

MID PENN BANCORP INC  
Form 10-Q  
August 12, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from            to

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

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

Registrant's telephone number, including area code 1.866.642.7736

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

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

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

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

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

As of August 12, 2016, the registrant had 4,230,311 shares of common stock outstanding.

MID PENN BANCORP, INC.

FORM 10-Q

TABLE OF CONTENTS

PART 1 – FINANCIAL INFORMATION	2
Item 1 – Financial Statements	2
Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015 (Unaudited)	2
Consolidated Statements of Income for the Three and Six Months Ended June 30, 2016 and June 30, 2015 (Unaudited)	3
Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2016 and June 30, 2015 (Unaudited)	4
Consolidated Statements of Changes in Shareholders' Equity for the Six Months Ended June 30, 2016 and June 30, 2015 (Unaudited)	5

Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2016 and June 30, 2015 (Unaudited)	6
Notes to Consolidated Financial Statements (Unaudited)	8
Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations	39
Item 3 – Quantitative and Qualitative Disclosures about Market Risk	51
Item 4 – Controls and Procedures	51
 PART II – OTHER INFORMATION	 52
Item 1 – Legal Proceedings	52
Item 1A – Risk Factors	52
Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds	52
Item 3 – Defaults upon Senior Securities	52
Item 4 – Mine Safety Disclosures	52
Item 5 – Other Information	52
Item 6 – Exhibits Signatures	53

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



## MID PENN BANCORP, INC. Consolidated Balance Sheets (Unaudited)

## PART 1 – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

(Dollars in thousands, except share data)	June 30, 2016	December 31, 2015
<b>ASSETS</b>		
Cash and due from banks	\$ 14,625	\$ 12,329
Interest-bearing balances with other financial institutions	1,232	955
Federal funds sold	25,103	-
Total cash and cash equivalents	40,960	13,284
Interest-bearing time deposits with other financial institutions	987	4,317
Investment securities available for sale	167,342	135,721
Loans and leases, net of unearned interest	769,153	739,191
Less: Allowance for loan and lease losses	(6,912)	(6,168)
Net loans and leases	762,241	733,023
Bank premises and equipment, net	13,492	13,993
Cash surrender value of life insurance	12,651	12,516
Restricted investment in bank stocks	2,643	4,266
Foreclosed assets held for sale	540	1,185
Accrued interest receivable	3,943	3,813
Deferred income taxes	618	1,821
Goodwill	3,918	3,918
Core deposit and other intangibles, net	594	665
Other assets	2,955	3,116
Total Assets	\$ 1,012,884	\$ 931,638
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing demand	\$ 122,731	\$ 103,721
Interest-bearing demand	297,838	247,356
Money Market	239,878	208,386
Savings	60,767	56,731
Time	172,226	160,849
Total Deposits	893,440	777,043
Short-term borrowings	-	31,596
Long-term debt	30,194	40,305
Subordinated debt	7,409	7,414
Accrued interest payable	698	390
Other liabilities	6,669	4,822

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Total Liabilities	938,410	861,570
Shareholders' Equity:		
Common stock, par value \$1.00; authorized 10,000,000 shares; 4,229,006 and 4,226,717 shares issued and outstanding at June 30, 2016, and at December 31, 2015, respectively	4,229	4,227
Additional paid-in capital	40,609	40,559
Retained earnings	25,860	23,470
Accumulated other comprehensive income	3,776	1,812
Total Shareholders' Equity	74,474	70,068
Total Liabilities and Shareholders' Equity	\$ 1,012,884	\$ 931,638

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

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

MID PENN BANCORP, INC. Consolidated Statements of Income (Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
<b>INTEREST INCOME</b>				
Interest and fees on loans and leases	\$ 8,905	\$ 8,743	\$ 17,712	\$ 15,897
Interest on interest-bearing balances	2	11	9	22
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	311	304	633	635
State and political subdivision obligations, tax-exempt	548	517	1,012	1,048
Other securities	78	68	172	199
Interest on federal funds sold and securities purchased under agreements to resell	15	1	18	1
<b>Total Interest Income</b>	<b>9,859</b>	<b>9,644</b>	<b>19,556</b>	<b>17,802</b>
<b>INTEREST EXPENSE</b>				
Interest on deposits	1,092	980	2,131	1,894
Interest on short-term borrowings	12	11	25	22
Interest on long-term debt	222	167	452	362
<b>Total Interest Expense</b>	<b>1,326</b>	<b>1,158</b>	<b>2,608</b>	<b>2,278</b>
<b>Net Interest Income</b>	<b>8,533</b>	<b>8,486</b>	<b>16,948</b>	<b>15,524</b>
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>				
<b>Net Interest Income After Provision for Loan and Lease Losses</b>	<b>8,138</b>	<b>8,186</b>	<b>16,213</b>	<b>14,924</b>
<b>NONINTEREST INCOME</b>				
Income from fiduciary activities	139	120	245	247
Service charges on deposits	158	167	313	317
Net gain on sales of investment securities	213	-	213	177
Earnings from cash surrender value of life insurance	65	71	135	127
Mortgage banking income	246	153	432	220
ATM debit card interchange income	209	196	409	351
Merchant services income	85	61	152	111
Net gain on sales of SBA loans	75	143	265	143
Other income	208	182	466	349
<b>Total Noninterest Income</b>	<b>1,398</b>	<b>1,093</b>	<b>2,630</b>	<b>2,042</b>
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	3,723	3,440	7,446	6,760
Occupancy expense, net	499	496	1,046	950
Equipment expense	411	422	846	735
Pennsylvania Bank Shares tax expense	206	116	409	231
FDIC Assessment	147	165	300	304
Legal and professional fees	183	161	385	304
Marketing and advertising expense	139	147	223	235
Software licensing	334	404	665	723
Telephone expense	143	140	285	263
Loss (gain) on sale or write-down of foreclosed assets	28	(15)	132	17
Intangible amortization	34	29	71	43



Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Merger and acquisition expense	-	-	-	762
Other expenses	1,074	1,137	2,095	1,955
Total Noninterest Expense	6,921	6,642	13,903	13,282
INCOME BEFORE PROVISION FOR INCOME TAXES	2,615	2,637	4,940	3,684
Provision for income taxes	593	593	1,113	677
NET INCOME	2,022	2,044	3,827	3,007
Series B preferred stock dividends	-	88	-	175
Series C preferred stock dividend	-	4	-	4
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$ 2,022	\$ 1,952	\$ 3,827	\$ 2,828
PER COMMON SHARE DATA:				
Basic Earnings Per Common Share	\$ 0.48	\$ 0.46	\$ 0.91	\$ 0.71
Cash Dividends Distributed	\$ 0.12	\$ 0.10	\$ 0.34	\$ 0.20

