corresponding regulatory capital positions of DNB and the Bank at December 31, 2016.

At December 31, 2016, DNB owned \$4.1 million of Federal Home Loan Bank of Pittsburgh (“FHLBP”) stock and had outstanding borrowings of \$55.3 million and outstanding letters of credit of \$75.0 million from the FHLBP. DNB recognized dividend income on FHLBP stock of \$127,000 in 2016. At December 31, 2016, DNB's excess borrowing capacity from the FHLBP was \$456.3 million. Generally, the loan terms from the FHLBP are better than the terms DNB can receive from other sources.

## 6. Off Balance Sheet Arrangements

In the normal course of business, various commitments and contingent liabilities are outstanding, such as guarantees and commitments to extend credit, borrow money or act in a fiduciary capacity, which are not reflected in the consolidated financial statements. Management does not anticipate any significant losses as a result of these commitments.

DNB had outstanding stand-by letters of credit totaling \$2.8 million and unfunded loan and lines of credit commitments totaling \$185.8 million at December 31, 2016.

These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The exposure to credit loss, in the event of non-performance by the party to the financial instrument for commitments to extend credit and stand-by letters of credit, is represented by the contractual amount. Management uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. DNB evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, obtained upon the extension of credit, usually consists of real estate, but may include securities, property or other assets.

Stand-by letters of credit are conditional commitments issued by DNB to guarantee the performance or repayment of a financial obligation of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risks involved in issuing letters of credit are essentially the same as those involved in extending loan facilities to customers. DNB holds various forms of collateral to support these commitments.

DNB maintains borrowing arrangements with various correspondent banks, the FHLBP and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB has available credit of approximately \$516.3 million at December 31, 2016. At December 31, 2016, DNB had \$55.3 million of FHLBP borrowings outstanding and the FHLBP had issued letters of credit, on DNB's behalf, totaling \$75.0 million against its available credit lines.

As of December 31, 2016, approximately \$214.2 million of assets are held by DNB First Wealth Management in a fiduciary, custody or agency capacity. These assets are not assets of DNB, and are not included in the consolidated financial statements.

### ***Off Balance Sheet Obligations*** *(Dollars in thousands)*

	Total	Expiration by Period			More than 5 Years
		Less than 1 Year	1-3 Years	3-5 Years	
Commitments to extend credit	\$185,810	\$37,128	\$33,648	\$3,774	\$111,260
Letters of credit	2,776	2,201	—	—	575
<b>Total</b>	<b>\$188,586</b>	<b>\$39,329</b>	<b>\$33,648</b>	<b>\$3,774</b>	<b>\$111,835</b>

For detailed information regarding FHLBP Advances and Short Term Borrowed Funds, see Note 8 to our Consolidated Financial Statements beginning at page 62.

The following table sets forth DNB's known contractual obligations as of December 31, 2016. The amounts presented below do not include interest.

**Contractual Obligations**  
(Dollars in thousands)

	Total	Payments Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
FHLBP advances	\$55,332	\$23,319	\$20,670	\$11,343	\$ —
Repurchase agreements	11,889	11,889	—	—	—
Capital lease obligations	418	52	130	170	66
Operating lease obligations	4,890	1,076	1,988	1,215	611
Long-term subordinated debt	9,750	—	—	—	9,750
Junior subordinated debentures	9,279	—	—	—	9,279
<b>Total</b>	<b>\$91,558</b>	<b>\$36,336</b>	<b>\$22,788</b>	<b>\$12,728</b>	<b>\$19,706</b>

**Item 7A. 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 December 31, 2016 and 2015, DNB’s variance in the EVE as a percentage of assets with an instantaneous and sustained parallel shift of 200 basis points was within its negative 3% guideline, as shown in the following table. The change as a percentage of the present value of equity with a 200 basis point increase was within DNB’s negative 25% guideline at December 31, 2016 and 2015.

**Quantitative and Qualitative Disclosures About Market Risk**  
(Dollars in thousands)

Change in rates	December 31, 2016			December 31, 2015		
	Flat	-200bp	+200bp	Flat	-200bp	+200bp
EVE	\$118,298	\$111,279	\$114,771	\$68,118	\$58,298	\$58,936
Change		(7,019)	(3,527)		(9,820)	(9,182)
Change as a % of assets		(0.7)%	(0.3)%		(1.3)%	(1.2)%
Change as a % of PV equity		(5.9)%	(3.0)%		(14.4)%	(13.5)%

**Item 8. Financial Statements and Supplementary Data***DNB FINANCIAL CORPORATION AND SUBSIDIARIES**Consolidated Statements of Financial Condition**(Dollars in thousands, except share data)*

	December 31	
	2016	2015
<b>Assets</b>		
Cash and due from banks	\$ 22,103	\$ 21,119
<b>Cash and cash equivalents</b>	<b>22,103</b>	21,119
Available-for-sale investment securities at fair value (amortized cost of \$116,830 and \$153,559)	115,184	152,379
Held-to-maturity investment securities (fair value of \$66,124 and \$68,431)	67,022	67,829
<b>Total investment securities</b>	<b>182,206</b>	220,208
Loans	817,529	481,758
Allowance for credit losses	(5,373)	(4,935)
<b>Net loans</b>	<b>812,156</b>	476,823
Restricted stock	5,381	3,447
Office property and equipment, net	9,243	6,806
Accrued interest receivable	3,567	2,410
Other real estate owned & other repossessed property	2,767	2,581
Bank owned life insurance (BOLI)	9,552	9,326
Core deposit intangible	537	66
Goodwill	15,590	—
Net deferred taxes	5,250	3,733
Other assets	2,333	2,299
<b>Total assets</b>	<b>\$1,070,685</b>	\$748,818
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Non-interest-bearing deposits	\$ 173,467	\$125,581
Interest-bearing deposits:		
NOW	224,219	185,973
Money market	184,783	137,555
Savings	86,176	72,660
Time	187,256	66,018
Brokered deposits	29,286	18,488
<b>Total deposits</b>	<b>885,187</b>	606,275
Federal Home Loan Bank of Pittsburgh (FHLBP) advances	55,332	30,000
Repurchase agreements	11,889	32,416
Junior subordinated debentures	9,279	9,279
Subordinated debt	9,750	9,750
Other borrowings	418	464
<b>Total borrowings</b>	<b>86,668</b>	81,909
Accrued interest payable	534	345
Other liabilities	3,456	4,801
<b>Total liabilities</b>	<b>975,845</b>	693,330
Commitments and contingencies	—	—
<b>Stockholders' Equity</b>		
Common stock, \$1.00 par value; 10,000,000 shares authorized; 4,334,352 and 2,833,049 issued, respectively; 4,240,778 and 2,823,840 outstanding, respectively	4,351	2,955
Treasury stock, at cost; 93,574 and 109,209 shares, respectively	(1,730)	(2,015)
Surplus	68,973	35,097
Retained earnings	25,520	21,436
Accumulated other comprehensive loss, net	(2,274)	(1,985)
<b>Total stockholders' equity</b>	<b>94,840</b>	55,488
<b>Total liabilities and stockholders' equity</b>	<b>\$1,070,685</b>	\$748,818

*See accompanying notes to consolidated financial statements.*

*DNB FINANCIAL CORPORATION AND SUBSIDIARIES*  
**Consolidated Statements of Income**  
(Dollars in thousands, except share and per share data)

	Year Ended December 31 2016	2015
<b>Interest and Dividend Income:</b>		
Interest and fees on loans	\$ 24,944	\$ 20,082
Interest and dividends on investment securities:		
Taxable	2,896	2,955
Exempt from federal taxes	1,210	1,399
Interest on cash and cash equivalents	129	42
Total interest and dividend income	29,179	24,478
<b>Interest Expense:</b>		
Interest on NOW, money market and savings	1,004	590
Interest on time deposits	706	396
Interest on brokered deposits	301	179
Interest on FHLBP advances	451	787
Interest on repurchase agreements	40	51
Interest on junior subordinated debentures	344	301
Interest on subordinated debt	414	341
Interest on other borrowings	64	67
Total interest expense	3,324	2,712
Net interest income	25,855	21,766
Provision for credit losses	730	1,105
Net interest income after provision for credit losses	25,125	20,661
<b>Non-interest Income:</b>		
Service charges	1,146	1,131
Wealth management	1,634	1,485
Mortgage banking, net	282	171
Increase in cash surrender value of BOLI	226	228
Gain from insurance proceeds	1,180	120
Gains on sale of investment securities, net	431	78
Gains on sale of loans	39	484
Other fees	1,426	1,312
Total non-interest income	6,364	5,009
<b>Non-interest Expense:</b>		
Salaries and employee benefits	12,299	10,551
Furniture and equipment	1,493	1,239
Occupancy	2,083	1,919
Professional and consulting	1,339	1,185
Advertising and marketing	707	631
Printing and supplies	191	161
FDIC insurance	507	497
PA shares tax	634	602
Telecommunications	297	245
Loss on sale or write down of OREO, net	644	134
Due diligence and merger expense	2,241	—
Other expenses	2,206	1,865
Total non-interest expense	24,641	19,029
Income before income tax expense	6,848	6,641
Income tax expense	1,869	1,503
<b>Net income</b>	<b>4,979</b>	<b>5,138</b>
Preferred stock dividends	—	50
<b>Net income available to common stockholders</b>	<b>\$ 4,979</b>	<b>\$ 5,088</b>
<b>Earnings per common share:</b>		
Basic	\$ 1.56	\$ 1.82
Diluted	\$ 1.55	\$ 1.79
<b>Cash dividends per common share</b>	<b>\$ 0.28</b>	<b>\$ 0.28</b>
<b>Weighted average common shares outstanding:</b>		
Basic	3,186,079	2,801,881
Diluted	3,218,884	2,847,488

See accompanying notes to consolidated financial statements.

*DNB FINANCIAL CORPORATION AND SUBSIDIARIES*  
**Consolidated Statements of Comprehensive Income**  
(Dollars in thousands)

	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Net income	<b>\$4,979</b>	\$5,138
Other comprehensive (loss) income:		
<b>Unrealized holding losses on AFS investment securities arising during the period</b>		
Before tax amount	(56)	(437)
Tax effect	19	149
	(37)	(288)
<b>Accretion of discount on AFS to HTM reclassification<sup>(1)</sup></b>		
Before tax amount	9	7
Tax effect <sup>(2)</sup>	(3)	(2)
	6	5
<b>Less reclassification for gains on sales of AFS investment securities included in net income</b>		
Before tax amount	(410)	(78)
Tax effect <sup>(2)</sup>	139	27
	(271)	(51)
Other comprehensive loss — securities	(302)	(334)
<b>Unrealized actuarial gains (losses) — pension</b>		
Before tax amount	20	(79)
Tax effect	(7)	27
	13	(52)
Total other comprehensive loss	(289)	(386)
Total comprehensive income	<b>\$4,690</b>	\$4,752

<sup>(1)</sup> Amounts are included in interest and dividends on investment securities in the consolidated statements of income.

<sup>(2)</sup> Amounts are included in income tax expense in the consolidated statements of income.

<sup>(3)</sup> Amounts are included in “Gains on sale of investment securities, net” in the consolidated statements of income.

*See accompanying notes to consolidated financial statements.*

*DNB FINANCIAL CORPORATION AND SUBSIDIARIES*  
**Consolidated Statements of Stockholders' Equity**  
(Dollars in thousands)

	Preferred Stock	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2015	\$ 13,000	\$2,931	\$(2,301)	\$34,745	\$17,132	\$(1,599)	\$ 63,908
Net income	—	—	—	—	5,138	—	5,138
Other comprehensive loss	—	—	—	—	—	(386)	(386)
Redemption of preferred stock (13,000 shares)	(13,000)	—	—	—	—	—	(13,000)
Restricted stock compensation expense (13,048 restricted stock shares)	—	19	—	323	—	—	342
Exercise of stock options (16,391 shares)	—	16	—	386	—	—	402
Taxes on stock option exercise and share award vest	—	(11)	—	(458)	—	—	(469)
Cash dividends — common (\$0.28 per share)	—	—	—	—	(784)	—	(784)
Cash dividends SBLF preferred	—	—	—	—	(50)	—	(50)
Sale of treasury shares to 401(k) (10,519 shares)	—	—	192	68	—	—	260
Sale of treasury shares to deferred comp. plan (5,158 shares)	—	—	94	33	—	—	127
Balance at December 31, 2015	—	2,955	(2,015)	35,097	21,436	(1,985)	55,488
Net income	—	—	—	—	4,979	—	4,979
Other comprehensive loss	—	—	—	—	—	(289)	(289)
ERB acquisition (1,368,527 shares)	—	1,369	—	33,337	—	—	34,706
Restricted stock compensation expense (26,952 shares vested)	—	42	—	898	—	—	940
Taxes on stock option exercise and share award vest	—	(21)	—	(680)	—	—	(701)
Exercise of stock options (5,824 shares)	—	6	—	(6)	—	—	—
Tax benefit for restricted stock vest and stock option exercise	—	—	—	188	—	—	188
Cash dividends — common (\$0.28 per share)	—	—	—	—	(895)	—	(895)
Sale of treasury shares to 401(k) (9,762 shares)	—	—	178	87	—	—	265
Sale of treasury shares to deferred comp. plan (5,873 shares)	—	—	107	52	—	—	159
Balance at December 31, 2016	\$ —	\$4,351	\$(1,730)	\$68,973	\$25,520	\$(2,274)	\$ 94,840

See accompanying notes to consolidated financial statements.

*DNB FINANCIAL CORPORATION AND SUBSIDIARIES*  
**Consolidated Statements of Cash Flows**  
(Dollars in thousands)

	Year Ended December 31	
	2016	2015
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 4,979	\$ 5,138
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	1,622	1,806
Provision for credit losses	730	1,105
Stock based compensation	940	342
Net gain on sale of securities	(431)	(78)
Net loss on sale and write down of OREO and other repossessed property	644	134
Earnings from investment in BOLI	(226)	(228)
Deferred tax expense (benefit)	344	(88)
Proceeds from sales of loans	12,246	18,739
Loans originated for sale	(12,207)	(17,638)
Gain on sale of loans	(39)	(484)
Gain on insurance proceeds	(1,180)	(120)
Write off of property and equipment	—	698
Increase in accrued interest receivable	(59)	(157)
Decrease (increase) in other assets	4,859	(475)
Increase (decrease) in accrued interest payable	60	(6)
Decrease in other liabilities	(1,772)	(260)
<b>Net Cash Provided By Operating Activities</b>	<b>10,510</b>	<b>8,428</b>
<b>Cash Flows From Investing Activities:</b>		
Activity in available-for-sale securities:		
Sales	43,913	17,988
Maturities, repayments and calls	55,195	58,262
Purchases	(59,646)	(57,928)
Activity in held-to-maturity securities:		
Sales	761	—
Maturities, repayments and calls	13,647	1,822
Purchases	(13,507)	(10,093)
Net cash disbursed in connection with acquisition	(5,488)	—
Net decrease (increase) in restricted stock	999	(860)
Net increase in loans	(29,693)	(29,020)
Proceeds from insurance company	1,180	1,250
Purchases of office property and equipment	(3,181)	(1,791)
Expenses capitalized in OREO	(1,236)	(202)
Proceeds from sale of OREO and other repossessed property	432	177
<b>Net Cash Provided By (Used In) Investing Activities</b>	<b>3,376</b>	<b>(20,395)</b>
<b>Cash Flows From Financing Activities:</b>		
Net increase in deposits	51,759	1,192
Repayment of FHLBP advances	(43,104)	(10,000)
Funding of FHLBP advances	—	20,000
Net (decrease) increase in repurchase agreements	(20,527)	13,195
Proceeds from issuance of subordinated debt	—	9,750
Decrease in other borrowings	(46)	(41)
Dividends paid	(895)	(834)
Proceeds from the exercise of stock options	—	402
Taxes on stock option exercise and share award vest	(701)	(469)
Tax benefit for restricted stock vesting	188	—
Redemption of preferred stock	—	(13,000)
Sale of treasury stock	424	387
<b>Net Cash (Used in) Provided by Financing Activities</b>	<b>(12,902)</b>	<b>20,582</b>
Net Change in Cash and Cash Equivalents	984	8,615
Cash and Cash Equivalents at Beginning of Period	21,119	12,504
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 22,103</b>	<b>\$ 21,119</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash paid during the period for:		
Interest	\$ 3,264	\$ 2,718
Income taxes	1,175	1,777
<b>Supplemental Disclosure of Non-cash Flow Information:</b>		
Transfers from loans to other real estate owned and other repossessed property	26	1,789
Assets, Liabilities, and Equity in Connection with Merger (Noncash):		
Assets acquired:		
Investment securities	\$ 3,027	\$ —
Loans	306,396	—
Goodwill	15,590	—
Core deposit intangible	508	—
Other assets	10,838	—
	<b>\$336,359</b>	<b>\$ —</b>
Liabilities assumed:		
Deposits	\$227,153	\$ —
FHLBP advances	68,436	—
Other liabilities	576	—
	<b>\$296,165</b>	<b>\$ —</b>

See accompanying notes to consolidated financial statements.

