

MID PENN BANCORP INC  
Form 10-Q  
August 11, 2017

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 June 30, 2017

OR

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

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

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

|   |  |
|---|--|
| Pennsylvania<br>(State or Other Jurisdiction of<br>Incorporation or Organization)             | 25-1666413<br>(I.R.S. Employer<br>Identification Number) |
| 349 Union Street<br><br>Millersburg, Pennsylvania<br>(Address of Principal Executive Offices) | 17061<br>(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”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check One).

|                            |                      |                          |                              |                            |
|----------------------------|----------------------|--------------------------|------------------------------|----------------------------|
| Large accelerated<br>filer | Accelerated<br>filer | Non-accelerated<br>filer | Smaller reporting<br>company | Emerging growth<br>company |
|----------------------------|----------------------|--------------------------|------------------------------|----------------------------|

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

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

As of August 11, 2017, the registrant had 4,238,423 shares of common stock outstanding.

MID PENN BANCORP, INC.

FORM 10-Q

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Signatures

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

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MID PENN BANCORP, INC.

## PART 1 – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| (Dollars in thousands, except share data)   | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| <b>ASSETS</b>   |                  |                      |
| Cash and due from banks   | \$25,246         | \$ 13,493            |
| Interest-bearing balances with other financial institutions                             | 2,813            | 2,003                |
| Federal funds sold  | 1,120            | 30,477               |
| Total cash and cash equivalents   | 29,179           | 45,973               |
| Investment securities available for sale, at fair value                                 | 111,353          | 133,625              |
| Investment securities held to maturity, at amortized cost (fair value \$71,199 and \$0) | 71,096           | —                    |
| Loans held for sale   | 2,369            | 1,959                |
| Loans and leases, net of unearned interest  | 862,307          | 813,924              |
| Less: Allowance for loan and lease losses   | (7,713 )         | (7,183 )             |
| Net loans and leases  | 854,594          | 806,741              |
| Bank premises and equipment, net  | 11,190           | 11,074               |
| Bank premises and equipment held for sale   | —                | 1,894                |
| Cash surrender value of life insurance  | 12,911           | 12,780               |
| Restricted investment in bank stocks  | 3,985            | 2,443                |
| Foreclosed assets held for sale   | —                | 224                  |
| Accrued interest receivable   | 3,991            | 3,928                |
| Deferred income taxes   | 3,396            | 4,286                |
| Goodwill  | 3,918            | 3,918                |
| Core deposit and other intangibles, net   | 486              | 539                  |
| Other assets  | 3,408            | 3,215                |
| Total Assets  | \$1,111,876      | \$ 1,032,599         |
| <b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>   |                  |                      |
| Deposits:   |                  |                      |
| Noninterest-bearing demand  | \$140,837        | \$ 122,811           |
| Interest-bearing demand   | 339,057          | 317,533              |
| Money Market  | 240,107          | 252,271              |
| Savings   | 63,232           | 60,163               |
| Time  | 204,235          | 182,595              |
| Total Deposits  | 987,468          | 935,373              |

|  |                    |                     |
|--|--------------------|---------------------|
| Short-term borrowings  | 21,468             | —                   |
| Long-term debt   | 13,467             | 13,581              |
| Subordinated debt  | 7,419              | 7,414               |
| Accrued interest payable   | 788                | 515                 |
| Other liabilities  | 5,630              | 5,249               |
| <b>Total Liabilities</b>   | <b>1,036,240</b>   | <b>962,132</b>      |
| <b>Shareholders' Equity:</b>   |                    |                     |
| Common stock, par value \$1.00; authorized 10,000,000 shares;<br>4,235,237 and 4,233,297 shares issued and outstanding at<br>June 30, 2017, and at December 31, 2016, respectively | 4,235              | 4,233               |
| Additional paid-in capital   | 40,775             | 40,688              |
| Retained earnings  | 31,637             | 28,399              |
| Accumulated other comprehensive loss   | (1,011 )           | (2,853 )            |
| <b>Total Shareholders' Equity</b>  | <b>75,636</b>      | <b>70,467</b>       |
| <b>Total Liabilities and Shareholders' Equity</b>  | <b>\$1,111,876</b> | <b>\$ 1,032,599</b> |

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   |              | Six Months Ended |               |
|--|----------------|--------------|------------------|---------------|
|  | Ended June 30, | 2016         | June 30,         | 2016          |
|  | 2017           |              | 2017             | 2016          |
| <b>INTEREST INCOME</b>   |                |              |                  |               |
| Interest and fees on loans and leases                                | \$9,949        | \$8,905      | \$19,651         | \$17,712      |
| Interest on interest-bearing balances                                | 5              | 2            | 7                | 9             |
| Interest and dividends on investment securities:                     |                |              |                  |               |
| U.S. Treasury and government agencies                                | 574            | 311          | 1,019            | 633           |
| State and political subdivision obligations, tax-exempt              | 264            | 548          | 580              | 1,012         |
| Other securities   | 64             | 78           | 107              | 172           |
| Interest on federal funds sold                                       | 23             | 15           | 74               | 18            |
| <b>Total Interest Income</b>   | <b>10,879</b>  | <b>9,859</b> | <b>21,438</b>    | <b>19,556</b> |
| <b>INTEREST EXPENSE</b>  |                |              |                  |               |
| Interest on deposits   | 1,277          | 1,092        | 2,481            | 2,131         |
| Interest on short-term borrowings                                    | 13             | 12           | 13               | 25            |
| Interest on long-term and subordinated debt                          | 179            | 222          | 359              | 452           |
| <b>Total Interest Expense</b>  | <b>1,469</b>   | <b>1,326</b> | <b>2,853</b>     | <b>2,608</b>  |
| <b>Net Interest Income</b>   | <b>9,410</b>   | <b>8,533</b> | <b>18,585</b>    | <b>16,948</b> |
| <b>PROVISION FOR LOAN AND LEASE LOSSES</b>                           | <b>100</b>     | <b>395</b>   | <b>225</b>       | <b>735</b>    |
| <b>Net Interest Income After Provision for Loan and Lease Losses</b> | <b>9,310</b>   | <b>8,138</b> | <b>18,360</b>    | <b>16,213</b> |
| <b>NONINTEREST INCOME</b>  |                |              |                  |               |
| Income from fiduciary activities                                     | 200            | 139          | 396              | 245           |
| Service charges on deposits  | 174            | 158          | 379              | 313           |
| Net gain on sales of investment securities                           | 12             | 213          | 20               | 213           |
| Earnings from cash surrender value of life insurance                 | 66             | 65           | 131              | 135           |
| Mortgage banking income  | 225            | 246          | 416              | 432           |
| ATM debit card interchange income                                    | 232            | 209          | 456              | 409           |
| Merchant services income   | 92             | 85           | 166              | 152           |
| Net gain on sales of SBA loans                                       | 157            | 75           | 441              | 265           |
| Other income   | 204            | 208          | 393              | 466           |
| <b>Total Noninterest Income</b>                                      | <b>1,362</b>   | <b>1,398</b> | <b>2,798</b>     | <b>2,630</b>  |
| <b>NONINTEREST EXPENSE</b>   |                |              |                  |               |
| Salaries and employee benefits                                       | 4,159          | 3,723        | 8,389            | 7,446         |
| Occupancy expense, net   | 593            | 499          | 1,241            | 1,046         |
| Equipment expense  | 370            | 411          | 751              | 846           |
| Pennsylvania bank shares tax expense                                 | 160            | 206          | 330              | 409           |
| FDIC Assessment  | 194            | 147          | 388              | 300           |
| Legal and professional fees  | 189            | 183          | 366              | 385           |
| Marketing and advertising expense                                    | 131            | 139          | 238              | 223           |
| Software licensing   | 370            | 334          | 699              | 665           |
| Telephone expense  | 133            | 143          | 259              | 285           |
| Loss on sale or write-down of foreclosed assets                      | 6              | 28           | 88               | 132           |
| Intangible amortization  | 24             | 34           | 53               | 71            |

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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Merger and acquisition expense              | 14      | —       | 224     | —       |
| Other expenses                              | 1,215   | 1,074   | 2,334   | 2,095   |
| Total Noninterest Expense                   | 7,558   | 6,921   | 15,360  | 13,903  |
| INCOME BEFORE PROVISION FOR INCOME TAXES    | 3,114   | 2,615   | 5,798   | 4,940   |
| Provision for income taxes                  | 769     | 593     | 1,459   | 1,113   |
| NET INCOME                                  | \$2,345 | \$2,022 | \$4,339 | \$3,827 |
| PER COMMON SHARE DATA:                      |         |         |         |         |
| Basic and Diluted Earnings Per Common Share | \$0.55  | \$0.48  | \$1.02  | \$0.91  |
| Cash Dividends Paid                         | \$0.13  | \$0.12  | \$0.36  | \$0.34  |

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<br>Ended June 30, |         |
|--|--------------------------------|---------|
|  | 2017                           | 2016    |
| Net income   | \$2,345                        | \$2,022 |
| Other comprehensive income:  |                                |         |
| Unrealized gains arising during the period on available-for-sale securities, net of income taxes of \$763 and \$955, respectively                                    | 1,480                          | 1,854   |
| Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of (\$4) and (\$73), respectively (a) | (8 )                           | (140 )  |
| Change in defined benefit plans, net of income taxes of (\$1) and (\$1), respectively (b)  | (1 )                           | (2 )    |
| Total other comprehensive income   | 1,471                          | 1,712   |
| Total comprehensive income   | \$3,816                        | \$3,734 |

| (Dollars in thousands)   | Six Months<br>Ended June 30, |         |
|--|------------------------------|---------|
|  | 2017                         | 2016    |
| Net income   | \$4,339                      | \$3,827 |
| Other comprehensive income:  |                              |         |
| Unrealized gains arising during the period on available-for-sale securities, net of income taxes of \$958 and \$1,144, respectively                                  | 1,859                        | 2,220   |
| Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of (\$7) and (\$73), respectively (a) | (13 )                        | (140 )  |
| Change in defined benefit plans, net of income taxes of (\$2) and (\$60), respectively (b)   | (4 )                         | (116 )  |
| Total other comprehensive income   | 1,842                        | 1,964   |
| Total comprehensive income   | \$6,181                      | \$5,791 |

(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 Six Months Ended June 30, 2017 and 2016

(Dollars in thousands)

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income | Total<br>Shareholders'<br>Equity |
|--|-----------------|----------------------------------|----------------------|--|----------------------------------|
| Balance, January 1, 2017                       | \$ 4,233        | \$ 40,688                        | \$ 28,399            | \$ (2,853 )  | \$ 70,467                        |
| Net income                                     | —               | —                                | 4,339                | —  | 4,339                            |
| Total other comprehensive income, net of taxes | —               | —                                | —                    | 1,842  | 1,842                            |
| Employee Stock Purchase Plan (1,940 shares)    | 2               | 50                               | —                    | —  | 52                               |
| Common stock dividends                         | —               | —                                | (1,101 )             | —  | (1,101 )                         |
| Restricted stock activity                      | —               | 37                               | —                    | —  | 37                               |
| Balance, June 30, 2017                         | \$ 4,235        | \$ 40,775                        | \$ 31,637            | \$ (1,011 )  | \$ 75,636                        |
| Balance, January 1, 2016                       | \$ 4,227        | \$ 40,559                        | \$ 23,470            | \$ 1,812   | \$ 70,068                        |
| Net income                                     | —               | —                                | 3,827                | —  | 3,827                            |
| Total other comprehensive income, net of taxes | —               | —                                | —                    | 1,964  | 1,964                            |
| Employee Stock Purchase Plan (2,289 shares)    | 2               | 33                               | —                    | —  | 35                               |
| Common stock dividends                         | —               | —                                | (1,437 )             | —  | (1,437 )                         |
| Restricted stock activity                      | —               | 17                               | —                    | —  | 17                               |
| Balance, June 30, 2016                         | \$ 4,229        | \$ 40,609                        | \$ 25,860            | \$ 3,776   | \$ 74,474                        |

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)  | Six Months Ended |                 |
|---|------------------|-----------------|
|   | June 30,<br>2017 | 2016            |
| <b>Operating Activities:</b>  |                  |                 |
| Net Income  | \$4,339          | \$3,827         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                 |
| Provision for loan and lease losses   | 225              | 735             |
| Depreciation  | 715              | 820             |
| Amortization of intangibles   | 53               | 71              |
| Net (accretion) amortization of security discounts/premiums                       | (742 )           | 11,330          |
| Gain on sales of investment securities  | (20 )            | (213 )          |
| Earnings on cash surrender value of life insurance                                | (131 )           | (135 )          |
| Mortgage loans originated for sale  | (23,234)         | (7,731 )        |
| Proceeds from sales of mortgage loans originated for sale                         | 23,240           | 8,163           |
| Gain on sale of mortgage loans  | (416 )           | (432 )          |
| SBA loans originated for sale   | (5,605 )         | (3,318 )        |
| Proceeds from sales of SBA loans originated for sale                              | 6,046            | 3,583           |
| Gain on sale of SBA loans   | (441 )           | (265 )          |
| Loss on disposal of property, plant, and equipment                                | 26               | —               |
| Loss on sale or write-down of foreclosed assets                                   | 88               | 132             |
| Restricted stock compensation expense   | 37               | 17              |
| Deferred income tax (benefit) expense   | (65 )            | 16              |
| Increase in accrued interest receivable   | (63 )            | (130 )          |
| (Increase) decrease in other assets   | (193 )           | 161             |
| Increase in accrued interest payable  | 273              | 308             |
| Increase in other liabilities   | 381              | 1,847           |
| <b>Net Cash Provided By Operating Activities</b>                                  | <b>4,513</b>     | <b>18,786</b>   |
| <b>Investing Activities:</b>  |                  |                 |
| Net decrease in interest-bearing time deposits with other financial institutions  | —                | 3,330           |
| Proceeds from the sale of available-for-sale securities                           | 37,667           | 38,501          |
| Proceeds from the maturity or call of available-for-sale securities               | 3,579            | 6,264           |
| Purchases of available-for-sale securities  | (13,827)         | (84,352 )       |
| Purchases of held-to-maturity securities  | (72,684)         | —               |
| (Purchases) redemptions of restricted investment in bank stock                    | (1,542 )         | 1,623           |
| Net increase in loans and leases  | (48,078)         | (30,054 )       |
| Proceeds from the sale of bank premises and equipment held for sale               | 2,201            | —               |
| Purchases of bank premises and equipment  | (1,164 )         | (319 )          |
| Proceeds from the sale of foreclosed assets                                       | 136              | 614             |
| <b>Net Cash Used In Investing Activities</b>                                      | <b>(93,712)</b>  | <b>(64,393)</b> |
| <b>Financing Activities:</b>  |                  |                 |
| Net increase in deposits  | 52,095           | 116,397         |
| Net increase (decrease) in short-term borrowings                                  | 21,468           | (31,596)        |

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|  |          |           |
|--|----------|-----------|
| Common stock dividend paid                           | (1,101 ) | (1,437 )  |
| Employee Stock Purchase Plan                         | 52       | 35        |
| Long-term debt repayment                             | (109 )   | (10,116 ) |
| Net Cash Provided By Financing Activities            | 72,405   | 73,283    |
| Net (decrease) increase in cash and cash equivalents | (16,794) | 27,676    |
| Cash and cash equivalents, beginning of period       | 45,973   | 13,284    |
| Cash and cash equivalents, end of period             | \$29,179 | \$40,960  |

MID PENN BANCORP, INC.

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

| (Dollars in thousands)                                    | Six Months     |         |
|---|----------------|---------|
|   | Ended June 30, |         |
|   | 2017           | 2016    |
| <b>Supplemental Disclosures of Cash Flow Information:</b> |                |         |
| Interest paid   | \$2,580        | \$2,300 |
| Income taxes paid   | \$2,190        | \$565   |
| <b>Supplemental Noncash Disclosures:</b>                  |                |         |
| Loan transfers to foreclosed assets held for sale         | \$-            | \$101   |

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

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 the Bank, 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 June 30, 2016 and December 31, 2016 balances have been reclassified, when, and if necessary, to conform to the 2017 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, 2016.

On March 29, 2017, Mid Penn announced the signing of a definitive merger agreement with The Scottdale Bank and Trust Company (“Scottdale”). Under the merger agreement, Scottdale will merge with and into Mid Penn Bank, with Mid Penn Bank as the surviving bank. Before the merger is completed, the shareholders of Mid Penn and Scottdale must approve and adopt the merger agreement, and customary regulatory approvals must be received. Refer to Note 12, Agreement and Plan of Merger, as well as Form 8-K filed on March 30, 2017, for more information.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2017, 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)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, pledging requirements, and other factors related to effective portfolio management. Securities to be held to maturity are carried at amortized cost.

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 are based on the difference between the amortized cost and fair value of each security as of the respective reporting date. Unrealized 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 for the respective period.

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, in addition to the credit condition of the underlying issuer, 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.

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 June 30, 2017, December 31, 2016, or June 30, 2016, 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.



