

MID PENN BANCORP INC  
Form 10-Q  
November 10, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania (State or Other Jurisdiction of Incorporation or Organization)	25-1666413 (I.R.S. Employer Identification Number)
349 Union Street  Millersburg, Pennsylvania (Address of Principal Executive Offices)	17061 (Zip Code)

Registrant's telephone number, including area code 1.866.642.7736

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

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

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

Large accelerated filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company

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

As of November 10, 2016, the registrant had 4,232,166 shares of common stock outstanding.

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MID PENN BANCORP, INC.

FORM 10-Q

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Unless the context otherwise requires, the terms “Mid Penn”, “we”, “us”, and “our” refer to Mid Penn Bancorp, Inc. and its consolidated subsidiaries.

MID PENN BANCORP, INC.

## PART 1 – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)	September 30, 2016	December 31, 2015
<b>ASSETS</b>		
Cash and due from banks	\$ 15,697	\$ 12,329
Interest-bearing balances with other financial institutions	942	955
Federal funds sold	27,130	-
Total cash and cash equivalents	43,769	13,284
Interest-bearing time deposits with other financial institutions	-	4,317
Investment securities available for sale	173,444	135,721
Loans and leases, net of unearned interest	791,484	739,191
Less: Allowance for loan and lease losses	(7,482 )	(6,168 )
Net loans and leases	784,002	733,023
Bank premises and equipment, net	13,325	13,993
Cash surrender value of life insurance	12,716	12,516
Restricted investment in bank stocks	2,709	4,266
Foreclosed assets held for sale	501	1,185
Accrued interest receivable	4,032	3,813
Deferred income taxes	1,076	1,821
Goodwill	3,918	3,918
Core deposit and other intangibles, net	562	665
Other assets	2,633	3,116
Total Assets	\$ 1,042,687	\$ 931,638
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing demand	\$ 128,013	\$ 103,721
Interest-bearing demand	321,976	247,356
Money Market	249,204	208,386
Savings	59,302	56,731
Time	179,722	160,849
Total Deposits	938,217	777,043
Short-term borrowings	-	31,596

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Long-term debt	13,638	40,305
Subordinated debt	7,411	7,414
Accrued interest payable	748	390
Other liabilities	7,588	4,822
Total Liabilities	967,602	861,570
<b>Shareholders' Equity:</b>		
Common stock, par value \$1.00; authorized 10,000,000 shares; 4,232,166 and 4,226,717 shares issued and outstanding at September 30, 2016, and at December 31, 2015, respectively		
	4,232	4,227
Additional paid-in capital	40,644	40,559
Retained earnings	27,253	23,470
Accumulated other comprehensive income	2,956	1,812
Total Shareholders' Equity	75,085	70,068
Total Liabilities and Shareholders' Equity	\$ 1,042,687	\$ 931,638

The accompanying notes are an integral part of these consolidated financial statements.

MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
<b>INTEREST INCOME</b>				
Interest and fees on loans and leases	\$9,134	\$8,448	\$26,846	\$24,345
Interest on interest-bearing balances	2	12	11	34
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	339	293	972	928
State and political subdivision obligations, tax-exempt	550	484	1,562	1,532
Other securities	64	102	236	301
Interest on federal funds sold	36	-	54	1
<b>Total Interest Income</b>	<b>10,125</b>	<b>9,339</b>	<b>29,681</b>	<b>27,141</b>
<b>INTEREST EXPENSE</b>				
Interest on deposits	1,162	987	3,293	2,881
Interest on short-term borrowings	-	14	15	36
Interest on long-term and subordinated debt	205	149	657	511
<b>Total Interest Expense</b>	<b>1,367</b>	<b>1,150</b>	<b>3,965</b>	<b>3,428</b>
<b>Net Interest Income</b>	<b>8,758</b>	<b>8,189</b>	<b>25,716</b>	<b>23,713</b>
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>				
<b>Net Interest Income After Provision for Loan and Lease Losses</b>	<b>8,173</b>	<b>7,924</b>	<b>24,396</b>	<b>22,848</b>
<b>NONINTEREST INCOME</b>				
Income from fiduciary activities	104	120	349	367
Service charges on deposits	171	186	484	503
Net gain on sales of investment securities	200	138	413	315
Earnings from cash surrender value of life insurance	65	71	200	198
Mortgage banking income	266	106	698	326
ATM debit card interchange income	214	189	623	540
Merchant services income	89	64	241	175
Net gain on sales of SBA loans	89	73	354	216
Other income	221	138	687	487
<b>Total Noninterest Income</b>	<b>1,419</b>	<b>1,085</b>	<b>4,049</b>	<b>3,127</b>
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	3,982	3,471	11,428	10,231
Occupancy expense, net	496	498	1,542	1,448
Equipment expense	412	346	1,258	1,081
Pennsylvania Bank Shares Tax expense	197	106	606	337
FDIC Assessment	134	166	434	470
Legal and professional fees	130	151	515	455
Marketing and advertising expense	146	137	369	372
Software licensing	350	380	1,015	1,103
Telephone expense	135	169	420	432
Loss on sale or write-down of foreclosed assets	26	47	158	64