## *Notes to Consolidated Financial Statements*

### **(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

DNB Financial Corporation (the “Corporation” or “DNB”) through its wholly owned subsidiary, DNB First, National Association (the “Bank”), formerly Downingtown National Bank, has been serving individuals and small to medium sized businesses of southeastern Pennsylvania since 1860. DNB Capital Trust I and II are special purpose Delaware business trusts, which are not consolidated as they are considered variable interest entities and the Corporation is not the primary beneficiary (see additional discussion in Junior Subordinated Debentures — Note 10). The Bank is a locally managed commercial bank providing personal and commercial loans and deposit products, in addition to investment and trust services from fifteen community offices. The Bank encounters vigorous competition for market share from commercial banks, thrift institutions, credit unions and other financial intermediaries.

The consolidated financial statements of DNB and its subsidiary, the Bank, which together are managed as a single operating segment (“Community Banking”), are prepared in accordance with U.S. generally accepted accounting principles applicable to the banking industry.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Statements of Financial Condition, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Amounts subject to significant estimates are items such as the allowance for credit losses and lending related commitments, the fair value of repossessed assets, pension and post-retirement obligations, the fair value of financial instruments, other-than-temporary impairments of investment securities, the valuation of assets acquired and liabilities assumed in business combinations, and the valuations of goodwill for impairment. Among other effects, such changes could result in future impairments of investment securities, and establishment of allowances for credit losses and lending related commitments as well as increased benefit plans’ expenses. The comparability of the financial condition of DNB as of December 31, 2016 compared to December 31, 2015, and the results of operations for the year ended 2016 compared to 2015, in general, have been impacted by the acquisition of ERB on October 1, 2016. The assets and liabilities of ERB were recorded on the consolidated balance sheet at their established fair value as of October 1, 2016, and their results of operations have been included in the consolidated income statement since that date.

***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, the FASB issued ASU Nos. 2016-10, 2016-12 and 2016-20 that provide additional guidance related to the identification of performance obligations within a contract, assessing collectability, contract costs, and other technical corrections and improvements. ASU 2014-09 will become effective for the Company for the annual period beginning after December 15, 2017 and for interim periods within the annual period. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. DNB is evaluating the anticipated effects of these ASUs on the Consolidated Financial Statements and related disclosures. DNB is in the process of determining the revenue streams that are in the scope of these updates. Preliminary results indicate that certain noninterest income financial statement line items, including service charges on deposit accounts, card fees, other charges and fees, investment banking income, trust and investment management income, retail investment services, and other noninterest income, contain revenue streams that are in scope of these updates. Preliminary findings indicate that there may be some changes in the presentation of certain revenues and expenses based on the principal versus agent guidance within these updates; the materiality of these changes is still being

assessed. DNB plans to adopt the standards beginning January 1, 2018 and expects to use the modified retrospective method of adoption.

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. The adoption of this update is not expected to have a material impact on DNB's consolidated financial position or results of operations.

DNB adopted ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments* on a prospective basis. This amendment eliminates the requirement to account for adjustments to provisional amounts recognized in a business combination retrospectively. Instead, the acquirer will recognize the adjustments to provisional amounts during the period in which the adjustments are determined, including the effect on earnings of any amounts the acquirer would have recorded in previous periods if the accounting had been completed at the acquisition date.

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 evaluated the provisions of ASU 2016-02 to determine the potential impact of the new standard and has determined that it is not expected to have a material impact on DNB's financial position, results of operations or cash flows. DNB has determined that the provisions of ASU No. 2016-02 may result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities. DNB is still in the process of determining the impact on DNB's financial position, results of operations or cash flows.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*. This ASU simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods therein. DNB has evaluated the provisions of ASU 2016-09 to determine the potential impact of the new standard and has determined that it is not expected to have a material impact on DNB's financial position, results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, (ASU 2016-13), which addresses concerns regarding the perceived delay in recognition of credit losses under the existing incurred loss model. The amendment introduces a new, single model for recognizing credit losses on all financial instruments presented on cost basis. Under the new model, entities must estimate current expected credit losses by considering all available relevant information, including historical and current information, as well as reasonable and supportable forecasts of future events. The update also requires additional qualitative and quantitative information to allow users to better understand the credit risk within the

portfolio and the methodologies for determining allowance. ASU 2016-13 is effective for DNB on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted. While DNB is currently in the process of evaluating the impact of the amended guidance on its consolidated financial statements, it currently expects the ALLL to increase upon adoption given that the allowance will be required to cover the full remaining expected life of the portfolio upon adoption, rather than the incurred loss model under current U.S. GAAP. The extent of this increase is still being evaluated and will depend on economic conditions and the composition of DNB's loan portfolio at the time of adoption.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The amendments in this update provide guidance for eight specific cash flow classification issues for which current guidance is unclear or does not exist, thereby reducing diversity in practice. For public companies, the update is effective for annual periods beginning after December 15, 2017. DNB has evaluated the impact that this guidance will have on its consolidated financial statements and has determined that the guidance does not have a material impact on DNB's consolidated financial statements.

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. The adoption of this update is not expected to have a material impact on DNB's consolidated financial position or results of operations.

**Principles of Consolidation** The accompanying consolidated financial statements include the accounts of DNB and its wholly owned subsidiary, the Bank. All significant inter-company transactions have been eliminated.

**Cash and Due From Banks** For purposes of the consolidated statement of cash flows, cash and due from banks, and federal funds sold are considered to be cash equivalents. Generally, federal funds are sold for one-day periods.

**Investment Securities** Investment securities are classified at the time of purchase and accounted for as follows:

**Held-To-Maturity ("HTM")** Includes debt securities that DNB has the positive intent and ability to hold to maturity. Debt securities are reported at cost, adjusted for amortization of premiums and accretion of discounts. DNB may sell HTM securities when DNB collects greater than 85% of the original recorded investment on the HTM securities prior to the sale.

**Available-For-Sale ("AFS")** Includes debt and equity securities not classified as HTM securities. Securities classified as AFS are securities that DNB intends to hold for an indefinite period of time, but not necessarily to maturity. Such securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of tax (if applicable), as a separate component of stockholders' equity. Realized gains and losses on the sale of AFS securities are computed on the basis of specific identification of the adjusted cost of each security. Amortization of premiums and accretion of discounts for all types of securities are computed using a level-yield basis.

*Other Than Temporary Impairment (“OTTI”) Analysis* Securities are evaluated on a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether declines in their value are other-than-temporary. To determine whether a loss in value is other-than-temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and duration of the decline, and whether or not management intends to sell or expects that it is more likely than not that it will be required to sell the security prior to an anticipated recovery of the fair value. Once a decline in value for a debt security is determined to be other-than-temporary, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total impairment related to credit losses is included in earnings. The amount of the total impairment related to all other factors is included in other comprehensive income. DNB recorded no impairment charges in 2016 or 2015.

**Restricted Stock** Restricted investment in bank stocks consist of Philadelphia Federal Reserve Bank (“FRB”) stock, Pittsburgh Federal Home Loan Bank (“FHLBP”) stock, and Atlantic Community Bankers Bank (“ACBB”) stock. Federal law requires a member institution of the district FRB and FHLB to hold stock according to predetermined formulas. ACBB requires its correspondent banking institutions to hold stock as a condition of membership. The restricted investment in bank stock is carried at cost. Quarterly, the Corporation evaluates the bank stocks for impairment. DNB evaluates recent and long-term operating performance, liquidity, funding and capital positions, stock repurchase history, dividend history, and impact of legislative and regulatory changes. At December 31, 2016, DNB owned \$4.1 million of stock of the FHLBP, \$1.1 million of stock of the FRB and \$156,000 of stock of ACBB. At December 31, 2015, DNB owned \$2.3 million of stock of the FHLBP, \$1.1 million of stock of the FRB and \$106,000 of stock of ACBB.

**Loans** Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for credit losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. DNB is generally amortizing these amounts over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

The loans receivable portfolio is segmented into residential mortgage loans, commercial mortgage loans, commercial loans (which consist of commercial term loans and commercial construction loans), leases, and consumer loans (which consist of home equity loans and other consumer loans.)

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

**Loans acquired in business combinations** Loans that DNB acquires in connection with business combinations are recorded at fair value with no carryover of the existing related allowance for credit losses. Fair value of the loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

For loans acquired with credit deterioration, the excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. These loans are accounted for under the Accounting Standard Codification (“ASC”) 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows will require DNB to evaluate the need for an additional allowance for credit losses. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount which DNB will then reclassify as accretable discount that will be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that do meet the specific criteria of ASC 310-30 are individually evaluated each period to analyze expected cash flows. To the extent that the expected cash flows of a loan have decreased due to credit deterioration, DNB establishes an allowance.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for credit losses established at the acquisition date for acquired performing loans. An allowance for credit losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Acquired loans that met the criteria for impaired or nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent if DNB expects to fully collect the new carrying value (i.e. fair value) of the loans. As such, DNB may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount. In addition, charge-offs on such loans would be first applied to the nonaccretable difference portion of the fair value adjustment.

***Deferred Loan Fees and Costs*** Loan origination and commitment fees and related direct-loan origination costs of completed loans are deferred and accreted to income as a yield adjustment over the life of the loan using the level-yield method. The accretion to income is discontinued when a loan is placed on non-accrual status. When a loan is paid off, any unamortized net deferred fee balance is credited to income. When a loan is sold, any unamortized net deferred fee balance is considered in the calculation of gain or loss.

***Allowance for Credit Losses*** The allowance for credit losses represents management’s estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for credit losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for credit losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of Bankruptcy, or if there is an amount deemed uncollectible. No portion of the allowance for credit losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on DNB’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant

factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure, based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans
3. Nature and volume of the portfolio and terms of loans
4. Experience, ability, and depth of lending management and staff
5. Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications
6. Quality of DNB's loan review system, and the degree of oversight by DNB's Board of Directors
7. Existence and effect of any concentrations of credit and changes in the level of such concentrations
8. Effect of external factors, such as competition and legal and regulatory requirements
9. Changes in the value of underlying collateral for collateral-dependent loans

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for credit loss calculation.

Residential mortgage loans involve certain risks such as interest rate risk and risk of non-repayment. Adjustable-rate single family real estate loans decreases the interest rate risk to the Company that is associated with changes in interest rates but involve other risks, primarily because as interest rates rise, the payment by the borrower rises to the extent permitted by the terms of the loan, thereby increasing the potential for default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. Repayment risk can be affected by job loss, divorce, illness and personal bankruptcy or the borrower.

Commercial real estate lending entails significant additional risks as compared with single-family residential property lending. Such loans typically involve large loan balances to single borrowers or groups of related borrowers. The payment experience on such loans is typically dependent on the successful operation of the real estate project. The success of such projects is sensitive to changes in supply and demand conditions in the market for commercial real estate as well as economic conditions generally.

Commercial loans, which are also referred to as commercial and industrial loans ("C & I loans"), include advances to businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit or term loans. Although C & I loans may be unsecured to our highest rated borrowers, the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment. In a significant number of these loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. C & I loans present credit exposure to DNB, as they are more susceptible to risk of loss during a downturn in the economy, as borrowers may have greater difficulty in

meeting their debt service requirements and the value of the collateral may decline. DNB attempts to mitigate this risk through its underwriting standards, including evaluating the credit worthiness of the borrower and to the extent available, credit ratings on the business. Additionally, monitoring of the loans through annual renewals and meetings with the borrowers are typical. However, these procedures cannot eliminate the risk of loss associated with this type of lending.

Construction lending is generally considered to involve a higher level of risk as compared to single-family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effects of general economic conditions on developers and builders. Moreover, a construction loan can involve additional risks because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost (including interest) of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. DNB has attempted to minimize the foregoing risks by, among other things, limiting the extent of its construction lending and has adopted underwriting guidelines which impose stringent loan-to-value, debt service and other requirements for loans which are believed to involve higher elements of credit risk, by limiting the geographic area in which DNB will do business and by working with builders with whom it has established relationships.

Consumer loans generally have shorter terms and higher interest rates than mortgage loans but generally involve more credit risk than mortgage loans because of the type and nature of the collateral and, in certain cases, the absence of collateral. In addition, consumer lending collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely effected by job loss, divorce, illness and personal bankruptcy. In most cases, any repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance because of improper repair and maintenance of the underlying security. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. DNB believes that the generally higher yields earned on consumer loans compensate for the increased credit risk associated with such loans and that consumer loans are important to its efforts to provide a full range of services to its customers.

An unallocated component is maintained to cover uncertainties 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.

A loan is considered impaired when, based on current information and events, it is probable that DNB will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and industrial loans, commercial real estate loans and commercial construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance for credit losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of DNB's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original

appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

We perform separate impairment analyses once residential or consumer loans become significantly delinquent. This is essentially the same process for all loan types. Once on non-accrual or at 90 days delinquent (if not before), we generally get updated valuations (appraisals, etc.) and then perform the impairment analysis. So, the general reserve is used to cover the performing loans until we pull out the problem accounts.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review DNB's allowance for credit losses and may require DNB to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for credit losses is appropriate.

***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 December 31, 2016 and 2015 are as follows:

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

<i>(Dollars in thousands)</i>	<b>Pre-Modification Outstanding Recorded Investment</b>	<b>December 31, 2015 Post-Modification Outstanding Recorded Investment</b>	<b>Recorded Investment</b>
Consumer:			
Home equity	\$102	\$102	\$102
Other	40	42	40
<b>Total</b>	<b>\$142</b>	<b>\$144</b>	<b>\$142</b>

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

At December 31, 2015, DNB had two TDRs with recorded investment totaling \$142,000, one of which totaled \$102,000, represented an accruing impaired home equity loan in compliance with the terms of the modification. The remaining \$40,000 was a nonaccrual impaired consumer installment loan and resulted in a collateral evaluation. As a result of the evaluation, a specific reserve was taken. As of December 31, 2015, DNB recognized a partial charge-off of \$2,000 to the consumer installment TDR. As of December 31, 2015, 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 2015.

**Reserve for unfunded loan commitments** The reserve for unfunded loan commitments represents management's estimate of losses inherent in off-balance sheet items related to the loan portfolio which consist of commitments to extend credit and letters of credit. The same risk and loss factors are applied to both funded and unfunded commitments. However, the bank calculates reserves required to support unfunded commitments in each loan category based only on the estimated likelihood (the probability) that DNB would advance funds into a known troubled situation, and then sustain a loss on the newly advanced funds. The amount of reserve for unfunded loan commitments, which is included in "Other liabilities" on the statement of financial condition, was \$345,000 and \$188,000 at December 31, 2016 and December 31, 2015, respectively.

**Other Real Estate Owned & Other Repossessed Property** Other real estate owned ("OREO") and other repossessed property consists of properties acquired as a result of, or in-lieu-of, foreclosure as well as other repossessed property. Properties classified as OREO 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 properties are capitalized and costs relating to holding the properties are charged to expense. DNB had \$3.1 million of commercial mortgage loans in the process of foreclosure at December 31, 2016. DNB had no commercial loans in the process of foreclosure at December 31, 2015.

**Office Properties and Equipment** Office properties and equipment are recorded at cost. Depreciation is computed using the straight-line method over the expected useful lives of the assets. The costs of maintenance and repairs are expensed as they are incurred; renewals and betterments are capitalized. All long-lived assets are reviewed for impairment when conditions indicate that impairment may have occurred, based on the fair value of the asset. In addition, long-lived assets to be disposed of are generally reported at the lower of carrying amount or fair value, less cost to sell. Gains or losses on disposition of properties and equipment are reflected in operations.