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

The amortized cost, fair value, and unrealized gains and losses on investment securities at June 30, 2017 and December 31, 2016 are as follows:

| (Dollars in thousands)                      | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|---------------------|----------------------|---------------|
| <b>June 30, 2017</b>                        |                   |                     |                      |               |
| Available-for-sale securities:              |                   |                     |                      |               |
| U.S. Treasury and U.S. government agencies  | \$ 42,629         | \$ -                | \$ 858               | \$ 41,771     |
| Mortgage-backed U.S. government agencies    | 28,543            | 3                   | 307                  | 28,239        |
| State and political subdivision obligations | 39,539            | 70                  | 514                  | 39,095        |
| Corporate debt securities                   | 1,100             | 5                   | -                    | 1,105         |
| Equity securities                           | 1,168             | 15                  | 40                   | 1,143         |
| Total available-for-sale securities         | 112,979           | 93                  | 1,719                | 111,353       |
| Held-to-maturity securities:                |                   |                     |                      |               |
| U.S. Treasury and U.S. government agencies  | 10,984            | 24                  | 5                    | 11,003        |
| Mortgage-backed U.S. government agencies    | 51,248            | 72                  | 99                   | 51,221        |
| State and political subdivision obligations | 8,864             | 120                 | 9                    | 8,975         |
| Corporate debt securities                   | -                 | -                   | -                    | -             |
| Equity securities                           | -                 | -                   | -                    | -             |
| Total held-to-maturity securities           | 71,096            | 216                 | 113                  | 71,199        |
| Total                                       | \$ 184,075        | \$ 309              | \$ 1,832             | \$ 182,552    |

| (Dollars in thousands)                      | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|---------------------|----------------------|---------------|
| <b>December 31, 2016</b>                    |                   |                     |                      |               |
| Available-for-sale securities:              |                   |                     |                      |               |
| U.S. Treasury and U.S. government agencies  | \$ 48,520         | \$ 34               | \$ 1,542             | \$ 47,012     |
| Mortgage-backed U.S. government agencies    | 26,181            | 17                  | 579                  | 25,619        |
| State and political subdivision obligations | 61,079            | 91                  | 2,332                | 58,838        |
| Corporate debt securities                   | 1,100             | -                   | -                    | 1,100         |
| Equity securities                           | 1,168             | -                   | 112                  | 1,056         |
| Total available-for-sale securities         | \$ 138,048        | \$ 142              | \$ 4,565             | \$ 133,625    |

There were no held-to-maturity securities as of December 31, 2016.

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

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. Please refer to Note (4) – Fair Value Measurement for more information on the fair value of investment securities.

Investment securities having a fair value of \$126,032,000 at June 30, 2017 and \$131,469,000 at December 31, 2016, were pledged to secure public deposits and certain other borrowings.

Mid Penn realized gross gains and losses of \$77,000 and (\$65,000), respectively, on sales of securities available for sale during the three months ended June 30, 2017, while gross gains and losses of \$200,000 and (\$180,000), respectively, were realized on sales of securities available for sale during the six months ended June 30, 2017. Mid Penn realized gross gains and losses of \$450,000 and (\$237,000), respectively, on sales of securities available for sale during the six months ended June 30, 2016.

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 June 30, 2017 and December 31, 2016.

| (Dollars in thousands)                                   | Less Than 12 Months        |               |                      | 12 Months or More          |               |                      | Total                      |               |                      |
|--|----------------------------|---------------|----------------------|----------------------------|---------------|----------------------|----------------------------|---------------|----------------------|
|  | Number<br>of<br>Securities | Fair<br>Value | Unrealized<br>Losses | Number<br>of<br>Securities | Fair<br>Value | Unrealized<br>Losses | Number<br>of<br>Securities | Fair<br>Value | Unrealized<br>Losses |
| June 30, 2017  |                            |               |                      |                            |               |                      |                            |               |                      |
| Available-for-sale securities:                           |                            |               |                      |                            |               |                      |                            |               |                      |
| U.S. Treasury and U.S. government agencies               | 21                         | \$39,077      | \$ 852               | 1                          | \$2,694       | \$ 6                 | 22                         | \$41,771      | \$ 858               |
| Mortgage-backed U.S. government agencies                 | 18                         | 26,466        | 291                  | 1                          | 535           | 16                   | 19                         | 27,001        | 307                  |
| State and political subdivision obligations              | 48                         | 24,121        | 381                  | 7                          | 3,845         | 133                  | 55                         | 27,966        | 514                  |
| Equity securities  | 0                          | -             | -                    | 1                          | 550           | 40                   | 1                          | 550           | 40                   |
| Total temporarily impaired available-for-sale securities | 87                         | 89,664        | 1,524                | 10                         | 7,624         | 195                  | 97                         | 97,288        | 1,719                |
| Held-to-maturity securities:                             |                            |               |                      |                            |               |                      |                            |               |                      |
| U.S. Treasury and U.S. government agencies               | 2                          | 4,991         | 5                    | 0                          | -             | -                    | 2                          | 4,991         | 5                    |
| Mortgage-backed U.S. government agencies                 | 14                         | 22,879        | 99                   | 0                          | -             | -                    | 14                         | 22,879        | 99                   |
| State and political subdivision                          | 3                          | 1,536         | 9                    | 0                          | -             | -                    | 3                          | 1,536         | 9                    |

obligations

|   |     |           |         |    |         |       |     |           |         |
|---|-----|-----------|---------|----|---------|-------|-----|-----------|---------|
| Total temporarily<br>impaired<br>held-to-maturity<br>securities | 19  | 29,406    | 113     | 0  | -       | -     | 19  | 29,406    | 113     |
| Total   | 106 | \$119,070 | \$1,637 | 10 | \$7,624 | \$195 | 116 | \$126,694 | \$1,832 |

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

| (Dollars in thousands)                                   | Less Than 12 Months        |               |                      | 12 Months or More          |               |                      | Total                      |               |                      |
|--|----------------------------|---------------|----------------------|----------------------------|---------------|----------------------|----------------------------|---------------|----------------------|
|  | Number<br>of<br>Securities | Fair<br>Value | Unrealized<br>Losses | Number<br>of<br>Securities | Fair<br>Value | Unrealized<br>Losses | Number<br>of<br>Securities | Fair<br>Value | Unrealized<br>Losses |
| December 31, 2016  |                            |               |                      |                            |               |                      |                            |               |                      |
| Available-for-sale securities:                           |                            |               |                      |                            |               |                      |                            |               |                      |
| U.S. Treasury and U.S. government agencies               | 23                         | \$43,698      | \$ 1,542             | 0                          | \$-           | \$ -                 | 23                         | \$43,698      | \$ 1,542             |
| Mortgage-backed U.S. government agencies                 | 18                         | 24,321        | 579                  | 0                          | -             | -                    | 18                         | 24,321        | 579                  |
| State and political subdivision obligations              | 108                        | 50,582        | 2,332                | 0                          | -             | -                    | 108                        | 50,582        | 2,332                |
| Equity securities  | 0                          | -             | -                    | 2                          | 1,056         | 112                  | 2                          | 1,056         | 112                  |
| Total temporarily impaired available-for-sale securities | 149                        | \$118,601     | \$ 4,453             | 2                          | \$1,056       | \$ 112               | 151                        | \$119,657     | \$ 4,565             |

There were no held-to-maturity securities as of December 31, 2016.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such additional evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than amortized 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 were primarily caused by the movement of interest rates and not due to an erosion of credit quality of the underlying issuers.

At June 30, 2017, the majority of the unrealized losses on available-for-sale securities in an unrealized loss position were attributed to obligations of state and political subdivisions and U.S. Treasury and government agencies, while the majority of the unrealized losses on held-to-maturity securities in an unrealized loss position were attributed to mortgage-backed U.S. government agencies. At December 31, 2016, the majority of the unrealized losses on securities in an unrealized loss position were attributed to state and political subdivision obligations and U.S. Treasury and government agencies.

The table below illustrates the maturity distribution of investment securities at amortized cost and fair value as of June 30, 2017.

| (Dollars in thousands)                | Available-for-sale |            | Held-to-maturity |            |
|---------------------------------------|--------------------|------------|------------------|------------|
|                                       | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| June 30, 2017                         |                    |            |                  |            |
| Due in 1 year or less                 | \$1,293            | \$1,292    | \$-              | \$-        |
| Due after 1 year but within 5 years   | 20,311             | 20,178     | 14,486           | 14,546     |
| Due after 5 years but within 10 years | 47,618             | 46,801     | 5,362            | 5,432      |
| Due after 10 years                    | 14,046             | 13,700     | -                | -          |
|                                       | 83,268             | 81,971     | 19,848           | 19,978     |
| Mortgage-backed securities            | 28,543             | 28,239     | 51,248           | 51,221     |
| Equity securities                     | 1,168              | 1,143      | -                | -          |
|                                       | \$112,979          | \$111,353  | \$71,096         | \$71,199   |

### (3) 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, 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.

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

For all classes of loans, the accrual of interest generally 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 past due 90 days or more 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, is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Nonaccrual loans may be 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.

#### 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.

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

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 junior lien 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.

#### 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 \$127,000 at June 30, 2017 and \$120,000 at December 31, 2016. 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 by management to be 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 BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

The unallocated component of the allowance for loan and lease losses covers several considerations that are not specifically measurable through either the specific and general components. For example, we believe that we could face increasing credit risks and uncertainties, not yet reflected in recent historical losses or qualitative factor assessments, associated with unpredictable changes in economic growth or business conditions in our markets or for certain industries in which we have commercial loan borrowers, or unanticipated stresses to the values of real estate held as collateral. Any or all of these additional issues can adversely affect our borrowers' ability to timely repay their loans. Additionally, we have experienced continued strong commercial loan growth, including growth in newer markets where we have less of a loss history. Also, the unallocated component allocation recognizes the inherent imprecision in our allowance for loan and lease loss methodology, or any alternative methodology, for estimating specific and general loan losses, including the unpredictable timing and amounts of charge-offs, the fact that historical loss averages don't necessarily correlate to future loss trends, and unexpected changes to specific-credit or general portfolio future cash flows and collateral values which could negatively impact unimpaired portfolio loss factors.

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 well-secured or otherwise not probable for collection. The collateral shortfall of the consumer loan is recommended for charge-off at this point.

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.

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

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.

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.

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

The classes of the loan portfolio, summarized by the pass rating (net of deferred fees and costs of \$435,000 as of June 30, 2017 and \$196,000 as of December 31, 2016), and the classified ratings of special mention, substandard, and doubtful within Mid Penn's internal risk rating system as of June 30, 2017 and December 31, 2016, are as follows:

| (Dollars in thousands)                | Special    |          |             |          |            |
|---------------------------------------|------------|----------|-------------|----------|------------|
| June 30, 2017                         | Pass       | Mention  | Substandard | Doubtful | Total      |
| Commercial and industrial             | \$ 175,700 | \$ 4,385 | \$ 1,283    | \$ -     | \$ 181,368 |
| Commercial real estate                | 473,078    | 1,757    | 7,306       | -        | 482,141    |
| Commercial real estate - construction | 52,543     | 191      | 571         | -        | 53,305     |
| Lease financing                       | 307        | -        | -           | -        | 307        |
| Residential mortgage                  | 101,186    | 102      | 1,349       | -        | 102,637    |
| Home equity                           | 38,154     | 124      | 393         | -        | 38,671     |
| Consumer                              | 3,878      | -        | -           | -        | 3,878      |
|                                       | \$ 844,846 | \$ 6,559 | \$ 10,902   | \$ -     | \$ 862,307 |

| (Dollars in thousands)                | Special    |          |             |          |            |
|---------------------------------------|------------|----------|-------------|----------|------------|
| December 31, 2016                     | Pass       | Mention  | Substandard | Doubtful | Total      |
| Commercial and industrial             | \$ 170,780 | \$ 937   | \$ 801      | \$ -     | \$ 172,518 |
| Commercial real estate                | 437,592    | 1,683    | 7,249       | -        | 446,524    |
| Commercial real estate - construction | 52,888     | 202      | 1,286       | -        | 54,376     |
| Lease financing                       | 425        | -        | -           | -        | 425        |
| Residential mortgage                  | 97,994     | 107      | 1,356       | -        | 99,457     |
| Home equity                           | 37,242     | 142      | 224         | -        | 37,608     |
| Consumer                              | 3,016      | -        | -           | -        | 3,016      |
|                                       | \$ 799,937 | \$ 3,071 | \$ 10,916   | \$ -     | \$ 813,924 |

Impaired loans by loan portfolio class as of June 30, 2017 and December 31, 2016 are summarized as follows:

| (Dollars in thousands)                     | June 30, 2017          |                                |                      | December 31, 2016      |                                |                      |
|--|------------------------|--------------------------------|----------------------|------------------------|--------------------------------|----------------------|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| <b>With no related allowance recorded:</b> |                        |                                |                      |                        |                                |                      |
| Commercial and industrial                  | \$-                    | \$ 18                          | \$ -                 | \$ 4                   | \$ 9                           | \$ -                 |
| <b>Commercial real estate:</b>             |                        |                                |                      |                        |                                |                      |
| Commercial real estate                     | 900                    | 1,390                          | -                    | 726                    | 1,792                          | -                    |
| Acquired with credit deterioration         | 573                    | 573                            | -                    | 842                    | 842                            | -                    |
| Commercial real estate - construction      | 331                    | 334                            | -                    | 618                    | 618                            | -                    |
| <b>Residential mortgage:</b>               |                        |                                |                      |                        |                                |                      |
| Residential mortgage                       | 902                    | 931                            | -                    | 848                    | 882                            | -                    |
| Acquired with credit deterioration         | 324                    | 324                            | -                    | 389                    | 389                            | -                    |
| Home equity                                | 327                    | 369                            | -                    | 111                    | 129                            | -                    |

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With an allowance recorded:

|                                       |       |       |      |       |       |      |
|---------------------------------------|-------|-------|------|-------|-------|------|
| Commercial and industrial             | \$-   | \$ -  | \$ - | \$56  | \$ 62 | \$ 6 |
| Commercial real estate                | 2,751 | 2,915 | 893  | 2,520 | 2,646 | 711  |
| Commercial real estate - construction | 240   | 242   | 70   | 242   | 242   | 72   |
| Residential mortgage                  | 66    | 68    | 66   | 68    | 68    | 68   |
| Home equity                           | -     | -     | -    | 29    | 49    | 1    |

Total Impaired Loans:

|                                       |       |       |      |       |       |      |
|---------------------------------------|-------|-------|------|-------|-------|------|
| Commercial and industrial             | \$-   | \$ 18 | \$ - | \$60  | \$ 71 | \$ 6 |
| Commercial real estate                | 4,224 | 4,878 | 893  | 4,088 | 5,280 | 711  |
| Commercial real estate - construction | 571   | 576   | 70   | 860   | 860   | 72   |
| Residential mortgage                  | 1,292 | 1,323 | 66   | 1,305 | 1,339 | 68   |
| Home equity                           | 327   | 369   | -    | 140   | 178   | 1    |

## 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 six months ended June 30, 2017 and 2016 are summarized as follows:

| (Dollars in thousands)                     | Three Months Ended<br>June 30, 2017        |                      | June 30, 2016                              |                      |
|--|--|----------------------|--|----------------------|
|  | Average Interest<br>Recorded<br>Investment | Income<br>Recognized | Average Interest<br>Recorded<br>Investment | Income<br>Recognized |
| <b>With no related allowance recorded:</b> |  |                      |  |                      |
| Commercial and industrial                  | \$36                                       | \$ -                 | \$11                                       | \$ -                 |
| <b>Commercial real estate:</b>             |  |                      |  |                      |
| Commercial real estate                     | 644  | -                    | 960  | -                    |
| Acquired with credit deterioration         | 644  | 110                  | 943  | -                    |
| Commercial real estate - construction      | 473  | -                    | -  | -                    |
| Lease financing                            | -  | -                    | -  | -                    |
| <b>Residential mortgage:</b>               |  |                      |  |                      |
| Residential mortgage                       | 860  | 7                    | 831  | 7                    |
| Acquired with credit deterioration         | 326  | 2                    | 377  | -                    |
| <b>Home equity:</b>                        |  |                      |  |                      |
| Home equity                                | 90   | -                    | -  | -                    |
| Acquired with credit deterioration         | -  | -                    | -  | -                    |
| Consumer                                   | -  | -                    | -  | -                    |
| <b>With an allowance recorded:</b>         |  |                      |  |                      |
| Commercial and industrial                  | \$-  | \$ -                 | \$59                                       | \$ -                 |
| Commercial real estate                     | 2,792                                      | -                    | 2,201                                      | -                    |
| Commercial real estate - construction      | 240  | -                    | -  | -                    |
| Lease financing                            | -  | -                    | -  | -                    |
| Residential mortgage                       | 66   | -                    | -  | -                    |
| Home equity                                | -  | -                    | 17   | -                    |
| Consumer                                   | -  | -                    | -  | -                    |
| <b>Total Impaired Loans:</b>               |  |                      |  |                      |
| Commercial and industrial                  | \$36                                       | \$ -                 | \$70                                       | \$ -                 |
| Commercial real estate                     | 4,080                                      | 110                  | 4,104                                      | -                    |
| Commercial real estate - construction      | 713  | -                    | -  | -                    |
| Lease financing                            | -  | -                    | -  | -                    |
| Residential mortgage                       | 1,252                                      | 9                    | 1,208                                      | 7                    |
| Home equity                                | 90   | -                    | 83   | -                    |





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

| (Dollars in thousands)                     | Six Months Ended |                           | June 30, 2016 |                           |
|--|------------------|---------------------------|---------------|---------------------------|
|  | June 30, 2017    | Average Interest Recorded | June 30, 2016 | Average Interest Recorded |
|  | Investment       | Recognized                | Investment    | Recognized                |
| <b>With no related allowance recorded:</b> |                  |                           |               |                           |
| Commercial and industrial                  | \$18             | \$ -                      | \$14          | \$ -                      |
| <b>Commercial real estate:</b>             |                  |                           |               |                           |
| Commercial real estate                     | 524              | 279                       | 1,001         | -                         |
| Acquired with credit deterioration         | 738              | 110                       | 934           | -                         |
| Commercial real estate - construction      | 313              | -                         | -             | -                         |
| Lease financing                            | -                | -                         | -             | -                         |
| <b>Residential mortgage:</b>               |                  |                           |               |                           |
| Residential mortgage                       | 843              | 18                        | 777           | 9                         |
| Acquired with credit deterioration         | 350              | -                         | 375           | 4                         |
| Home equity                                | 101              | 2                         | 53            | -                         |
| Consumer                                   | -                | -                         | -             | -                         |
| <b>With an allowance recorded:</b>         |                  |                           |               |                           |
| Commercial and industrial                  | \$-              | \$ -                      | \$61          | \$ -                      |
| Commercial real estate                     | 2,660            | -                         | 1,851         | -                         |
| Commercial real estate - construction      | 144              | -                         | -             | -                         |
| Lease financing                            | -                | -                         | -             | -                         |
| Residential mortgage                       | 40               | -                         | -             | -                         |
| Home equity                                | -                | -                         | 19            | -                         |
| Consumer                                   | -                | -                         | -             | -                         |
| <b>Total Impaired Loans:</b>               |                  |                           |               |                           |
| Commercial and industrial                  | \$18             | \$ -                      | \$75          | \$ -                      |
| Commercial real estate                     | 3,922            | 389                       | 3,786         | -                         |
| Commercial real estate - construction      | 457              | -                         | -             | -                         |
| Lease financing                            | -                | -                         | -             | -                         |
| Residential mortgage                       | 1,233            | 18                        | 1,152         | 13                        |
| Home equity                                | 101              | 2                         | 72            | -                         |