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Intangible amortization	31	36	102	79
Merger and acquisition expense	-	-	-	762
Other expenses	1,126	1,062	3,231	3,017
Total Noninterest Expense	7,165	6,569	21,078	19,851
INCOME BEFORE PROVISION FOR INCOME TAXES	2,427	2,440	7,367	6,124
Provision for income taxes	526	546	1,639	1,223
NET INCOME	1,901	1,894	5,728	4,901
Series B preferred stock dividends	-	88	-	263
Series C preferred stock dividends	-	4	-	8
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$ 1,901	\$ 1,802	\$ 5,728	\$ 4,630
PER COMMON SHARE DATA:				
Basic Earnings Per Common Share	\$0.45	\$0.43	\$1.35	\$1.14
Cash Dividends Paid	\$0.12	\$0.12	\$0.46	\$0.32

The accompanying notes are an integral part of these consolidated financial statements.

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MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands)	Three Months Ended September 30, 2016    2015	
Net income	\$1,901	\$1,894
Other comprehensive (loss) income:		
Unrealized (losses) gains arising during the period on available-for-sale securities, net of income taxes of (\$349) and \$464, respectively	(677 )	898
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of (\$68) and (\$47), respectively (a)	(132 )	(91 )
Change in defined benefit plans, net of income taxes of (\$6) and \$2, respectively (b)	(11 )	2
Total other comprehensive (loss) income	(820 )	809
Total comprehensive income	\$1,081	\$2,703

(Dollars in thousands)	Nine Months Ended September 30, 2016    2015	
Net income	\$5,728	\$4,901
Other comprehensive income (loss):		
Unrealized gains arising during the period on available-for-sale securities, net of income taxes of \$795 and \$66, respectively	1,543	128
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of (\$141) and (\$107), respectively (a)	(272 )	(208 )
Change in defined benefit plans, net of income taxes of (\$66) and \$4, respectively (b)	(127 )	7
Total other comprehensive income (loss)	1,144	(73 )
Total comprehensive income	\$6,872	\$4,828

(a) Amounts are included in net gain on sales of investment securities on the Consolidated Statements of Income as a separate element within total noninterest income.

(b) Amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income as a separate element within total noninterest expense.

The accompanying notes are an integral part of these consolidated financial statements.

## MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

For the Nine Months Ended September 30, 2016 and 2015

(Dollars in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2016	\$ -	\$ 4,227	\$ 40,559	\$ 23,470	\$ 1,812	\$ 70,068
Net income	-	-	-	5,728	-	5,728
Total other comprehensive income, net of taxes	-	-	-	-	1,144	1,144
Employee Stock Purchase Plan (3,334 shares)	-	3	53	-	-	56
Common stock dividends	-	-	-	(1,945 )	-	(1,945 )
Restricted stock activity (2,115 shares)	-	2	32	-	-	34
Balance, September 30, 2016	\$ -	\$ 4,232	\$ 40,644	\$ 27,253	\$ 2,956	\$ 75,085
Balance, January 1, 2015	\$ 5,000	\$ 3,498	\$ 29,902	\$ 19,217	\$ 1,513	\$ 59,130
Net income	-	-	-	4,901	-	4,901
Total other comprehensive income (loss), net of taxes	-	-	-	-	(73 )	(73 )
Employee Stock Purchase Plan (3,166 shares)	-	3	47	-	-	50
Common stock dividends	-	-	-	(1,278 )	-	(1,278 )
Series B preferred stock dividends	-	-	-	(263 )	-	(263 )
Series C preferred stock dividend	-	-	-	(8 )	-	(8 )
SBLF preferred stock from Phoenix acquisition	1,750	-	-	-	-	1,750
Common stock issued to Phoenix shareholders	-	724	10,568	-	-	11,292
Restricted stock activity (875 shares)	-	1	18	-	-	19
Balance, September 30, 2015	\$ 6,750	\$ 4,226	\$ 40,535	\$ 22,569	\$ 1,440	\$ 75,520

The accompanying notes are an integral part of these consolidated financial statements.



MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)	Nine Months Ended September 30,	
	2016	2015
<b>Operating Activities:</b>		
Net Income	\$5,728	\$4,901
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	1,320	865
Depreciation	1,238	1,082
Amortization of intangibles	103	66
Net amortization of security premiums	8,429	1,867
Gain on sales of investment securities	(413 )	(315 )
Earnings on cash surrender value of life insurance	(200 )	(198 )
SBA loans originated for sale	(4,436 )	(2,915 )
Proceeds from sales of SBA loans originated for sale	4,790	3,131
Gain on sale of loans	(354 )	(216 )
Loss on sale or write-down of foreclosed assets	158	64
Restricted stock compensation expense	34	19
Deferred income tax	(37 )	(300 )
(Increase) decrease in accrued interest receivable	(219 )	31
Decrease in other assets	483	882
Increase in accrued interest payable	358	224
Increase in other liabilities	2,766	1,322
Net Cash Provided By Operating Activities	19,748	10,510
<b>Investing Activities:</b>		
Net decrease in interest-bearing time deposits with other financial institutions	4,317	459
Proceeds from the maturity or call of investment securities	14,983	8,080
Proceeds from the sale of investment securities	49,635	33,962
Purchases of investment securities	(108,431)	(24,446)
Net cash received from acquisition	-	8,095
Redemptions (purchases) of restricted investment in bank stock	1,557	(229 )
Net increase in loans and leases	(52,517 )	(38,671)
Purchases of bank premises and equipment	(570 )	(1,261 )
Proceeds from sale of foreclosed assets	744	396
Net Cash Used In Investing Activities	(90,282 )	(13,615)
<b>Financing Activities:</b>		
Net increase in deposits	161,174	13,990
Net (decrease) increase in short-term borrowings	(31,596 )	5,134
Series B preferred stock dividends paid	-	(263 )
Series C preferred stock dividends paid	-	(8 )
Common stock dividend paid	(1,945 )	(1,278 )
Employee Stock Purchase Plan	56	50
Long-term debt repayment	(26,670 )	(5,168 )
Net Cash Provided By Financing Activities	101,019	12,457

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Net increase in cash and cash equivalents	30,485	9,352
Cash and cash equivalents, beginning of period	13,284	9,882
Cash and cash equivalents, end of period	\$43,769	\$19,234
Supplemental Disclosures of Cash Flow Information:		
Interest paid	\$3,607	\$3,173
Income taxes paid	\$990	\$930
Supplemental Noncash Disclosures:		
Loan transfers to foreclosed assets held for sale	\$218	\$885

MID PENN BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued)

## Assets, Liabilities, and Equity in Connection with Merger:

(Dollars in thousands)	Nine Months Ended September 30,	
	2016	2015
<b>Assets Acquired:</b>		
Securities	\$-	\$11,331
Loans	-	110,363
Restricted stock	-	509
Property and equipment	-	1,792
Accrued interest receivable	-	388
Core deposit and other intangible assets	-	578
Bank-owned life insurance	-	3,673
Other assets	-	1,127
	\$-	\$129,761
<b>Liabilities Assumed:</b>		
Deposits	\$-	\$123,238
Accrued interest payable	-	32
Long-term debt	-	3,570
Other liabilities	-	876
	\$-	\$127,716
<b>Equity Acquired:</b>		
Preferred stock	\$-	\$1,750

The accompanying notes are an integral part of these consolidated financial statements.

MID PENN BANCORP, INC.

MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

(1)Basis of Presentation

The accompanying consolidated financial statements include the accounts of Mid Penn Bancorp, Inc. (the “Company”) and its wholly-owned subsidiaries, Mid Penn Bank (the “Bank”), and the Bank’s former wholly-owned subsidiary, Mid Penn Insurance Services, LLC (collectively, “Mid Penn”). All material intercompany accounts and transactions have been eliminated in consolidation.

Effective March 1, 2016, Mid Penn Insurance Services, LLC, an immaterial subsidiary of Mid Penn, was liquidated.

Certain information and disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Mid Penn believes the information presented is not misleading and the disclosures are adequate. For comparative purposes, the September 30, 2015 and December 31, 2015 balances have been reclassified, when, and if necessary, to conform to the 2016 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2016, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

(2)Mergers and Acquisitions

On March 1, 2015, Phoenix Bancorp, Inc. (“Phoenix”) merged with, and into, Mid Penn, with Mid Penn continuing as the surviving entity. Simultaneously with the consummation of the foregoing merger, Miners Bank (“Miners”), a Pennsylvania-state chartered bank and wholly-owned subsidiary of Phoenix, merged with and into the Bank.