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

MID PENN BANCORP, INC. Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)	Three Months Ended June 30,	
	2016	2015
Net income	\$ 2,022	\$ 2,044
Other comprehensive (loss) income:		
Unrealized gains (losses) arising during the period on available-for-sale securities, net of income taxes of \$955 and (\$642), respectively	1,854	(1,245)
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of (\$73) and \$0, respectively (a)	(140)	-
Change in defined benefit plans, net of income taxes of (\$1) and \$1, respectively (b)	(2)	2
Total other comprehensive income (loss)	1,712	(1,243)
Total comprehensive income	\$ 3,734	\$ 801

(Dollars in thousands)	Six Months Ended June 30,	
	2016	2015
Net income	\$ 3,827	\$ 3,007
Other comprehensive income (loss):		
Unrealized gains (losses) arising during the period on available-for-sale securities, net of income taxes of \$1,144 and (\$398), respectively	2,220	(770)
Reclassification adjustment for net gain on sales of available-for-sale securities		

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

included in net income, net of income taxes of (\$73) and (\$60), respectively (a)	(140)	(117)
Change in defined benefit plans, net of income taxes of (\$60) and \$2, respectively (b)	(116)	5
Total other comprehensive income (loss)	1,964	(882)
Total comprehensive income	\$ 5,791	\$ 2,125

- (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, 2016 AND 2015

(Dollars in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
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 compensation expense	-	-	17	-	-	17
Balance, June 30, 2016	\$ -	\$ 4,229	\$ 40,609	\$ 25,860	\$ 3,776	\$ 74,474
Balance, January 1, 2015	\$ 5,000	\$ 3,498	\$ 29,902	\$ 19,217	\$ 1,513	\$ 59,130
Net income	-	-	-	3,007	-	3,007
Total other comprehensive income (loss), net of taxes	-	-	-	-	(882)	(882)
Employee Stock Purchase Plan (1,002 shares)	-	2	29	-	-	31
Common stock dividends	-	-	-	(772)	-	(772)
Series B preferred stock dividends	-	-	-	(175)	-	(175)
Series C preferred stock dividend	-	-	-	(4)	-	(4)
SBLF preferred stock from Phoenix acquisition	1,750	-	-	-	-	1,750
Common stock issued to Phoenix shareholders	-	724	10,568	-	-	11,292
Restricted stock compensation expense	-	-	8	-	-	8
Balance, June 30, 2015	\$ 6,750	\$ 4,224	\$ 40,507	\$ 21,273	\$ 631	\$ 73,385

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,	
	2016	2015
<b>Operating Activities:</b>		
Net Income	\$ 3,827	\$ 3,007
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	735	600
Depreciation	820	708
Amortization of intangibles	71	30
Net amortization of security premiums	11,330	1,905
Gain on sales of investment securities	(213)	(177)
Earnings on cash surrender value of life insurance	(135)	(127)
SBA loans originated for sale	(3,318)	(1,897)
Proceeds from sales of SBA loans originated for sale	3,583	2,040
Gain on sale of loans	(265)	(143)
Loss on sale or write-down of foreclosed assets	132	17
Restricted stock compensation expense	17	8
Deferred income tax expense	16	69
Increase in accrued interest receivable	(130)	(19)
Decrease (increase) in other assets	161	(1,148)
Increase in accrued interest payable	308	160
Increase (decrease) in other liabilities	1,847	(504)
Net Cash Provided By Operating Activities	18,786	4,529
<b>Investing Activities:</b>		
Net decrease in interest-bearing time deposits with other financial institutions	3,330	103
Proceeds from the maturity or call of investment securities	6,264	4,964
Proceeds from the sale of investment securities	38,501	16,091
Purchases of investment securities	(84,352)	(8,312)
Net cash received from acquisition	-	8,095
Redemptions (purchases) of restricted investment in bank stock	1,623	(134)
Net increase in loans and leases	(30,054)	(24,202)
Purchases of bank premises and equipment	(319)	(1,035)
Proceeds from sale of foreclosed assets	614	262
Net Cash Used In Investing Activities	(64,393)	(4,168)
<b>Financing Activities:</b>		
Net increase (decrease) in deposits	116,397	(7,235)
Net (decrease) increase in short-term borrowings	(31,596)	14,403
Series B preferred stock dividends paid	-	(175)
Series C preferred stock dividends paid	-	(4)
Common stock dividend paid	(1,437)	(772)
Employee Stock Purchase Plan	35	31

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Long-term debt repayment	(10,116)	(5,110)
Net Cash Provided By Financing Activities	73,283	1,138
Net increase in cash and cash equivalents	27,676	1,499
Cash and cash equivalents, beginning of period	13,284	9,882
Cash and cash equivalents, end of period	\$ 40,960	\$ 11,381

## MID PENN BANCORP, INC. Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)	Six Months Ended	
	June 30,	
	2016	2015
Supplemental Disclosures of Cash Flow Information:		
Interest paid	\$ 2,300	\$ 2,086
Income taxes paid	\$ 565	\$ 630
Supplemental Noncash Disclosures:		
Loan transfers to foreclosed assets held for sale	\$ 101	\$ 481

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

(Dollars in thousands)

Assets Acquired:		
Securities	\$ -	\$ 11,331
Loans	-	110,363
Restricted stock	-	509
Property and equipment	-	1,792
Accrued interest receivable	-	388
Core deposit and other intangible assets	-	578
Bank-owned life insurance	-	3,673
Other assets	-	1,127
	\$ -	\$ 129,761
Liabilities Assumed:		
Deposits	\$ -	\$ 123,238
Accrued interest payable	-	32
Long-term debt	-	3,570
Other liabilities	-	876
	\$ -	\$ 127,716
Equity Acquired:		
Preferred stock	\$ -	\$ 1,750



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

7

---

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

(1) Basis of Presentation

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

Effective March 1, 2016, Mid Penn Insurance Services, LLC, an immaterial subsidiary of Mid Penn, was liquidated due to the lack of consistent profitability and growth.