Nonaccrual loans by loan portfolio class as of June 30, 2017 and December 31, 2016 are summarized as follows:

| (Dollars in thousands)                | June 30, 2017 | December 31, 2016 |
|---------------------------------------|---------------|-------------------|
| Commercial and industrial             | \$ -          | \$ 4              |
| Commercial real estate                | 3,630         | 2,939             |
| Commercial real estate - construction | 571           | 860               |
| Residential mortgage                  | 690           | 715               |

|             |         |          |
|-------------|---------|----------|
| Home equity | 327     | 140      |
|             | \$5,218 | \$ 4,658 |

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

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The classes of the loan portfolio summarized by the past due status as of June 30, 2017 and December 31, 2016 are summarized as follows:

| (Dollars in thousands)                | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days | Total<br>Past<br>Due | Current    | Total Loans | Loans<br>Receivable ><br>90 Days and<br>Accruing |
|---------------------------------------|------------------------------|------------------------------|----------------------------|----------------------|------------|-------------|--|
| June 30, 2017                         |                              |                              |                            |                      |            |             |  |
| Commercial and industrial             | \$ 101                       | \$ 4,083                     | \$ -                       | \$ 4,184             | \$ 177,184 | \$ 181,368  | \$ -   |
| Commercial real estate:               |                              |                              |                            |                      |            |             |  |
| Commercial real estate                | 250                          | 43                           | 2,502                      | 2,795                | 478,773    | 481,568     | -  |
| Acquired with credit deterioration    | 516                          | -                            | 57                         | 573                  | -          | 573         | 57   |
| Commercial real estate - construction | 371                          | 120                          | 451                        | 942                  | 52,363     | 53,305      | -  |
| Lease financing                       | -                            | -                            | -                          | -                    | 307        | 307         | -  |
| Residential mortgage:                 |                              |                              |                            |                      |            |             |  |
| Residential mortgage                  | 174                          | -                            | 299                        | 473                  | 101,840    | 102,313     | -  |
| Acquired with credit deterioration    | 32                           | -                            | 226                        | 258                  | 66         | 324         | -  |
| Home equity                           | 13                           | -                            | 298                        | 311                  | 38,360     | 38,671      | -  |
| Consumer                              | -                            | -                            | -                          | -                    | 3,878      | 3,878       | -  |
| Total                                 | \$ 1,457                     | \$ 4,246                     | \$ 3,833                   | \$ 9,536             | \$ 852,771 | \$ 862,307  | \$ 57  |

| (Dollars in thousands)                | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days | Total<br>Past<br>Due | Current    | Total Loans | Loans<br>Receivable ><br>90 Days and<br>Accruing |
|---------------------------------------|------------------------------|------------------------------|----------------------------|----------------------|------------|-------------|--|
| December 31, 2016                     |                              |                              |                            |                      |            |             |  |
| Commercial and industrial             | \$ 164                       | \$ 12                        | \$ 4                       | \$ 180               | \$ 172,338 | \$ 172,518  | \$ -   |
| Commercial real estate:               |                              |                              |                            |                      |            |             |  |
| Commercial real estate                | 475                          | -                            | 1,004                      | 1,479                | 444,203    | 445,682     | -  |
| Acquired with credit deterioration    | -                            | -                            | 59                         | 59                   | 783        | 842         | 59   |
| Commercial real estate - construction | -                            | 404                          | 84                         | 488                  | 53,888     | 54,376      | -  |
| Lease financing                       | -                            | -                            | -                          | -                    | 425        | 425         | -  |
| Residential mortgage:                 |                              |                              |                            |                      |            |             |  |
| Residential mortgage                  | 548                          | 124                          | 237                        | 909                  | 98,159     | 99,068      | -  |
| Acquired with credit deterioration    | -                            | -                            | 238                        | 238                  | 151        | 389         | -  |
| Home equity                           | 33                           | 13                           | 125                        | 171                  | 37,437     | 37,608      | -  |
| Consumer                              | -                            | -                            | -                          | -                    | 3,016      | 3,016       | -  |
| Total                                 | \$ 1,220                     | \$ 553                       | \$ 1,751                   | \$ 3,524             | \$ 810,400 | \$ 813,924  | \$ 59  |



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

The following tables summarize the allowance and recorded investments in loans receivable.

(Dollars in thousands)

| As of, and for the<br>months ended, June 30, 2017 | Commercial                      |                              |  |                    |                         |                |          |             | Unallocated | Total |
|---|---------------------------------|------------------------------|--|--------------------|-------------------------|----------------|----------|-------------|-------------|-------|
|   | Commercial<br>and<br>industrial | Commercial<br>real<br>estate | Commercial<br>real<br>estate -<br>construction | Lease<br>financing | Residential<br>mortgage | Home<br>equity | Consumer | Unallocated |             |       |
| Allowance for loan and lease losses:              |                                 |                              |  |                    |                         |                |          |             |             |       |
| Beginning balance, April 1, 2017                  | \$ 1,630                        | \$ 4,715                     | \$ 101   | \$ 1               | \$ 532                  | \$ 364         | \$ 3     | \$ 274      | \$ 7,620    |       |
| Charge-offs                                       | -                               | (30 )                        | -  | -                  | -                       | -              | (10 )    | -           | (40 )       |       |
| Recoveries  | 3                               | 22                           | -  | -                  | 2                       | 5              | 1        | -           | 33          |       |
| Provisions  | (5 )                            | 274                          | 39   | -                  | 5                       | 35             | 10       | (258 )      | 100         |       |
| Ending balance, June 30, 2017                     | \$ 1,628                        | \$ 4,981                     | \$ 140   | \$ 1               | \$ 539                  | \$ 404         | \$ 4     | \$ 16       | \$ 7,713    |       |

(Dollars in thousands)

| As of, and for the<br>six<br>months<br>ended, June 30,<br>2017 | Commercial                      |                              |  |                    |                         |                |          |             | Unallocated | Total |
|--|---------------------------------|------------------------------|--|--------------------|-------------------------|----------------|----------|-------------|-------------|-------|
|  | Commercial<br>and<br>industrial | Commercial<br>real<br>estate | Commercial<br>real<br>estate -<br>construction | Lease<br>financing | Residential<br>mortgage | Home<br>equity | Consumer | Unallocated |             |       |
| Allowance for loan and lease losses:                           |                                 |                              |  |                    |                         |                |          |             |             |       |
| Beginning balance, January 1, 2017                             | \$ 1,580                        | \$ 4,323                     | \$ 144   | \$ 1               | \$ 541                  | \$ 379         | \$ 3     | \$ 212      | \$ 7,183    |       |
| Charge-offs  | (12 )                           | (30 )                        | -  | -                  | (18 )                   | -              | (16 )    | -           | (76 )       |       |
| Recoveries   | 7                               | 361                          | -  | -                  | 4                       | 5              | 4        | -           | 381         |       |
| Provisions   | 53                              | 327                          | (4 )   | -                  | 12                      | 20             | 13       | (196 )      | 225         |       |
| Ending balance, June 30, 2017                                  | 1,628                           | 4,981                        | 140  | 1                  | 539                     | 404            | 4        | 16          | 7,713       |       |
| Ending balance: individually evaluated for impairment          | -                               | 893                          | 70   | -                  | 66                      | -              | -        | -           | 1,029       |       |
| Ending balance: collectively evaluated for impairment          | \$ 1,628                        | \$ 4,088                     | \$ 70  | \$ 1               | \$ 473                  | \$ 404         | \$ 4     | \$ 16       | \$ 6,684    |       |
| Loans receivables:   |                                 |                              |  |                    |                         |                |          |             |             |       |
| Ending balance   | \$ 181,368                      | \$ 482,141                   | \$ 53,305                                      | \$ 307             | \$ 102,637              | \$ 38,671      | \$ 3,878 | \$ -        | \$ 862,307  |       |
| Ending balance:  |                                 |                              |  |                    |                         |                |          |             |             |       |

|  |            |            |           |        |            |           |          |      |            |
|--|------------|------------|-----------|--------|------------|-----------|----------|------|------------|
| individually<br>evaluated for<br>impairment                    | -          | 3,651      | 571       | -      | 968        | 327       | -        | -    | 5,517      |
| Ending balance:<br>acquired with<br>credit deterioration       | -          | 573        | -         | -      | 324        | -         | -        | -    | 897        |
| Ending balance:<br>collectively<br>evaluated for<br>impairment | \$ 181,368 | \$ 477,917 | \$ 52,734 | \$ 307 | \$ 101,345 | \$ 38,344 | \$ 3,878 | \$ - | \$ 855,893 |

(Dollars in thousands)

| As of, and for the<br>months ended, June 30, 2016 | Commercial               |                           |   |                                  |                                       |                              |                        |                           |            | Total    |
|---|--------------------------|---------------------------|---|----------------------------------|---------------------------------------|------------------------------|------------------------|---------------------------|------------|----------|
|   | Commercial<br>industrial | Commercial<br>real estate | Commercial<br>real estate -<br>construction | Commercial<br>Lease<br>financing | Commercial<br>Residential<br>mortgage | Commercial<br>Home<br>equity | Commercial<br>Consumer | Commercial<br>Unallocated | Commercial |          |
| Allowance for loan and lease<br>losses:           |                          |                           |   |                                  |                                       |                              |                        |                           |            |          |
| Beginning balance,<br>April 1, 2016               | \$ 1,427                 | \$ 3,777                  | \$ 119                                      | \$ 1                             | \$ 516                                | \$ 303                       | \$ 9                   | \$ 287                    |            | \$ 6,439 |
| Charge-offs                                       | -                        | (54 )                     | -   | -                                | -                                     | (25 )                        | (7 )                   | -                         |            | (86 )    |
| Recoveries  | 1                        | 136                       | -   | -                                | 25                                    | -                            | 2                      | -                         |            | 164      |
| Provisions  | (56 )                    | 382                       | 1   | -                                | (20 )                                 | 47                           | 5                      | 36                        |            | 395      |
| Ending balance,<br>June 30, 2016                  | \$ 1,372                 | \$ 4,241                  | \$ 120                                      | \$ 1                             | \$ 521                                | \$ 325                       | \$ 9                   | \$ 323                    |            | \$ 6,912 |

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

(Dollars in thousands)

As of, and for the six months ended, June 30, 2016

|   | Commercial and industrial | Commercial real estate - real estate | Commercial real estate - construction | Lease financing | Residential mortgage | Home equity | Consumer | Unallocated | Total      |
|---|---------------------------|--------------------------------------|---------------------------------------|-----------------|----------------------|-------------|----------|-------------|------------|
| Allowance for loan and lease losses:                  |                           |                                      |                                       |                 |                      |             |          |             |            |
| Beginning balance, January 1, 2016                    | \$ 1,393                  | \$ 3,552                             | \$ 153                                | \$ 1            | \$ 534               | \$ 317      | \$ 12    | \$ 206      | \$ 6,168   |
| Charge-offs   | -                         | (150 )                               | -                                     | -               | -                    | (25 )       | (10 )    | -           | (185 )     |
| Recoveries  | 2                         | 161                                  | -                                     | -               | 25                   | -           | 6        | -           | 194        |
| Provisions  | (23 )                     | 678                                  | (33 )                                 | -               | (38 )                | 33          | 1        | 117         | 735        |
| Ending balance, June 30, 2016                         | 1,372                     | 4,241                                | 120                                   | 1               | 521                  | 325         | 9        | 323         | 6,912      |
| Ending balance: individually evaluated for impairment | 3                         | 769                                  | -                                     | -               | -                    | 2           | -        | -           | 774        |
| Ending balance: collectively evaluated for impairment | \$ 1,369                  | \$ 3,472                             | \$ 120                                | \$ 1            | \$ 521               | \$ 323      | \$ 9     | \$ 323      | \$ 6,138   |
| Loans receivables:                                    |                           |                                      |                                       |                 |                      |             |          |             |            |
| Ending balance  | \$ 160,278                | \$ 410,786                           | \$ 56,074                             | \$ 565          | \$ 103,822           | \$ 34,579   | \$ 3,049 | \$ -        | \$ 769,153 |
| Ending balance: individually evaluated for impairment | 68                        | 3,657                                | -                                     | -               | 824                  | 81          | -        | -           | 4,630      |
| Ending balance: acquired with credit deterioration    | -                         | 951                                  | -                                     | -               | 370                  | -           | -        | -           | 1,321      |
| Ending balance: collectively evaluated for impairment | \$ 160,210                | \$ 406,178                           | \$ 56,074                             | \$ 565          | \$ 102,628           | \$ 34,498   | \$ 3,049 | \$ -        | \$ 763,202 |

(Dollars in thousands)

|                   | Commercial and industrial | Commercial real estate - real estate | Commercial real estate - construction | Lease financing | Residential mortgage | Home equity | Consumer | Unallocated | Total |
|-------------------|---------------------------|--------------------------------------|---------------------------------------|-----------------|----------------------|-------------|----------|-------------|-------|
| December 31, 2016 |                           |                                      |                                       |                 |                      |             |          |             |       |



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|                                       |            |            |           |        |           |           |          |        |            |
|---------------------------------------|------------|------------|-----------|--------|-----------|-----------|----------|--------|------------|
| Allowance for loan and lease losses:  |            |            |           |        |           |           |          |        |            |
| Ending balance                        | \$ 1,580   | \$ 4,323   | \$ 144    | \$ 1   | \$ 541    | \$ 379    | \$ 3     | \$ 212 | \$ 7,183   |
| Ending balance:                       |            |            |           |        |           |           |          |        |            |
| individually evaluated for impairment |            |            |           |        |           |           |          |        |            |
|                                       | 6          | 711        | 72        | -      | 68        | 1         | -        | -      | 858        |
| Ending balance:                       |            |            |           |        |           |           |          |        |            |
| collectively evaluated for impairment |            |            |           |        |           |           |          |        |            |
|                                       | \$ 1,574   | \$ 3,612   | \$ 72     | \$ 1   | \$ 473    | \$ 378    | \$ 3     | \$ 212 | \$ 6,325   |
| Loans receivable:                     |            |            |           |        |           |           |          |        |            |
| Ending balance                        | \$ 172,518 | \$ 446,524 | \$ 54,376 | \$ 425 | \$ 99,457 | \$ 37,608 | \$ 3,016 | \$ -   | \$ 813,924 |
| Ending balance:                       |            |            |           |        |           |           |          |        |            |
| individually evaluated                |            |            |           |        |           |           |          |        |            |
| for impairment                        | 60         | 3,246      | 860       | -      | 916       | 140       | -        | -      | 5,222      |
| Ending balance:                       |            |            |           |        |           |           |          |        |            |
| acquired with credit deterioration    |            |            |           |        |           |           |          |        |            |
|                                       | -          | 842        | -         | -      | 389       | -         | -        | -      | 1,231      |
| Ending balance:                       |            |            |           |        |           |           |          |        |            |
| collectively evaluated                |            |            |           |        |           |           |          |        |            |
| for impairment                        | \$ 172,458 | \$ 442,436 | \$ 53,516 | \$ 425 | \$ 98,152 | \$ 37,468 | \$ 3,016 | \$ -   | \$ 807,471 |

The recorded investments in troubled debt restructured loans at June 30, 2017 and December 31, 2016 are as follows:

|                        | (Dollars in thousands)       |                               | Recorded Investment |
|------------------------|------------------------------|-------------------------------|---------------------|
|                        | Pre-Modification Outstanding | Post-Modification Outstanding |                     |
| June 30, 2017          |                              |                               |                     |
| Commercial real estate | \$ 3,457                     | \$ 4,003                      | \$ 2,407            |
| Residential mortgage   | 759                          | 743                           | 623                 |
|                        | \$ 4,216                     | \$ 4,746                      | \$ 3,030            |

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

| (Dollars in thousands)    | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Recorded<br>Investment |
|---------------------------|---|--|------------------------|
| December 31, 2016         |   |  |                        |
| Commercial and industrial | \$ 40   | \$ 35  | \$ 5                   |
| Commercial real estate    | 4,569   | 4,031  | 2,871                  |
| Residential mortgage      | 759   | 757  | 639                    |
|                           | \$ 5,368  | \$ 4,823   | \$ 3,515               |

Mid Penn entered into forbearance or modification agreements on all loans currently classified as troubled debt restructures and all of these agreements have resulted in additional principal repayment. The terms of these forbearance agreements vary whereby principal payments have been decreased, interest rates have been reduced and/or the loan will be repaid as collateral is sold.

Mid Penn had troubled debt restructured loans at June 30, 2017 totaling \$3,030,000. Four loans totaling \$557,000 represented accruing impaired residential loans to unrelated borrowers in compliance with the terms of the modification, with one loan comprising \$503,000 of this total. The remaining \$2,473,000 representing ten loans among four relationships are nonaccrual impaired loans based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$2,057,000 of the total \$2,473,000 in nonaccrual impaired troubled debt restructured loans.

At December 31, 2016, Mid Penn's troubled debt restructured loans totaled \$3,515,000, of which five loans totaling \$877,000 represented accruing impaired loans in compliance with the terms of the modification. Of the \$877,000, four are accruing impaired residential mortgages to unrelated borrowers totaling \$571,000 and the other one is an accruing impaired commercial real estate loan for \$306,000. The remaining \$2,638,000 representing ten loans among four relationships are nonaccrual impaired loans based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships account for \$2,170,000 of the \$2,638,000 nonaccrual impaired troubled debt restructured loan total.