As part of this transaction, Phoenix shareholders received either 3.167 shares of the Company’s common stock or \$51.60 in cash in exchange for each share of Phoenix common stock. Holders of contingent rights issued by Phoenix received approximately 0.414 shares of the Company’s common stock as settlement of such rights. As a result, Mid Penn issued 723,851 shares of common stock with an acquisition date fair value of approximately \$11,292,000 based on the closing stock price of Mid Penn’s common stock on February 27, 2015 of \$15.60 and cash of \$2,949,000. Including an insignificant amount of cash paid in lieu of fractional shares, the fair value of total consideration paid was \$14,241,000.

Additionally, as part of this transaction, on March 1, 2015, Mid Penn assumed all of the liabilities and obligations of Phoenix with respect to 1,750 shares of Phoenix’s preferred stock issued to the United States Department of Treasury (“Treasury”) in connection with the Small Business Lending Fund and issued 1,750 shares of the Company’s Senior Non-Cumulative Perpetual Preferred Stock, Series C, having a \$1,000 liquidation preference per share (the “SBLF Preferred Shares”), to the Treasury. The SBLF Preferred Shares qualified as Tier 1 capital and had terms and conditions identical to those shares of preferred stock issued by Phoenix to the Treasury. Subsequent to the



acquisition, on December 15, 2015, Mid Penn redeemed all of the outstanding SBLF Preferred Shares for an aggregate redemption price of \$1,754,000 including dividends payable at that date.

The assets and liabilities of Miners and Phoenix were recorded on the consolidated balance sheet at their estimated fair value as of March 1, 2015, and their results of operations have been included in the consolidated income statement since such date.

Included in the purchase price was goodwill and a core deposit intangible of \$2,902,000 and \$578,000, respectively. The core deposit intangible will be amortized over a ten-year period using a sum of the year's digits basis. The goodwill 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 succeeding five years beginning 2016 is estimated to be \$96,000, \$86,000, \$75,000, \$65,000, and \$54,000 per year, respectively, and \$114,000 in total for years after 2020.

## MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

The allocation of the purchase price is as follows:

(Dollars in thousands)

Assets acquired:	
Cash and cash equivalents	\$ 11,044
Investment securities	11,331
Loans	110,363
Goodwill	2,902
Core deposit and other intangibles	578
Other assets	7,489
Total assets acquired	143,707
Liabilities assumed:	
Deposits	123,238
FHLB borrowings	3,570
Other liabilities	908
Total liabilities assumed	127,716
Equity acquired:	
Preferred stock	1,750
Total equity acquired and liabilities assumed	129,466
Consideration paid	\$ 14,241
Cash paid	\$ 2,949
Fair value of common stock issued, including replacement equity awards	11,292

The following table summarizes the fair value of the assets acquired, and liabilities and equity assumed by Mid Penn through the Phoenix merger at March 1, 2015.

(Dollars in thousands)

Total purchase price	\$ 14,241
Net assets acquired:	
Cash and cash equivalents	11,044
Investment securities	11,331
Restricted stock	509
Loans	110,363
Bank owned life insurance	3,673
Premises and equipment	1,792
Deferred income taxes	503
Accrued interest receivable	388
Core deposit and other intangibles	578
Other assets	624

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Deposits	(123,238)
FHLB borrowings	(3,570 )
Accrued interest payable	(32 )
Other liabilities	(876 )
Preferred stock	(1,750 )
	11,339
Goodwill	\$2,902

## MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

The fair value of the financial assets acquired included loans receivable with a gross amortized cost basis of \$112,816,000. 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.

(Dollars in thousands)

Gross amortized cost basis at March 1, 2015	\$112,816
Market rate adjustment	270
Credit fair value adjustment on pools of homogeneous loans	(1,461 )
Credit fair value adjustment on impaired loans	(1,262 )
Fair value of purchased loans at March 1, 2015	\$110,363

The market rate adjustment represents the movement in market interest rates, irrespective of credit adjustments, compared to the stated rates of the acquired loans. The credit adjustment made on pools of homogeneous loans represents the changes in credit quality of the underlying borrowers from the loan inception to the acquisition date. The credit adjustment on impaired loans is derived in accordance with ASC 310-30-30 and represents the portion of the loan balance that has been deemed uncollectible based on our expectations of future cash flows for each respective loan.