**Goodwill and Intangible Assets** DNB accounts for goodwill and intangible assets in accordance with ASC 350, “Intangibles — Goodwill and Other.” Goodwill is the excess of the purchase price over the fair value of the net assets acquired in connection with the 2016 acquisition of East River Bank. If certain events occur, which indicate goodwill might be impaired between annual tests, goodwill must be tested when such events occur. In making this assessment, DNB considers a number of factors including operating results, business plans, economic projections, anticipated future cash flows, current market data, stock price, etc. There are inherent uncertainties related to these factors and management’s judgment in applying them to the analysis of goodwill impairment. Changes in economic and operating conditions could result in goodwill impairment in future periods. DNB did not identify any impairment during 2016. The annual test date in 2017 is October 1<sup>st</sup>.

**Income Taxes** DNB accounts for income taxes in accordance with the income tax accounting guidance set forth in FASB ASC Topic 740, Income Taxes.

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. DNB determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

DNB recognizes interest and penalties on income taxes as a component of income tax expense. DNB is no longer subject to examinations by taxing authorities for the years before January 1, 2013. DNB had no unrecognized tax positions as of December 31, 2016.

**Pension Plan** The Bank maintains a noncontributory defined benefit pension plan covering substantially all employees over the age of 21 with one year of service. Plan benefits are based on years of service and the employee’s monthly average compensation for the highest five consecutive years of their last ten years of service (see Note 14 — Benefit Plans). The Bank recognizes the overfunded or underfunded status of pension and other post retirement benefit plans on the balance sheet. Gains and losses, prior service costs and credits, and any remaining transition amounts that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost.

**Stock Based Compensation** Stock compensation accounting guidance (FASB ASC Topic 718, Compensation — Stock Compensation) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees’ service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black Sholes model is used to estimate the fair value of stock options. The market price of DNB’s common stock at the date of grant is used for restricted stock awards.

**Earnings Per Common Share (EPS)** Basic EPS is computed based on the weighted average number of common shares outstanding during the year. Diluted EPS reflects the potential dilution that could occur from unvested stock awards and the exercise of stock options and warrants computed using the treasury stock method. Stock options and awards for which the exercise price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the EPS calculation. Treasury shares are not deemed outstanding for earnings per share calculations.

**Comprehensive Income** Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, accretion of discount on securities transferred from available-for-sale to held-to-maturity, and changes in the funded status of the pension plan of which the accumulated amounts are also recognized as separate components of stockholders' equity.

<b>Accumulated Other Comprehensive Loss</b> <i>(Dollars in thousands)</i>	<b>Before-Tax Amount</b>	<b>Tax Effect</b>	<b>Net-of-Tax Amount</b>
<b>December 31, 2016</b>			
Net unrealized loss on AFS securities	\$(1,646)	\$ 560	\$(1,086)
Discount on AFS to HTM reclassification	(8)	3	(5)
Unrealized actuarial losses-pension	(1,792)	609	(1,183)
	<b>\$(3,446)</b>	<b>\$1,172</b>	<b>\$(2,274)</b>
<b>December 31, 2015</b>			
Net unrealized loss on AFS securities	\$(1,180)	\$ 402	\$ (778)
Discount on AFS to HTM reclassification	(17)	6	(11)
Unrealized actuarial losses-pension	(1,812)	616	(1,196)
	<b>\$(3,009)</b>	<b>\$1,024</b>	<b>\$(1,985)</b>

**Treasury Stock** Shares of the Company's common stock which are repurchased on the open market are classified as treasury stock on the consolidated balance sheet. Treasury stock is recorded at the cost at which it was obtained in the open market, and at the date of reissuance, treasury stock on the consolidated balance sheet is reduced by the cost for which it was purchased, using a weighted average price of the remaining treasury stock.

**Bank-Owned Life Insurance** The Bank is the beneficiary of insurance policies on the lives of certain officers of the Bank. The Bank has recognized the amount that could be realized under the insurance policies as an asset in the consolidated statements of financial condition.

**Trust Assets** Assets held by DNB First Wealth Management, a wholly owned subsidiary of the Bank, in fiduciary or agency capacities are not included in the consolidated financial statements since such items are not assets of DNB. Operating income and expenses of DNB First Wealth Management are included in the consolidated statements of income and are recorded on an accrual basis.

**Advertising and Marketing Costs** DNB follows the policy of charging the costs of advertising and marketing to expense as incurred. Advertising and marketing costs were approximately \$707,000 and \$631,000 for the years ended December 31, 2016 and December 31, 2015, respectively.

**Significant Concentrations of Credit Risk** Most of DNB's activities are with customers located throughout southeastern Pennsylvania. DNB's commercial portfolio has a concentration in loans to commercial real estate investors and developers as defined by regulation. There are numerous risks associated with commercial loans that could impact the borrower's ability to repay on a timely basis. They include, but are not limited to: the owner's business expertise; changes in local, national, and in some cases international economies; competition; governmental regulation; and the general financial stability of the borrowing entity.

DNB attempts to mitigate these risks by completing an analysis of the borrower's business and industry history, the borrower's financial position, as well as that of the business owner. DNB will also require the borrower to periodically provide financial information on the operation of the business over the life of the loan. In addition, most commercial loans are secured by assets of the business or those of the

business owner, which can be liquidated if the borrower defaults, along with the personal surety of the business owner.

**Reclassifications** Certain amounts previously reported have been reclassified, when necessary, to conform with presentations used in the 2016 consolidated financial statements. Such reclassifications have no effect on the Corporation's net income.

**Subsequent Events** Management has evaluated events and transactions occurring subsequent to December 31, 2016 for items that should potentially be recognized or disclosed in these Consolidated Financial Statements. The evaluation was conducted through the date these financial statements were issued.

## **(2) BUSINESS COMBINATIONS**

### **Mergers and Acquisition**

On April 4, 2016, DNB Financial Corporation (the "Company" or "DNBF"), the parent company of DNB First, N.A. ("DNB First"), entered into an Agreement and Plan of Merger (the "Merger Agreement") with East River Bank ("ERB"). Under the transaction, ERB merged with and into DNB First. The merger was consummated on October 1, 2016. The acquisition was an opportunity for DNB to strengthen its competitive position as one of the premier community banks headquartered in Southeastern Pennsylvania. Additionally, the ERB acquisition enhanced DNB's footprint in Southeastern Pennsylvania. The goodwill arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations DNB and ERB.

Pursuant to the Merger Agreement, each outstanding share of ERB common stock was converted into the right to receive, at the election of the ERB shareholder (subject to certain conditions, including conditions relating to pro-ration): (i) 0.6562 shares of DNB common stock or (ii) \$18.65 in cash. The Merger Agreement provided that election of shares of DNB stock or cash was subject to pro-ration such that 2,085,662 ERB shares of common stock, or approximately 85.3% of the current outstanding ERB shares, would be exchanged for DNB common stock with the remaining ERB shares to be exchanged for cash and that the aggregate cash consideration payable to ERB shareholders was \$6.7 million. The Merger Agreement also provided that options to purchase ERB common stock outstanding be exchanged for a cash payment equal to the difference between the per share cash consideration under the Merger Agreement and the corresponding exercise price of such option. Options to acquire an aggregate of 248,000 shares of ERB common stock were exchanged for a cash payment of \$1.9 million. Additionally, \$2,399 of cash was paid in lieu of fractional shares.

The acquisition of ERB was accounted for as a business combination using the acquisition method of accounting, which includes estimating the fair value of assets acquired, liabilities assumed and consideration paid as of the acquisition date. The assets and liabilities of ERB were recorded on the consolidated statement of financial condition at their estimated fair values as of October 1, 2016, and ERB's results of operations have been included in the consolidated income statement since that date.

Included in the purchase price was goodwill and a core deposit intangible of \$15,590,000 and \$508,000, respectively. The core deposit intangible will be amortized over a ten-year period using a sum of the year's digits basis. The goodwill is not taxable and will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense projected for the next five years beginning in 2017 is estimated to be \$90,000, \$81,000, \$72,000, \$62,000, and \$53,000 per year, respectively, and \$127,000 in total for years after 2021. DNB does not expect any further adjustments to the purchase price as it was finalized as of December 31, 2016.

The allocation of the purchase price is as follows:

*(Dollars in thousands)*

Assets acquired:	
Cash and cash equivalents	\$ 3,116
AFS investment securities	3,027
Loans	306,396
Goodwill	15,590
Core deposit and other intangible	508
Other assets	10,838
<b>Total assets acquired</b>	<b>\$339,475</b>
Liabilities assumed:	
Deposits	\$227,153
FHLBP borrowings	68,436
Other liabilities	576
<b>Total liabilities assumed</b>	<b>\$296,165</b>
<b>Consideration transferred</b>	<b>\$ 43,310</b>
Cash paid	\$ 8,604
Fair value of common stock issued (1,368,527 shares — fair value per share of \$25.36)	34,706

The following table summarizes the estimated fair value of the assets acquired and liabilities and equity assumed.

*(Dollars in thousands)*

<b>Total purchase price</b>	<b>\$ 43,310</b>
Net assets acquired:	
Cash and cash equivalents	\$ 3,116
AFS investment securities	3,027
Restricted stock	2,933
Loans	306,396
Premises and equipment	204
Deferred income taxes	1,713
Accrued interest receivable	1,098
Core deposit and other intangibles	508
Other assets	4,890
Deposits	(227,153)
FHLBP borrowings	(68,436)
Accrued interest payable	(129)
Other liabilities	(447)
<b>Net assets acquired</b>	<b>\$ 27,720</b>
<b>Goodwill</b>	<b>\$ 15,590</b>

The fair value of the financial assets acquired included loans receivable with a gross amortized cost basis of \$312,279,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired. The credit adjustment on impaired loans is

derived in accordance with ASC 310-30 and represents the portion of the loan balances that has been deemed uncollectible based on the Company's expectations of future cash flows for each respective loan.

*(Dollars in thousands)*

Gross amortized cost basis at October 1, 2016	<b>\$312,279</b>
Interest rate fair value adjustment on pools of homogeneous loan	<b>(200)</b>
Credit fair value adjustment on pools of homogeneous loans	<b>(4,846)</b>
Credit fair value adjustment on impaired loans	<b>(837)</b>
Fair value of purchased loans at October 1, 2016	<b>\$306,396</b>

For loans acquired without evidence of credit quality deterioration, DNB prepared the interest rate loan fair value and credit fair value adjustments. Loans were grouped into homogenous pools by characteristics such as loan type, term, collateral and rate. Market rates for similar loans were obtained from various internal and external data sources and reviewed by management for reasonableness. The average of these rates was used as the fair value interest rate a market participant would utilize. A present value approach was utilized to calculate the interest rate fair value discount of \$200,000.

Additionally for loans acquired without credit deterioration, a credit fair value adjustment was calculated using a two part credit fair value analysis: 1) expected lifetime credit migration losses; and 2) estimated fair value adjustment for certain qualitative factors. The expected lifetime losses were calculated using historical losses observed at the Bank, ERB and peer banks. DNB also estimated an environmental factor to apply to each loan type. The environmental factor represents potential discount which may arise due to general credit and economic factors. A credit fair value discount of \$4.8 million was determined. Both the interest rate and credit fair value adjustments relate to loans acquired with evidence of credit quality deterioration will be substantially recognized as interest income on a level yield amortization method based upon the expected life of the loans.

The information about the acquired ERB loans accounted for under ASC 310-30 as of October 1, 2016 is as follows:

*(Dollars in thousands)*

Contractually required principal and interest at acquisition	<b>\$ 3,142</b>
Contractual cash flows not expected to be collected (nonaccretable discount)	<b>(1,124)</b>
Expected cash flows at acquisition	<b>\$ 2,018</b>
Interest component of expected cash flows (accretable discount)	<b>(348)</b>
Fair value of acquired loans	<b>\$ 1,670</b>

The following table presents pro forma information as if the merger between the company and ERB had been completed on January 1, 2015. The pro forma information does not necessarily reflect the results of operations that would have occurred had DNB merged with ERB at the beginning of 2015. Supplemental pro forma earnings for 2016 were adjusted to exclude \$4.7 million of merger related costs incurred for the year ended December 31, 2016. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market

conditions or revenues, expense efficiencies, or other factors. The pro forma data is intended for informational purposes and is not indicative of the future results of operations.

<i>(Dollars in thousands, except per share data)</i>	<b>(Unaudited)</b>	
	<b>Years Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
Net interest income after provision for credit losses	<b>\$34,056</b>	\$32,281
Non-interest income	<b>6,777</b>	5,565
Non-interest expense	<b>29,245</b>	27,169
Net income available to common stockholders	<b>8,537</b>	7,737
Net income per common share-Basic	<b>2.01</b>	1.88
Net income per common share-Diluted	<b>1.98</b>	1.84

The amount of total revenue, consisting of interest income plus noninterest income specifically related to ERB for the period beginning October 1, 2016, included in the consolidated statements of income of DNB for the year ended 2016 is incalculable due to the fact that East River Bank and its operations are no longer accounted for on a stand-alone basis.

### **(3) INVESTMENT SECURITIES**

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

<i>(Dollars in thousands)</i>	<b>Amortized Cost</b>	<b>December 31, 2016</b>		<b>Estimated Fair Value</b>
		<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
<b>Held To Maturity</b>				
US Government agency obligations	<b>\$ 8,224</b>	<b>\$309</b>	<b>\$ —</b>	<b>\$ 8,533</b>
Government Sponsored Entities (GSE) mortgage-backed securities	<b>1,440</b>	<b>38</b>	<b>—</b>	<b>1,478</b>
Corporate bonds	<b>12,825</b>	<b>230</b>	<b>(63)</b>	<b>12,992</b>
Collateralized mortgage obligations GSE	<b>1,966</b>	<b>2</b>	<b>(22)</b>	<b>1,946</b>
State and municipal taxable	<b>1,008</b>	<b>6</b>	<b>—</b>	<b>1,014</b>
State and municipal tax-exempt	<b>41,559</b>	<b>8</b>	<b>(1,406)</b>	<b>40,161</b>
<b>Total</b>	<b>\$ 67,022</b>	<b>\$593</b>	<b>\$(1,491)</b>	<b>\$ 66,124</b>
<b>Available For Sale</b>				
US Government agency obligations	<b>\$ 52,428</b>	<b>\$ 31</b>	<b>\$ (150)</b>	<b>\$ 52,309</b>
GSE mortgage-backed securities	<b>30,861</b>	<b>2</b>	<b>(723)</b>	<b>30,140</b>
Collateralized mortgage obligations GSE	<b>12,957</b>	<b>3</b>	<b>(387)</b>	<b>12,573</b>
Corporate bonds	<b>15,474</b>	<b>5</b>	<b>(299)</b>	<b>15,180</b>
State and municipal tax-exempt	<b>5,084</b>	<b>—</b>	<b>(128)</b>	<b>4,956</b>
Asset-backed security	<b>26</b>	<b>—</b>	<b>—</b>	<b>26</b>
<b>Total</b>	<b>\$116,830</b>	<b>\$ 41</b>	<b>\$(1,687)</b>	<b>\$115,184</b>

<i>(Dollars in thousands)</i>	<b>December 31, 2015</b>			
	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Estimated Fair Value</b>
<b>Held To Maturity</b>				
US Government agency obligations	\$ 7,973	\$320	\$ —	\$ 8,293
Government Sponsored Entities (GSE) mortgage-backed securities	2,759	83	—	2,842
Corporate bonds	11,518	234	(42)	11,710
Collateralized mortgage obligations GSE	2,623	9	(26)	2,606
State and municipal tax-exempt	42,956	300	(276)	42,980
<b>Total</b>	<b>\$ 67,829</b>	<b>\$946</b>	<b>\$ (344)</b>	<b>\$ 68,431</b>
<b>Available For Sale</b>				
US Government agency obligations	\$ 58,460	\$ —	\$ (252)	\$ 58,208
GSE mortgage-backed securities	40,663	13	(325)	40,351
Collateralized mortgage obligations GSE	16,241	3	(438)	15,806
Corporate bonds	20,921	—	(350)	20,571
State and municipal tax-exempt	17,274	180	(11)	17,443
<b>Total</b>	<b>\$153,559</b>	<b>\$196</b>	<b>\$(1,376)</b>	<b>\$152,379</b>

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 table below details the aggregate unrealized losses and aggregate fair value of the underlying securities whose fair values are below their amortized cost at December 31, 2016 and 2015.