As a result of management evaluations at June 30, 2017, June 30, 2016, and December 31, 2016, any specific allocations and charge-offs have been taken as appropriate. During the periods ended June 30, 2017 and June 30, 2016, there were no charge-offs associated with troubled debt restructured loans under forbearance agreements. There were no troubled debt restructured loans that defaulted within twelve months of restructure during the three and six months ended June 30, 2017 and 2016.

There were no additional troubled debt restructured loans added during the three and six months ended June 30, 2017 and 2016.

As of June 30, 2017, Mid Penn had no residential real estate held in other real estate owned. There were three consumer mortgage loans secured by residential real estate properties totaling \$140,000 for which formal foreclosure proceedings were in process. As of December 31, 2016, Mid Penn had \$57,000 of residential real estate held in other real estate owned, and no loans for which formal foreclosure proceedings were in process.



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

The following tables provide activity for the accretable yield of acquired impaired loans for the three and six months ended June 30, 2017.

(Dollars in thousands)

|  |      |
|--|------|
| Accretable yield, April 1, 2017                    | \$80 |
| Accretable yield amortized to interest income      | (12) |
| Reclassification from nonaccretable difference (a) | -    |
| Accretable yield, June 30, 2017                    | \$68 |

(Dollars in thousands)

|  |      |
|--|------|
| Accretable yield, January 1, 2017                  | \$67 |
| Accretable yield amortized to interest income      | (22) |
| Reclassification from nonaccretable difference (a) | 23   |
| Accretable yield, June 30, 2017                    | \$68 |

(a) Reclassification from non-accretable difference represents an increase to the estimated cash flows to be collected on the underlying portfolio.

#### (4) Fair Value Measurement

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance provides additional information on determining when the volume and level of activity for the asset or liability has significantly decreased. The guidance also includes information on identifying circumstances when a transaction may not be considered orderly.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with the fair value measurement and disclosure guidance.

This guidance clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Inputs to valuation techniques refer to the assumptions that market participants would use in measuring the fair value of an asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants

would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. Fair value measurement and disclosure guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. An asset's or liability's placement in the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement or disclosure. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Inputs - Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 Inputs - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

There were no transfers of assets between fair value Level 1 and Level 2 for the six months ended June 30, 2017 and 2016.

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

The following tables illustrate the assets measured at fair value on a recurring basis segregated by hierarchy fair value levels.

| (Dollars in thousands)                      |                   | Fair value measurements at June 30, 2017 using: |   |   |
|---|-------------------|---|---|---|
|   |                   | Quoted prices in active markets (Level 1)       | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|   |                   | Total carrying value at June 30, 2017           |   |   |
| Assets:                                     |                   |   |   |   |
| Available-for-sale securities:              |                   |   |   |   |
| U.S. Treasury and U.S. government agencies  | \$ 41,771         | \$-   | \$41,771                                      | \$ -                                      |
| Mortgage-backed U.S. government agencies    | 28,239            | -   | 28,239  | -   |
| State and political subdivision obligations | 39,095            | -   | 39,095  | -   |
| Corporate debt securities                   | 1,105             |   | 1,105   |   |
| Equity securities                           | 1,143             | 1,143   | -   | -   |
| <b>Total</b>                                | <b>\$ 111,353</b> | <b>\$1,143</b>                                  | <b>\$ 110,210</b>                             | <b>\$ -</b>                               |

| (Dollars in thousands)                      |                   | Fair value measurements at December 31, 2016 using: |   |   |
|---|-------------------|---|---|---|
|   |                   | Quoted prices in active markets (Level 1)           | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|   |                   | Total carrying value at December 31, 2016           |   |   |
| Assets:                                     |                   |   |   |   |
| Available-for-sale securities:              |                   |   |   |   |
| U.S. Treasury and U.S. government agencies  | \$ 47,012         | \$1,864   | \$45,148                                      | \$ -                                      |
| Mortgage-backed U.S. government agencies    | 25,619            | -   | 25,619  | -   |
| State and political subdivision obligations | 58,838            | -   | 58,838  | -   |
| Corporate debt securities                   | 1,100             | -   | 1,100   |   |
| Equity securities                           | 1,056             | 1,056   | -   | -   |
| <b>Total</b>                                | <b>\$ 133,625</b> | <b>\$2,920</b>                                      | <b>\$ 130,705</b>                             | <b>\$ -</b>                               |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following tables illustrate the assets measured at fair value on a nonrecurring basis segregated by hierarchy fair value levels.

| (Dollars in thousands)          | Total carrying value at | Fair value measurements at June 30, 2017 using: |   |   |
|---------------------------------|-------------------------|---|---|---|
|                                 |                         | Quoted prices in active markets (Level 1)       | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets:                         | June 30, 2017           |   |   |   |
| Impaired Loans                  | \$ 2,061                | \$-   | \$ -  | \$ 2,061                                  |
| Foreclosed Assets Held for Sale | -                       | -   | -   | -   |
| Mortgage Servicing Rights       | 135                     | -   | -   | 135                                       |

| (Dollars in thousands)          | Total carrying value at | Fair value measurements at December 31, 2016 using: |   |   |
|---------------------------------|-------------------------|---|---|---|
|                                 |                         | Quoted prices in active markets (Level 1)           | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets:                         | December 31, 2016       |   |   |   |
| Impaired Loans                  | \$ 2,404                | \$-   | \$ -  | \$ 2,404                                  |
| Foreclosed Assets Held for Sale | 135                     | -   | -   | 135                                       |
| Mortgage Servicing Rights       | 144                     | -   | -   | 144                                       |

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

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which Mid Penn has utilized Level 3 inputs to determine the fair value.

| (Dollars in thousands) Quantitative Information about Level 3 Fair Value Measurements |            |                                  |   |             |                  |
|---|------------|----------------------------------|---|-------------|------------------|
|   | Fair Value | Valuation Technique              | Unobservable Input                                | Range       | Weighted Average |
| June 30, 2017   | Estimate   |                                  |   |             |                  |
| Impaired Loans  | \$2,061    | Appraisal of collateral (a)      | Appraisal adjustments (b)                         | 26% - 43%   | 35%              |
| Foreclosed Assets Held for Sale   | -          | Appraisal of collateral (a), (c) | Appraisal adjustments (b)                         | 0% - 0%     | 0%               |
| Mortgage Servicing Rights   | 135        | Multiple of annual service fee   | Estimated prepayment speed based on rate and term | 210% - 400% | 365%             |

| (Dollars in thousands) Quantitative Information about Level 3 Fair Value Measurements |            |                                  |   |             |                  |
|---|------------|----------------------------------|---|-------------|------------------|
|   | Fair Value | Valuation Technique              | Unobservable Input                                | Range       | Weighted Average |
| December 31, 2016   | Estimate   |                                  |   |             |                  |
| Impaired Loans  | \$2,404    | Appraisal of collateral (a)      | Appraisal adjustments (b)                         | 11% - 70%   | 30%              |
| Foreclosed Assets Held for Sale   | 135        | Appraisal of collateral (a), (c) | Appraisal adjustments (b)                         | 26% - 31%   | 27%              |
| Mortgage Servicing Rights   | 144        | Multiple of annual service fee   | Estimated prepayment speed based on rate and term | 210% - 400% | 365%             |

- (a) Fair value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not observable.
- (b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal. Higher downward adjustments are caused by negative changes to the collateral or conditions in the real estate market, actual offers or sales contracts received, or age of the appraisal.
- (c) Includes qualitative adjustments by management and estimated liquidation expenses.

The following methodologies and assumptions were used to estimate the fair value of Mid Penn's financial instruments:

Cash and Cash Equivalents:

The carrying value of cash and cash equivalents is considered to be a reasonable estimate of fair value.

Interest-bearing Balances with other Financial Institutions:



The estimate of fair value was determined by comparing the present value of quoted interest rates on like deposits with the weighted average yield and weighted average maturity of the balances.

Securities Available for Sale:

The fair value of securities classified as available-for-sale is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted prices.

Held-to-Maturity Securities:

The fair values of held-to-maturity securities are based on a market approach using observable inputs such as benchmark yields and securities, reported trades, issuer spreads, current bids and offers, monthly payment information and collateral performance.

Loans Held for Sale:

The fair values of mortgage loans originated and intended for sale in the secondary market are carried at fair value, as determined by outstanding commitments from investors.

Impaired Loans (included in "Net Loans and Leases" in the following tables):

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

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

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days 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 for loan loss issues; however no allowance recommendation will be made until Mid Penn is in receipt of the updated valuation.

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. Mid Penn considers the estimates used in its impairment analysis to be Level 3 inputs.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values, either in a positive or negative way, due to the passage of time or some other change in one or more valuation inputs. Collateral values for impaired loans will be reassessed by management at least every 12 months for possible revaluation by an independent third party.

Loans:

For variable rate loans that reprice frequently and which entail no significant changes in credit risk, carrying values approximated fair value. The fair value of other loans are estimated by calculating the present value of the cash flow difference between the current rate and the market rate, for the average maturity, discounted quarterly at the market rate.

Foreclosed Assets Held for Sale:

Certain assets included in foreclosed assets held for sale are carried at fair value and accordingly is presented as measured on a non-recurring basis. Values are estimated using Level 3 inputs, based on appraisals that consider the sales prices of property in the proximate vicinity.

Accrued Interest Receivable and Payable:

The carrying amount of accrued interest receivable and payable approximates their fair values.

Restricted Investment in Bank Stocks:

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

Mortgage Servicing Rights:

The fair value of servicing rights is based on the present value of estimated future cash flows on pools of mortgages stratified by rate and maturity date.

Deposits:

The fair value for demand deposits (e.g., interest and noninterest checking, savings, and money market deposit accounts) is, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). Fair value for fixed-rate certificates of deposit was estimated using a discounted cash flow calculation by combining all fixed-rate certificates into a pool with a weighted average yield and a weighted average maturity for the pool and comparing the pool with interest rates currently being offered on a similar maturity.

**Short-term Borrowings:**

Because of time to maturity, the estimated fair value of short-term borrowings approximates the book value.

**Long-term and Subordinated Debt:**

The estimated fair values of long-term and subordinated debt were determined using discounted cash flow analysis, based on currently available borrowing rates for similar types of borrowing arrangements.

**Commitments to Extend Credit and Letters of Credit:**

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present credit worthiness of the counterparties. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements.

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

The following table summarizes the carrying value and fair value of financial instruments at June 30, 2017 and December 31, 2016.

| (Dollars in thousands)                          | June 30, 2017  |            | December 31, 2016 |            |
|---|----------------|------------|-------------------|------------|
|   | Carrying Value | Fair Value | Carrying Value    | Fair Value |
| <b>Financial assets:</b>                        |                |            |                   |            |
| Cash and cash equivalents                       | \$29,179       | \$29,179   | \$45,973          | \$45,973   |
| Available-for-sale investment securities        | 111,353        | 111,353    | 133,625           | 133,625    |
| Held-to-maturity investment securities          | 71,096         | 71,199     | -                 | -          |
| Loans held for sale                             | 2,369          | 2,369      | 1,959             | 1,959      |
| Net loans and leases                            | 854,594        | 874,192    | 806,741           | 824,293    |
| Restricted investment in bank stocks            | 3,985          | 3,985      | 2,443             | 2,443      |
| Accrued interest receivable                     | 3,991          | 3,991      | 3,928             | 3,928      |
| Mortgage servicing rights                       | 135            | 135        | 144               | 144        |
| <b>Financial liabilities:</b>                   |                |            |                   |            |
| Deposits  | \$987,468      | \$988,200  | \$935,373         | \$935,075  |
| Short-term borrowings                           | 21,468         | 21,468     | -                 | -          |
| Long-term debt                                  | 13,467         | 12,149     | 13,581            | 13,614     |
| Subordinated debt                               | 7,419          | 7,420      | 7,414             | 7,534      |
| Accrued interest payable                        | 788            | 788        | 515               | 515        |
| <b>Off-balance sheet financial instruments:</b> |                |            |                   |            |
| Commitments to extend credit                    | \$-            | \$-        | \$-               | \$-        |
| Financial standby letters of credit             | -              | -          | -                 | -          |

The following tables present the carrying amount, fair value, and placement in the fair value hierarchy of Mid Penn's financial instruments as of June 30, 2017 and December 31, 2016. Carrying values approximate fair values for cash and cash equivalents, interest-bearing time balances with other financial institutions, loans held for sale, restricted investment in bank stocks, mortgage servicing rights, accrued interest receivable and payable, and short-term borrowings. Other than cash and cash equivalents, which are considered Level 1 Inputs and mortgage servicing rights, which are Level 3 Inputs, these instruments are Level 2 Inputs. These tables exclude financial instruments for which the carrying amount approximates fair value, not previously disclosed.

| (Dollars in thousands) | Fair Value Measurements                              |                          |
|------------------------|--|--------------------------|
|                        | Quoted Prices in Active Markets for Identical Assets | Significant Unobservable |
|                        |  |                          |

| June 30, 2017                              | Carrying<br>Amount | Fair<br>Value | or Observable<br>Liabilities |           | Inputs<br>(Level 3) |
|--|--------------------|---------------|------------------------------|-----------|---------------------|
|  |                    |               | (Level 1)                    | (Level 2) |                     |
| <b>Financial instruments - assets</b>      |                    |               |                              |           |                     |
| Held-to-maturity investment                |                    |               |                              |           |                     |
| securities                                 | \$71,096           | \$71,199      | \$-                          | \$71,199  | \$-                 |
| Net loans and leases                       | 854,594            | 874,192       | -                            | -         | 874,192             |
| <b>Financial instruments - liabilities</b> |                    |               |                              |           |                     |
| Deposits                                   | \$987,468          | \$988,200     | \$-                          | \$988,200 | \$-                 |
| Short-term borrowings                      | 21,468             | 21,468        | -                            | 21,468    | -                   |
| Long-term debt                             | 13,467             | 12,149        | -                            | 12,149    | -                   |
| Subordinated debt                          | 7,419              | 7,420         | -                            | 7,420     | -                   |

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

| (Dollars in thousands)                         | Carrying<br>Amount | Fair<br>Value | Fair Value Measurements  |  |  |
|--|--------------------|---------------|--|--|--|
|  |                    |               | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>or<br>Liabilities<br>(Level<br>1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| December 31, 2016                              |                    |               |  |  |  |
| <b>Financial instruments - assets</b>          |                    |               |  |  |  |
| Net loans and leases                           | \$ 806,741         | \$ 824,293    | \$ -   | \$ -   | \$ 824,293   |
| <b>Financial instruments -<br/>liabilities</b> |                    |               |  |  |  |
| Deposits                                       | \$ 935,373         | \$ 935,075    | \$ -   | \$ 935,075                                       | \$ -   |
| Long-term debt                                 | 13,581             | 13,614        | -  | 13,614   | -  |
| Subordinated debt                              | \$ 7,414           | \$ 7,534      |  | \$ 7,534   |  |

## (5) Guarantees and Commitments

In the normal course of business, Mid Penn makes various commitments and incurs certain contingent liabilities which are not reflected in the accompanying consolidated financial statements. The commitments include various guarantees and commitments to extend credit. 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. Mid Penn evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Mid Penn had \$23,595,000 and \$14,000,000 standby letters of credit outstanding as of June 30, 2017 and December 31, 2016, respectively. Mid Penn does not anticipate any losses because of these transactions. The amount of the liability as of June 30, 2017 and December 31, 2016 for payment under standby letters of credit issued was not material.

As of June 30, 2017, Mid Penn had entered into fixed asset acquisition commitments related to (i) purchasing a commercial building in Harrisburg, PA for \$2,100,000; (ii) purchasing two vacant and undeveloped lots adjacent to the commercial building for approximately \$462,000; and (iii) purchasing vacant land in Halifax, PA for approximately \$504,000. The commercial building and adjacent lots in Harrisburg, PA will be renovated at some future time to serve as an administrative center for the Company. The Halifax land will be the site upon which Mid Penn Bank will construct a new retail office (the Company has received all required bank regulatory approvals for this

branch). The purchase of the building and lots were closed and settlement payments made in July 2017. The properties are not expected to have related construction or renovations and improvements completed until late 2017 or possibly beginning in 2018; therefore, any additional costs incurred related to these properties in 2017 are not expected to have a material impact on the 2017 financial statements.

(6) Subordinated Debt

On December 9, 2015, Mid Penn sold \$7,500,000 aggregate principal amount of Subordinated Debt ("Notes") due 2025. The Notes are treated as Tier 2 capital for regulatory capital purposes.

The Notes bear interest at a rate of 5.15% per year for the first five years and then float at the Wall Street Journal's Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 4.0%. Interest will be payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, beginning on January 1, 2016. The Notes will mature on December 9, 2025 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 9, 2020, and prior to December 9, 2025. Additionally, Mid Penn may redeem the Notes in whole at any time, or in part from time to time, upon at least 30 days' notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended, in each case at 100% of the principal amount of the subordinated notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holders of the Notes may not accelerate the maturity of the Notes, except upon Mid Penn's or Mid Penn Bank's bankruptcy, insolvency, liquidation, receivership or similar event.

ASC Subtopic 835-30, Simplifying the Presentation of Debt Issuance Costs, requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability. The unamortized debt issuance costs associated with the Notes were \$81,000 at June 30, 2017 and \$86,000 at December 31, 2016.

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

(7) Defined Benefit Plans

Mid Penn has an unfunded noncontributory defined benefit retirement plan for directors. The plan provides defined benefits based on years of service. In addition, Mid Penn sponsors a defined benefit health care plan that provides post-retirement medical benefits and life insurance to qualifying full-time employees. These health care and life insurance plans are noncontributory. A December 31 measurement date for the plans is used.