The information about the acquired Phoenix impaired loan portfolio as of March 1, 2015 is as follows:

(Dollars in thousands)

Contractually required principal and interest at acquisition	\$3,548
Contractual cash flows not expected to be collected (nonaccretable discount)	(804 )
Expected cash flows at acquisition	2,744
Interest component of expected cash flows (accretable discount)	(458 )
Fair value of acquired loans	\$2,286

The following table presents pro forma information as if the merger between Mid Penn and Phoenix had been completed on January 1, 2014. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn merged with Phoenix at the beginning of 2014. Supplemental pro forma earnings for 2015 were adjusted to exclude \$0 and \$762,000 of merger related costs incurred for the three and nine months ended September 30, 2015. 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.

September 30,  
(Dollars in thousands, except per share data) 2015

	Three Months Ended	Nine Months Ended
Net interest income after loan loss provision	\$7,924	\$23,484
Noninterest income	1,085	3,192
Noninterest expense	7,353	20,934
Net income available to common shareholders	1,251	4,403
Net income per common share	0.30	1.04

### (3) Investment Securities

Securities to be held for indefinite periods, but not intended to be held to maturity, are classified as available for sale and carried at fair value. Securities held for indefinite periods include securities that management intends to use as part of its asset and liability management strategy and that may be sold in response to liquidity needs, changes in interest rates, resultant prepayment risk, and other factors related to effective portfolio management.

Realized gains and losses on dispositions are based on the net proceeds and the amortized cost of the securities sold, using the specific identification method. Unrealized gains and losses on investment securities available for sale are based on the difference between amortized cost and fair value of each security. These gains and losses are credited or charged to other comprehensive income, whereas realized gains and losses flow through Mid Penn's consolidated statements of income.

ASC Topic 320, Investments – Debt and Equity Securities, clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment.

## MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

In instances when a determination is made that other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, this guidance changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. 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 other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Mid Penn had no securities considered by management to be other than temporarily impaired as of September 30, 2016 or December 31, 2015, and did not record any securities impairment charges in the respective periods ended on these dates. Mid Penn does not consider the securities with unrealized losses on the respective dates to be other-than-temporarily impaired as the unrealized losses were deemed to relate to changes in interest rates and not erosion of credit quality.

The amortized cost, fair value, and unrealized gains and losses on investment securities at September 30, 2016 and December 31, 2015 are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>September 30, 2016</b>				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 50,046	\$ 1,099	\$ (14 )	\$ 51,131
Mortgage-backed U.S. government agencies	25,426	369	(8 )	25,787
State and political subdivision obligations	90,407	2,970	(83 )	93,294
Equity securities	3,268	73	(109 )	3,232
	\$ 169,147	\$ 4,511	\$ (214 )	\$ 173,444

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>December 31, 2015</b>				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 26,316	\$ 729	\$ (55 )	\$ 26,990
Mortgage-backed U.S. government agencies	38,983	49	(228 )	38,804
State and political subdivision obligations	64,780	1,914	(77 )	66,617
Equity securities	3,271	82	(43 )	3,310
	\$ 133,350	\$ 2,774	\$ (403 )	\$ 135,721

Estimated fair values of debt securities are based on quoted market prices, where applicable. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Investment securities having a fair value of \$168,085,000 at September 30, 2016 and \$130,298,000 at December 31, 2015, were pledged to secure public deposits and certain other borrowings.

Mid Penn realized net gains on sales of securities available-for-sale of \$200,000 and \$138,000, respectively, during the three months ended September 30, 2016 and 2015. Mid Penn realized net gains on sales of securities available-for-sale of \$413,000 and \$315,000, respectively, during the nine months ended September 30, 2016 and 2015.

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MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

The following tables present gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2016 and December 31, 2015.

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
September 30, 2016									
Available for sale securities:									
U.S. Treasury and U.S. government agencies	3	\$7,486	\$ (14 )	0	\$-	\$-	3	\$7,486	\$ (14 )
Mortgage-backed U.S. government agencies	3	2,029	(8 )	0	-	-	3	2,029	(8 )
State and political subdivision obligations	24	10,969	(83 )	0	-	-	24	10,969	(83 )
Equity securities	0	-	-	2	1,059	(109 )	2	1,059	(109 )
Total temporarily impaired available for sale securities	30	\$20,484	\$ (105 )	2	\$1,059	\$ (109 )	32	\$21,543	\$ (214 )

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
December 31, 2015									
Available for sale securities:									
U.S. Treasury and U.S. government agencies	6	\$6,259	\$ (43 )	2	\$1,383	\$ (12 )	8	\$7,642	\$ (55 )
Mortgage-backed U.S. government agencies	13	12,759	(124 )	11	6,282	(104 )	24	19,041	(228 )
State and political subdivision obligations	9	4,041	(32 )	3	1,631	(45 )	12	5,672	(77 )
Equity securities	1	990	(10 )	2	615	(33 )	3	1,605	(43 )
Total temporarily impaired available for sale securities	29	\$24,049	\$ (209 )	18	\$9,911	\$ (194 )	47	\$33,960	\$ (403 )

Management evaluates securities for other-than-temporary impairment on a quarterly basis; and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, and the financial condition and near term prospects of the issuer. In addition, for debt securities, Mid Penn considers (a) whether management has the intent to sell the security, (b) it is more likely than not that management will be required to sell the security prior to its anticipated recovery, and (c) whether management expects to recover the entire amortized cost basis. For equity securities, management considers



the intent and ability to hold securities until recovery of unrealized losses.