<i>(Dollars in thousands)</i>	<b>December 31, 2016</b>					
	<b>Total Fair Value</b>	<b>Total Unrealized Loss</b>	<b>Fair value Impaired Less Than 12 Months</b>	<b>Unrealized Loss Less Than 12 Months</b>	<b>Fair value Impaired More Than 12 Months</b>	<b>Unrealized Loss More Than 12 Months</b>
<b>Held To Maturity</b>						
Corporate bonds	\$ 5,962	\$ (63)	\$ 3,992	\$ (39)	\$ 1,970	\$ (24)
Collateralized mortgage obligations GSE	1,104	(22)	1,104	(22)	—	—
State and municipal tax-exempt	32,690	(1,406)	32,690	(1,406)	—	—
<b>Total</b>	<b>\$39,756</b>	<b>\$(1,491)</b>	<b>\$37,786</b>	<b>\$(1,467)</b>	<b>\$ 1,970</b>	<b>\$ (24)</b>
<b>Available For Sale</b>						
US Government agency obligations	\$27,270	\$ (150)	\$27,270	\$ (150)	\$ —	\$ —
GSE mortgage-backed securities	29,145	(723)	29,145	(723)	—	—
Collateralized mortgage obligations GSE	12,116	(387)	4,868	(94)	7,248	(293)
Corporate bonds	13,031	(299)	7,593	(218)	5,438	(81)
State and municipal tax-exempt	4,956	(128)	4,956	(128)	—	—
Asset-backed security	26	—	26	—	—	—
<b>Total</b>	<b>\$86,544</b>	<b>\$(1,687)</b>	<b>\$73,858</b>	<b>\$(1,313)</b>	<b>\$12,686</b>	<b>\$(374)</b>

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

As of December 31, 2016, there were fifteen GSE mortgage-backed securities, fifty-three municipalities, twelve corporate bonds, six agency notes, one asset-backed security, and seventeen collateralized mortgage obligations which were in an unrealized loss position. DNB does not intend to sell these securities and management of DNB does not expect to be required to sell any of these securities prior to a recovery of its cost basis. Management has reviewed all of these securities and believes that DNB will collect all principal and interest that is due on debt securities on a timely basis. Management does not believe any individual unrealized loss as of December 31, 2016 represents an other-than-temporary impairment. DNB reviews its investment portfolio on a quarterly basis judging each investment for OTTI. The OTTI analysis focuses on the duration and the amount a particular security is below book.

Factors affecting the market price include credit risk, market risk, interest rates, economic cycles, and liquidity risk. The magnitude of any unrealized loss may be affected by the relative concentration of the Corporation's investment in any one issuer or industry. DNB has established policies to reduce exposure through diversification of concentration of the investment portfolio including limits on concentrations to any one issuer and as such, management believes the investment portfolio is prudently diversified.

The declines in value are related to a change in interest rates and/or subsequent change in credit spreads required for these issues affecting market price. All issues are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. Short to intermediate average durations and in certain cases monthly principal payments should reduce further market value exposure to increases in rates.

*Collateralized mortgage obligations GSE* There are seventeen impaired securities classified as collateralized mortgage obligations, nine of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 4.47% 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 has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from December 31, 2016 levels. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2016.

*State and municipal tax-exempt* There are fifty-three impaired securities in this category, which are comprised of intermediate to long-term municipal bonds, none of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 8.60% of its carrying value. 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, geographic location, population and debt ratios. In certain cases, options for calls reduce the effective duration and in turn the 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 conservative in nature 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. Thirty-four of the impaired municipals are school districts that have PA school district credit enhancement programs and twenty of those also have additional insurance. The remaining nineteen are two insured school districts, two uninsured school districts, six insured townships and nine uninsured townships, all of which have strong underlying ratings. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2016.

*US Government agency obligations* There are six impaired securities classified as agencies, none of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 0.74% 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 has 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 December 31, 2016.

*Asset-backed securities* There is one impaired security classified as asset-backed, which was not impaired for more than 12 months. The unrealized loss of this security is 0.02% of its carrying value. DNB has received timely interest payments on this security and it has never defaulted. DNB anticipates a recovery in the market value as the security approaches its maturity date. Management concluded that this security was not other-than-temporarily impaired at December 31, 2016.

*GSE mortgage-backed securities* There are fifteen impaired bonds classified as GSE mortgage-backed securities, none of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 3.29% 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 has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from December 31, 2016 levels. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2016.

*Corporate bonds* There were twelve impaired bonds classified as corporate bonds, two of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 5.15% 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 December 31, 2016 levels. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2016.

In determining that the securities giving rise to the previously mentioned unrealized losses were not other than temporary, the Corporation evaluated the factors cited above, which the Corporation considers when assessing whether a security is other-than-temporarily impaired. In making these evaluations the Corporation must exercise considerable judgment. Accordingly, there can be no assurance that the actual results will not differ from the Corporation’s judgments and that such differences may not require the future recognition of other-than-temporary impairment charges that could have a material affect on the

Corporation's financial position and results of operations. In addition, the value of, and the realization of any loss on, an investment security is subject to numerous risks as cited above.

The amortized cost and estimated fair value of investment securities as of December 31, 2016, by final contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid without penalties.

<i>(Dollars in thousands)</i>	<b>Held to Maturity</b>		<b>Available for Sale</b>	
	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
Due in one year or less	\$ —	\$ —	\$ 19,731	\$ 19,720
Due after one year through five years	23,862	24,327	49,398	49,088
Due after five years through ten years	27,896	27,366	8,752	8,608
Due after ten years	15,264	14,431	38,949	37,768
<b>Total investment securities</b>	<b>\$67,022</b>	<b>\$66,124</b>	<b>\$116,830</b>	<b>\$115,184</b>

The principal values of investment securities sold as of the dates indicated are shown below. The HTM securities sold during 2016 were sold in accordance with GAAP, as DNB collected greater than 85% of the original recorded investment on the HTM securities prior to the sale. As a result, it is appropriate to continue to carry the remaining HTM portfolio as currently classified.

<i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Available for sale securities sold	\$43,913	\$17,988
Held to maturity securities sold	761	—
<b>Total sold securities</b>	<b>\$44,674</b>	<b>\$17,988</b>

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

<i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Gross realized gains-AFS	\$440	\$ 90
Gross realized gains-HTM	21	—
Gross realized losses-AFS	(30)	(12)
Gross realized losses-HTM	—	—
<b>Net realized gain</b>	<b>\$431</b>	<b>\$ 78</b>

At December 31, 2016 and 2015, investment securities with a carrying value of approximately \$116.7 million and \$147.9 million, respectively, were pledged to secure public funds, repurchase agreements, FHLBP advances and for other purposes as required by law. See Note 8 regarding the use of certain securities as collateral.

#### (4) LOANS

The major classifications of loans outstanding, net of fair value marks and deferred loan origination fees and costs are summarized as follows.

<i>(Dollars in thousands)</i>	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
Residential mortgage	\$ 87,581	\$ 28,651
Commercial mortgage	465,486	274,132
Commercial:		
Commercial term	123,175	102,178
Commercial construction	72,755	20,364
Consumer:		
Home equity	62,560	51,270
Other	5,972	5,163
Total loans	\$817,529	\$481,758
Less allowance for credit losses	(5,373)	(4,935)
Net loans	<b>\$812,156</b>	<b>\$476,823</b>

Some of DNB's directors and executive officers, and their related interests had transactions with the Bank in the ordinary course of business. It is anticipated that similar transactions will occur in the future.

<i>(Dollars in thousands)</i>	<b>2016</b>	<b>2015</b>
Related party loans at beginning of period	\$ 67	\$ 70
Advances	14	8
Purchases of related party loans from acquisition	446	—
Repayments	(19)	(11)
Related party loans at end of period	<b>\$508</b>	<b>\$ 67</b>

#### (5) ALLOWANCE FOR CREDIT LOSSES

The performance and credit quality of the loan portfolio is monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following tables

present the classes of the loan portfolio summarized by the past due status as of December 31, 2016 and December 31, 2015:

*Age Analysis of Past Due Loans Receivables*

<i>(Dollars in thousands)</i>	December 31, 2016						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivables	Loans Receivable > 90 Days and Accruing
Residential mortgage (less acquired with credit deterioration)	\$ 728	\$ 374	\$ 491	\$ 1,593	\$ 85,977	\$ 87,570	\$—
Acquired residential mortgage with credit deterioration	—	—	11	11	—	11	—
Commercial mortgage (less acquired with credit deterioration)	1,202	762	2,169	4,133	459,679	463,812	—
Acquired commercial mortgage with credit deterioration	389	83	673	1,145	529	1,674	—
Commercial:							
Commercial term	747	377	23	1,147	122,028	123,175	—
Commercial construction	112	—	1,242	1,354	71,401	72,755	—
Consumer:							
Home equity	263	—	300	563	61,997	62,560	—
Other	27	65	151	243	5,729	5,972	—
<b>Total</b>	<b>\$3,468</b>	<b>\$1,661</b>	<b>\$5,060</b>	<b>\$10,189</b>	<b>\$807,340</b>	<b>\$817,529</b>	<b>\$—</b>

<i>(Dollars in thousands)</i>	December 31, 2015						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivables	Loans Receivable > 90 Days and Accruing
Residential mortgage	\$502	\$ 552	\$2,076	\$3,130	\$ 25,521	\$ 28,651	\$457
Commercial mortgage	36	86	96	218	273,914	274,132	—
Commercial:							
Commercial term	—	—	—	—	102,178	102,178	—
Commercial construction	—	581	447	1,028	19,336	20,364	—
Consumer:							
Home equity	7	310	153	470	50,800	51,270	—
Other	100	—	148	248	4,915	5,163	—
<b>Total</b>	<b>\$645</b>	<b>\$1,529</b>	<b>\$2,920</b>	<b>\$5,094</b>	<b>\$476,664</b>	<b>\$481,758</b>	<b>\$457</b>

DNB had no residential mortgage loans in the process of foreclosure and \$170,000 in residential mortgage loans in other real estate owned as of December 31, 2016. DNB had \$1.0 million in residential mortgage loans in the process of foreclosure and \$437,000 in residential mortgage loans in other real estate owned as of December 31, 2015.

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.

Interest that would have been recognized on nonaccrual loans had they been current in accordance with their original terms was \$590,000 and \$473,000 for the years ended December 31, 2016 and December 31, 2015, respectively.

***Non-Performing Assets***

<i>(Dollars in thousands)</i>	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
Non-accrual loans:		
Residential mortgage	\$ 1,770	\$1,619
Commercial mortgage	4,593	1,048
Commercial:		
Commercial term	198	188
Commercial construction	1,242	1,028
Consumer:		
Home equity	442	563
Other	256	189
Total non-accrual loans	<b>8,501</b>	4,635
Loans 90 days past due and still accruing	—	457
Total non-performing loans	<b>8,501</b>	5,092
Other real estate owned & other repossessed property	<b>2,767</b>	2,581
<b>Total non-performing assets</b>	<b>\$11,268</b>	<b>\$7,673</b>

The following tables summarize information in regards to impaired loans by loan portfolio class as of December 31, 2016 and December 31, 2015 and for the years then ended.

**Impaired Loans**

<i>(Dollars in thousands)</i>	<b>December 31, 2016</b>				
	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<b>With no related allowance recorded:</b>					
Residential mortgage	\$ 653	\$ 680	\$ —	\$1,134	\$—
Acquired residential mortgage with credit deterioration	11	11	—	2	—
Commercial mortgage	2,919	3,330	—	2,265	—
Acquired commercial mortgage with credit deterioration	1,674	1,680	—	335	—
<b>Commercial:</b>					
Commercial term	22	24	—	19	—
Commercial construction	795	795	—	914	—
<b>Consumer:</b>					
Home equity	544	595	—	634	4
Other	114	122	—	104	—
<b>Total</b>	<b>\$6,732</b>	<b>\$ 7,237</b>	<b>\$ —</b>	<b>\$5,407</b>	<b>\$ 4</b>
<b>With allowance recorded:</b>					
Residential mortgage	\$1,107	\$ 1,368	\$143	\$ 605	\$—
Acquired residential mortgage with credit deterioration	—	—	—	—	—
Commercial mortgage	—	—	—	—	—
Acquired commercial mortgage with credit deterioration	—	—	—	—	—
<b>Commercial:</b>					
Commercial term	176	196	97	185	—
Commercial construction	447	2,833	89	358	—
<b>Consumer:</b>					
Home equity	—	—	—	—	—
Other	142	142	5	114	—
<b>Total</b>	<b>\$1,872</b>	<b>\$ 4,539</b>	<b>\$334</b>	<b>\$1,262</b>	<b>\$—</b>
<b>Total:</b>					
Residential mortgage	\$1,760	\$ 2,048	\$143	\$1,739	\$—
Acquired residential mortgage with credit deterioration	11	11	—	2	—
Commercial mortgage	2,919	3,330	—	2,265	—
Acquired commercial mortgage with credit deterioration	1,674	1,680	—	335	—
<b>Commercial:</b>					
Commercial term	198	220	97	204	—
Commercial construction	1,242	3,628	89	1,272	—
<b>Consumer:</b>					
Home equity	544	595	—	634	4
Other	256	264	5	218	—
<b>Total</b>	<b>\$8,604</b>	<b>\$11,776</b>	<b>\$334</b>	<b>\$6,669</b>	<b>\$ 4</b>

<i>(Dollars in thousands)</i>	December 31, 2015				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential mortgage	\$1,620	\$1,919	\$ —	\$1,883	\$ 5
Commercial mortgage	1,181	1,461	—	2,501	85
Commercial:					
Commercial term	—	—	—	—	—
Commercial construction	1,140	3,526	—	838	—
Consumer:					
Home equity	691	716	—	535	4
Other	82	90	—	124	2
<b>Total</b>	<b>\$4,714</b>	<b>\$7,712</b>	<b>\$ —</b>	<b>\$5,881</b>	<b>\$96</b>
With allowance recorded:					
Residential mortgage	\$ —	\$ —	\$ —	\$ 105	\$—
Commercial mortgage	—	—	—	121	—
Commercial:					
Commercial term	200	211	110	200	—
Commercial construction	—	—	—	537	—
Consumer:					
Home equity	—	—	—	18	—
Other	107	107	4	29	—
<b>Total</b>	<b>\$ 307</b>	<b>\$ 318</b>	<b>\$114</b>	<b>\$1,010</b>	<b>\$—</b>
<b>Total:</b>					
Residential mortgage	\$1,620	\$1,919	\$ —	\$1,988	\$ 5
Commercial mortgage	1,181	1,461	—	2,622	85
Commercial:					
Commercial term	200	211	110	200	—
Commercial construction	1,140	3,526	—	1,375	—
Consumer:					
Home equity	691	716	—	553	4
Other	189	197	4	153	2
<b>Total</b>	<b>\$5,021</b>	<b>\$8,030</b>	<b>\$114</b>	<b>\$6,891</b>	<b>\$96</b>

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 December 31, 2016 and December 31, 2015.

## Credit Quality Indicators

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

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

## Allowance for Credit Losses and Recorded Investment in Related Loans

The following tables set forth the activity and composition of DNB's allowance for credit losses at the dates and periods indicated.