The components of net periodic benefit costs from these defined benefit plans are as follows:

| (Dollars in thousands)                         | Three Months Ended<br>June 30, |      |                   |      |
|--|--------------------------------|------|-------------------|------|
|  | Pension<br>Benefits            |      | Other<br>Benefits |      |
|  | 2017                           | 2016 | 2017              | 2016 |
| Service cost                                   | \$9                            | \$8  | \$1               | \$1  |
| Interest cost                                  | 11                             | 11   | 5                 | 5    |
| Amortization (accretion) of prior service cost | 4                              | 8    | (6)               | 6    |
| Net periodic benefit cost                      | \$24                           | \$27 | \$-               | \$12 |

  

| (Dollars in thousands)                         | Six Months Ended<br>June 30, |      |                   |       |
|--|------------------------------|------|-------------------|-------|
|  | Pension<br>Benefits          |      | Other<br>Benefits |       |
|  | 2017                         | 2016 | 2017              | 2016  |
| Service cost                                   | \$18                         | \$17 | \$2               | \$2   |
| Interest cost                                  | 22                           | 23   | 10                | 11    |
| Amortization (accretion) of prior service cost | 7                            | 25   | (12)              | 91    |
| Net periodic benefit cost                      | \$47                         | \$65 | \$-               | \$104 |

(8) Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of taxes, are as follows:

| (Dollars in thousands)  | Unrealized<br>Loss<br>on<br>Securities | Defined<br>Benefit<br>Plans | Accumulated Other<br>Comprehensive<br>Loss |
|-------------------------|--|-----------------------------|--|
| Balance - June 30, 2017 | \$ (1,073 )                            | \$ 62                       | \$ (1,011 )                                |



Balance - December 31, 2016 \$ (2,919 ) \$ 66 \$ (2,853 )

(9) Common Stock

On June 25, 2014, the 2014 Restricted Stock Plan (the “Plan”) provides awards that shall not exceed, in the aggregate, 100,000 shares of common stock. Awards under the Plan are limited to employees and directors of the Company and the Bank selected by the Compensation Committee of the Board of Directors, to advance the best interest of Mid Penn and its shareholders.

Share-based compensation expense relating to restricted stock is recognized on a straight-line basis over the vesting periods of the awards and is a component of salaries and benefits expense. As of June 30, 2017, a total of 16,045 restricted shares were granted under the plan, with 2,990 of the granted shares being vested, while the remaining 13,055 granted shares remain unvested. The Plan grants and vesting resulted in \$19,000 in compensation expense for the three months ended June 30, 2017, while \$8,000 expense was recorded for the three months ended June 30, 2016. Compensation expense related to the Plan was \$37,000 for the six months ended June 30, 2017, while it was \$17,000 for the same period in 2016.

(10) Earnings per Common Share

Earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during each of the years presented. The following data show the amounts used in computing basic earnings per common share.

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

The computations of basic earnings per common share follow:

| (Dollars in thousands, except per share data) | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | June 30,           |           | June 30,         |           |
|   | 2017               | 2016      | 2017             | 2016      |
| Net income                                    | \$2,345            | \$2,022   | \$4,339          | \$3,827   |
| Weighted average common shares outstanding    | 4,234,291          | 4,227,992 | 4,234,525        | 4,227,362 |
| Basic earnings per common share               | \$0.55             | \$0.48    | \$1.02           | \$0.91    |

Mid Penn had no dilutive instruments outstanding during the periods ended June 30, 2017 and 2016.

#### (11) Recent Accounting Pronouncements

ASU 2017-08: The Financial Accounting Standards Board (“FASB”) issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities.

The ASU shortens the amortization period for premiums on purchased callable debt securities to the earliest call date (i.e., yield-to-earliest call amortization), rather than amortizing over the full contractual term, but does not change the accounting for securities held at a discount.

The ASU applies to callable debt securities with explicit, noncontingent call features that are callable at fixed prices and on preset dates. If a security may be prepaid based upon prepayments of the underlying loans, not because the issuer exercised a date specific call option, it is excluded from the scope of the new standard. However, for instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the amendments. Further, it applies to all premiums on callable debt securities, regardless of how they were generated.

The ASU requires companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. If the security has additional future call dates, any excess of the amortized cost basis over the amount repayable by the issuer at the next call date should be amortized to the next call date.

It is effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those years. For all other entities, the amendments are effective for annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

Mid Penn has early adopted this standard, and the financial statements as of and for the three month and six month periods ended June 30, 2017, reflect the impact of premium amortization on callable debt securities to the earliest call date. The adoption of this ASU did not have a material impact on Mid Penn’s consolidated financial statements.

ASU 2017-07: The FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.

The ASU requires that an employer disaggregate the service cost component from the other components of net benefit cost. Service cost must be presented in the same line item(s) as other employee compensation costs. These costs are generally included within income from continuing operations, but in some cases may be eligible for capitalization, if certain criteria are met. All other components of net benefit cost must be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. These generally include interest cost, actual return on plan assets, amortization of prior service cost included in accumulated other comprehensive income, and gains or losses from changes in the value of the projected benefit obligation or plan assets. If a separate line item is used to present the other components of net benefit cost, it must be appropriately described. If a separate line item is not used, an entity must disclose the line item(s) in the income statement that includes the other components of net benefit cost. The ASU clarifies that these costs are not eligible for capitalization.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those years. For other entities, the amendments are effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted as of the beginning of an annual period.

As disclosed in Note 7, Defined Benefit Plans, Mid Penn does disclose the service cost component of net benefit cost, but the related amounts are not material. Accordingly, when this ASU is implemented as required, the impact to reported salaries and employee benefits expense for interim and annual periods is expected to be immaterial.

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

ASU 2017-05: The FASB issued ASU 2017-05, Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets.

The ASU was issued to clarify the scope of Subtopic 610-20 and to add guidance for partial sales of nonfinancial assets, including partial sales of real estate. Historically, U.S. GAAP contained several different accounting models to evaluate whether the transfer of certain assets qualified for sale treatment. Moving forward, the new standard reduces the number of potential accounting models that might apply and clarifies which model does apply in various circumstances. Specifically, it clarifies the scope of Subtopic 610-20 by defining the term “in substance nonfinancial asset”. If substantially all of the fair value of the assets (recognized and unrecognized) promised to a counterparty in a contract is concentrated in nonfinancial assets, a financial asset in the same arrangement would still be considered part of an in substance nonfinancial asset. Also, nonfinancial assets may include nonfinancial assets contained within a legal entity that is transferred to a counterparty (e.g., through transfer of ownership interest). It clarifies also that derecognition of a business is not in scope of Subtopic 610-20, but rather, is governed by Topic 810.

In addition, the ASU indicates an entity should identify each distinct nonfinancial asset (e.g., real estate and inventory) or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it.

Finally, the ASU adds guidance on accounting for partial sales of nonfinancial assets. It requires an entity to derecognize a distinct nonfinancial asset or distinct in substance nonfinancial asset in a partial sale transaction when two criteria are met: 1) the entity does not have (or ceases to have) a controlling financial interest in the legal entity that holds the asset in accordance with Topic 810, and 2) the entity transfers control of the asset in accordance with Topic 606.

The effective date and transition requirements for the ASU are the same as the effective date and transition requirements of Topic 606, and must be applied at the same date that Topic 606 is initially applied. That is, the amendments are effective for public entities for annual reporting periods beginning after December 15, 2017, including interim periods within those periods, and for nonpublic entities for annual reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. Consistent with Topic 606, early adoption is permitted but no earlier than annual reporting periods beginning after December 15, 2016 for all entities.

Mid Penn has evaluated this ASU and does not anticipate the adoption to have a material impact on its consolidated financial statements since Mid Penn typically does not engage in partial sale transactions.

ASU 2017-04: The FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.

The amendments in this ASU are required for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. To simplify the subsequent measurement of goodwill, the Update eliminates Step 2 from the goodwill impairment test. An entity should now perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill

impairment loss, if applicable.

The ASU eliminates the requirements for any reporting unit with a 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. Therefore, the same impairment assessment applies to all reporting units. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary.

An entity should apply the amendments in this Update on a prospective basis. A public business entity should adopt the amendments in this Update 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.

Mid Penn plans to early adopt this ASU for its annual goodwill impairment test at the end of 2017 by comparing its fair value to its carrying value. The adoption of this ASU is not expected to have a material impact on Mid Penn's consolidated financial statements.

ASU 2016-15: The FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments.

The ASU clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are intended to reduce diversity in practice.

◆Cash payments for debt prepayment or extinguishment costs will be classified in financing activities.

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

Upon settlement of zero-coupon bonds and bonds with insignificant cash coupons, the portion of the payment attributable to imputed interest will be classified as an operating activity, while the portion of the payment attributable to principal will be classified as a financing activity.

Cash paid by an acquirer that isn't soon after a business combination for the settlement of a contingent consideration liability will be separated between financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date will be classified in financing activities; any excess will be classified in operating activities. Cash paid soon after the business combination will be classified in investing activities.

Cash proceeds received from the settlement of insurance claims will be classified on the basis of the related insurance coverage (that is, the nature of the loss). Cash proceeds from lump-sum settlements will be classified based on the nature of each loss included in the settlement.

Cash proceeds received from the settlement of corporate-owned life insurance ("COLI") and BOLI policies will be classified as cash inflows from investing activities. Cash payments for premiums on COLI and BOLI may be classified as cash outflows for investing, operating, or a combination of both.

A transferor's beneficial interest obtained in a securitization of financial assets will be disclosed as a noncash activity, and cash received from beneficial interests will be classified in investing activities.

Distributions received from equity method investees will be classified using either a cumulative earnings approach or a look-through approach as an accounting policy election.

The ASU contains additional guidance clarifying when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance.

The amendments are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period.

Mid Penn is currently evaluating this ASU, particularly related to cash payments for debt prepayment costs and cash proceeds received from the settlement of BOLI policies as these areas might affect Mid Penn in the future. This ASU, however, is not expected to have a material impact on Mid Penn's operating results and consolidated financial statements because the guidance only affects the classification within the statement of cash flows.

ASU 2016-13: The FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.

The ASU requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss ("CECL") model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for purchased financial assets with a more-than insignificant amount of credit deterioration since

origination (“PCD assets”) should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. Certain incremental disclosures are required.

The Update has tiered effective dates, with early adoption permitted for all entities as of the fiscal year beginning after December 15, 2018. For public business entities that are SEC filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all other public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

Mid Penn is currently evaluating the details of this ASU and the impact the guidance will have on Mid Penn’s consolidated financial statements. Mid Penn expects that it is possible that the ASU will result in an increase in the allowance for credit losses resulting from the change to expected losses for the estimated life of the financial asset, including an allowance for debt securities. The amount of the increase in the allowance for credit losses resulting from the new guidance will be impacted by the portfolio composition and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption.

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

ASU 2016-09: The FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.

The ASU introduces targeted amendments intended to simplify the accounting for stock compensation. Specifically, the ASU requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits, and assess the need for a valuation allowance, regardless of whether the benefit reduces taxes payable in the current period. That is, off balance sheet accounting for net operating losses stemming from excess tax benefits would no longer be required and instead such net operating losses would be recognized when they arise. Existing net operating losses that are currently tracked off balance sheet would be recognized, net of a valuation allowance if required, through an adjustment to opening retained earnings in the period of adoption. Entities will no longer need to maintain and track an “APIC pool.” The ASU also requires excess tax benefits to be classified along with other income tax cash flows as an operating activity in the statement of cash flows.

In addition, the ASU elevates the statutory tax withholding threshold to qualify for equity classification up to the maximum statutory tax rates in the applicable jurisdiction(s). The ASU also clarifies that cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. The ASU provides an optional accounting policy election (with limited exceptions), to be applied on an entity-wide basis, to either estimate the number of awards that are expected to vest (consistent with existing U.S. GAAP) or account for forfeitures when they occur.

The amendments are effective for public business entities for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted.

As disclosed in Note 9, Common Stock, Mid Penn currently provides share-based stock compensation to employees and directors of the Company and the Bank selected by the Compensation Committee of the Board of Directors, to advance the best interest of Mid Penn and its shareholders. Mid Penn adopted this ASU in the first quarter of 2017 and the adoption had no material impact on Mid Penn’s consolidated financial statements.

ASU 2016-02: The FASB issued ASU 2016-02, Leases.

The new leases standard applies a right-of-use (“ROU”) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. At inception, lessees must classify all leases as either finance or operating based on five criteria. Balance sheet recognition of finance and operating leases is similar, but the pattern of expense recognition in the income statement, as well as the effect on the statement of cash flows, differs depending on the lease classification.

The new leases standard requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing U.S. GAAP. Classification depends on the same five criteria used by lessees plus certain additional factors. The subsequent accounting treatment for all three lease types is substantially equivalent to existing U.S. GAAP for sales-type leases, direct financing leases, and operating leases. However, the new standard updates certain



aspects of the lessor accounting model to align it with the new lessee accounting model, as well as with the new revenue standard under Topic 606.

Lessees and lessors are required to provide certain qualitative and quantitative disclosures to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The new leases standard addresses other considerations including identification of a lease, separating lease and non-lease components of a contract, sale and leaseback transactions, modifications, combining contracts, reassessment of the lease term, and remeasurement of lease payments. It also contains comprehensive implementation guidance with practical examples.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Specific transition requirements apply.

Mid Penn occupies certain offices under non-cancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. Mid Penn expects to recognize lease liabilities and ROU assets associated with these lease agreements as required by the ASU; however, the extent of the prospective impact on Mid Penn's consolidated financial statements and the materiality will be dependent upon the extent and type of lease arrangements involving Mid Penn at the time of the adoption of this standard.

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

ASU 2016-01: The FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.

This ASU requires equity investments to be measured at fair value with changes in fair value recognized in net income, excluding equity investments that are consolidated or accounted for under the equity method of accounting. The ASU allows equity investments without readily determinable fair values to be measured at cost minus impairment, with a qualitative assessment required to identify impairment. The ASU also requires public companies to use exit prices to measure the fair value of financial instruments, eliminates the disclosure requirements related to measurement assumptions for the fair value of instruments measured at amortized cost, and requires separate presentation of financial assets and liabilities based on form and measurement category. In addition, for liabilities measured at fair value under the fair value option, the changes in fair value due to changes in instrument-specific credit risk should be recognized in OCI.

This ASU is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years.

As of June 30, 2017, Mid Penn held \$1,171,000 of equity investments (excluding restricted investments in bank stocks). Mid Penn does not expect to make significant increases in the volume of its equity investments; therefore, the adoption of this ASU is not expected to be material to Mid Penn's consolidated financial statements.

ASU 2014-09: The FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606).

The amendments in this Update establish a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation.

In August 2015, the FASB issued ASU 2015-14, Revenue from contracts with Customers (Topic 606): Deferral of the Effective Date. This ASU defers the effective date of ASU 2014-09 for all entities by one year.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), as an amendment to ASU 2014-09 to improve Topic 606, by reducing: (i) the potential for diversity in practice arising from inconsistent and application of the principal versus agent guidance, and (ii) the cost and complexity of applying Topic 606 both at transition and on an ongoing basis.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, as an amendment to ASU 2014-09 to improve Topic 606, by reducing: (i) the potential for diversity in practice at initial applications, and (ii) the cost and complexity of applying Topic 606 both at transition and on an ongoing basis.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The amendments in this ASU do not change the core principles of Topic 606. These amendments affect only the narrow aspects of Topic 606: (i) Collectability Criterion, (ii) Presentation of Sales Taxes and Other Similar Taxes Collected from Customers, (iii) Noncash Consideration, (iv) Contract Modifications at Transition, and (v) Completed Contracts at Transition.

ASU 2014-09, including transition requirements for all amendments, is effective for interim and annual reporting periods in fiscal years beginning after December 15, 2017. Early adoption is permitted as of the original effective date for interim and annual reporting periods in fiscal years beginning after December 15, 2016.

Mid Penn's implementation efforts include the identification of revenue within the scope of the guidance, particularly in regards to assessing collectability. Mid Penn's review is ongoing, and it will continue to evaluate any prospective impact as additional guidance is issued and as its internal assessment progresses.

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

(12) Agreement and Plan of Merger

On March 29, 2017, Mid Penn entered into an Agreement and Plan of Merger (the “Merger Agreement”) with The Scottsdale Bank and Trust Company. The Merger Agreement provides that, upon the terms and subject to the conditions set forth therein, Scottsdale will merge with and into Mid Penn Bank, with Mid Penn Bank as the surviving bank (the “Merger”).

If the merger is completed, Scottsdale shareholders will have the right to receive for each share of Scottsdale common stock they own, at their election, (i) \$1,166 in cash or (ii) a fraction of a share (the “exchange ratio”) of Mid Penn common stock determined by dividing (y) \$1,166 by (z) the 10 trading day per share volume-weighted average price for Mid Penn common stock ending on the date that is five business days prior to the closing of the merger (the “Average Price”), provided that in no event may the exchange ratio be less than 38.88 or greater than 44.86, respectively. Scottsdale shareholders may also elect to receive a combination of cash and Mid Penn common stock. The Merger Agreement provides that not less than 90% of the outstanding shares of Scottsdale common stock will be converted into the right to receive shares of Mid Penn common stock and the remainder of the outstanding shares of Scottsdale common stock will be converted into the right to receive cash. However, the percentage of Scottsdale common stock converted to the right to receive Mid Penn common stock could be adjusted down to 85% in the event that shareholders perfecting their dissenters’ rights reach 15% of the outstanding shares of Scottsdale common stock.