The majority of the investment portfolio is comprised of securities issued by U.S. government agencies and state and political subdivision obligations. For the investment securities with an unrealized loss, Mid Penn has concluded, based on its analysis that the unrealized losses in the investments are primarily caused by the movement of interest rates.

At September 30, 2016, thirty debt securities and two equity securities with unrealized losses totaling \$214,000 were temporarily impaired approximately 1 percent from their amortized cost basis. At September 30, 2016, the majority of the unrealized losses on securities in an unrealized loss position were attributed to obligations of state and political subdivisions. At December 31, 2015, forty-four debt securities and three equity securities with unrealized losses totaling \$403,000 were temporarily impaired approximately; 1 percent from their amortized cost basis. At December 31, 2015, the majority of the unrealized losses on securities in an unrealized loss position were attributed to mortgage-backed U.S. government agencies.

## MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

The table below illustrates the maturity distribution of investment securities at amortized cost and fair value.

(Dollars in thousands)	September 30, 2016	
	Amortized Cost	Fair Value
Due in 1 year or less	\$16,978	\$17,001
Due after 1 year but within 5 years	46,261	47,617
Due after 5 years but within 10 years	71,216	73,815
Due after 10 years	5,998	5,992
	140,453	144,425
Mortgage-backed securities	25,426	25,787
Equity securities	3,268	3,232
	\$169,147	\$173,444

#### (4) Loans and Allowance for Loan and Lease Losses

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 loan 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. These amounts are generally being amortized 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 loan portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, commercial real estate-construction and lease financing. Consumer loans consist of the following classes: residential mortgage loans, home equity loans and other consumer loans.

For all classes of loans, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days or more 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 is placed on nonaccrual status, unpaid interest is credited to 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, at least nine consecutive 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.

#### Commercial and industrial

Mid Penn originates commercial and industrial loans. Most of the Bank's commercial and industrial loans have been extended to finance local and regional businesses and include short-term loans to finance machinery and equipment purchases, inventory, and accounts receivable. Commercial loans also involve the extension of revolving credit for a

combination of equipment acquisitions and working capital in expanding companies.

The maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Generally, the maximum term on non-mortgage lines of credit is one year. The loan-to-value ratio on such loans and lines of credit generally may not exceed 80 percent of the value of the collateral securing the loan. The Bank's commercial business lending policy includes credit file documentation and analysis of the borrower's character, capacity to repay the loan, the adequacy of the borrower's capital and collateral as well as an evaluation of conditions affecting the borrower. Analysis of the borrower's past, present, and future cash flows is also an important aspect of the Bank's current credit analysis. Nonetheless, such loans are believed to carry higher credit risk than other extensions of credit.

Commercial and industrial loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself, which, in turn, is likely to be dependent upon the general economic environment. Mid Penn's commercial and industrial loans are usually, but not always, secured by business assets and personal guarantees. However, the collateral securing the loans may depreciate over time, may be difficult to appraise, and may fluctuate in value based on the success of the business.

MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

Commercial real estate and commercial real estate - construction

Commercial real estate and commercial real estate construction loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. In addition, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

Residential mortgage

Mid Penn offers a wide array of residential mortgage loans for both permanent structures and those under construction. The Bank's residential mortgage originations are secured primarily by properties located in its primary market and surrounding areas. Residential mortgage loans have terms up to a maximum of 30 years and with loan-to-value ratios up to 100 percent of the lesser of the appraised value of the security property or the contract price. Private mortgage insurance is generally required in an amount sufficient to reduce the Bank's exposure to at or below the 85 percent loan to value level. Residential mortgage loans generally do not include prepayment penalties.

In underwriting residential mortgage loans, the Bank evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by Mid Penn are appraised by independent fee appraisers. The Bank generally requires borrowers to obtain title insurance and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Bank generally contain a "due on sale" clause allowing the Bank to declare the unpaid principal balance due and payable upon the sale of the security property.