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, 2015 and December 31, 2015 balances have been reclassified, when, and if necessary, to conform to the 2016 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

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

(2) Mergers and Acquisitions

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

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

Additionally, as part of this transaction, on March 1, 2015, Mid Penn assumed all of the liabilities and obligations of Phoenix with respect to 1,750 shares of Phoenix's preferred stock issued to the United States Department of Treasury ("Treasury") in connection with the Small Business Lending Fund and issued 1,750 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C, having a \$1,000 liquidation preference per share (the "SBLF Preferred Shares"), to the Treasury. The SBLF Preferred Shares qualified as Tier 1 capital and had terms and conditions identical to those shares of preferred stock issued by Phoenix to the Treasury. Subsequent to the acquisition, on December 15, 2015, Mid Penn redeemed all of the outstanding SBLF Preferred Shares for an aggregate redemption price of \$1,754,000 including dividends payable at that date.

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

Included in the purchase price was goodwill and a core deposit intangible of \$2,902,000 and \$578,000, respectively. The core deposit intangible will be amortized over a ten-year period using a sum of the year's digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense projected for the succeeding five years beginning 2016 is estimated to be \$96,000, \$86,000, \$75,000, \$65,000, and \$54,000 per year, respectively, and \$114,000 in total for years after 2020.

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

The allocation of the purchase price is as follows:

(Dollars in thousands)

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

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

(Dollars in thousands)

Total purchase price	\$ 14,241
Net assets acquired:	
Cash and cash equivalents	11,044
Investment securities	11,331
Restricted stock	509

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Loans	110,363
Bank owned life insurance	3,673
Premises and equipment	1,792
Deferred income taxes	503
Accrued interest receivable	388
Core deposit and other intangibles	578
Other assets	624
Deposits	(123,238)
FHLB borrowings	(3,570)
Accrued interest payable	(32)
Other liabilities	(876)
Preferred stock	(1,750)
	11,339
Goodwill	\$ 2,902

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

The fair value of the financial assets acquired included loans receivable with a gross amortized cost basis of \$112,816,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired.

(Dollars in thousands)

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

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

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

(Dollars in thousands)

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

The following table presents pro forma information as if the merger between Mid Penn and Phoenix had been completed on January 1, 2014. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn merged with Phoenix at the beginning of 2014. Supplemental pro forma earnings for 2015 were adjusted to exclude \$762,000 of merger related costs incurred for the three and six months ended June 30, 2015. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, expense efficiencies, or other

factors. The pro forma data is intended for informational purposes and is not indicative of the future results of operations.

(Dollars in thousands, except per share data)	June 30, 2015	
	Three Months Ended	Six Months Ended
Net interest income after loan loss provision	\$ 8,186	\$ 15,560
Noninterest income	1,093	2,107
Noninterest expense	6,642	13,582
Net income available to common shareholders	1,952	3,152
Net income per common share	0.46	0.75

### (3) Investment Securities

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

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

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

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

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, 2016 or December 31, 2015, and did not record any securities impairment charges in the respective periods ended on these dates. Mid Penn does not consider the securities with unrealized losses on the respective dates to be other-than-temporarily impaired as losses relate to changes in interest rates and not erosion of credit quality.

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

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2016				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 43,604	\$ 1,271	\$ -	\$ 44,875
Mortgage-backed U.S. government agencies	25,974	403	-	26,377
State and political subdivision obligations	88,973	3,876	11	92,838
Equity securities	3,168	140	56	3,252
	\$ 161,719	\$ 5,690	\$ 67	\$ 167,342



Edgar Filing: MID PENN BANCORP INC - Form 10-Q

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

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

Investment securities having a fair value of \$161,564,000 at June 30, 2016 and \$130,298,000 at December 31, 2015, were pledged to secure public deposits and other borrowings.

Mid Penn realized net gains of \$213,000 on sales of securities available-for-sale during the three and six months ended June 30, 2016. Mid Penn realized no gains on sales of securities available-for-sale during the three months ended June 30, 2015 and realized \$177,000 of net gains on sales of securities available-for-sale during the six months ended June 30, 2015.

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

The following table presents 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, 2016 and December 31, 2015.

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
June 30, 2016									
Available for sale securities:									
Mortgage-backed U.S. government agencies	1	\$ 131	\$ -	0	\$ -	\$ -	1	\$ 131	\$ -
State and political subdivision obligations	3	1,789	2	1	325	9	4	2,114	11
Equity securities	1	990	10	2	1,068	46	3	2,058	56
Total temporarily impaired available for sale securities	5	\$ 2,910	\$ 12	3	\$ 1,393	\$ 55	8	\$ 4,303	\$ 67

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
December 31, 2015									
Available for sale securities:									
U.S. Treasury and U.S. government agencies	6	\$ 6,259	\$ 43	2	\$ 1,383	\$ 12	8	\$ 7,642	\$ 55

Mortgage-backed U.S. government agencies	13	12,759	124	11	6,282	104	24	19,041	228
State and political subdivision obligations	9	4,041	32	3	1,631	45	12	5,672	77
Equity securities	1	990	10	2	615	33	3	1,605	43
Total temporarily impaired available for sale securities	29	\$ 24,049	\$ 209	18	\$ 9,911	\$ 194	47	\$ 33,960	\$ 403

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

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

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

At June 30, 2016, five debt securities and three equity securities with unrealized losses totaling \$67,000 were temporarily depreciated 1.56% from their amortized cost basis. At June 30, 2016, securities in an unrealized loss position were attributed to state and political subdivision obligations and equity securities. At December 31, 2015, 44 debt securities and 3 equity securities with unrealized losses totaling \$403,000 were temporarily depreciated 1.19% from their amortized cost basis. At December 31, 2015, the majority of the unrealized losses on securities in an unrealized loss position were attributed to mortgage-backed U.S. government agencies.

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

(Dollars in thousands)	June 30, 2016	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 20,259	\$ 20,299
Due after 1 year but within 5 years	45,319	46,809
Due after 5 years but within 10 years	62,105	65,602
Due after 10 years	4,894	5,003
	132,577	137,713
Mortgage-backed securities	25,974	26,377
Equity securities	3,168	3,252
	\$ 161,719	\$ 167,342

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

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

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

For all classes of loans, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days or more past due, or management has serious doubts about further collectability of principal or interest even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest is credited to income. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally, at least six 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.

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

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% 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% 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% loan to value level. Residential mortgage loans generally do not include prepayment penalties.

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

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

#### Consumer, including home equity

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

The largest component of Mid Penn's consumer loan portfolio consists of fixed rate home equity loans and variable rate home equity lines of credit. Substantially all home equity loans and lines of credit are secured by second mortgages on principal residences. The Bank will lend amounts, which, together with all prior liens, typically may be up to 85% 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.