Completion of the Merger is subject to a number of customary conditions, including, among others, (i) the approval of the Merger Agreement by the shareholders of both Scottsdale and Mid Penn, (ii) the effectiveness of the registration statement to be filed by Mid Penn with the SEC relating to the Mid Penn common stock to be issued in the Merger, (iii) approval of the listing on The Nasdaq Stock Market of the shares of Mid Penn common stock to be issued in the Merger, (iv) the absence of any order or other legal restriction prohibiting the closing of the Merger, (v) receipt of required regulatory approvals without the imposition of any condition or requirement, excluding standard conditions that are normally imposed by the regulatory authorities in bank merger transactions, that would, in the good faith reasonable judgment of the Board of Directors of either Mid Penn or Scottsdale, materially and adversely affect the business, operations, financial condition, property or assets of the combined enterprise or materially impair the value of Scottsdale to Mid Penn or the value of Mid Penn to Scottsdale, and (vi) Lawrence J Kiefer and Mid Penn Bank entering into a mutually acceptable employment agreement effective as of the closing. Each party’s obligations to complete the Merger is also subject to certain additional customary conditions, including: (a) subject to certain exceptions, the accuracy of the representations and warranties of the other party, (b) performance in all material respects by the other party of its obligations under the Merger Agreement, (c) not more than 15% of the outstanding shares of Scottsdale common stock have properly effected their dissenters rights, (d) the absence of any material adverse effect (as such term is defined in the Merger Agreement) with respect to the other party, and (e) the receipt by each party of an opinion from its counsel to the effect that the Merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended.

MID PENN BANCORP, INC.

## ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is Management’s Discussion of Consolidated Financial Condition as of June 30, 2017, compared to year-end 2016, and the Results of Operations for the three and six months ended June 30, 2017, compared to the same periods in 2016. For comparative purposes, the June 30, 2016 and December 31, 2016 balances have been reclassified, when, and if necessary, to conform to the 2017 presentation. Such reclassifications had no impact on net income. This discussion should be read in conjunction with the financial tables, statistics, and the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Annual Report”). The results of operations for interim periods are not necessarily indicative of operating results expected for the full year.

Forward-looking statements involve risks, uncertainties and assumptions. Although Mid Penn generally does not make forward-looking statements unless Mid Penn’s management believes its management has a reasonable basis for doing so, Mid Penn cannot guarantee the accuracy of any forward-looking statements. Actual results may differ materially from those expressed in any forward-looking statements due to a number of uncertainties and risks, including the risks described in the 2016 Annual Report, and other unforeseen risks. You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Quarterly Report on Form 10-Q, even if subsequently made available by us on Mid Penn’s website or otherwise, and Mid Penn undertakes no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Mid Penn to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words “expect”, “anticipates”, “intend”, “plan”, “believe”, “estimate”, and similar expressions are intended to identify such forward-looking statements.

Mid Penn’s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- the effects of potentially slowing or volatile future economic conditions on Mid Penn and its customers;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- future actions or inactions of the United States government, including a failure to increase the government debt limit or a prolonged shutdown of the federal government;
- an increase in the Pennsylvania Bank Shares Tax to which Mid Penn Bank’s capital stock is currently subject, or imposition of any additional taxes on Mid Penn or Mid Penn Bank;

- impacts of the capital and liquidity requirements imposed by the Basel III standards and other regulatory pronouncements and rules;
- the effect of changes in accounting policies and practices, as may be adopted by the supervisory agencies, as well as the Public Company Accounting Oversight Board, Financial Accounting Standards Board, and other accounting standard setters;
- the risks of changes in interest rates on the level and composition of deposits and other funding sources, loan demand and yields, values of loan collateral, securities and yields, and interest rate protection agreements;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn's market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- technological changes;
- our ability to implement business strategies, including our proposed acquisition of The Scottdale Bank and Trust Co. (Scottdale), and other business acquisition activities and organic branch, product and service expansion strategies;
- our current and future acquisition strategies may not be successful in locating or acquiring advantageous targets at favorable prices;
- our ability to successfully integrate any banks, companies, assets, liabilities, customers, systems and management personnel we acquire into our operations, including those related to our proposed acquisition of Scottdale, and our ability to realize related revenue synergies and cost savings within expected time frames;
- potential goodwill impairment charges, future impairment charges and fluctuations in the fair values of reporting units or of assets in the event projected financial results are not achieved within expected time frames;
- our ability to attract and retain qualified management and personnel;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- results of regulatory examination and supervision processes;
- our ability to maintain compliance with the exchange rules of The NASDAQ Stock Market LLC;
- the failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;
- acts of war or terrorism;
- disruptions due to flooding, severe weather, or other natural disasters of Acts of God; and
- volatilities in the securities markets.

The above list of factors that may affect future performance is illustrative, but by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with this understanding of inherent uncertainty.

MID PENN BANCORP, INC.

### Critical Accounting Estimates

Mid Penn's consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and conform to general practices within the banking industry. Application of these principles involves significant judgments and estimates by management that have a material impact on the carrying value of certain assets and liabilities. The judgments and estimates that we used are also based on historical experiences and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and estimates that we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

Management of the Company considers the accounting judgments relating to the allowance, the evaluation of the Company's investment securities for other-than-temporary impairment, the valuation of the Company's goodwill for impairment, and the valuation of assets acquired and liabilities assumed in business combinations, to be the accounting areas that require the most subjective and complex judgments.

The allowance represents management's estimate of probable incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan and lease portfolio also represents the largest asset type on the consolidated balance sheet. Throughout the remainder of this report, the terms "loan" or "loans" refers to both loans and leases.

Valuations for the investment portfolio are determined using quoted market prices, where available. If quoted market prices are not available, investment valuation is based on pricing models, quotes for similar investment securities, and observable yield curves and spreads. In addition to securities valuation, management must assess whether there are any declines in value below the carrying value of the investments that should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of the loss in the consolidated statement of income.

Goodwill recorded in connection with acquisitions is tested annually for impairment. 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, Mid Penn 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 Mid Penn'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.

Valuations of assets acquired and liabilities assumed in business combinations are measured at fair value as of the acquisition date. In many cases, determining the fair value of the assets acquired and liabilities assumed requires Mid Penn to estimate cash flows expected to result from these assets and liabilities and to discount these cash flows at appropriate rates of interest, which require the utilization of significant estimates and judgment in accounting for the acquisition.

### Results of Operations

#### Overview

Net income was \$2,345,000 or \$0.55 per common share, for the quarter ended June 30, 2017, compared to net income of \$2,022,000 or \$0.48 per common share, for the quarter ended June 30, 2016. During the six months ended June 30,

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2017, net income was \$4,339,000 or \$1.02 per common share, versus \$3,827,000 or \$0.91 per common share, for the six months ended June 30, 2016.

Net income as (i) a percent of average assets (return on average assets, or “ROA”) and (ii) shareholders' equity (return on average equity, or “ROE”) were as follows (calculated and reported on an annualized basis):

|                          | Three Months<br>Ended June 30, |         | Six Months<br>Ended June 30, |         |
|--------------------------|--------------------------------|---------|------------------------------|---------|
|                          | 2017                           | 2016    | 2017                         | 2016    |
| Return on average assets | 0.86 %                         | 0.82 %  | 0.82 %                       | 0.80 %  |
| Return on average equity | 12.74 %                        | 11.28 % | 12.05 %                      | 10.75 % |

### Net Interest Income/Funding Sources

Net interest income, Mid Penn’s primary source of revenue, is the amount by which interest income on loans and investments exceeds interest incurred on deposits and borrowings. The amount of net interest income is affected by changes in interest rates and changes in the volume and mix of interest-sensitive assets and liabilities. Net interest income and corresponding yields are presented in the analysis below on a taxable-equivalent basis. Income from tax-exempt assets, primarily loans to or securities issued by state and local governments, is adjusted by an amount equivalent to the federal income taxes which would have been paid if the income received on these assets was taxable at the statutory rate of 34%.



## MID PENN BANCORP, INC.

The following table includes average balances, amounts, and rates of interest income and expense, interest rate spread, and net interest margin for the three months ended June 30, 2017 and 2016.

| (Dollars in thousands)                         | Average Balances, Income and Interest Rates on a Taxable Equivalent Basis |            |               |               |                 |           |               |
|--|---|------------|---------------|---------------|-----------------|-----------|---------------|
|  | For the Three Months Ended  |            |               |               |                 |           |               |
|  | June 30, 2017   |            |               | June 30, 2016 |                 |           |               |
|  | Average Balance   | Interest   | Average Rates |               | Average Balance | Interest  | Average Rates |
| <b>ASSETS:</b>                                 |   |            |               |               |                 |           |               |
| Interest Bearing Balances                      | \$ 2,663  | \$ 5       | 0.75 %        |               | \$ 1,067        | \$ 2      | 0.75 %        |
| Investment Securities:                         |   |            |               |               |                 |           |               |
| Taxable  | 122,661   | 604        | 1.98 %        |               | 81,829          | 353       | 1.74 %        |
| Tax-Exempt                                     | 50,052  | 401 (a)    | 3.21 %        |               | 82,576          | 829 (a)   | 4.04 %        |
| Total Securities                               | 172,713   | 1,005      | 2.33 %        |               | 164,405         | 1,182     | 2.89 %        |
| Federal Funds Sold                             | 8,766   | 23         | 1.05 %        |               | 14,207          | 15        | 0.42 %        |
| Loans and Leases, Net                          | 848,980   | 10,060 (b) | 4.75 %        |               | 753,734         | 9,053 (b) | 4.83 %        |
| Restricted Investment in Bank Stocks           | 2,702   | 33         | 4.90 %        |               | 2,851           | 36        | 5.08 %        |
| Total Earning Assets                           | 1,035,824   | 11,126     | 4.31 %        |               | 936,264         | 10,288    | 4.42 %        |
| Cash and Due from Banks                        | 21,728  |            |               |               | 12,296          |           |               |
| Other Assets                                   | 33,831  |            |               |               | 39,248          |           |               |
| Total Assets                                   | \$ 1,091,383  |            |               |               | \$ 987,808      |           |               |
| <b>LIABILITIES &amp; SHAREHOLDERS' EQUITY:</b> |   |            |               |               |                 |           |               |
| Interest-bearing Demand                        |   |            |               |               |                 |           |               |
| Interest-bearing Demand                        | \$ 335,556  | 294        | 0.35 %        |               | \$ 286,879      | 241       | 0.34 %        |
| Money Market                                   | 249,928   | 357        | 0.57 %        |               | 232,455         | 321       | 0.56 %        |
| Savings  | 63,372  | 10         | 0.06 %        |               | 60,554          | 9         | 0.06 %        |
| Time   | 193,688   | 616        | 1.28 %        |               | 169,047         | 521       | 1.24 %        |
| Total Interest-bearing Deposits                | 842,544   | 1,277      | 0.61 %        |               | 748,935         | 1,092     | 0.59 %        |
| Short-term Borrowings                          |   |            |               |               |                 |           |               |
| Short-term Borrowings                          | 4,472   | 13         | 1.17 %        |               | 1,405           | 12        | 3.44 %        |
| Long-term Debt                                 |   |            |               |               |                 |           |               |
| Long-term Debt                                 | 13,496  | 80         | 2.38 %        |               | 35,607          | 123       | 1.39 %        |
| Subordinated Debt                              |   |            |               |               |                 |           |               |
| Subordinated Debt                              | 7,417   | 99         | 5.35 %        |               | 7,430           | 99        | 5.36 %        |
| Total Interest-bearing Liabilities             | 867,929   | 1,469      | 0.68 %        |               | 793,377         | 1,326     | 0.67 %        |
| Noninterest-bearing Demand                     |   |            |               |               |                 |           |               |
| Noninterest-bearing Demand                     | 138,423   |            |               |               | 113,249         |           |               |
| Other Liabilities                              |   |            |               |               |                 |           |               |
| Other Liabilities                              | 11,188  |            |               |               | 6,380           |           |               |
| Shareholders' Equity                           |   |            |               |               |                 |           |               |
| Shareholders' Equity                           | 73,843  |            |               |               | 74,802          |           |               |
| Total Liabilities & Shareholders' Equity       | \$ 1,091,383  |            |               |               | \$ 987,808      |           |               |
| Net Interest Income                            |   | \$ 9,657   |               |               |                 | \$ 8,962  |               |

|                                |        |        |
|--------------------------------|--------|--------|
| Total Yield on Earning Assets  | 4.31 % | 4.42 % |
| Rate on Supporting Liabilities | 0.68 % | 0.67 % |
| Average Interest Spread        | 3.63 % | 3.75 % |
| Net Interest Margin            | 3.74 % | 3.85 % |

(a) includes tax-equivalent adjustments on interest from tax-free municipal securities of \$136,000 and \$282,000 for the three months ended June 30, 2017 and 2016, respectively

(b) includes tax equivalent adjustments on interest from tax-free municipal loans of \$111,000 and \$147,000 for the three months ended June 30, 2017 and 2016, respectively

## MID PENN BANCORP, INC.

| (Dollars in thousands)                         | Average Balances, Income and Interest Rates on a Taxable Equivalent Basis |            |               |                 |            |               |  |
|--|---|------------|---------------|-----------------|------------|---------------|--|
|  | For the Six Months Ended  |            |               |                 |            |               |  |
|  | June 30, 2017   |            |               | June 30, 2016   |            |               |  |
|  | Average Balance   | Interest   | Average Rates | Average Balance | Interest   | Average Rates |  |
| <b>ASSETS:</b>                                 |   |            |               |                 |            |               |  |
| Interest Bearing Balances                      | \$ 2,462  | \$ 7       | 0.57 %        | \$ 1,109        | \$ 9       | 1.63 %        |  |
| <b>Investment Securities:</b>                  |   |            |               |                 |            |               |  |
| Taxable  | 109,670   | 1,070      | 1.97 %        | 80,053          | 723        | 1.82 %        |  |
| Tax-Exempt                                     | 52,511  | 879 (a)    | 3.38 %        | 75,592          | 1,533 (a)  | 4.08 %        |  |
| Total Securities                               | 162,181   | 1,949      | 2.42 %        | 155,645         | 2,256      | 2.91 %        |  |
| Federal Funds Sold                             | 15,976  | 74         | 0.93 %        | 8,073           | 18         | 0.45 %        |  |
| Loans and Leases, Net                          | 836,702   | 19,885 (b) | 4.79 %        | 748,494         | 18,001 (b) | 4.84 %        |  |
| Restricted Investment in Bank Stocks           | 2,518   | 56         | 4.48 %        | 3,017           | 82         | 5.47 %        |  |
| Total Earning Assets                           | 1,019,839   | 21,971     | 4.34 %        | 916,338         | 20,366     | 4.47 %        |  |
| Cash and Due from Banks                        | 18,647  |            |               | 12,081          |            |               |  |
| Other Assets                                   | 34,268  |            |               | 38,023          |            |               |  |
| Total Assets                                   | \$ 1,072,754  |            |               | \$ 966,442      |            |               |  |
| <b>LIABILITIES &amp; SHAREHOLDERS' EQUITY:</b> |   |            |               |                 |            |               |  |
| <b>EQUITY:</b>                                 |   |            |               |                 |            |               |  |
| Interest-bearing Demand                        | \$ 329,617  | 570        | 0.35 %        | \$ 275,697      | 468        | 0.34 %        |  |
| Money Market                                   | 250,396   | 705        | 0.57 %        | 225,450         | 623        | 0.56 %        |  |
| Savings  | 62,455  | 18         | 0.06 %        | 59,084          | 17         | 0.06 %        |  |
| Time   | 188,988   | 1,188      | 1.27 %        | 166,313         | 1,023      | 1.24 %        |  |
| Total Interest-bearing Deposits                | 831,456   | 2,481      | 0.60 %        | 726,544         | 2,131      | 0.59 %        |  |
| Short-term Borrowings                          | 2,256   | 13         | 1.16 %        | 4,767           | 25         | 1.05 %        |  |
| Long-term Debt                                 | 13,525  | 161        | 2.40 %        | 37,943          | 254        | 1.35 %        |  |
| Subordinated Debt                              | 7,416   | 198        | 5.38 %        | 7,452           | 198        | 5.34 %        |  |
| Total Interest-bearing Liabilities             | 854,653   | 2,853      | 0.67 %        | 769,254         | 2,608      | 0.68 %        |  |
| Noninterest-bearing Demand                     | 134,000   |            |               | 109,482         |            |               |  |
| Other Liabilities                              | 11,492  |            |               | 14,486          |            |               |  |
| Shareholders' Equity                           | 72,609  |            |               | 73,220          |            |               |  |
| Total Liabilities & Shareholders' Equity       | \$ 1,072,754  |            |               | \$ 966,442      |            |               |  |
| Net Interest Income                            |   | \$ 19,118  |               |                 | \$ 17,758  |               |  |
| Total Yield on Earning Assets                  |   |            | 4.34 %        |                 |            | 4.47 %        |  |
| Rate on Supporting Liabilities                 |   |            | 0.67 %        |                 |            | 0.68 %        |  |
| Average Interest Spread                        |   |            | 3.67 %        |                 |            | 3.79 %        |  |
| Net Interest Margin                            |   |            | 3.78 %        |                 |            | 3.90 %        |  |

- (a) includes tax equivalent adjustments on interest from tax-free municipal securities of \$299,000 and \$520,000 for the six months ended June 30, 2017 and 2016, respectively
  
- (b) includes tax equivalent adjustments on interest from tax-free municipal loans of \$234,000 and \$289,000 for the six months ended June 30, 2017 and 2016, respectively

## MID PENN BANCORP, INC.

Taxable-equivalent net interest income was \$9,657,000 for the three months ended June 30, 2017, an increase of \$695,000 or 8 percent compared to the three months ended June 30, 2016. During the six months ended June 30, 2017, taxable-equivalent net interest income increased \$1,360,000 or 8 percent to \$19,118,000 from \$17,758,000 during the six months ended June 30, 2016. Net interest income in the first half of 2017 was positively impacted by core loan growth funded by lower-cost deposits, as well as the recognition of \$279,000 of loan income from the successful workout of a loan relationship that included a previous charge-off in 2010.