(Dollars in thousands)	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	2016 Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
<b>Allowance for credit losses:</b>									
Beginning balance —									
January 1, 2016	\$ 216	\$ 2,375	\$ 989	\$ 569	\$—	\$ 195	\$ 64	\$527	\$ 4,935
Charge-offs	(206)	(39)	(45)	—	—	—	(21)	—	(311)
Recoveries	13	—	1	1	3	—	1	—	19
Provisions	326	195	(236)	399	(3)	1	17	31	730
Ending balance —									
December 31, 2016	<b>\$ 349</b>	<b>\$ 2,531</b>	<b>\$ 709</b>	<b>\$ 969</b>	<b>\$—</b>	<b>\$ 196</b>	<b>\$ 61</b>	<b>\$558</b>	<b>\$ 5,373</b>
Ending balance: individually evaluated for impairment	\$ 143	\$ —	\$ 97	\$ 89	\$—	\$ —	\$ 5	\$ —	\$ 334
Ending balance: collectively evaluated for impairment	\$ 206	\$ 2,531	\$ 612	\$ 880	\$—	\$ 196	\$ 56	\$558	\$ 5,039
Ending balance: Loan receivables	\$87,581	\$465,486	\$123,175	\$72,755	\$—	\$62,560	\$5,972		\$817,529
Ending balance: individually evaluated for impairment	\$ 1,760	\$ 2,919	\$ 198	\$ 1,242	\$—	\$ 544	\$ 256		\$ 6,919
Ending balance: acquired with credit deterioration	\$ 11	\$ 1,674	\$ —	\$ —	\$—	\$ —	\$ —		\$ 1,685
Ending balance: collectively evaluated for impairment	\$85,810	\$460,893	\$122,977	\$71,513	\$—	\$62,016	\$5,716		\$808,925

<i>(Dollars in thousands)</i>	Residential Mortgage	Commercial Mortgage	Commercial Term	Commercial Construction	2015 Lease Financing	Consumer Home Equity	Consumer Other	Unallocated	Total
<b>Allowance for credit losses:</b>									
Beginning balance —									
January 1, 2015	\$ 269	\$ 2,300	\$ 709	\$ 881	\$ —	\$ 189	\$ 70	\$488	\$ 4,906
Charge-offs	(194)	(105)	(200)	(581)	—	(11)	(63)	—	(1,154)
Recoveries	4	—	13	10	49	—	2	—	78
Provisions	137	180	467	259	(49)	17	55	39	1,105
Ending balance —									
December 31, 2015	\$ 216	\$ 2,375	\$ 989	\$ 569	\$ —	\$ 195	\$ 64	\$527	\$ 4,935
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ 110	\$ —	\$ —	\$ —	\$ 4	\$ —	\$ 114
Ending balance: collectively evaluated for impairment	\$ 216	\$ 2,375	\$ 879	\$ 569	\$ —	\$ 195	\$ 60	\$527	\$ 4,821
Ending balance: Loan receivables	\$28,651	\$274,132	\$102,178	\$20,364	\$ —	\$51,270	\$5,163		\$481,758
Ending balance: individually evaluated for impairment	\$ 1,620	\$ 1,181	\$ 200	\$ 1,140	\$ —	\$ 691	\$ 189		\$ 5,021
Ending balance: collectively evaluated for impairment	\$27,031	\$272,951	\$101,978	\$19,224	\$ —	\$50,579	\$4,974		\$476,737

The changes in the accretable yield of acquired loans accounted for under ASC 310-30 for the years ended December 31, 2016 and 2015 were as follows:

<i>(Dollars in thousands)</i>	2016	2015
Beginning balance, January 1	\$ —	\$ —
Accretable yield acquired	348	—
Accretion	(34)	—
Payments	—	—
Ending balance, December 31	\$314	\$ —

#### (6) OFFICE PROPERTY AND EQUIPMENT

<i>(Dollars in thousands)</i>	Estimated Useful Lives	December 31 2016	2015
Land		\$ 840	\$ 840
Buildings and leasehold improvements	5-31.5 years	12,984	10,982
Furniture, fixtures and equipment	2-20 years	16,094	14,712
Total cost		29,918	26,534
Less accumulated depreciation		(20,675)	(19,728)
Office property and equipment, net		\$ 9,243	\$ 6,806

Amounts charged to operating expense for depreciation for the years ended December 31, 2016 and 2015 amounted to \$947,000 and \$825,000, respectively.

The Bank leases office space from Headwaters Associates, a Pennsylvania general partnership for which William S. Latoff (who passed away on January 11, 2016), the Company's former Chairman of the Board and Chief Executive Officer until the time of his death, was one of two general partners. Pursuant to the terms of the Lease, the Bank paid Headwaters an aggregate of \$303,000 in 2016, and \$139,000 in 2015. As a general partner in Headwaters, Mr. Latoff or his estate received \$151,000 and \$69,000 in 2016 and 2015, respectively, as a result of the lease. Mary D. Latoff, a director, is the Executrix for The Estate of William S. Latoff, and in her role as Executrix, has the sole investment power with respect to the portion of Headwaters owned by the Estate.

(7) **DEPOSITS**

Included in interest bearing time deposits are time and brokered deposit issued in amounts of \$250,000 or more in the amount of \$78.6 million and \$32.7 million at December 31, 2016 and 2015, respectively. These certificates and their remaining maturities at December 31, 2016 were as follows:

<i>(Dollars in thousands)</i>	December 31, 2016		
	Time Deposits	Brokered Deposits	Total
Three months or less	\$17,011	\$ —	\$17,011
Over three through six months	37,859	250	38,109
Over six through twelve months	16,042	—	16,042
Over one year through two years	3,444	—	3,444
Over two years	3,982	—	3,982
Total	\$78,338	\$250	\$78,588

Time and brokered deposit scheduled to mature have the following remaining maturities:

<i>(Dollars in thousands)</i>	December 31, 2016		
	Time Deposits	Brokered Deposits	Total
One year or less	\$145,491	\$13,468	\$158,959
Over one year through two years	18,937	4,051	22,988
Over two years through three years	13,818	1,494	15,312
Over three years through four years	6,840	5,321	12,161
Over four years through five years	2,167	4,952	7,119
Over five years	3	—	3
Total	\$187,256	\$29,286	\$216,542

At December 31, 2016 and 2015, deposits of related parties amounted to \$7.1 million and \$556,000, respectively. The large increase from 2015 to 2016 was primarily due to the acquisition of ERB's related party deposits.

The aggregate amount of demand deposit overdrafts that were reclassified as loans were \$309,000 at December 31, 2016, compared to \$277,000 at December 31, 2015.

(8) **FHLBP ADVANCES AND SHORT-TERM BORROWED FUNDS**

The schedule below provides a summary of short-term borrowings that consist of securities sold under agreements to repurchase, federal funds purchased and other borrowings. Securities sold under agreements to repurchase are overnight borrowings between DNB and its commercial depositors and are subject to daily repricing. Federal Funds purchased from correspondent banks mature in one business day and re-price daily based on the Federal Funds rate. As of December 31, 2016, DNB's total availability under Federal Funds lines was \$60.0 million. Other short-term borrowings consist of credit available through the Federal Home Loan Bank of Pittsburgh (FHLBP) and the Federal Reserve Discount Window. DNB maintains a line-of-credit (Open Repo Plus) with the FHLBP which is a revolving term commitment used on an overnight basis. The term of this commitment may not exceed 364 days and it re-prices daily at market rates. Under terms of a blanket collateral agreement with the FHLBP, the line-of-credit and long term advances are secured by FHLBP stock and qualifying loan receivables, principally real estate secured loans. As of December 31, 2016 DNB's total availability was \$456.3 million with the FHLBP and availability at the Federal Reserve Discount Window is dependent upon the market value of the collateral delivered to the Federal Reserve at the time funds are borrowed.

The following table presents a summary of aggregate short-term borrowings as of and for the years ended December 31, 2016 and 2015.

<i>(Dollars in thousands)</i>	2016		2015	
	Repurchase Agreements	Other Short-term Borrowings	Repurchase Agreements	Other Short-term Borrowings
Amount outstanding at end of year	\$11,889	\$ —	\$32,416	\$ —
Weighted average interest rate at end of year	0.20%	—%	0.20%	—%
Maximum amount outstanding at any month-end	\$22,360	\$ —	\$35,271	\$ —
Daily average amount outstanding	\$19,811	\$ 450	\$25,574	\$ 204
Weighted average interest rate for the year	0.20%	0.51%	0.20%	0.51%

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

<i>(Dollars in thousands)</i>	Overnight and Continuous	Up to 30 days	30-90 days	Greater than 90 days	Total
<b>December 31, 2016</b>					
Repurchase agreements and repurchase-to-maturity transactions	\$11,889	\$—	\$—	\$—	\$11,889
Gross amount of recognized liabilities for repurchase agreements in statement of condition	\$11,889				\$11,889
<b>December 31, 2015</b>					
Repurchase agreements and repurchase-to-maturity transactions	\$32,416	\$—	\$—	\$—	\$32,416
Gross amount of recognized liabilities for repurchase agreements in statement of condition	\$32,416				\$32,416

As of December 31, 2016 and December 31, 2015, DNB had \$11.9 million and \$32.4 million of repurchase agreements, respectively. In conjunction with these repurchase agreements, a fair value of \$12.1 million and \$33.1 million of state and municipal securities were sold on an overnight basis as of December 31, 2016 and December 31, 2015, respectively, which represents 102% of the repurchase agreement amount. DNB may be required to provide additional collateral based on the fair value of the underlying securities. Daily procedures are followed to ensure repurchase agreements are properly collateralized.

In addition to short-term borrowings, DNB maintains borrowing arrangements with the FHLBP to meet borrowing needs exceeding 30 days. The advances are collateralized by loans, and a lien on the Bank's FHLBP stock. There were \$638.2 million in loans used as collateral for FHLBP borrowings. After a collateral weighting of 70.33%, that amount totaled \$448.9 million. Below, certain advances are convertible term advances and are callable, at the FHLBP's option, at various dates. If an advance is called by the FHLBP, DNB has the option of repaying the borrowing, or continuing to borrow at three month Libor plus 14 basis points. In addition to the \$55.3 million of borrowings from the FHLBP at December 31, 2016, the

FHLBP had issued letters of credit, on DNB's behalf, totaling \$75.0 million against DNB's available credit lines. These letters of credit were used to secure public deposits as required by law.

<i>(Dollars in thousands)</i>	<b>December 31, 2016</b>		<b>December 31, 2015</b>	
	<b>Weighted Average Rate</b>	<b>Amount</b>	<b>Weighted Average Rate</b>	<b>Amount</b>
Due by December 31, 2016	—%	\$ —	0.51%	\$10,000
Due by December 31, 2017	0.96	23,319	1.22	2,000
Due by December 31, 2018	0.05	6,078	1.46	2,000
Due by December 31, 2019	1.43	14,592	1.91	10,000
Due by December 31, 2020	1.64	11,343	1.88	6,000
<b>Total</b>	<b>1.13%</b>	<b>\$55,332</b>	<b>1.36%</b>	<b>\$30,000</b>

**(9) OTHER BORROWINGS**

Included in other borrowings is a long-term capital lease agreement, which relates to DNB's West Goshen branch. As of December 31, 2016 the lease has a carrying amount of \$172,000 net of accumulated depreciation of \$578,000, and is included in the balance of office properties and equipment in the accompanying statements of financial condition. The following is a schedule of the future minimum capital lease payments, together with the present value of the net minimum lease payments, as of December 31, 2016:

<i>(Dollars in thousands)</i>	<b>Year ended December 31</b>
2017	\$ 107
2018	106
2019	107
2020	106
2021	106
Thereafter	69
<b>Total minimum lease payments</b>	<b>601</b>
<b>Less amount representing interest</b>	<b>(183)</b>
<b>Present value of net minimum lease payments</b>	<b>\$ 418</b>

DNB recognized rent expense of \$755,000 and \$614,000 for the years ended December 31, 2016 and 2015, respectively. The following is a schedule of the future minimum non-cancelable operating lease payments for the Operations Center in Downtown and leased branches as of December 31, 2016.

<i>(Dollars in thousands)</i>	<b>Year ended December 31</b>
2017	\$1,076
2018	1,059
2019	929
2020	680
2021	535
Thereafter	611
<b>Total minimum lease payments</b>	<b>\$4,890</b>

## **(10) SUBORDINATED DEBENTURES AND NOTES**

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, 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. This issuance of debentures are at floating rates 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 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 \$5,155,000 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. This issuance of debentures are at floating rates 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 \$4,124,000 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 the Company 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% or greater 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.

## **(11) FAIR VALUES**

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, asset-backed securities, and state and municipal tax-exempt 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 investments 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. 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 table summarizes the assets at December 31, 2016 and December 31, 2015 that are recognized on DNB's balance sheet using fair value measurement determined based on the differing levels of input.

<i>(Dollars in thousands)</i>	December 31, 2016			Assets at Fair Value
	Level 1	Level 2	Level 3	
<b>Assets Measured at Fair Value on a Recurring Basis</b>				
US Government agency obligations	\$—	\$ 52,309	\$ —	\$ 52,309
GSE mortgage-backed securities	—	30,140	—	30,140
Collateralized mortgage obligations GSE	—	12,573	—	12,573
Corporate bonds	—	15,180	—	15,180
State and municipal tax-exempt	—	4,956	—	4,956
Asset-backed security	—	26	—	26
Total assets measured at fair value on a recurring basis	\$—	\$115,184	\$ —	\$115,184
<b>Assets Measured at Fair Value on a Nonrecurring Basis</b>				
Impaired loans	\$—	\$ —	\$1,538	\$ 1,538
OREO & other repossessed property	—	—	2,485	2,485
Total assets measured at fair value on a nonrecurring basis	\$—	\$ —	\$4,023	\$ 4,023

<i>(Dollars in thousands)</i>	December 31, 2015			Assets at Fair Value
	Level 1	Level 2	Level 3	
<b>Assets Measured at Fair Value on a Recurring Basis</b>				
US Government agency obligations	\$—	\$ 58,208	\$ —	\$ 58,208
GSE mortgage-backed securities	—	40,351	—	40,351
Collateralized mortgage obligations GSE	—	15,806	—	15,806
Corporate bonds	—	20,571	—	20,571
State and municipal tax-exempt	—	17,443	—	17,443
Total assets measured at fair value on a recurring basis	\$—	\$152,379	\$ —	\$152,379
<b>Assets Measured at Fair Value on a Nonrecurring Basis</b>				
Impaired loans	\$—	\$ —	\$ 964	\$ 964
OREO & other repossessed property	—	—	682	682
Total assets measured at fair value on a nonrecurring basis	\$—	\$ —	\$1,646	\$ 1,646

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

**Quantitative Information about Level 3 Fair Value Measurement  
December 31, 2016**

<i>(Dollars in thousands)</i>	<b>Fair Value Estimate</b>	<b>Valuation Techniques</b>	<b>Unobservable Input</b>	<b>Range (Weighted Average)</b>		
Impaired loans — Residential mortgage	<b>\$ 964</b>	Appraisal of collateral <sup>(1)</sup>	Appraisal adj. <sup>(2)</sup> Disposal costs <sup>(2)</sup>	0%	to	-25% (-22%) -8% to -12% (-9%)
Impaired loans — Commercial term	<b>79</b>	Appraisal of collateral <sup>(1)</sup>	Appraisal adj. <sup>(2)</sup> Disposal costs <sup>(2)</sup>	-72%	to	-72% (-72%) -11% to -11% (-11%)
Impaired loans — Commercial construction	<b>358</b>	Appraisal of collateral <sup>(1)</sup>	Appraisal adj. <sup>(2)</sup> Disposal costs <sup>(2)</sup>	0%	to	0% (0%) -8% to -8% (-8%)
Impaired loans — Consumer other	<b>137</b>	Appraisal of collateral <sup>(1)</sup>	Appraisal adj. <sup>(2)</sup> Disposal costs <sup>(2)</sup>	0%	to	0% (0%) -8% to -8% (-8%)
Impaired loan total	<b>\$1,538</b>					
Other real estate owned	<b>\$2,485</b>		Disposal costs <sup>(2)</sup>	-8%	to	-8% (-8%)

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

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

<sup>(1)</sup> 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.

<sup>(2)</sup> Appraisals are adjusted by management for qualitative factors and disposal costs.

**Impaired loans.** Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$8.6 million at December 31, 2016. Of this, \$1.9 million had specific valuation allowances of \$334,000, leaving a fair value of \$1.5 million as of December 31, 2016. DNB did not have any impaired loans that were partially charged down during the year ended December 31, 2016.

Impaired loans had a carrying amount of \$5.0 million at December 31, 2015. Of this, \$307,000 had specific valuation allowances of \$114,000, leaving a fair value of \$193,000 at December 31, 2015. In addition, DNB had \$931,000 in impaired loans that were partially charged down by \$160,000, leaving \$771,000 at fair value as of December 31, 2015. The total fair value of impaired loans at December 31, 2015 was \$964,000.