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

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 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 \$117,000 at June 30, 2016 and \$94,500 at December 31, 2015. The allowance for loan and lease losses 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 for loan and lease losses, 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 for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.



The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a monthly evaluation of the adequacy of the allowance. The allowance is based on Mid Penn's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include changes in economic conditions, fluctuations in loan quality measures, changes in collateral values, changes in the experience of the lending staff and loan review systems, changes in lending policies and procedures (including underwriting standards), changes in the mix and volume of loans originated, the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio, shifting industry or portfolio concentrations, and other relevant factors.

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

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

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

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 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 (including home equity loans and other consumer loans) are recommended for charge-off after reaching delinquency of 90 days and the loan is not in the process of collection. The collateral shortfall of the consumer loan is recommended for charge-off at this point.

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

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

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

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

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

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

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

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 six 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 for loan and lease losses 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 for credit losses. 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.

## 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 \$200,000 as of June 30, 2016 and \$178,000 as of December 31, 2015), and the classified ratings of special mention, substandard, and doubtful within Mid Penn's internal risk rating system as of June 30, 2016 and December 31, 2015, are as follows:

(Dollars in thousands) June 30, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$ 158,254	\$ 729	\$ 1,295	\$ -	\$ 160,278
Commercial real estate	398,805	4,254	7,727	-	410,786
Commercial real estate - construction	54,342	1,732	-	-	56,074
Lease financing	565	-	-	-	565
Residential mortgage	102,397	180	1,245	-	103,822
Home equity	34,166	167	246	-	34,579
Consumer	3,049	-	-	-	3,049
	\$ 751,578	\$ 7,062	\$ 10,513	\$ -	\$ 769,153

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

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

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

(Dollars in thousands)	June 30, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	\$ 9	\$ 44	\$ -	\$ 14	\$ 49	\$ -
Commercial real estate:						
Commercial real estate	935	1,970	-	1,023	2,020	-
Acquired with credit deterioration	951	951	-	931	931	-
Residential mortgage:						
Residential mortgage	824	870	-	1,329	1,434	-
Acquired with credit deterioration	370	370	-	400	400	-
Home equity	64	73	-	115	137	-
With an allowance recorded:						
Commercial and industrial	\$ 59	\$ 63	\$ 3	\$ 113	\$ 128	\$ 51
Commercial real estate	2,722	2,783	769	1,947	1,981	429
Residential mortgage	-	-	-	32	32	23
Home equity	17	36	2	-	-	-
Total Impaired Loans:						
Commercial and industrial	\$ 68	\$ 107	\$ 3	\$ 127	\$ 177	\$ 51
Commercial real estate	4,608	5,704	769	3,901	4,932	429
Residential mortgage	1,194	1,240	-	1,761	1,866	23
Home equity	81	109	2	115	137	-

## 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, 2016 and June 30, 2015 are summarized as follows:

(Dollars in thousands)	Three Months Ended		June 30, 2015	
	Average Investment	Interest Recognized	Average Investment	Interest Recognized
With no related allowance recorded:				
Commercial and industrial:				
Commercial and industrial	\$ 11	\$ -	\$ 28	\$ -
Acquired with credit deterioration	-	-	194	105
Commercial real estate:				
Commercial real estate	960	-	1,164	-
Acquired with credit deterioration	943	-	992	347
Residential mortgage:				
Residential mortgage	831	7	956	-
Acquired with credit deterioration	377	-	428	-
Home equity	66	-	39	-
With an allowance recorded:				
Commercial and industrial	\$ 59	\$ -	\$ 578	\$ -
Commercial real estate	2,201	-	5,090	-
Residential mortgage	-	-	31	-
Home equity	17	-	202	-
Total Impaired Loans:				
Commercial and industrial	\$ 70	\$ -	\$ 800	\$ 105
Commercial real estate	4,104	-	7,246	347
Residential mortgage	1,208	7	1,415	-
Home equity	83	-	241	-



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

(Dollars in thousands)	Six Months Ended			
	June 30, 2016		June 30, 2015	
	Average	Interest	Average	Interest
	Recorded	Recognized	Recorded	Recognized
	Investmen	Investmen	Investmen	Investmen
With no related allowance recorded:				
Commercial and industrial:				
Commercial and industrial	\$ 14	\$ -	\$ 33	\$ -
Acquired with credit deterioration	-	-	78	105
Commercial real estate:				
Commercial real estate	1,001	-	1,272	-
Acquired with credit deterioration	934	-	397	347
Residential mortgage:				
Residential mortgage	777	9	817	-
Acquired with credit deterioration	375	4	171	-
Home equity	53	-	30	-
With an allowance recorded:				
Commercial and industrial	\$ 61	\$ -	\$ 374	\$ -
Commercial real estate	1,851	-	5,118	-
Residential mortgage	-	-	13	-
Home equity	19	-	154	-
Total Impaired Loans:				
Commercial and industrial	\$ 75	\$ -	\$ 485	\$ 105
Commercial real estate	3,786	-	6,787	347
Residential mortgage	1,152	13	1,001	-
Home equity	72	-	184	-

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

(Dollars in thousands)	June 30,	December
	2016	31, 2015

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Commercial and industrial	\$ 9	\$ 66
Commercial real estate	3,292	2,607
Residential mortgage	598	1,630
Home equity	96	115
	\$ 3,995	\$ 4,418

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

The performance and credit quality of the loan portfolio is also monitored by the 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, 2016 and December 31, 2015 are summarized as follows:

(Dollars in thousands)	30-59 Days Past	60-89 Days Past	Greater than 90 Days	Total Past	Current	Loans Receivable > 90 Days and Accruing	
						Total Loans	
June 30, 2016	Due	Due	Days	Due	Current	Total Loans	Accruing
Commercial and industrial	\$ -	\$ -	\$ 9	\$ 9	\$ 160,269	\$ 160,278	\$ -
Commercial real estate:							
Commercial real estate	-	6	2,062	2,068	407,767	409,835	16
Acquired with credit deterioration	-	-	57	57	894	951	57
Commercial real estate - construction	-	-	-	-	56,074	56,074	-
Lease financing	-	-	-	-	565	565	-
Residential mortgage:							
Residential mortgage	161	-	126	287	103,165	103,452	-
Acquired with credit deterioration	73	-	218	291	79	370	-
Home equity	-	7	79	86	34,493	34,579	-
Consumer	20	-	-	20	3,029	3,049	-
Total	\$ 254	\$ 13	\$ 2,551	\$ 2,818	\$ 766,335	\$ 769,153	\$ 73