The Bank underwrites residential mortgage loans to the standards established by the secondary mortgage market, i.e., Fannie Mae, Ginnie Mae, Freddie Mac, or Pennsylvania Housing Finance Agency standards, with the intention of selling the majority of residential mortgages originated into the secondary market. In the event that the facts and circumstances surrounding a residential mortgage application do not meet all underwriting conditions of the secondary mortgage market, the Bank will evaluate the failed conditions and evaluate the potential risk of holding the residential mortgage in the Bank's portfolio rather than rejecting the loan request. In the event that the loan is held in the Bank's portfolio, the interest rate on the residential mortgage would be increased to compensate for the added portfolio risk.

Consumer, including home equity

Mid Penn offers a variety of secured consumer loans, including home equity, automobile, and deposit secured loans. In addition, the Bank offers other secured and unsecured consumer loans. Most consumer loans are originated in Mid Penn's primary market and surrounding areas.

The largest component of Mid Penn's consumer loan portfolio consists of fixed rate home equity loans and variable rate home equity lines of credit. Substantially all home equity loans and lines of credit are secured by second mortgages on principal residences. The Bank will lend amounts, which, together with all prior liens, typically may be up to 85 percent of the appraised value of the property securing the loan. Home equity term loans may have maximum terms up to 20 years while home equity lines of credit generally have maximum terms of five years.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards employed by the Bank for consumer loans include an application, a

determination of the applicant's payment history on other debts, and an assessment of ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount.

Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market weakens and property values deteriorate.

MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

Allowance for Loan and Lease Losses

The allowance for credit losses (“allowance”) consists of (i) the allowance for loan and lease losses, and (ii) the reserve for unfunded lending commitments. The allowance for loan and lease 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 reserve for unfunded lending commitments represents management’s estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated balance sheet. The reserve for unfunded lending commitments was \$120,000 at September 30, 2016 and \$94,500 at December 31, 2015. The allowance is increased by the provision for loan and lease losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. 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. Because all identified losses are immediately charged off, no portion of the allowance 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 is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a monthly evaluation of the adequacy of the allowance. The allowance is based on Mid Penn’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, 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 changes in economic conditions, fluctuations in loan quality measures, changes in collateral values, changes in the experience of the lending staff and loan review systems, changes in lending policies and procedures (including underwriting standards), changes in the mix and volume of loans originated, the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio, shifting industry or portfolio concentrations, and other relevant factors.

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 loan loss calculation.

Mid Penn generally considers a commercial loan (consisting of commercial and industrial, commercial real estate, commercial real estate-construction, and lease financing loan classes) to be impaired when it becomes 90 days or more past due and not in the process of collection or sooner when it is probable that Mid Penn will be unable to collect all contractual principal and interest due. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would generally be considered collateral dependent as the discounted cash flow method would generally indicate no operating income available for evaluating the collateral position; therefore, most impaired loans are deemed to be collateral dependent.

In addition, Mid Penn's rating system assumes any loans classified as nonaccrual, included in the substandard rating, to be impaired, and most of these loans are considered collateral dependent; therefore, most of Mid Penn's impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

Mid Penn evaluates loans for charge-off on a monthly basis. Policies that govern the recommendation for charge-off are unique to the type of loan being considered. Commercial loans rated as substandard nonaccrual or lower will first have a collateral evaluation completed in accordance with the guidance on impaired loans. Once the collateral evaluation has been completed, a specific allocation of allowance is made based upon the results of the evaluation. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. Commercial real estate loans rated as impaired will also have an initial collateral evaluation completed in accordance with the guidance on impaired loans. An updated real estate valuation is ordered and the collateral evaluation is modified to reflect any variations in value. A specific allocation of allowance is made for any anticipated collateral shortfall. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charging off a residential mortgage loan begins when a loan becomes delinquent for 90 days and is not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans (including home equity loans and other consumer loans) are recommended for charge-off after reaching delinquency of 90 days and the loan is not in the process of collection. The collateral shortfall of the consumer loan is recommended for charge-off at this point.

MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

As noted above, Mid Penn assesses a specific allocation for commercial loans and commercial real estate loans. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In addition, Mid Penn takes a preemptive step when any commercial loan becomes classified under its internal classification system. A preliminary collateral evaluation, in accordance with the guidance on impaired loans, is prepared using the existing collateral information in the loan file. This process allows Mid Penn to review both the credit and documentation files to determine the status of the information needed to make a collateral evaluation. This collateral evaluation is preliminary but allows Mid Penn to determine if any potential collateral shortfalls exist.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate as soon as practically possible of the credit being classified as substandard nonaccrual. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance issues; however, no allowance recommendation will be made until such time Mid Penn is in receipt of the updated valuation. The Asset Recovery department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no material time lapses noted with the above processes.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction sales or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary.