**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 \$2.8 million of such assets at December 31, 2016, which consisted of \$2.6 million in OREO and \$191,000 in other repossessed property. DNB had \$2.6 million of such assets at December 31, 2015, which consisted of \$2.4 million in OREO and \$165,000 in other repossessed property. Subsequent to the repossession of these assets, DNB wrote down the carrying values of certain assets by \$505,000 and \$154,000 in OREO during the years ended December 31, 2016 and December 31, 2015, respectively.

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

<i>(Dollars in thousands)</i>	Carrying Amount	December 31, 2016			
		Estimated Fair Value	Level 1	Level 2	Level 3
<b>Financial assets</b>					
Cash and cash equivalents	\$ 22,103	\$ 22,103	\$22,103	\$ —	\$ —
AFS investment securities	115,184	115,184	—	115,184	—
HTM investment securities	67,022	66,124	—	64,124	2,000
Restricted stock	5,381	5,381	—	5,381	—
Loans held-for-sale	—	—	—	—	—
Loans, net of allowance, including impaired	812,156	792,190	—	—	792,190
Accrued interest receivable	3,567	3,567	—	3,567	—
<b>Financial liabilities</b>					
Deposits:					
Non-interest-bearing deposits	173,467	173,467	—	173,467	—
Interest-bearing deposits:	495,178	495,178	—	495,178	—
Time	187,256	186,012	—	186,012	—
Brokered deposits	29,286	28,873	—	28,873	—
Repurchase agreements	11,889	11,889	—	11,889	—
FHLBP advances	55,332	54,734	—	54,734	—
Junior subordinated debentures and other borrowings	9,279	8,637	—	8,637	—
Subordinated debt	9,750	10,493	—	10,493	—
Accrued interest payable	534	534	—	534	—
Off-balance sheet instruments	—	—	—	—	—

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

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

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

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

**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 was 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 and Repurchase Agreements*** 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 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.

***Short-Term Borrowings*** The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on DNB's current incremental borrowing rates for similar types of borrowing arrangements.

***Long-Term Debt*** The fair value of DNB's fixed rate long-term borrowings which includes FHLBP advances, subordinated note, junior subordinated debentures, and other borrowings is estimated using a discounted cash flow analysis based on the open market's rate for similar types of borrowing arrangements. The carrying amounts of variable-rate long-term borrowings approximate their fair values at the reporting date.

***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.

***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.

(12) **FEDERAL INCOME TAXES**

Income tax expense was comprised of the following:

<i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Current tax expense:		
Federal	<b>\$1,515</b>	\$1,581
State	<b>10</b>	10
Deferred income tax (benefit) expense:		
Federal	<b>344</b>	(88)
<b>Income tax expense</b>	<b>\$1,869</b>	<b>\$1,503</b>

The effective income tax rates of 27.3% for 2016 and 22.6% for 2015 were different than the applicable statutory Federal income tax rate of 34%. The reason for these differences follows:

<i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Federal income taxes at statutory rate	<b>\$2,328</b>	\$2,258
Decrease resulting from:		
Tax-exempt interest and dividend preference	<b>(643)</b>	(640)
Bank owned life insurance	<b>(77)</b>	(78)
Other, net (decrease) increase	<b>261</b>	(37)
<b>Income tax expense</b>	<b>\$1,869</b>	<b>\$1,503</b>

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities are presented below:

<i>(Dollars in thousands)</i>	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Deferred tax assets:</b>		
Allowance for credit losses	\$ 1,827	\$1,677
Unrealized losses on securities	560	402
Unrealized losses on reclassified securities	2	6
Unrealized loss on pension obligation	609	616
Capital loss disallowance	4	1
State net operating losses	620	528
Unvested stock awards	103	147
Deferred compensation (SERP)	680	732
Nonqualified stock options	48	59
Depreciation	123	—
Pension	6	—
Non-accrued interest	661	468
Provision for unfunded loans	117	64
OREO write-downs	52	52
Core deposit intangible	16	14
Accrued expenses	165	57
Purchase accounting loan general credit mark	1,482	—
Purchase accounting loan specific credit mark	273	—
Purchase accounting loan interest rate mark	96	—
Purchase accounting CD rate mark	236	—
Purchase accounting term FHLBP advances	163	—
Organization costs	23	—
Other reserves — reserve for unfunded	29	—
<b>Total gross deferred tax assets</b>	<b>7,895</b>	<b>4,823</b>
<b>Deferred tax liabilities:</b>		
Depreciation	—	(31)
Pension expense	—	(27)
Bank shares tax credit	(204)	(199)
Prepaid expenses	(313)	(219)
Mortgage servicing rights	(44)	(44)
Deferred gain from insurance proceeds	(401)	(41)
Bad debt reserve	(241)	—
Market discount accretion	(18)	—
Purchase accounting core deposit intangible	(165)	—
Prepaid expenses (acquired)	(23)	—
Purchase accounting deferred loan fees	(615)	—
<b>Total gross deferred tax liabilities</b>	<b>(2,024)</b>	<b>(561)</b>
Valuation allowance	(621)	(529)
<b>Net deferred tax asset</b>	<b>\$ 5,250</b>	<b>\$3,733</b>

As of December 31, 2016, DNB had no material unrecognized tax benefits or accrued interest and penalties. It is DNB's policy to account for interest and penalties accrued relative to unrecognized tax

benefits as a component of income tax expense. Federal and state tax years 2013 through 2015 were open for examination as of December 31, 2016.

DNB had net state operating loss carryovers with the Commonwealth of Pennsylvania of \$8.7 million and \$7.4 million at December 31, 2016 and 2015, respectively for which a full valuation allowance has been established. These carryovers will begin to expire in 2021.

**(13) EARNINGS PER COMMON 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 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 earnings per share calculations. There were no anti-dilutive stock options outstanding, and 14,100 anti-dilutive stock awards at December 31, 2016. There were no anti-dilutive stock options outstanding, and no anti-dilutive stock awards at December 31, 2015. The following table sets forth the computation of basic and diluted earnings per share:

<i>(In thousands, except per share data)</i>	Year Ended December 31					
	2016			2015		
	Income	Shares	Amount	Income	Shares	Amount
<b>Basic EPS</b>						
Net income available to common stockholders	\$4,979	3,186	\$ 1.56	\$5,088	2,802	\$ 1.82
Effect of potential dilutive common stock equivalents — stock options and restricted shares	—	33	(0.01)	—	45	(0.03)
<b>Diluted EPS</b>						
Income available to common stockholders after assumed exercises	\$4,979	3,219	\$ 1.55	\$5,088	2,847	\$ 1.79

**(14) BENEFIT PLANS**

**Pension Plan** The Bank maintains a defined benefit pension plan (the “Plan”) covering all employees, including officers, who have been employed for one year and have attained 21 years of age. Prior to May 1, 1985, an individual must have attained the age of 25 and accrued one year of service. The Plan provides pension benefits to eligible retired employees at 65 years of age equal to 1.5% of their average monthly pay multiplied by their years of accredited service (maximum 40 years). The accrued benefit is based on the monthly average of their highest five consecutive years of their last ten years of service. The Plan generally covers only full-time employees.

Effective December 31, 2003, DNB amended its Plan to curtail future eligibility and so that no participants will earn additional benefits under the Plan after December 31, 2003. As a result of this amendment, no further service or compensation was credited under the Plan after December 31, 2003. The Plan, although frozen, will continue to provide benefit payments and eligible employees can still earn vesting credits until retirement.

The following table summarizes the changes in the fair value of plan assets, changes in the projected benefit obligation (PBO), the funded status of both the accumulated benefit obligation (ABO) and the

PBO, and the weighted-average assumptions used to determine benefit obligations for the pension plan at December 31, 2016 and 2015. Amounts recognized at December 31, 2016 and 2015 are reflected in other assets, and in accrued expenses and other liabilities on the Consolidated Statements of Financial Condition. The estimation of DNB's PBO associated with these plans considers various actuarial assumptions for mortality rates and discount rates.

The following table sets forth the Plan's funded status, as of the measurement dates of December 31, 2016 and 2015 and amounts recognized in DNB's consolidated financial statements at December 31, 2016 and 2015:

<i>(Dollars in thousands)</i>	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
Projected benefit obligation	<b>\$(6,695)</b>	\$(6,583)
Accumulated benefit obligation	<b>(6,695)</b>	(6,583)
Fair value of plan assets	<b>4,887</b>	4,851
<b>Amounts recognized in the statement of financial condition consist of:</b>		
Other liabilities	<b>\$(1,808)</b>	\$(1,732)
Funded status	<b>\$(1,808)</b>	\$(1,732)
<b>Amounts recognized in accumulated other comprehensive loss consist of:</b>		
Net loss	<b>\$ 1,792</b>	\$ 1,812
Total	<b>\$ 1,792</b>	\$ 1,812

The amounts and changes in DNB's pension benefit obligation and fair value of plan assets for the years ended December 31, 2016 and 2015 are as follows:

<i>(Dollars in thousands)</i>	<b>Year ended December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	<b>\$6,583</b>	\$6,783
Interest cost	<b>254</b>	243
Actuarial loss (gain)	<b>143</b>	(162)
Benefits paid	<b>(285)</b>	(281)
Benefit obligation at end of year	<b>\$6,695</b>	\$6,583
<b>Change in plan assets</b>		
Fair value of assets at beginning of year	<b>\$4,851</b>	\$5,197
Actual return on plan assets	<b>304</b>	(58)
Employer contribution	<b>93</b>	57
Benefits paid	<b>(285)</b>	(281)
Estimated expenses	<b>(76)</b>	(64)
Fair value of assets at end of year	<b>\$4,887</b>	\$4,851

The Plan's assets are invested using an asset allocation strategy in units of certain equity, bond, real estate and money market funds. The following table summarizes the weighted average asset allocations as of the dates indicated:

	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
Cash and cash equivalents	3.5%	2.6%
Equity securities	53.0	55.1
Fixed income securities	43.5	42.3
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

Equity securities consist mainly of equity common trust funds and mutual funds. Fixed income securities consist mainly of fixed income common trust funds. Pension plan assets are invested with a moderate growth objective, with target asset allocations of approximately 50 - 60% bonds and cash and approximately 40 - 50% in stocks. As of December 31, 2016, the plan held 47.0% of its assets in bonds and cash.

Net periodic pension costs for the years indicated include the following components:

<i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Service cost	\$ 59	\$ 46
Interest cost	254	243
Expected return on plan assets	(252)	(272)
Recognized net actuarial loss	128	109
<b>Net periodic cost</b>	<b>\$ 189</b>	<b>\$ 126</b>
<b>Assumptions used:</b>		
Discount rate:		
Obligation	4.09%	4.05%
Expense	4.05	3.75
Rate of increase in compensation level	N/A	N/A
Expected long-term rate of return on assets	5.50	5.50

In selecting the expected long-term rate of return on assets used for the Plan, DNB considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of the Plan. This included considering the asset allocation and the expected returns likely to be earned over the life of the plan. This basis is consistent with the prior year. The discount rate is the rate used to determine the present value of DNB's future benefit obligations for its pension. The projected benefit obligation at December 31, 2016 was determined using a variation of the RP-2014 mortality tables published by the Society of Actuaries.

DNB anticipates making contributions to the plan totaling \$211,000 in 2017. DNB's estimated future benefit payments are as follows:

<i>(Dollars in thousands)</i>	<b>Period</b>	<b>Benefits</b>
	2017	\$ 378
	2018	455
	2019	981
	2020	847
	2021	255
	2022-2026	1,993

The estimated costs that will be amortized from accumulated other comprehensive loss into net periodic pension cost during the 2017 fiscal year are as follows:

*(Dollars in thousands)*

Service cost	\$ 66
Interest cost	261
Expected return on plan assets	(257)
Amortization of net loss	133
Recognized net actuarial loss	107
<b>Estimated 2017 net periodic benefit cost</b>	<b>\$ 310</b>

The fair value of DNB's pension plan assets by asset category are as follows:

<i>(Dollars in thousands)</i>	December 31, 2016			Assets at Fair Value
	Level 1	Level 2	Level 3	
Mutual fund — equity:				
US equities	\$1,398	\$—	\$—	\$1,398
International equities	1,080	—	—	1,080
Real estate	113	—	—	113
Mutual funds — fixed income:				
Domestic fixed income	2,128	—	—	2,128
US corporate bonds, notes and cash:				
Corporate bonds	—	—	—	—
Cash	168	—	—	168
<b>Total assets measured at fair value on a recurring basis</b>	<b>\$4,887</b>	<b>\$—</b>	<b>\$—</b>	<b>\$4,887</b>

<i>(Dollars in thousands)</i>	December 31, 2015			Assets at Fair Value
	Level 1	Level 2	Level 3	
Mutual fund — equity:				
US equities	\$1,345	\$—	\$—	\$1,345
International equities	1,202	—	—	1,202
Real estate	126	—	—	126
Mutual funds — fixed income:				
Domestic fixed income	2,052	—	—	2,052
US corporate bonds, notes and cash:				
Corporate bonds	—	—	—	—
Cash	126	—	—	126
<b>Total assets measured at fair value on a recurring basis</b>	<b>\$4,851</b>	<b>\$—</b>	<b>\$—</b>	<b>\$4,851</b>

**Retirement and Death Benefit Agreement** During 1999, the Bank and Henry F. Thorne, its then current Chief Executive Officer (the “Executive”), entered into a Death Benefit Agreement providing for supplemental death and retirement benefits for him (the “Supplemental Plan”). In 2003, the Supplemental Plan was replaced by a Retirement and Death Benefit Agreement (the “Replacement Plan”).

The Replacement Plan provides that the Bank and the Executive share in the rights to the cash surrender value and death benefits of a split-dollar life insurance policy (the “Policy”) The policy is

designed to provide the Executive, upon attaining age 65, with projected annual after-tax payments of approximately \$35,000. In addition, the Policy is intended to provide the Executive with a projected death benefit of \$750,000.

In July 2008, DNB commenced making monthly payments of \$3,658 to the Executive. The remaining liability under the plan was \$739,000 and \$739,000 as of December 31, 2016 and 2015, respectively. The annual expense for the same respective periods was \$56,000 and \$54,000.

**Supplemental Executive Retirement Plan for Chairman and Chief Executive Officer** (William S. Latoff passed away on January 11, 2016) DNB had a Supplemental Executive Retirement Plan (also known as a SERP) for its former Chairman and Chief Executive Officer, William S. Latoff. The purpose of the SERP was to provide Mr. Latoff a pension supplement beginning at age 70 to compensate him for the loss of retirement plan funding opportunities from his other business interests because of his commitments to DNB as Chairman and CEO. The liability based on the contract is \$1.3 million at December 31, 2016. This amount will be paid out in 2019.

**401(k) Retirement Savings Plan** The Bank has adopted a retirement savings 401(k) plan. Participants are permitted to authorize pre-tax savings contributions to a separate trust established under the 401(k) plan, subject to limitations on deductibility of contributions imposed by the Internal Revenue Code. The plan allows after-tax contributions to be made as well. The contributions are subject to the same limitations. Management evaluates discretionary matching contributions each quarter based upon DNB's financial performance. DNB made no matching contributions to the 401(k) plan in 2016 and 2015.

**Profit Sharing Plan** The Bank maintains a Profit Sharing Plan for eligible employees. The plan provides that the Bank make contributions equal to 3% of the eligible participant's W-2 wages. DNB's related expense associated with the Profit Sharing Plan was \$304,000 and \$262,000 in 2016 and 2015, respectively.

**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 December 31, 2016 and 2015. All options currently outstanding are immediately exercisable. DNB fully recorded all stock option expense by the end of 2014. DNB had no stock option expense in 2016 or 2015.