  

(Dollars in thousands)	30-59 Days Past	60-89 Days Past	Greater than 90 Days	Total Past	Current	Loans Receivable > 90 Days and Accruing	
						Total Loans	
December 31, 2015	Due	Due	Days	Due	Current	Total Loans	Accruing
Commercial and industrial	\$ 55	\$ 204	\$ 66	\$ 325	\$ 159,936	\$ 160,261	\$ -
Commercial real estate:							
Commercial real estate	211	608	1,456	2,275	366,258	368,533	-
Acquired with credit deterioration	215	518	55	788	143	931	55
Commercial real estate - construction	-	-	-	-	68,068	68,068	-
Lease financing	-	-	-	-	727	727	-
Residential mortgage:							
Residential mortgage	694	550	778	2,022	100,921	102,943	-

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Acquired with credit deterioration	12	-	222	234	166	400	-
Home equity	-	50	23	73	33,338	33,411	-
Consumer	10	5	-	15	3,902	3,917	-
Total	\$ 1,197	\$ 1,935	\$ 2,600	\$ 5,732	\$ 733,459	\$ 739,191	\$ 55

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

The following tables summarize the allowance for loan and lease losses and recorded investments in loans receivable.

(Dollars in thousands)

As of, and for the periods and ended, June 30, 2016	Commercial industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Allowance for loan and lease losses:									
Beginning balance, 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, June 30, 2016	\$ 1,372	\$ 4,241	\$ 120	\$ 1	\$ 521	\$ 325	\$ 9	\$ 323	\$ 6,912

Allowance for loan and lease losses:	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
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:									

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

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

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

(Dollars in thousands)

As of, and for the periods and ended, June 30, 2015	Commercial industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Allowance for loan and lease losses:									
Beginning balance, April 1, 2015	\$ 1,639	\$ 3,626	\$ 35	\$ 1	\$ 544	\$ 519	\$ 37	\$ 165	\$ 6,566
Charge-offs	-	(55)	-	-	-	-	(6)	-	(61)
Recoveries	-	41	-	-	-	-	5	-	46
Provisions	109	279	5	1	(63)	92	4	(127)	300
Ending balance, June 30, 2015	\$ 1,748	\$ 3,891	\$ 40	\$ 2	\$ 481	\$ 611	\$ 40	\$ 38	\$ 6,851

Allowance for loan and lease losses:	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Beginning balance, January 1, 2015	\$ 1,393	\$ 3,925	\$ 33	\$ 2	\$ 450	\$ 653	\$ 35	\$ 225	\$ 6,716
Charge-offs	-	(505)	-	-	(1)	(29)	(11)	-	(546)
Recoveries	-	43	-	-	-	29	9	-	81
Provisions	355	428	7	-	32	(42)	7	(187)	600
Ending balance, June 30, 2015	1,748	3,891	40	2	481	611	40	38	6,851
Ending balance: individually evaluated for	219	1,367	-	-	23	134	-	-	1,743

impairment									
Ending									
balance:									
collectively									
evaluated for									
impairment	\$ 1,529	\$ 2,524	\$ 40	\$ 2	\$ 458	\$ 477	\$ 40	\$ 38	\$ 5,108
Loans									
receivables:									
Ending									
balance	\$ 162,783	\$ 339,877	\$ 66,477	\$ 925	\$ 98,833	\$ 32,839	\$ 3,418	\$ -	\$ 705,152
Ending									
balance:									
individually									
evaluated for									
impairment	603	6,197	-	-	1,008	237	-	-	8,045
Ending									
balance:									
acquired with									
credit									
deterioration	198	929	-	-	430	-	-	-	1,557
Ending									
balance:									
collectively									
evaluated for									
impairment	\$ 161,982	\$ 332,751	\$ 66,477	\$ 925	\$ 97,395	\$ 32,602	\$ 3,418	\$ -	\$ 695,550



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

(Dollars in thousands)

December 31, and 2015	Commercial industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Allowance for loan and lease losses:									
Ending balance	\$ 1,393	\$ 3,552	\$ 153	\$ 1	\$ 534	\$ 317	\$ 12	\$ 206	\$ 6,168
Ending balance: individually evaluated for impairment	51	429	-	-	23	-	-	-	503
Ending balance: collectively evaluated for impairment	\$ 1,342	\$ 3,123	\$ 153	\$ 1	\$ 511	\$ 317	\$ 12	\$ 206	\$ 5,665
Loans receivable:									
Ending balance	\$ 160,261	\$ 369,464	\$ 68,068	\$ 727	\$ 103,343	\$ 33,411	\$ 3,917	\$ -	\$ 739,191
Ending balance: individually evaluated for impairment	127	2,970	-	-	1,361	115	-	-	4,573
Ending balance: acquired with credit deterioration	-	931	-	-	400	-	-	-	1,331
Ending balance: collectively evaluated for impairment	\$ 160,134	\$ 365,563	\$ 68,068	\$ 727	\$ 101,582	\$ 33,296	\$ 3,917	\$ -	\$ 733,287

The recorded investments in troubled debt restructured loans at June 30, 2016 and December 31, 2015 are as follows:

(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
June 30, 2016			
Commercial and industrial	\$ 40	\$ 35	\$ 9
Commercial real estate	3,634	3,117	2,107
Residential mortgage	733	727	584
	\$ 4,407	\$ 3,879	\$ 2,700

(Dollars in thousands)	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
December 31, 2015			
Commercial and industrial	\$ 40	\$ 35	\$ 15
Commercial real estate	3,634	3,117	2,235
Residential mortgage	733	727	555
	\$ 4,407	\$ 3,879	\$ 2,805

Mid Penn entered into forbearance 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 BANCORP, INC. Notes to Consolidated Financial Statements (Unaudited)

Mid Penn had troubled debt restructured loans at June 30, 2016 totaled \$2,700,000. Five loans totaling \$932,000 represented accruing impaired loans in compliance with the terms of the modification. Four of these loans totaling \$582,000 are accruing impaired residential mortgages to unrelated borrowers, with one loan comprising \$521,000 of this total. Another loan is an accruing impaired commercial real estate loan for \$350,000. The remaining \$1,768,000, representing eight loans among three relationships, are nonaccrual impaired loans based upon a collateral evaluation in accordance with the guidance on impaired loans. One large relationship accounted for \$1,319,000 of the total \$1,768,000 in nonaccrual impaired troubled debt restructured loans.