For the three months ended June 30, 2017, Mid Penn's tax-equivalent net interest margin was 3.74% compared to 3.85% for the three months ended June 30, 2016. For the six months ended June 30, 2017, Mid Penn's tax-equivalent net interest margin was 3.78% versus 3.90% for the six months ended June 30, 2016. The decrease in the net interest margin year over year was primarily attributed to the lower yield earned on the investment portfolio. For the first six months of 2017, the overall investment portfolio yield was 2.42%, compared to an investment portfolio yield of 2.91% for the same period in 2016. The reduction was attributed to Mid Penn establishing, in the first half of 2017, a \$71,096,000 held-to-maturity investment portfolio comprised primarily of lower-risk and lower-yielding U.S. Treasury notes and U.S. agency mortgage-backed securities. The held-to-maturity portfolio was established to support the Bank's growth in public fund deposit pledging requirements.

Although the effective interest rate impact on earning assets and funding sources can be reasonably estimated at current interest rate levels, the options selected by customers, and the future mix of the loan, investment, and deposit products in the Bank's portfolios, may significantly change the estimates used in Mid Penn's asset and liability management and related interest rate risk simulation models. In addition, our net interest income may be impacted by further interest rate actions of the Board of Governors of the Federal Reserve System.

#### Provision for Loan Losses

The provision for loan and lease losses is the expense necessary to maintain the allowance at a level adequate to absorb management's estimate of probable losses in the loan and lease portfolio. Mid Penn's provision for loan and lease losses is based upon management's monthly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans and leases, analyze delinquencies, ascertain loan and lease growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets Mid Penn serves.

Mid Penn has maintained the allowance in accordance with Mid Penn's assessment process, which takes into consideration, among other relevant factors, the risk characteristics of the loan portfolio, the growth in the loan portfolio during the first six months of 2017, and shifting collateral values from December 31, 2016 to June 30, 2017.

Based upon its analysis of loan and lease loss allowance adequacy, management recorded a \$100,000 loan loss provision for the three months ended June 30, 2017, compared to a provision of \$395,000 for the three months ended June 30, 2016. During the six months ended June 30, 2017, the provision for loan and lease losses was \$225,000 compared to \$735,000 for the six months ended June 30, 2016. The amount of the loan loss provision for the first six months of 2017 was less than the same period in 2016 as Mid Penn had net loan recoveries of \$305,000 in the first six months of 2017 which substantially increased the allowance for loan loss balance. The allowance as a percentage of total loans was 0.89% at June 30, 2017, compared to 0.88% at December 31, 2016. For further discussion of factors affecting the provision for loan and lease losses please see Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses in the Financial Condition section of this Management's Discussion and Analysis.

#### Noninterest Income

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During the three months ended June 30, 2017, noninterest income was \$1,362,000 reflecting a decrease of \$36,000 or 3 percent compared to noninterest income of \$1,398,000 for the three months ended June 30, 2016. For the six months ended June 30, 2017, noninterest income totaled \$2,798,000, an increase of \$168,000 or 6 percent, compared to noninterest income of \$2,630,000 for the same period in 2016.

The following components of noninterest income showed significant changes:

| (Dollars in Thousands)                     | Three Months Ended June 30, |       |          |          |   |
|--|-----------------------------|-------|----------|----------|---|
|  | 2017                        | 2016  | \$       | %        |   |
|  |                             |       | Variance | Variance |   |
| Income from fiduciary activities           | \$200                       | \$139 | \$ 61    | 44       | % |
| Service charges on deposits                | 174                         | 158   | 16       | 10       | % |
| Net gain on sales of investment securities | 12                          | 213   | (201 )   | -94      | % |
| Net gain on sales of SBA loans             | 157                         | 75    | 82       | 109      | % |
| Other income                               | 204                         | 208   | (4 )     | -2       | % |

| (Dollars in Thousands)                     | Six Months Ended June 30, |       |          |          |   |
|--|---------------------------|-------|----------|----------|---|
|  | 2017                      | 2016  | \$       | %        |   |
|  |                           |       | Variance | Variance |   |
| Income from fiduciary activities           | \$396                     | \$245 | \$ 151   | 62       | % |
| Service charges on deposits                | 379                       | 313   | 66       | 21       | % |
| Net gain on sales of investment securities | 20                        | 213   | (193 )   | -91      | % |
| Net gain on sales of SBA loans             | 441                       | 265   | 176      | 66       | % |
| Other income                               | 393                       | 466   | (73 )    | -16      | % |

## MID PENN BANCORP, INC.

Income from fiduciary activities was \$396,000 for the first six months of 2017, an increase of \$151,000 or 62 percent compared to fiduciary income of \$245,000 during the same period in 2016. These additional revenues were attributed to wealth management assets under management significantly increasing over the past twelve months as a result of successful business development efforts by Mid Penn's expanded team of trust and retail investment officers.

For the six months ended June 30, 2017, service charges on deposits were \$379,000, an increase of \$66,000 or 21 percent, compared to service charges of \$313,000 for the six months ended June 30, 2016. This increase was driven by an increase in the volume of transactional deposit accounts, and by an increase in overdraft charges collected.

Net gains on sales of securities was \$20,000 for the first six months of 2017, a decrease of \$193,000 or 91 percent compared to net gains on sales of securities of \$213,000 during the same period ended June 30, 2016. During the second quarter of 2016, Mid Penn took advantage of favorable market conditions and increased fair values on several securities to reposition some of its investment portfolio, including selling a large volume of longer-term and rate-sensitive CMOs, as well as certain municipal bonds and agency notes. The securities sales in the first half of 2017 also involved strategic portfolio management, but were fewer in both volume and net gain impact compared to securities sales in the first half of 2016.

Mid Penn experienced increased origination and sales activity in Small Business Administration ("SBA") loans, resulting in gains of \$441,000 from related loan sales during the first six months of 2017. The gains on SBA loan sales for the first half of 2017 reflected an increase of \$176,000 or 66 percent compared to SBA loan sales gains of \$265,000 for the first six months of 2016. More qualified small business borrowers continue to take advantage of Mid Penn's Preferred Lender status with the SBA.

Other noninterest income declined \$73,000 for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. The decrease was attributed to Mid Penn realizing an \$86,000 from the gain on the sale of insurance policies during the first half of 2016. The sale of the insurance policies occurred upon the dissolution of Mid Penn Insurance Services, LLC, a then wholly-owned subsidiary of Mid Penn Bank.

## Noninterest Expense

During the three months ended June 30, 2017, noninterest expenses totaled \$7,558,000, an increase of \$637,000 or 9 percent compared to noninterest expenses of \$6,921,000 for the three months ended June 30, 2016. Noninterest expenses for the six months ended June 30, 2017 totaled \$15,360,000, an increase of \$1,457,000 or 10 percent compared to noninterest expenses of \$13,903,000 for the first six months of 2016.

The changes were primarily a result of the following components of noninterest expense which had notable variances when comparing results for periods ending in 2017 versus the similar periods in 2016:

| (Dollars in Thousands)               | Three Months Ended June 30, |         |        |       |
|--------------------------------------|-----------------------------|---------|--------|-------|
|                                      | 2017                        | 2016    | \$     | %     |
| Salaries and employee benefits       | \$4,159                     | \$3,723 | \$ 436 | 12 %  |
| Occupancy expense, net               | 593                         | 499     | 94     | 19 %  |
| Pennsylvania bank shares tax expense | 160                         | 206     | (46 )  | -22 % |

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|                 |       |       |     |    |   |
|-----------------|-------|-------|-----|----|---|
| FDIC Assessment | 194   | 147   | 47  | 32 | % |
| Other expenses  | 1,215 | 1,074 | 141 | 13 | % |

| (Dollars in Thousands)               | Six Months Ended June 30, |         |        |     |   |
|--------------------------------------|---------------------------|---------|--------|-----|---|
|                                      | 2017                      | 2016    | \$     | %   |   |
| Salaries and employee benefits       | \$8,389                   | \$7,446 | \$ 943 | 13  | % |
| Occupancy expense, net               | 1,241                     | 1,046   | 195    | 19  | % |
| Pennsylvania bank shares tax expense | 330                       | 409     | (79 )  | -19 | % |
| FDIC Assessment                      | 388                       | 300     | 88     | 29  | % |
| Other expenses                       | 2,334                     | 2,095   | 239    | 11  | % |

Salaries and employee benefits expense increased \$943,000 during the first six months of 2017 versus the same period in 2016, with the increase attributable to (i) the addition of lending personnel, credit support staff, and executive management in alignment with Mid Penn's core banking growth; (ii) added retail staff for the Oregon Pike, New Holland, and Orwigsburg offices opened after June of 2016, and (iii) increased healthcare costs from Mid Penn's self-funded medical plan during the first half of 2017.

Occupancy expenses for the six months ended June 30, 2017 increased \$195,000 or 19 percent compared to the same period in 2016, primarily due to the facility operating costs associated with Mid Penn opening three new branch offices and loan production offices in Lancaster and Franklin Counties in Pennsylvania, during the past twelve months.

Pennsylvania bank shares tax expense decreased \$79,000 during the six months ended June 30, 2017 versus the same period in 2016, due to tax credits generated from Mid Penn's increased level of Pennsylvania tax-credit-eligible donations to support education and economic development throughout the markets it serves.



MID PENN BANCORP, INC.

Mid Penn's FDIC assessment increased by \$88,000 or 29 percent from \$300,000 during the six months ended June 30, 2016, to \$388,000 during the six months ended June 30, 2017, due to the Company's growing deposits and assets, which increased the base amount used to determine the FDIC insurance assessment.

Other expenses for the three months ended June 30, 2017 increased \$141,000 or 13 percent compared to the same period in 2016. Other expenses increased by \$239,000 or 11 percent from \$2,095,000 during the six months ended June 30, 2016 to \$2,334,000 for the six months ended June 30, 2017. The change is primarily attributable to franchise expansion and an increase in the number of operating locations and the overall number of Company personnel, resulting in increased non-compensation employee expenses including travel, business meals, and other employee management expenses. Also contributing to the increase in other expenses was an increase in the amount and volume of charitable donations across the extended Company footprint, with many of these donations generating tax credits which, depending upon the credit, reduced either Pennsylvania bank shares tax or federal income tax liabilities.

#### Income Taxes

The provision for income taxes was \$769,000 for the three months ended June 30, 2017 compared to \$593,000 for the three months ended June 30, 2016. The effective tax rate for the three months ended June 30, 2017 was 24.7% compared to 22.7% for the three months ended June 30, 2016. The provision for income taxes for the six months ended June 30, 2017 was \$1,459,000 compared to \$1,113,000 during the same period in 2016. The effective tax rate for the six months ended June 30, 2017 was 25.2% compared to 22.5% for the six months ended June 30, 2016. In addition to the increased pre-tax income in 2017, contributing to the increase in the effective tax rates for 2017, a portion of Mid Penn's merger-related expenses of \$224,000 are nondeductible for federal income tax purposes.

Generally, Mid Penn's effective tax rate is below the statutory rate due to earnings on tax-exempt loans, investments, and BOLI, as well as the impact of tax credits. The realization of Mid Penn's deferred tax assets is dependent on future earnings. Mid Penn currently anticipates that future earnings will be adequate to fully realize the currently recorded deferred tax assets.

#### Financial Condition

##### Overview

Mid Penn's total assets were \$1,111,876,000 as of June 30, 2017, an increase of \$79,277,000 or 8 percent compared to total assets of \$1,032,599,000 as of December 31, 2016. In the first six months of 2017, Mid Penn realized favorable loan growth, primarily in commercial relationships, of \$47,853,000 or 6 percent since December 31, 2016. This asset and loan growth was substantially funded by an increase in deposits of \$52,095,000 or over 5 percent since year-end 2016.

##### Loans

Total portfolio loans (excluding loans held for sale) at June 30, 2017 were \$862,307,000 compared to \$813,924,000 at December 31, 2016, an increase of \$48,383,000 or 6 percent (or an annualized loan growth rate of 12 percent). The

main driver of Mid Penn's loan growth continues to be commercial loans, including both commercial and industrial financing, and commercial real estate credits as noted in the table below.

| (Dollars in thousands)                | June 30, 2017 |         | December 31, 2016 |         |
|---------------------------------------|---------------|---------|-------------------|---------|
|                                       | Amount        | %       | Amount            | %       |
| Commercial and industrial             | \$181,368     | 21.0 %  | \$172,518         | 21.2 %  |
| Commercial real estate                | 482,141       | 55.9 %  | 446,524           | 54.9 %  |
| Commercial real estate - construction | 53,305        | 6.2 %   | 54,376            | 6.7 %   |
| Lease financing                       | 307           | 0.0 %   | 425               | 0.1 %   |
| Residential mortgage                  | 102,637       | 11.9 %  | 99,457            | 12.2 %  |
| Home equity                           | 38,671        | 4.5 %   | 37,608            | 4.6 %   |
| Consumer                              | 3,878         | 0.5 %   | 3,016             | 0.3 %   |
|                                       | \$862,307     | 100.0 % | \$813,924         | 100.0 % |

#### Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses

For the first six months ended June 30, 2017, Mid Penn had net recoveries of \$305,000 compared to net recoveries of \$9,000 during the same period of 2016. The primary reason for this favorable net recoveries amount was that, during the first half of 2017, Mid Penn recovered \$318,000 of principal, as well as collected \$279,000 in interest income from the successful workout of a commercial real estate relationship that was partially charged-off in 2010. Similar recoveries were not recognized during the six months ended June 30, 2016.

Loans charged off during the first six months of 2017 totaled \$76,000 and included two residential mortgage loans from one relationship for \$18,000, one commercial and industrial loan for \$12,000, one commercial real estate loan for \$30,000 and \$16,000 in deposit account charge-offs. Mid Penn may need to make future adjustments to the allowance and the provision for loan and lease losses if economic conditions or loan credit quality differs substantially from the assumptions used in making Mid Penn's evaluation of the level of the allowance for loan losses as compared to the balance of outstanding loans.

## MID PENN BANCORP, INC.

Changes in the allowance for the three months ended June 30, 2017 and 2016 are summarized as follows:

| (Dollars in thousands)  | Six Months     |         |
|---|----------------|---------|
|   | Ended June 30, |         |
|   | 2017           | 2016    |
| Balance, beginning of period  | \$7,183        | \$6,168 |
| Loans charged off during period   | (76 )          | (185 )  |
| Recoveries of loans previously charged off  | 381            | 194     |
| Net recoveries  | 305            | 9       |
| Provision for loan and lease losses   | 225            | 735     |
| Balance, end of period  | \$7,713        | \$6,912 |
| Ratio of net loans (recovered)/charged off to average loans outstanding, annualized | -0.07 %        | 0.00 %  |
| Ratio of allowance for loan losses to net loans at end of period                    | 0.89 %         | 0.90 %  |

Other than as described herein, Mid Penn does not believe there are any trends or events at this time that are reasonably expected to have a material impact on future results of operations, liquidity, or capital resources. Further, based on known information, Mid Penn believes that the effects of current and past economic conditions and other unfavorable business conditions may influence certain borrowers' abilities to comply with their repayment terms. Mid Penn continues to monitor closely the financial strength of these borrowers. Mid Penn does not engage in practices which may be used to artificially shield certain borrowers from the negative economic or business cycle effects that may compromise their ability to repay. Mid Penn does not normally structure construction loans with interest reserve components. Mid Penn has not in the past performed any commercial real estate or other type of loan workouts whereby an existing loan was restructured into multiple new loans. Also, Mid Penn does not extend loans at maturity solely due to the existence of guarantees, without recognizing the credit as impaired. While the existence of a guarantee may be a mitigating factor in determining the proper level of allowance once impairment has been identified, the guarantee does not affect the impairment analysis.

The following table presents the change in nonperforming asset categories as of June 30, 2017, December 31, 2016, and June 30, 2016.

| (Dollars in thousands)                    | June 30,<br>2017 | December 31,<br>2016 | June 30,<br>2016 |
|---|------------------|----------------------|------------------|
| <b>Nonperforming Assets:</b>              |                  |                      |                  |
| Nonaccrual loans                          | \$5,218          | \$ 4,658             | \$3,995          |
| Accruing troubled debt restructured loans | 557              | 877                  | 932              |
| Total nonperforming loans                 | 5,775            | 5,535                | 4,927            |
| Foreclosed real estate                    | -                | 224                  | 540              |

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|   |          |          |          |
|---|----------|----------|----------|
| Other repossessed property              | -        | -        | 1        |
| Total non-performing assets             | 5,775    | 5,759    | 5,468    |
| Accruing loans 90 days or more past due | 57       | 59       | 73       |
| Total risk elements                     | \$5,832  | \$ 5,818 | \$5,541  |
| Nonperforming loans as a % of total     |          |          |          |
| loans outstanding                       | 0.67 %   | 0.68 %   | 0.64 %   |
| Nonperforming assets as a % of total    |          |          |          |
| loans outstanding and other real estate | 0.67 %   | 0.71 %   | 0.71 %   |
| Ratio of allowance for loan losses      |          |          |          |
| to nonperforming loans                  | 133.56 % | 129.78 % | 140.28 % |

In the table above, troubled debt restructured loans that are no longer accruing interest are included in nonaccrual loans.

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Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact and is not treated as a restructured credit. The following table provides additional analysis of partially charged-off loans.

(Dollars in thousands)

|   | June 30,<br>2017 | December 31,<br>2016 |        |   |
|---|------------------|----------------------|--------|---|
| Period ending total loans outstanding   | \$862,307        | \$ 813,924           |        |   |
| Allowance for loan and lease losses   | 7,713            | 7,183                |        |   |
| Total Nonperforming loans   | 5,775            | 5,535                |        |   |
| Nonperforming and impaired loans with partial charge-offs                                 | 1,223            | 1,604                |        |   |
| Ratio of nonperforming loans with partial charge-offs to total loans                      | 0.14             | %                    | 0.20   | % |
| Ratio of nonperforming loans with partial charge-offs to total nonperforming loans        | 21.18            | %                    | 28.97  | % |
| Coverage ratio net of nonperforming loans with partial charge-offs                        | 169.44           | %                    | 182.71 | % |
| Ratio of total allowance to total loans less nonperforming loans with partial charge-offs | 0.90             | %                    | 0.88   | % |

Mid Penn considers a commercial loan or commercial real estate loan to be impaired when it becomes 90 days or more past due and not well-secured or otherwise not probable for collection. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would be considered collateral dependent as the discounted cash flow method indicates no operating income is available for evaluating the collateral position; therefore, most impaired loans are deemed to be 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 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 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 variation in value. A specific allocation of allowance is made for any anticipated collateral shortfall. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and 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 are recommended for charge-off after reaching delinquency of 90 days and the loan is not well-secured or otherwise not probable for collection. The collateral shortfall of the consumer loan is recommended for charge-off at this point.