The award agreement provides that, upon issuance of the plan shares, the grantee may elect to pay federal withholding taxes on the award in cash or by electing to apply some of the awarded shares at their fair market value, or both. Under the Stock Option Plan, 14,800 shares were exercised in 2016. The shares awarded from the NQ cashless exercises resulted in an increase in shares outstanding of 5,824. There was a

cash equivalent of 8,976 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, 2015	163,586	\$15.13
Issued	—	—
Exercised	(99,086)	19.34
Forfeited	—	—
Expired	—	—
Outstanding December 31, 2015	64,500	\$ 8.67
Issued	—	—
Exercised	(14,800)	6.93
Forfeited	—	—
Expired	—	—
Outstanding December 31, 2016	<b>49,700</b>	<b>\$ 9.18</b>

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

December 31, 2016					
Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average		Intrinsic Value
			Exercise Price	Remaining Contractual Life	
<b>\$6.93-10.99</b>	<b>49,700</b>	<b>49,700</b>	<b>\$9.18</b>	<b>1.40 years</b>	<b>\$955,000</b>

December 31, 2015					
Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average		Intrinsic Value
			Exercise Price	Remaining Contractual Life	
\$6.93-10.99	64,500	64,500	\$ 8.67	2.15 years	\$1,344,000

**Other Stock-Based Compensation** DNB maintains an Incentive Equity and Deferred Compensation Plan. The plan provides that up to 243,101 shares of common stock may be granted, at the discretion of the Board, to individuals of DNB. Shares already granted are issuable on the earlier of three years or four years after the date of the grant or a change in control of DNB if the recipients are then employed by DNB (“Vest Date”). For awards granted prior to December 2016, 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 fair market value of shares. Awards are being amortized to expense over a three or four-year cliff-vesting period. Restricted stock awards are non-participating shares.

For the twelve-month periods ended December 31, 2016 and 2015, \$940,000 and \$342,000 was amortized to expense. DNB issued 23,240 restricted stock awards to officers and directors in December 2016. These awards cliff vest in three years.

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

At December 31, 2016, approximately \$1.0 million in additional compensation will be recognized over the weighted average remaining service period of approximately 2.24 years. At December 31, 2016, 64,929 shares were reserved for future grants under the plan. 47,720 restricted shares vested in 2016. The shares awarded from the cashless exercises resulted in an increase in shares outstanding of 26,952. There was a cash equivalent of 20,768 shares used to pay all applicable taxes on the transactions. Stock grant activity is indicated below.

	Shares	Weighted Average Stock Price
Non-vested stock awards — January 1, 2015	75,930	\$17.66
Granted	26,595	27.55
Forfeited	(1,270)	19.21
Vested	(24,000)	12.28
Non-vested stock awards — December 31, 2015	77,255	\$22.71
Granted	26,240	27.82
Forfeited	—	—
Vested	(47,720)	22.11
Non-vested stock awards — December 31, 2016	<b>55,775</b>	<b>\$25.63</b>

**(15) COMMITMENTS, CONTINGENT LIABILITIES AND OFF-BALANCE-SHEET RISK**

In the normal course of business, various commitments and contingent liabilities are outstanding, such as guarantees and commitments to extend credit, borrow money or act in a fiduciary capacity, which are not reflected in the consolidated financial statements. Management does not anticipate any significant losses as a result of these commitments.

DNB had outstanding stand-by letters of credit totaling \$2.8 million and unfunded loan and lines of credit commitments totaling \$185.8 million at December 31, 2016, of which, \$171.2 million were variable rate and \$14.6 million were fixed rate. The amount of reserve for unfunded loan commitments at December 31, 2016 was \$345,000. DNB had outstanding stand-by letters of credit totaling \$3.2 million and unfunded loan and lines of credit commitments totaling \$116.4 million at December 31, 2015, of which, \$103.3 million were variable rate and \$13.1 million were fixed rate. The amount of reserve for unfunded loan commitments at December 31, 2015 was \$188,000.

These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The exposure to credit loss in the event of non-performance by the party to the financial instrument for commitments to extend credit and stand-by letters of credit is represented by the contractual amount. Management uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Stand-by letters of credit are conditional commitments issued by DNB to guarantee the performance or repayment of a financial obligation of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risks involved in issuing letters of credit are essentially the same as those involved in extending loan facilities to customers. DNB holds various forms of collateral to support these commitments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. DNB evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, obtained upon the extension of credit, usually consists of real estate, but may include securities, property or other assets.

DNB maintains borrowing arrangements with correspondent banks and the FHLBP, as well as access to the discount window at the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB has available credit of approximately \$516.3 million.

Assets held by DNB First Wealth Management in a fiduciary, custody or agency capacity at December 31, 2016 totaled \$214.2 million. These assets are not assets of DNB, and are not included in the consolidated financial statements.

DNB is a party to a number of lawsuits arising in the ordinary course of business. While any litigation causes an element of uncertainty, management is of the opinion that the liability, if any, resulting from the actions, will not have a material effect on the accompanying financial statements.

**(16) PARENT COMPANY FINANCIAL INFORMATION**

Condensed financial information of DNB Financial Corporation follows:

<b>Condensed Statements of Financial Condition</b> <i>(Dollars in thousands)</i>	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Assets</b>		
Cash	\$ 1,354	\$ 75
Investment securities, at fair value	—	—
Investment in subsidiary	112,150	74,243
Other assets	484	302
<b>Total assets</b>	<b>\$113,988</b>	<b>\$74,620</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Junior subordinated debentures	\$ 9,279	\$ 9,279
Subordinated debt	9,750	9,750
Other liabilities	119	103
<b>Total liabilities</b>	<b>19,148</b>	<b>19,132</b>
<b>Stockholders' equity</b>	<b>94,840</b>	<b>55,488</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$113,988</b>	<b>\$74,620</b>

<b>Condensed Statements of Income</b> <i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Income:</b>		
Equity in undistributed income of subsidiary	\$ (3,213)	\$1,429
Loss on sale of equity securities	—	(8)
Dividends from subsidiary	8,950	4,359
<b>Total income</b>	<b>5,737</b>	<b>5,780</b>
<b>Expense:</b>		
Interest expense	758	642
<b>Total expense</b>	<b>758</b>	<b>642</b>
<b>Net income</b>	<b>\$ 4,979</b>	<b>\$5,138</b>

<b>Condensed Statements of Comprehensive Income</b> <i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
Net income	\$4,979	\$5,138
Other comprehensive (loss) income:		
<b>Unrealized holding losses on AFS investment securities arising during the period</b>		
Before tax amount	(56)	(437)
Tax effect	19	149
	(37)	(288)
<b>Accretion of discount on AFS to HTM reclassification<sup>(1)</sup></b>		
Before tax amount	9	7
Tax effect <sup>(2)</sup>	(3)	(2)
	6	5
<b>Less reclassification for gains on sales of AFS investment securities included in net income</b>		
Before tax amount	(410)	(78)
Tax effect <sup>(2)</sup>	139	27
	(271)	(51)
Other comprehensive loss — securities	(302)	(334)
<b>Unrealized actuarial gains (losses) — pension</b>		
Before tax amount	20	(79)
Tax effect	(7)	27
	13	(52)
<b>Total other comprehensive loss</b>	<b>(289)</b>	<b>(386)</b>
<b>Total comprehensive income</b>	<b>\$4,690</b>	<b>\$4,752</b>

<sup>(1)</sup> Amounts are included in interest and dividends on investment securities in the consolidated statements of income.

<sup>(2)</sup> Amounts are included in income tax expense in the consolidated statements of income.

<b>Condensed Statements of Cash Flows</b> <i>(Dollars in thousands)</i>	<b>Year Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 4,979	\$ 5,138
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in income of subsidiary and dividends	(5,737)	(5,787)
Loss on sale of equity securities	—	8
Stock based compensation	940	342
Dividends to holding company	8,950	4,358
Net change in other liabilities	16	(198)
Net change in other assets	(1,397)	(198)
<b>Net Cash Provided by Operating Activities</b>	<b>7,751</b>	<b>3,663</b>
<b>Cash Flows From Investing Activities:</b>		
Net cash disbursed in connection with acquisition	(5,488)	—
Sale of available-for-sale equity securities	—	19
<b>Net Cash (Used in) Provided by Investing Activities</b>	<b>(5,488)</b>	<b>19</b>
<b>Cash Flows From Financing Activities:</b>		
Sale of treasury stock	424	387
Proceeds from exercise of stock options	—	402
Tax benefit for restricted stock vesting	188	(3)
Taxes on exercise of stock options	(701)	(469)
Proceeds from issuance of subordinated debt	—	9,750
Payment to repurchase preferred stock	—	(13,000)
Dividends paid	(895)	(834)
<b>Net Cash Used in Financing Activities</b>	<b>(984)</b>	<b>(3,767)</b>
<b>Net Change in Cash and Cash Equivalents</b>	<b>1,279</b>	<b>(85)</b>
Cash and cash equivalents at Beginning of Period	75	160
<b>Cash and cash equivalents at End of Period</b>	<b>\$ 1,354</b>	<b>\$ 75</b>

**(17) REGULATORY MATTERS**

Under the Federal Reserve's Regulation H, the Bank may not, without regulatory approval, declare or pay a dividend to DNB if the total of all dividends declared in a calendar year exceeds the total of (a) the Bank's net income for that year and (b) its retained net income for the preceding two calendar years, less any required transfers to additional paid-in capital or to a fund for the retirement of preferred stock.

In July of 2013 the respective U.S. federal banking agencies issued final rules implementing Basel III and the Dodd-Frank Act capital requirements to be fully phased in on a global basis on January 1, 2019. The new regulations establish a new tangible common equity capital requirement, increase the minimum requirement for the current Tier 1 risk-weighted asset ("RWA") ratio, phase out certain kinds of intangibles treated as capital and certain types of instruments and change the risk weightings of certain assets used to determine required capital ratios. The new common equity Tier 1 capital component requires capital of the highest quality — predominantly composed of retained earnings and common stock instruments. For community banks such as DNB First, National Association, a common equity Tier 1 capital ratio 4.5% became effective on January 1, 2015. The new capital rules also increased the current minimum Tier 1 capital ratio from 4.0% to 6.0% beginning on January 1, 2015. In addition, in order to make capital distributions and pay discretionary bonuses to executive officers without restriction, an institution must also maintain greater than 2.5% in common equity attributable to a capital conservation buffer to be phased in by 0.625% per year from January 1, 2016 until January 1, 2019. The new rules also increase the risk weights for several categories of assets, including an increase from 100% to 150% for

certain acquisition, development and construction loans and more than 90-day past due exposures. The new capital rules maintain the general structure of the prompt corrective action rules, but incorporate the new common equity Tier 1 capital requirement and the increased Tier 1 RWA requirement into the prompt corrective action framework.

The Bank will remain well capitalized under the implementation of Basel III, which was effective January 1, 2015. In assessing a bank's capital adequacy, regulators also consider other factors such as interest rate risk exposure; liquidity, funding and market risks; quality and level of earnings; concentrations of credit, quality of loans and investments; risks of any nontraditional activities; effectiveness of bank policies; and management's overall ability to monitor and control risks.

Quantitative measures established by regulation to ensure capital adequacy require DNB to maintain certain minimum amounts and ratios as set forth below. Based on management's assessment, DNB and the Bank meet all capital adequacy requirements to which they are subject. The Bank is considered "Well Capitalized" under the regulatory framework for prompt corrective action. To be categorized as Well Capitalized, the Bank must maintain minimum ratios as set forth below. There are no conditions or events since the most recent regulatory notification that management believes would have changed the Bank's category. Actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes*		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in thousands)</i>						
<b>DNB Financial Corporation</b>						
December 31, 2016:						
Total risk-based capital	\$105,669	12.50%	\$72,924	8.625%	N/A	N/A
Common equity tier 1 capital	81,201	9.60	43,332	5.125	N/A	N/A
Tier 1 risk-based capital	90,201	10.67	56,014	6.625	N/A	N/A
Tier 1 (leverage) capital	90,201	8.42	42,864	4.000	N/A	N/A
December 31, 2015:						
Total risk-based capital	\$ 81,321	14.78%	\$44,003	8.00%	N/A	N/A
Common equity tier 1 capital	57,448	10.44	24,752	4.50	N/A	N/A
Tier 1 risk-based capital	66,448	12.08	33,002	6.00	N/A	N/A
Tier 1 (leverage) capital	66,448	8.94	29,717	4.00	N/A	N/A
<b>DNB First, N.A.</b>						
December 31, 2016:						
Total risk-based capital	\$103,094	12.22%	\$72,785	8.625%	\$84,388	10.00%
Common equity tier 1 capital	97,376	11.54	43,249	5.125	54,852	6.50
Tier 1 risk-based capital	97,376	11.54	55,907	6.625	67,511	8.00
Tier 1 (leverage) capital	97,376	9.09	42,830	4.000	53,537	5.00
December 31, 2015:						
Total risk-based capital	\$ 80,286	14.63%	\$43,904	8.00%	\$68,600	12.50%
Common equity tier 1 capital	75,163	13.70	24,696	4.50	49,392	9.00
Tier 1 risk-based capital	75,163	13.70	32,928	6.00	57,624	10.50
Tier 1 (leverage) capital	75,163	10.13	29,670	4.00	37,087	5.00

\* Includes capital conversion buffer of 0.625%.

## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and  
Stockholders of DNB Financial Corporation  
Downingtown, Pennsylvania

We have audited the accompanying consolidated statements of financial condition of DNB Financial Corporation and its subsidiaries (collectively the “Corporation”) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders’ equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of DNB Financial Corporation and its subsidiaries at December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania  
March 27, 2017

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

DNB's Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of December 31, 2016, the end of the period covered by this report, in accordance with the requirements of Exchange Act Rule 240.13a-15(b). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that DNB's disclosure controls and procedures are effective as of December 31, 2016.

**Management's Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management, with the participation of our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of DNB's internal control over financial reporting at December 31, 2016. To make this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework (2013)*. Management believes that, as of December 31, 2016, DNB's internal control over financial reporting was effective. This annual report on Form 10-K does not include an attestation report of DNB's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by DNB's independent registered public accounting firm pursuant to the exemption provided to issuers that are not "large accelerated filers" or "accelerated filers".

There have been no changes in internal controls over financial reporting that occurred during our fourth quarter of 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None

### Part III

#### Item 10. Directors and Executive Officers of the Registrant

The information required herein with respect to Registrant’s directors, officers and corporate governance is incorporated by reference to pages 17-24 of DNB’s Proxy Statement for the 2017 Annual Meeting of Stockholders, and the information required herein with respect to compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to page 11 of DNB’s Proxy Statement for the Annual Meeting of Shareholders. DNB has adopted a Code of Ethics that applies to DNB’s principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. DNB’s current Code of Ethics is incorporated herein by reference as Exhibit 14 to this report.

#### Item 11. Executive Compensation

The information required herein is incorporated by reference to pages 31-40 of DNB’s Proxy Statement for the 2017 Annual Meeting of Shareholders.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

##### (a) Information Regarding Equity Compensation Plans

The following table summarizes certain information relating to equity compensation plans maintained by DNB as of December 31, 2016:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders:			
1995 Stock Option Plan	49,700	\$ 9.18	354,090
2004 Incentive Equity and Deferred Compensation Plan	55,775	25.63	64,929
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>105,475</b>	<b>\$17.88</b>	<b>419,019</b>

(b) The balance of the information required herein is incorporated by reference to pages 42-45 of DNB’s Proxy Statement for the 2017 Annual Meeting of Shareholders.

#### Item 13. Certain Relationships and Related Party Transactions and Director Independence

The information required herein is incorporated by reference to page 47 of DNB’s Proxy Statement for the 2017 Annual Meeting of Shareholders. Amounts of Related Party Loans are disclosed in Note 4 “Loans” and Note 6 “Office Property and Equipment” in this Form 10-K.

#### Item 14. Principal Accountant Fees and Services

The information required herein is incorporated by reference to page 48 of DNB’s Proxy Statement for the 2017 Annual Meeting of Shareholders.

## Part IV

### Item 15. Exhibits, Financial Statement Schedules.

#### (a)(1) Financial Statements.

The 2016 and 2015 consolidated financial statements listed below, together with an opinion of BDO USA, LLP, dated March 27, 2017 for the years ending December 31, 2016 and 2015 with respect thereto, are set forth beginning at page 57 of this report under Item 8, “Financial Statements and Supplementary Data.”

Report of Independent Registered Public Accounting Firm  
Consolidated Statements of Financial Condition  
Consolidated Statements of Income  
Consolidated Statements of Comprehensive Income  
Consolidated Statements of Stockholders' Equity  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

#### (a)(2) Not applicable

#### (a)(3) Exhibits, pursuant to Item 601 of Regulation S-K.

The exhibits listed on the Index to Exhibits on pages 117-120 of this report are incorporated by reference and filed or furnished herewith in response to this Item.