At December 31, 2015, Mid Penn's troubled debt restructured loans totaled \$2,805,000, of which four loans totaling \$459,000, represented accruing impaired loans in compliance with the terms of the modification. Of the \$459,000, three are accruing impaired residential mortgages to unrelated borrowers totaling \$64,000 and the other one is an accruing impaired commercial real estate loan for \$395,000. The remaining \$2,346,000, representing nine loans among four relationships, are nonaccrual impaired loans based upon a collateral evaluation in accordance with the guidance on impaired loans. One large relationship accounts for \$1,370,000 of the \$2,346,000 nonaccrual impaired troubled debt restructured loan total.

As a result of management evaluations at June 30, 2016 and June 30, 2015, any specific allocations and charge-offs have been taken as appropriate. As of June 30, 2016 and June 30, 2015, 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, 2016. There were also no troubled debt restructured loans that defaulted within twelve months of restructure during the three months ended June 30, 2015; however, there were two troubled debt restructured loans to unrelated borrowers that defaulted within twelve months of restructuring totaling \$3,411,000 during the six months ended June 30, 2015. As of June 30, 2016, one forbearance agreement was negotiated during 2008, nine forbearance agreements were negotiated during 2009, two forbearance agreements were negotiated in 2013, and one forbearance agreement was negotiated during 2014.

There were no additional troubled debt restructured loans added during the three and six months ended June 30, 2016 or 2015.

As of June 30, 2016, Mid Penn had \$177,000 of residential real estate held in other real estate owned, and no loans for which formal foreclosure proceedings were in process. As of December 31, 2015, Mid Penn had \$358,000 of residential real estate held in other real estate owned, and no loans for which formal foreclosure proceedings were in process.

The following table provides activity for the accretable yield of acquired impaired loans for the three and six months ended June 30, 2016.

(Dollars in thousands)

Accretable yield, April 1, 2016	\$ 174
Accretable yield amortized to interest income	(31)
Reclassification from nonaccretable difference (a)	-
Accretable yield, June 30, 2016	\$ 143

(Dollars in thousands)

Accretable yield, January 1, 2016	\$ 178
Accretable yield amortized to interest income	(65)
Reclassification from nonaccretable difference (a)	30
Accretable yield, June 30, 2016	\$ 143

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

## (5) 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.

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

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.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the 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 three and six months ended June 30, 2016.

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

(Dollars in thousands)	Total carrying value at June 30, 2016	Fair value measurements at June 30, 2016 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
U.S. Treasury and U.S. government agencies	\$ 44,875	\$ -	\$ 44,875	\$ -
Mortgage-backed U.S. government agencies	26,377	-	26,377	-
State and political subdivision obligations	92,838	-	92,838	-
Equity securities	3,252	1,088	2,164	-
	\$ 167,342	\$ 1,088	\$ 166,254	\$ -

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

(Dollars in thousands)	Total carrying value at December 31, 2015	Fair value measurements at December 31, 2015 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
U.S. Treasury and U.S. government agencies	\$ 26,990	\$ -	\$ 26,990	\$ -
Mortgage-backed U.S. government agencies	38,804	-	38,804	-
State and political subdivision obligations	66,617	-	66,617	-
Equity securities	3,310	1,240	2,070	-
	\$ 135,721	\$ 1,240	\$ 134,481	\$ -

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 June 30, 2016	Fair value measurements at June 30, 2016 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Impaired Loans	\$ 2,415	\$ -	\$ -	\$ 2,415
Foreclosed Assets Held for Sale	474	-	-	474
Mortgage Servicing Rights	152	-	-	152

(Dollars in thousands)	Total carrying value at December	Fair value measurements at December 31, 2015 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:	31, 2015			
Impaired Loans	\$ 2,088	\$ -	\$ -	\$ 2,088
Foreclosed Assets Held for Sale	453	-	-	453
Mortgage Servicing Rights	174	-	-	174



## 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 Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
June 30, 2016					
Impaired Loans	\$ 2,415	Appraisal of collateral (a)	Appraisal adjustments (b)	10% - 60%	30%
Foreclosed Assets Held for Sale	474	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	17% - 31%	25%
Mortgage Servicing Rights	152	Multiple of annual service fee	Estimated prepayment speed based on rate and term	210% - 400%	360%

(Dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
December 31, 2015					
Impaired Loans	\$ 2,088	Appraisal of collateral (a)	Appraisal adjustments (b)	11% - 60%	30%
Foreclosed Assets Held for Sale	453	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	17% - 27%	26%
Mortgage Servicing Rights	174	Multiple of annual service fee	Estimated prepayment speed based on rate and term	210% - 400%	360%

(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.

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

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 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 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 issues; however no allowance recommendation will be made until which time 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 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.

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.



## 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, 2016 and December 31, 2015.

(Dollars in thousands)	June 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 40,960	\$ 40,960	\$ 13,284	\$ 13,284
Interest-bearing time balances with other financial institutions	987	987	4,317	4,317
Investment securities	167,342	167,342	135,721	135,721
Net loans and leases	762,241	778,031	733,023	738,773
Restricted investment in bank stocks	2,643	2,643	4,266	4,266
Accrued interest receivable	3,943	3,943	3,813	3,813
Mortgage servicing rights	152	152	174	174
<b>Financial liabilities:</b>				
Deposits	\$ 893,440	\$ 895,257	\$ 777,043	\$ 777,320
Short-term borrowings	-	-	31,596	31,596
Long-term debt	30,194	30,093	40,305	39,626
Subordinated debt	7,409	7,409	7,414	7,414
Accrued interest payable	698	698	390	390
<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, 2016 and December 31, 2015. Carrying values approximate fair values for cash and cash equivalents, interest-bearing time balances with other financial institutions, 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)	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2016					
Financial instruments - assets					
Net loans and leases	\$ 762,241	\$ 778,031	\$ -	\$ -	\$ 778,031
Financial instruments - liabilities					
Deposits	\$ 893,440	\$ 895,257	\$ -	\$ 895,257	\$ -
Long-term debt	30,194	30,093	-	30,093	-

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

(Dollars in thousands)	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015					
Financial instruments - assets					
Net loans and leases	\$ 733,023	\$ 738,773	\$ -	\$ -	\$ 738,773
Financial instruments - liabilities					
Deposits	\$ 777,043	\$ 777,320	\$ -	\$ 777,320	\$ -
Long-term debt	40,305	39,626	-	39,626	-

(6) Guarantees

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 \$13,845,000 and \$15,805,000 standby letters of credit outstanding as of June 30, 2016 and December 31, 2015, respectively. Mid Penn does not anticipate any losses because of these transactions. The current amount of the liability as of June 30, 2016 for payment under standby letters of credit issued was not material.