For impaired loans with no valuation allowance required, Mid Penn's practice of obtaining independent third party market valuations on the subject property as soon as practically possible of the credit being placed on nonaccrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 12 months for possible revaluation by an independent third party.

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.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, Mid Penn does not separately identify individual residential mortgage loans, home equity loans and other consumer loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the borrowers have been granted 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. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for nine consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.



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. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful, and loss. Loans criticized as 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. Any loans not classified as noted above are rated pass.

In addition, Federal and State regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance and may require the Bank 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 loan losses is adequate.

#### Acquired Loans

Loans that Mid Penn acquires in connection with business combinations are recorded at fair value with no carryover of the existing related allowance for loan 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.

## MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

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 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 Mid Penn to evaluate the need for an additional allowance. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount which Mid Penn 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 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, Mid Penn 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 loan losses established at the acquisition date for acquired performing loans. An allowance for loan 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 Mid Penn expects to fully collect the new carrying value (i.e. fair value) of the loans. As such, Mid Penn 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.

The classes of the loan portfolio, summarized by the pass rating, (net of deferred fees and costs of \$203,000 as of September 30, 2016 and \$178,000 as of December 31, 2015), and the classified ratings of special mention, substandard, and doubtful within Mid Penn's internal risk rating system as of September 30, 2016 and December 31, 2015, are as follows:

(Dollars in thousands) September 30, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$ 165,931	\$ 581	\$ 1,563	\$ -	\$ 168,075
Commercial real estate	410,158	3,876	7,418	-	421,452
Commercial real estate - construction	55,646	1,673	-	-	57,319
Lease financing	506	-	-	-	506
Residential mortgage	102,886	320	1,277	-	104,483
Home equity	36,028	195	228	-	36,451
Consumer	3,198	-	-	-	3,198
	\$ 774,353	\$ 6,645	\$ 10,486	\$ -	\$ 791,484

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(Dollars in thousands) December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$ 158,302	\$ 1,289	\$ 670	\$ -	\$ 160,261
Commercial real estate	359,859	2,088	7,517	-	369,464
Commercial real estate - construction	65,665	2,403	-	-	68,068
Lease financing	727	-	-	-	727
Residential mortgage	101,507	475	1,361	-	103,343
Home equity	32,928	261	222	-	33,411
Consumer	3,917	-	-	-	3,917
	\$ 722,905	\$ 6,516	\$ 9,770	\$ -	\$ 739,191

MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

Impaired loans by loan portfolio class as of September 30, 2016 and December 31, 2015 are summarized as follows:

(Dollars in thousands)	September 30, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>With no related allowance recorded:</b>						
Commercial and industrial	\$6	\$ 42	\$ -	\$14	\$ 49	\$ -
<b>Commercial real estate:</b>						
Commercial real estate	773	1,825	-	1,023	2,020	-
Acquired with credit deterioration	972	972	-	931	931	-
<b>Residential mortgage:</b>						
Residential mortgage	847	884	-	1,329	1,434	-
Acquired with credit deterioration	380	380	-	400	400	-
Home equity	60	73	-	115	137	-
<b>With an allowance recorded:</b>						
Commercial and industrial	\$879	\$ 884	\$ 828	\$113	\$ 128	\$ 51
Commercial real estate	2,625	2,702	764	1,947	1,981	429
Residential mortgage	-	-	-	32	32	23
Home equity	30	49	2	-	-	-
<b>Total Impaired Loans:</b>						
Commercial and industrial	\$885	\$ 926	\$ 828	\$127	\$ 177	\$ 51
Commercial real estate	4,370	5,499	764	3,901	4,932	429
Residential mortgage	1,227	1,264	-	1,761	1,866	23
Home equity	90	122	2	115	137	-

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MID PENN BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

The average recorded investment of impaired loans and related interest income recognized for the three and nine months ended September 30, 2016 and 2015 are summarized as follows:

(Dollars in thousands)	Three Months Ended September 30, 2016		September 30, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded:</b>				
<b>Commercial and industrial:</b>				
Commercial and industrial	\$8	\$ -	\$ 18	\$ -
Acquired with credit deterioration	-	-	-	100
<b>Commercial real estate:</b>				
Commercial real estate	797	-	991	14
Acquired with credit deterioration	965	-	926	-
<b>Residential mortgage:</b>				
Residential mortgage	834	6	735	8
Acquired with credit deterioration	376	-	426	-
<b>Home equity:</b>				
Home equity	62	-	21	-
Acquired with credit deterioration	-	-	-	3
<b>With an allowance recorded:</b>				