### Item 16. Form 10-K Summary.

None

## SIGNATURES

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.

DNB FINANCIAL CORPORATION

March 27, 2017

BY: /s/ William J. Hieb

William J. Hieb, Chief Executive Officer,  
President and Director (Principal Executive  
Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ James H. Thornton

James H. Thornton, Chairman of the  
Board

March 27, 2017

/s/ William J. Hieb

William J. Hieb, Chief Executive Officer,  
President and Director (Principal  
Executive Officer)

March 27, 2017

/s/ Gerald F. Sopp

Gerald F. Sopp,  
Chief Financial Officer (Principal  
Financial Officer and Accounting  
Officer)

March 27, 2017

/s/ John F. McGill, Jr.

John F. McGill, Jr.,  
Vice Chairman of the Board

March 27, 2017

/s/ James R. Biery

James R. Biery,  
Director

March 27, 2017

/s/ Thomas A. Fillippo

Thomas A. Fillippo,  
Director

March 27, 2017

/s/ Gerard F. Griesser

Gerard F. Griesser,  
Director

March 27, 2017

/s/ Mildred C. Joyner  
Mildred C. Joyner,  
Director

March 27, 2017

/s/ James J. Koegel  
James J. Koegel,  
Director

March 27, 2017

/s/ Mary D. Latoff  
Mary D. Latoff,  
Director

March 27, 2017

/s/ Charles A. Murray  
Charles A. Murray,  
Director

March 27, 2017

/s/ G. Daniel O'Donnell  
G. Daniel O'Donnell,  
Director

March 27, 2017

## Index to Exhibits

Exhibit No.  
Under Item 601  
of Regulation S-K

- |    |       |  |
|----|-------|--|
| 2  | (i)   | 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  | (i)   | Amended and Restated Articles of Incorporation, as amended effective December 8, 2008, filed March 31, 2009 as Exhibit 3(i) to Form 10-K for the fiscal year-ended December 31, 2008 and incorporated herein by reference.   |
|    | (ii)  | 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.   |
| 4  | (a)   | Registrant has certain debt obligations outstanding, for none of which do the instruments defining holders rights authorize an amount of securities in excess of 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis. Registrant agrees to furnish copies of such agreements to the Commission on request.                            |
|    | (b)   | Subordinated Note, by and between DNB Financial Corporation and Jersey Shore State Bank, dated as of March 5, 2015, filed as Exhibit 4.1 to Form 8-K on March 5, 2015 and incorporated herein by reference.  |
| 10 | (a)*  | Amended and Restated Change of Control Agreements dated December 20, 2006 between DNB Financial Corporation and DNB First, N.A. and the following executive officers, each in the form filed March 26, 2007 as Exhibit 10(a) to Form 10-K for the fiscal year-ended December 31, 2006 and incorporated herein by reference: Bruce E. Moroney and C. Tomlinson Kline III. |
|    | (b)** | 1995 Stock Option Plan of DNB Financial Corporation (as amended and restated, effective as of April 25, 2012), filed on March 22, 2012 as Appendix A to Registrant's Proxy Statement for its Annual Meeting of Shareholders held April 25, 2012 and incorporated herein by reference.  |
|    | (c)** | DNB Financial Corporation Incentive Equity and Deferred Compensation Plan (As Amended and Restated Effective May 5, 2009), filed March 31, 2009 as Appendix A to Registrant's Proxy Statement for its Annual Meeting of Shareholders held May 5, 2009 and incorporated herein by reference.  |

- (d)\* Agreement of Lease dated February 10, 2005 between Headwaters Associates, a Pennsylvania general partnership, as Lessor, and DNB First, National Association as Lessee for a portion of premises at 2 North Church Street, West Chester, Pennsylvania, filed March 10, 2005 as Exhibit 10(l) to Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference, as amended by Addendum to Agreement of Lease dated as of November 15, 2005, filed March 23, 2006 as Exhibit 10(l) to Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference, and as further amended by Second Addendum to Agreement of Lease dated as of May 25, 2006, filed August 14, 2006 as Exhibit 10(l) to Form 10-Q for the fiscal quarter ended June 30, 2006 and incorporated herein by reference, and as further amended by Third Addendum to Agreement of Lease dated as of June 9, 2010, filed August 13, 2010 as Exhibit 10(f) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference and as further amended by Fourth Addendum to Agreement of Lease dated as of June 30, 2013, filed August 9, 2013 as Exhibit 10.1 to Form 10-Q for the fiscal quarter ended June 30, 2013 and incorporated herein by reference. This lease was further amended by the Amended and Restated Agreement of Lease on September 21, 2016, effective May 1, 2016, filed as Exhibit 10.1 to Form 8-K on September 23, 2016 and incorporated herein by reference.
- (e)\*\* Form of Stock Option Agreement for grants prior to 2005 under the Registrant's Stock Option Plan, filed May 11, 2005 as Exhibit 10(n) to Form 10-Q for the fiscal quarter ended March 31, 2005 and incorporated herein by reference.
- (f)\*\* Form of Nonqualified Stock Option Agreement for April 18, 2005 and subsequent grants prior to April 23, 2010 under the Stock Option Plan, filed May 11, 2005 as Exhibit 10(o) to Form 10-Q for the fiscal quarter ended March 31, 2005 and incorporated herein by reference.
- (g)\* Amended and Restated Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and William J. Hieb, filed May 15, 2007 as Exhibit 10(l) to Form 10-Q for the fiscal quarter ended March 31, 2007 and incorporated herein by reference.
- (h)\*\* Form of Nonqualified Stock Option Agreement for grants on and after December 22, 2005 and prior to April 23, 2010 under the Stock Option Plan, filed March 23, 2006 as Exhibit 10(s) to Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
- (i)\* Deferred Compensation Plan For Directors of DNB Financial Corporation (adopted effective October 1, 2006), filed November 14, 2006 as Exhibit 10(s) to Form 10-Q for the fiscal quarter ended September 30, 2006 and incorporated herein by reference.
- (j)\* DNB Financial Corporation Deferred Compensation Plan (adopted effective October 1, 2006), filed November 14, 2006 as Exhibit 10(t) to Form 10-Q for the fiscal quarter ended September 30, 2006 and incorporated herein by reference.
- (k)\* Change of Control Agreements among DNB Financial Corporation, DNB First, N.A. and Gerald F. Sopp, in the form filed March 26, 2007 as Exhibit 10(q) to Form 10-K for the fiscal year-ended December 31, 2006 and incorporated herein by reference.

- (l)\* DNB Financial Corporation Supplemental Executive Retirement Plan for William S. Latoff as amended and restated effective April 1, 2007, filed May 15, 2007 as Exhibit 10(r) to Form 10-Q for the fiscal quarter ended March 31, 2007 and incorporated herein by reference, as further amended by Amendment dated December 8, 2008, filed March 31, 2009 as Exhibit 3(r) to Form 10-K for the fiscal year-ended December 31, 2008 and incorporated herein by reference.
- (m)\* DNB Offer Letter to Gerald F. Sopp, dated December 20, 2006, filed March 26, 2007 as Exhibit 10(u) to Form 10-K for the fiscal year-ended December 31, 2006 and incorporated herein by reference.
- (n)\*\* Form of Restricted Stock Award Agreement dated November, 28, 2007, filed March 28, 2008 as Exhibit 10(v) to Form 10-K for the fiscal year-ended December 31, 2007 and incorporated herein by reference.
- (o)\*\* Form of Restricted Stock Option Agreement for non-employee directors for awards made on and after April 23, 2010 pursuant to the 1995 Stock Option Plan of DNB Financial Corporation (as amended and restated, effective as of April 27, 2004), filed August 13, 2010 as Exhibit 10(y) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (p)\*\* Form of Restricted Stock Option Agreement for employees for awards made on and after April 23, 2010 pursuant to the 1995 Stock Option Plan of DNB Financial Corporation (as amended and restated, effective as of April 27, 2004), filed August 13, 2010 as Exhibit 10(z) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (q)\*\* Form of Amendment effective April 23, 2010, to the Restricted Stock Award agreements made between James H. Thornton, James J. Koegel, Mildred C. Joyner and Thomas A. Fillippo, non-employee Directors of the registrant, and the registrant on November 28, 2007 and December 17, 2008, filed August 13, 2010 as Exhibit 10(aa) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (r)\*\* Form of Amendment effective April 23, 2010, to the Restricted Stock Award agreements made between William J. Hieb, Gerald F. Sopp and Bruce E. Moroney, officers of the registrant, and the registrant on November 28, 2007 and December 17, 2008, filed August 13, 2010 as Exhibit 10(cc) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (s)\* Form of Amendment to Change of Control Agreement For Named Executive Officers, filed as Exhibit 99.1 to Form 8-K on October 28, 2011 and incorporated herein by reference.
- (t)\*\* Form of Restricted Stock Award Agreement for Directors, filed as Exhibit 99.1 to Form 8-K on December 21, 2012 and incorporated herein by reference.
- (u)\*\* Form of Restricted Stock Award Agreement for employees, filed as Exhibit 99.2 to Form 8-K on December 21, 2012 and incorporated herein by reference.
- (v)\* Amended Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and Gerald F. Sopp, filed as Exhibit 99.3 to Form 8-K on December 21, 2012 and incorporated herein by reference.
- (w)\* Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and Vincent Liuzzi, filed August 11, 2014 as Exhibit 10.1 to Form 10-Q for the fiscal quarter ended June 30, 2014 and incorporated herein by reference.

- (x) Exhibit 10.1 Subordinated Note Purchase Agreement, by and between DNB Financial Corporation and Jersey Shore State Bank, dated as of March 5, 2015, filed as Exhibit 10.1 to Form 8-K on March 5, 2015 and incorporated herein by reference.
  - (y)\* Employment Agreement between DNB First, N.A. and Christopher P. McGill, dated April 4, 2016, filed June 24, 2016 as Exhibit 10.2 to Form S-4 and incorporated herein by reference.
  - (z)\* Employment Agreement between DNB First, N.A. and Jerry Cotlov, dated April 4, 2016, filed June 24, 2016 as Exhibit 10.3 to Form S-4 and incorporated herein by reference.
  - (aa)\* DNB First Success Sharing Supplemental Executive Retirement Plan Basic Plan Document dated February 22, 2017, filed as Exhibit 10.1 to Form 8-K on February 28, 2017 and incorporated herein by reference.
  - (bb)\* Form of DNB First Success Sharing Supplemental Executive Retirement Plan Adoption Agreement, filed as Exhibit 10.2 to Form 8-K on February 28, 2017 and incorporated herein by reference.
- 14 Code of Ethics as amended and restated effective February 23, 2005, filed March 10, 2005 as Exhibit 10(m) to Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference.
  - 21 List of Subsidiaries, filed herewith.
  - 23 Consent of BDO USA, LLP, filed herewith.
  - 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

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\* Management contract or compensatory plan arrangement.

\*\* Stockholder approved compensatory plan pursuant to which DNB's Common Stock may be issued to employees of DNB

# DNB Financial Corporation

## CORPORATE HEADQUARTERS

4 Brandywine Avenue  
Downingtown, PA 19335  
Tel. 610-269-1040 Fax 484-359-3176  
www.dnbfirst.com

## FINANCIAL INFORMATION

Investors, brokers, security analysts and others desiring financial information should contact Gerald F. Sopp at 484-359-3138 or gsopp@dnbfirst.com

## INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**BDO USA, LLP**  
Ten Penn Center, 1801 Market Street  
Suite 1700  
Philadelphia, PA 19103

## COUNSEL

**Stradley, Ronon, Stevens and Young, LLP**  
2600 One Commerce Square  
Philadelphia, PA 19103

## STOCK LISTING

DNB Financial Corporation shares are traded on the Nasdaq Capital Market under the symbol DNBF

## REGISTRAR AND STOCK TRANSFER AGENT

**Computershare Shareholder Services**  
211 Quality Circle, Suite 210  
P.O. Box 30170  
College Station, TX 77842-3170  
800-368-5948  
www-us.computershare.com/investor

## MARKET MAKERS

**Boenning & Scattergood, Inc.**  
800-842-8928

**FIG Partners**  
866-344-2657

**Raymond James Financial, Inc.**  
800-800-4693

## DIRECTORS

James H. Thornton, Chairman  
John "Jef" McGill, Vice Chairman  
James R. Biery  
Thomas A. Fillippo, Sr.  
Gerard F. Griesser  
William J. Hieb  
Mildred C. Joyner  
James J. Koegel  
Mary D. Latoff  
Charles A. Murray  
Daniel O'Donnell

## DIRECTORS EMERITUS

Vernon J. Jameson  
Eli Silberman  
Henry F. Thorne

## EXECUTIVE OFFICERS

William J. Hieb  
President and CEO

Vince Liuzzi  
Executive Vice President  
Chief Banking Officer

Christopher P. McGill  
Executive Vice President  
Chief Commercial Lending Officer

Gerald F. Sopp  
Executive Vice President  
Chief Financial Officer & Secretary

## DNB FIRST BANK ADVISORY BOARD

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Chairman, Buckley, Brion, McGuire & Morris LLP

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Partner, KMRD Partners, Inc.

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Boyd Funeral Home

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President, West Chester University

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Rosaria Hawkins, PhD  
President, Take Charge Consultants, Inc.

Matthew D. Kelly  
Partner, Carnegie Wealth Management

John E. McGovern, CPA, MST  
President/Founder, John E. McGovern &  
Associates, PC

James A. Mellon, Jr.  
President, Mellon Certified Restoration

Margarita Q. Mirkil  
Managing Director, Fairmont Ventures

A. Joseph Rubino  
General Partner, Rubino Holdings LP

Charles E. Swope, Jr.  
Swope Lees Commercial Real Estate, LLC

Joan D. Walsh  
Co-Owner, Kashbox Consulting

George C. Zumbano, Esq.  
Shareholder, Gawthrop Greenwood, PC

## DNB FIRST WEALTH MANAGEMENT ADVISORY BOARD

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Managing Director, DNB First Wealth  
Management

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Shareholder, Riley Riper  
Hollin & Colagreco

Jay G. Fischer, Esq.  
Partner, Valocchi & Fischer

Frank Hayes, Esq.  
Partner, Hayes & Romero

Suzanne R. Jackson, CPA  
Owner, SR Jackson, LLC

Jerry L. Johnson, Esq.  
Attorney at Law

Donald B. Lynn, Jr., Esq.  
Partner, Larmore Scarlett, LLP

Stacey Willits McConnell, Esq.  
Partner, Lamb McErlane, PC

John McKenna, Esq.  
Shareholder/Director, MacElree Harvey, Ltd.

Anthony Morris, Esq.  
Partner, Buckley, Brion, McGuire & Morris LLP

Stephen J. Olsen, Esq.  
Partner, Gawthrop Greenwood, PC

Robert S. Supplee, Esq.  
Robert S. Supplee, PC

## **DNB First Branch Locations**

### **BOOTHWYN**

3915 Chichester Avenue  
Boothwyn, PA 19061

### **CALN**

1835 East Lincoln Highway  
Coatesville, PA 19320

### **CHADDS FORD**

300 Oakland Road  
West Chester, PA 19382

### **DOWNINGTOWN/EAST END**

701 East Lancaster Avenue  
Downingtown, PA 19335

### **DOWNINGTOWN/MAIN**

4 Brandywine Avenue  
Downingtown, PA 19335

### **EAST FALLS**

4341 Ridge Avenue  
Philadelphia, PA 19129

### **EXTON**

410 Exton Square Parkway  
Exton, PA 19341

### **KENNETT SQUARE**

215 East Cypress Street  
Kennett Square, PA 19348

### **LIONVILLE**

891 North Pottstown Pike  
Exton, PA 19341

### **LITTLE WASHINGTON**

104 Culbertson Run Road  
Downingtown, PA 19335

### **LUDWIG'S CORNER**

1030 North Pottstown Pike  
Chester Springs, PA 19425

### **OLD CITY**

36 North 3rd Street  
Philadelphia, PA 19106

### **ROXBOROUGH**

6137 Ridge Avenue  
Philadelphia, PA 19128

### **WEST CHESTER**

2 North Church Street  
West Chester, PA 19380

### **WEST GOSHEN**

1115 West Chester Pike  
West Chester, PA 19380