(7) 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 times 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, its principal banking subsidiary’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 debt issuance costs associated with the Notes were \$91,000 at June 30, 2016 and \$86,000 at December 31, 2015.

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

## (8) 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 benefit plans are as follows:

(Dollars in thousands)	Three Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2016	2015	2016	2015
Service cost	\$ 8	\$ 9	\$ 1	\$ 3
Interest cost	11	12	5	8
Amortization of prior service cost	8	3	6	-
Net periodic benefit cost	\$ 27	\$ 24	\$ 12	\$ 11

(Dollars in thousands)	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2016	2015	2016	2015
Service cost	\$ 17	\$ 17	\$ 2	\$ 6
Interest cost	23	23	11	16
Amortization of prior service cost	25	7	91	-
Net periodic benefit cost	\$ 65	\$ 47	\$ 104	\$ 22

## (9) Accumulated Other Comprehensive Income

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

(Dollars in thousands)	Unrealized Gain on Securities	Defined Benefit Plans Liabilities	Accumulated Other Comprehensive Income
Balance - June 30, 2016	\$ 3,645	\$ 131	\$ 3,776
Balance - December 31, 2015	\$ 1,565	\$ 247	\$ 1,812

## (10) Common Stock

On May 6, 2014, the Mid Penn Bancorp, Inc. 2014 Restricted Stock Plan (the "Plan") was approved by shareholders. The Plan provides that awards 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. Current outstanding awards under the Plan require recipients to acquire specified ownership interest levels in Mid Penn in order for such award to vest, and thereby, encouraging them to contribute to the success of the company.

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, 2016, 8,975 shares have been granted under the plan, which resulted in \$8,000 in compensation expense for the three months ended June 30, 2016, while no expense was recorded for the three months ended June 30, 2015. Compensation expense was \$17,000 for the six months ended June 30, 2016 compared to \$8,000 for the same period in 2015. As of June 30, 2016, 875 of the granted shares were vested, while the remaining 8,100 granted shares remain unvested.



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

(11) Preferred Stock

Small Business Lending Fund Preferred Stock

On March 1, 2015, Mid Penn assumed all of the issued and outstanding shares of Phoenix with respect to 1,750 shares of Phoenix's preferred stock issued to the Treasury in connection with the Small Business Lending Fund and issued 1,750 shares of SBLF Preferred Shares, having a \$1,000 liquidation preference per share, to the Treasury. The SBLF Preferred Shares qualified as Tier 1 capital and had terms and conditions identical to those shares of preferred stock issued by Phoenix to the Treasury. Mid Penn paid noncumulative dividends payable quarterly on January 1, April 1, July 1, and October 1. The dividend rate was 1.00% per annum for payment dates up to January 19, 2016.

On December 15, 2015, Mid Penn, using a portion of the proceeds from the offering of its Subordinate Debt Notes (see Note 7), redeemed all of the outstanding shares of its SBLF Preferred Shares which were held by the Treasury for an aggregate redemption price of \$1,754,000, including accrued but unpaid dividends.

Series B Preferred Stock

Between September 26, 2012 and January 3, 2013, Mid Penn issued, via private placement, 5,000 shares of its 7% Non-Cumulative Non-Voting Non-Convertible Perpetual Preferred Stock, Series B ("Series B Preferred Stock") resulting in total gross proceeds of \$5,000,000 for the offering. On December 9, 2015, Mid Penn, using a portion of the proceeds from the offering of the Notes, redeemed all of its issued and outstanding shares of Series B Preferred Stock at a price equal to \$1,024.67 per share, which is equal to \$1,020 per share plus an amount equal to declared but unpaid dividends on December 9, 2015, for a total redemption price of \$5,123,000.

(12) Earnings per Common Share

Earnings per share are computed by dividing net income available to common shareholders 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.

The computations of basic earnings per common share are as follows:

(Dollars in thousands, except per share data)	Three Months Ended June		Six Months Ended June 30,	
	30, 2016	2015	2016	2015
Net Income	\$ 2,022	\$ 2,044	\$ 3,827	\$ 3,007
Less: Dividends on Series B preferred stock	-	88	-	175
Dividends on Series C preferred stock	-	4	-	4
Net income available to common shareholders	\$ 2,022	\$ 1,952	\$ 3,827	\$ 2,828
Weighted average common shares outstanding	4,227,992	4,222,704	4,227,362	3,986,249
Basic earnings per common share	\$ 0.48	\$ 0.46	\$ 0.91	\$ 0.71

Mid Penn had no dilutive instruments outstanding during the periods ended June 30, 2016 and 2015.

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

(13) Recent Accounting Pronouncements

ASU 2016-13: The Financial Accounting Standards Board (“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 credit losses 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 for credit losses 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 (AFS) 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 this ASU to determine the future impact on its consolidated financial statements.

ASU 2016-12: The FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.

The amendments do not alter the core principle of the new revenue standard, but make certain targeted changes to clarify the following:

- Assessing collectability - The amendments add a “substantially all” threshold to the collectability criterion, and also clarify that the objective of the collectability assessment is to determine whether the contract is valid and represents a substantive transaction based on whether a customer has the ability and intent to pay for the goods or services that will be transferred to the customer, as opposed to all of the goods or services promised in the contract. The ASU also clarifies how an entity may recognize as revenue consideration received in circumstances where a contract does not meet the criteria required at inception to apply the recognition guidance within the revenue standard.
- Presenting sales taxes and other similar taxes collected from customers - The amendments provide an accounting policy election whereby an entity may exclude from the measurement of transaction price all taxes assessed by a taxing authority related to the specific transaction and which are collected from the customer. Such amounts would be presented “net” under this option.
- Noncash consideration - The amendments clarify that the fair value of noncash consideration is measured at contract inception, and specify how to account for subsequent changes in the fair value of noncash consideration.
- Contract modifications at transition - The amendments provide a new practical expedient whereby an entity electing either the full or modified retrospective method of transition is permitted to reflect the aggregate effect of all prior period modifications (using hindsight) when identifying satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price to satisfied and unsatisfied obligations.
- Completed contracts at transition - The amendments include certain practical expedients in transition related to completed contracts. The amendments also clarify the definition of a completed contract.
- Disclosing the accounting change in the period of adoption – ASU 2016-12 provides an exception to the requirement in Topic 250 to disclose the effect on the current period of retrospectively adopting a new accounting standard

The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of Topic 606.