As noted above, Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans. The 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 or commercial real estate 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.

Larger groups of small-balance loans, such as residential mortgages and consumer installment loans are collectively evaluated for impairment. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures unless such loans are the subject of a restructuring agreement.

Mid Penn's rating system assumes any loans classified as substandard nonaccrual 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.

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.

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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 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 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.

Mid Penn had \$6,414,000 loans deemed impaired at June 30, 2017. Excluding \$897,000 in loans acquired with credit deterioration from the Phoenix Bancorp, Inc. ("Phoenix") acquisition, Mid Penn had several loan relationships deemed impaired with an aggregate carrying balance of \$5,517,000. This pool of loans was further broken down into a group of loans with an aggregate carrying balance of \$3,057,000 for which specific allocations totaling \$1,029,000 were included within the loan loss reserve for these loans. The remaining \$2,460,000 of loans required no specific allocation within the loan loss reserve. Of the \$5,517,000 of impaired loan relationships, excluding the loans acquired with credit deterioration from the Phoenix acquisition, \$3,651,000 were commercial real estate relationships, \$968,000 were residential relationships, \$571,000 were commercial real estate – construction relationships, and \$327,000 were home equity relationships. There were specific loan loss reserve allocations of \$893,000 against the commercial real estate relationships, \$66,000 against the residential real estate relationships, and \$70,000 against the commercial real estate – construction relationships. Management currently believes that the specific reserves are adequate to cover probable future losses related to these relationships.

The allowance is a reserve established in the form of a provision expense for loan and lease losses and is reduced by loan charge-offs net of recoveries. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risk on a monthly basis so that an appropriate allowance is maintained. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance to the Board of Directors, indicating any changes in the allowance since the last review. In making the evaluation, management considers the results of recent regulatory examinations, which typically include a review of the allowance an integral part of the examination process. As part of the examination process, federal or state regulatory agencies may require Mid Penn 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.

In establishing the allowance, management evaluates on a quantitative basis individual classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. In addition, an allowance for the remainder of the loan and lease portfolio is determined based on historical loss experience within certain components of the portfolio. These allocations may be modified if current conditions indicate that loan and lease losses may differ from historical experience.

In addition, a portion of the allowance is established for losses inherent in the loan and lease portfolio which have not been identified by the quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in historical loss experience. These factors include:

- 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;
- changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans;
- changes in the value of underlying collateral for collateral-dependent loans;
  - changes in the experience, ability, and depth of lending management and other relevant staff;
- 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 quality of the institution's loan review system;
- changes in the nature and volume of the portfolio and in the terms of loans;
- the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio; and
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.



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While the allowance is maintained at a level believed to be adequate by management to provide for probable losses inherent in the loan and lease portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. The unallocated component of the allowance for loan and lease losses covers several considerations that are not specifically measurable through either the specific and general components. For example, we believe that we could face increasing credit risks and uncertainties, not yet reflected in recent historical losses or qualitative factor assessments, associated with unpredictable changes in economic growth or business conditions in our markets or for certain industries in which we have commercial loan borrowers, or unanticipated stresses to the values of real estate held as collateral. Any or all of these additional issues can adversely affect our borrowers' ability to timely repay their loans. Additionally, we have experienced continued strong commercial loan growth, including growth in newer markets where we have less of a loss history. Also, the unallocated component allocation recognizes the inherent imprecision in our allowance for loan and lease loss methodology, or any alternative methodology, for estimating specific and general loan losses, including the unpredictable timing and amounts of charge-offs, the fact that historical loss averages don't necessarily correlate to future loss trends, and unexpected changes to specific-credit or general portfolio future cash flows and collateral values which could negatively impact unimpaired portfolio loss factors. Changes from these various other uncertainties and considerations may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance of \$7,713,000 is adequate as of June 30, 2017 to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

## Liquidity

Mid Penn's objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and to provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity provides resources for credit needs of borrowers, for depositor withdrawals, and for funding corporate operations. Sources of liquidity are as follows:

- a growing core deposit base;
- proceeds from the sale or maturity of investment securities;
- proceeds from interest-bearing time deposits with other financial institutions;
- payments received on loans and mortgage-backed securities;
- overnight correspondent bank borrowings on various credit lines; and
- borrowing capacity available from the FHLB, the Federal Reserve Discount Window, and other lines of credit currently available to Mid Penn.

The major sources of cash received in the first six months of 2017 came from the \$52,095,000 net increase in deposits and \$37,667,000 in proceeds from the sales of available-for-sale investment securities.

Major uses of cash in the first six months of 2017 were \$86,511,000 for investment purchases and \$48,078,000 for funding the increase in net loans and leases.

Major sources of cash received in the first six months of 2016 came from the \$116,397,000 net increase in deposits and the \$38,501,000 in proceeds from the sale of investment securities.

Major uses of cash in the first six months of 2016 were \$84,352,000 for investment purchases, \$41,707,000 for the repayment of short- and long-term borrowings, and \$30,054,000 for funding the increase in net loans and leases.

Mid Penn believes its core deposits are generally stable even in periods of changing interest rates. Liquidity is measured and monitored daily, allowing management to better understand and react to balance sheet trends. These measurements indicate that liquidity generally remains stable and exceeds our minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events, or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way.

On a quarterly basis, a comprehensive liquidity analysis is reviewed by the Asset Liability Committee and Board of Directors. The analysis provides a summary of the current liquidity measurements, projections, and future liquidity positions given various levels of liquidity stress. Management also maintains a detailed Contingency Funding Plan designed to respond to an overall decline in the financial condition of the banking industry or a problem specific to Mid Penn.

#### Subordinated Debt

On November 9, 2015, Mid Penn entered into agreements with investors to purchase \$7,500,000 aggregate principal amount of its Notes due 2025. The Notes are treated as Tier 2 capital for regulatory capital purposes. The offering closed in December 2015.

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The Notes bear interest at a rate of 5.15% per year for the first five years and then float at the Wall Street Journal's Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 4.0%. Interest is paid quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, beginning on January 1, 2016. The Notes will mature on December 9, 2025 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 9, 2020, and prior to December 9, 2025. Additionally, Mid Penn may redeem the Notes in whole at any time, or in part from time to time, upon at least 30 days' notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended, in each case at 100% of the principal amount of the subordinated notes, plus accrued and unpaid interest thereon to but excluding the date of redemption. The unamortized debt issuance costs associated with the Notes were \$81,000 at June 30, 2017 and \$86,000 at December 31, 2016.

Holders of the Notes may not accelerate the maturity of the Notes, except upon Mid Penn's or Mid Penn Bank's, its principal banking subsidiary's, bankruptcy, insolvency, liquidation, receivership, or similar event.

## Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2015. The final rules implemented higher minimum capital requirements, added a new common equity Tier 1 capital requirement, and established criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital. Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity Tier 1 capital above its minimum risk-based capital requirements, which amount must be greater than 2.5% of total risk-weighted assets at January 1, 2019. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations began on January 1, 2016 at the 0.625%. A summary of the payout restrictions based on the capital conservation buffer is as follows:

| Capital Conservation Buffer<br>(as a % of risk-weighted assets) | Maximum<br>Payout<br><br>(as a % of<br>eligible<br>retained<br>income) |
|---|--|
| > 2.5%  | No payout<br>limitation<br>applies                                     |
| ≤2.5% and >1.875%   | 60%  |
| ≤1.875% and >1.25%  | 40%  |
| ≤1.25% and >0.625%  | 20%  |
| ≤0.625%   | 0%   |

Implementation of the deductions and other adjustments to common equity Tier 1 capital began on January 1, 2015 and will be phased-in over a three-year period. The final rules called for the following minimum capital requirements to be considered “well-capitalized” (which include the impact of the capital conservation buffer that was effective January 1, 2016):

|   | As of January 1, |        |         |        |
|---|------------------|--------|---------|--------|
|   | 2016             | 2017   | 2018    | 2019   |
| Minimum common equity Tier 1 capital ratio                                  | 4.5 %            | 4.5 %  | 4.5 %   | 4.5 %  |
| Common equity Tier 1 capital conservation buffer                            | 0.625 %          | 1.25 % | 1.875 % | 2.5 %  |
| Minimum common equity Tier 1 capital ratio plus capital conservation buffer | 5.125 %          | 5.75 % | 6.375 % | 7.0 %  |
| Phase-in of most deductions from common equity Tier 1 capital               | 60 %             | 80 %   | 100 %   | 100 %  |
| Minimum Tier 1 capital ratio  | 6.0 %            | 6.0 %  | 6.0 %   | 6.0 %  |
| Minimum Tier 1 capital ratio plus capital conservation buffer               | 6.625 %          | 7.25 % | 7.875 % | 8.5 %  |
| Minimum total capital ratio   | 8.0 %            | 8.0 %  | 8.0 %   | 8.0 %  |
| Minimum total capital ratio plus capital conservation buffer                | 8.625 %          | 9.25 % | 9.875 % | 10.5 % |

The final rules allowed community banks to make a one-time election not to include the additional components of accumulated other comprehensive income (“AOCI”) in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. Mid Penn made the election not to include the additional components of AOCI in regulatory capital.

The final rules permanently grandfathered non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010 for inclusion in the Tier 1 capital of banking organizations with total consolidated assets less than \$15 billion as of December 31, 2009 and banking organizations that were mutual holding companies as of May 19, 2010.

Consistent with the Dodd-Frank Act, the new rules replaced the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures. Alternatively, banking organizations may use the existing gross-ups approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250% risk weight.

Under the new rules, mortgage servicing assets (“MSAs”) and certain deferred tax assets (“DTAs”) are subject to stricter limitations than those applicable under the current general risk-based capital rule. The new rules also increase the risk weights for past-due loans, certain risk weights and credit conversion factors.

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Mid Penn has implemented these changes in determining and reporting the regulatory ratios of Mid Penn and the Bank, and has concluded that the new rules did not have a material negative effect on Mid Penn's financial condition.

## Capital Resources

Shareholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The greater a corporation's capital resources, the more likely it is to meet its cash obligations and absorb unforeseen losses. Too much capital, however, indicates that not enough of the corporation's earnings have been invested in the continued growth of the business or paid to shareholders. An excess capital position may make it difficult for a corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital adequacy and capital management have been, and will continue to be, of paramount importance.

Shareholders' equity increased by \$5,169,000 or 7 percent, from \$70,467,000 at December 31, 2016 to \$75,636,000 at June 30, 2017. The increase was attributed to both retained earnings, and from an increase in other comprehensive income during the first six months of 2017 primarily from the unrealized appreciation (on an after-tax basis) of the available-for-sale investment portfolio since December 31, 2016.

Banks are evaluated for capital adequacy based on the ratio of capital to risk-weighted assets and total assets. The minimum capital to risk-adjusted assets requirements, including the capital conservation buffers, which became effective for Mid Penn and the Bank on January 1, 2016 are illustrated below. At June 30, 2017, regulatory capital ratios for both Mid Penn and the Bank met the definition of a "well-capitalized" institution under the regulatory framework for prompt corrective action, and exceeded the minimum capital requirements under Basel III.

Mid Penn and Mid Penn Bank maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios as of June 30, 2017 and December 31, 2016:

| (Dollars in thousands)                                 | Capital Adequacy  |        |                     |        | To Be Well-Capitalized Under Prompt |       |
|--|-------------------|--------|---------------------|--------|-------------------------------------|-------|
|  |                   |        | Minimum Capital     |        | Corrective Action Provisions:       |       |
|  | Actual:<br>Amount | Ratio  | Required:<br>Amount | Ratio  | Amount                              | Ratio |
| <b>Corporation</b>                                     |                   |        |                     |        |                                     |       |
| As of June 30, 2017:                                   |                   |        |                     |        |                                     |       |
| Tier 1 Capital (to Average Assets)                     | \$73,842          | 6.8 %  | \$43,662            | 4.0 %  | N/A                                 | N/A   |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 73,842            | 8.7 %  | 48,610              | 5.75 % | N/A                                 | N/A   |
| Tier 1 Capital (to Risk Weighted Assets)               | 73,842            | 8.7 %  | 61,291              | 7.25 % | N/A                                 | N/A   |
| Total Capital (to Risk Weighted Assets)                | 89,102            | 10.5 % | 78,199              | 9.25 % | N/A                                 | N/A   |
| <b>Bank</b>  |                   |        |                     |        |                                     |       |
| As of June 30, 2017:                                   |                   |        |                     |        |                                     |       |

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|  |          |        |          |        |          |        |
|--|----------|--------|----------|--------|----------|--------|
| Tier 1 Capital (to Average Assets)                     | \$80,345 | 7.4 %  | \$43,635 | 4.0 %  | \$54,544 | 5.0 %  |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 80,345   | 9.5 %  | 48,573   | 5.75 % | 54,908   | 6.5 %  |
| Tier 1 Capital (to Risk Weighted Assets)               | 80,345   | 9.5 %  | 61,244   | 7.25 % | 67,580   | 8.0 %  |
| Total Capital (to Risk Weighted Assets)                | 88,185   | 10.4 % | 78,139   | 9.25 % | 84,475   | 10.0 % |

Corporation

As of December 31, 2016:

|  |          |        |          |       |     |     |
|--|----------|--------|----------|-------|-----|-----|
| Tier 1 Capital (to Average Assets)                     | \$70,431 | 6.8 %  | \$41,595 | 4.0 % | N/A | N/A |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 70,431   | 9.1 %  | 34,807   | 4.5 % | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets)               | 70,431   | 9.1 %  | 46,409   | 6.0 % | N/A | N/A |
| Total Capital (to Risk Weighted Assets)                | 85,148   | 11.0 % | 61,879   | 8.0 % | N/A | N/A |

Bank

As of December 31, 2016:

|  |          |        |          |       |          |        |
|--|----------|--------|----------|-------|----------|--------|
| Tier 1 Capital (to Average Assets)                     | \$77,026 | 7.4 %  | \$41,568 | 4.0 % | \$51,960 | 5.0 %  |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 77,026   | 10.0 % | 34,781   | 4.5 % | 50,239   | 6.5 %  |
| Tier 1 Capital (to Risk Weighted Assets)               | 77,026   | 10.0 % | 46,374   | 6.0 % | 61,832   | 8.0 %  |
| Total Capital (to Risk Weighted Assets)                | 84,329   | 10.9 % | 61,832   | 8.0 % | 77,291   | 10.0 % |

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no material change in market risk since December 31, 2016, as reported in Mid Penn's Form 10-K filed with the SEC on March 23, 2017.

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#### ITEM 4 – CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Mid Penn maintains controls and procedures designed to ensure that information required to be disclosed in the reports that Mid Penn files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of June 30, 2017, Mid Penn's management, with the participation of the Principal Executive Officer and Principal Financial Officer, concluded that the disclosure controls and procedures were effective as of such date.

##### Changes in Internal Controls

During the three and six months ended June 30, 2017, there were no changes in Mid Penn's internal control over financial reporting that have materially affected, or are reasonable likely to materially affect, Mid Penn's internal control over financial reporting.

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## PART II – OTHER INFORMATION

### ITEM 1 – LEGAL PROCEEDINGS

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of Mid Penn or its subsidiaries taken as a whole. There are no proceedings pending other than ordinary routine litigation occurring in the normal course of business. In addition, management does not know of any material proceedings contemplated by governmental authorities against Mid Penn or any of its properties.

### ITEM 1A – RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2016, to determine if there were material changes applicable to the three and six months ended June 30, 2017. There are no material changes from the risk factors as previously disclosed in the Annual Report on Form 10-K.

### ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

### ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None

### ITEM 4 – MINE SAFETY DISCLOSURES

Not Applicable

### ITEM 5 – OTHER INFORMATION

None

### ITEM 6 – EXHIBITS

• Exhibit 2.1 – Agreement and Plan of Merger, dated as of March 29, 2017, by and among Mid Penn Bancorp, Inc., Mid Penn Bank, and The Scottdale Bank and Trust Company (Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K (File No. 001-13677) filed with the SEC on March 30, 2017.)

• Exhibit 3(i) – The Registrant's amended Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to Registrant's Registration Statement on Form S-4 (File No. 333-199740) filed with the SEC on October 31, 2014.)

• Exhibit 3(ii) – The Registrant's By-laws (Incorporated by reference to Exhibit 3(ii) to Registrant's Current Report on Form 8-K filed with the SEC on August 30, 2010.)

• Exhibit 11 – Statement re: Computation of Per Share Earnings. (Incorporated by reference to Part I Item 1 of this Quarterly Report on Form 10-Q.)

• Exhibit 31.1 – Certification of Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.

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Exhibit 31.2 - Certification of Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32 – Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS – XBRL Instance Document

Exhibit 101.SCH – XBRL Taxonomy Extension Schema

Exhibit 101.CAL – XBRL Taxonomy Extension Calculation Linkbase

Exhibit 101.DEF – XBRL Taxonomy Extension Definition Linkbase

Exhibit 101.LAB – XBRL Taxonomy Extension Label Linkbase

Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase

MID PENN BANCORP, INC.

SIGNATURES

Pursuant to the requirements 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.

Mid Penn Bancorp, Inc.

(Registrant)

By: /s/ Rory G. Ritrievi  
Rory G. Ritrievi  
President and CEO  
(Principal Executive Officer)

Date: August 11, 2017

By: /s/ Michael D. Peduzzi, CPA  
Michael D. Peduzzi, CPA  
Chief Financial Officer

Date: August 11, 2017