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

Mid Penn is currently evaluating this ASU to determine the impact on its consolidated financial statements.

ASU 2016-10: The FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.

The amendments in ASU 2016-10 provide more detailed guidance, including additional implementation guidance and examples in the following key areas of Topic 606:

#### Identifying performance obligations

The ASU more clearly articulates the guidance for assessing whether promises are separately identifiable in the overall context of the contract, which is one of two criteria for determining whether promises are distinct. The ASU also clarifies the factors an entity should consider when assessing whether two or more promises are separately identifiable, and provide additional examples within the implementation guidance for assessing these factors.

The ASU further clarifies that an entity is not required to identify promised goods or services that are immaterial in the context of the contract, although customer options to purchase additional goods or services which represent a material right should not be designated as immaterial in the context of the contract. It also provides an accounting policy election whereby an entity may account for shipping and handling activities as a fulfillment activity rather than as an additional promised service in certain circumstances.

#### Licenses of intellectual property

The ASU clarifies whether a license of intellectual property (IP) represents a right to use the IP, which is satisfied at a point in time, or a right to access the IP, which is satisfied over time, by categorizing the underlying IP as either functional or symbolic. The ASU describes attributes of functional and symbolic IP and provides examples of each. A promise to grant a license that is not a separate performance obligation must be considered in the context above (i.e., functional or symbolic), in order to determine whether the combined performance obligation is satisfied at a point in time or over time, and how to best measure progress toward completion if recognized over time. Regardless of a license's nature (i.e., functional or symbolic), an entity may not recognize revenue from a license of IP before 1) it provides or otherwise makes available a copy of the IP to the customer, and 2) the period during which the customer is able to use and benefit from the license has begun (i.e., the beginning of the license period).

Additionally, the ASU clarifies two aspects of the implementation guidance on when to recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of IP. Specifically: 1) an entity should not split a sales-based or usage-based royalty into a portion subject to the guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance; and 2) the guidance on sales-based and usage-based royalties applies

whenever the predominant item to which the royalty relates is a license of IP. The amendments also distinguish contractual provisions requiring the transfer of additional rights to use or access IP that the customer does not already control from provisions that are attributes of a license (e.g., restrictions of time, geography, or use). License attributes define the scope of the rights conveyed to the customer; they do not determine when the entity satisfies a performance obligation.

The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements of Topic 606.

ASU 2016-08: The FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).

ASU 2016-08 updates the new revenue standard by clarifying the principal versus agent implementation guidance, but does not change the core principle of the new standard. The updates to the principal versus agent guidance:

- require an entity to determine whether it is a principal or an agent for each distinct good or service (or a distinct bundle of goods or services) to be provided to the customer;
- illustrate how an entity that is a principal might apply the control principle to goods, services, or rights to services, when another party is involved in providing goods or services to a customer;
- clarify that the purpose of certain specific control indicators is to support or assist in the assessment of whether an entity controls a good or service before it is transferred to the customer, provide more specific guidance on how the indicators should be considered, and clarify that their relevance will vary depending on the facts and circumstances; and
- revise existing examples and add two new ones to more clearly depict how the guidance should be applied.

The effective date and transition requirements for ASU 2016-08 are the same as the effective date and transition requirements of Topic 606, which is described below under ASU 2015-14.

Mid Penn is currently evaluating this ASU to determine the impact on its consolidated financial statements.

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

ASU 2016-09: The Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.

ASU 2016-09 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.

Mid Penn is currently evaluating this ASU to determine the impact on its consolidated financial statements.

ASU 2016-07: The FASB issued ASU 2016-07, Investments-Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting.

The ASU requires an investor to initially apply the equity method of accounting from the date it qualifies for that method, i.e., the date the investor obtains significant influence over the operating and financial policies of an investee. It also eliminates the previous requirement to retroactively adjust the investment and record a cumulative catch up for

the periods that the investment had been held, but did not qualify for the equity method of accounting.

The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the application of the equity method. Early adoption is permitted.

Mid Penn is currently evaluating this ASU to determine the impact on its 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 nonlease 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.

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

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 is currently evaluating this ASU to determine the future impact on its consolidated financial statements.

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 a 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.

Mid Penn is currently evaluating this ASU to determine the future impact on its consolidated financial statements.

ASU 2015-16: The FASB issued ASU 2015-16, Business Combination (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments).

The ASU requires adjustments to provisional amounts that are identified during the measurement period to be recognized in the reporting period in which the adjustment amounts are determined. This includes any effect on earnings of changes in depreciation, amortization, or other income effects as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date.

In addition, the amendments in the proposed ASU would require an entity to disclose (either on the face of the income statement or in the notes) the nature and amount of measurement-period adjustments recognized in the current period, including separately the amounts in current-period income statement line items that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

The amendments are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The amendments in this ASU should be applied prospectively to measurement-period adjustments that occur after the effective date of this ASU.

Mid Penn early adopted this guidance in 2015. The adoption of this guidance was not material to the consolidated financial statements.

ASU 2015-14: The FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date.

The ASU defers the effective date of the new revenue recognition standard by one year. As such, it now takes effect for public entities in fiscal years beginning after December 15, 2017. All other entities have an additional year. However, early adoption is permitted for any entity that chooses to adopt the new standard as of the original effective date. Public business entities will adopt the standard for annual reporting periods beginning after December 15, 2017, including interim periods within that year. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year. All other entities will adopt the standard for annual reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. Early adoption is permitted as of either an annual reporting period beginning after December 15, 2016, including interim periods within that year, or an annual reporting period beginning after December 15, 2016 and interim periods within annual reporting periods beginning one year after the annual period in which an entity first applies the new standard.

Mid Penn is currently evaluating the effects this ASU to determine the future impact on its consolidated financial statements.



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, 2016, compared to year-end 2015, and the Results of Operations for the three and six months ended June 30, 2016, compared to the same periods in 2015. For comparative purposes, the June 30, 2015 and December 31, 2015 balances have been reclassified, when, and if necessary, to conform to the 2016 presentation. Such reclassifications had no impact on net income.

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, 2015 (the "2015 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 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 their accuracy. Actual results may differ materially from those expressed in these forward-looking statements due to a number of uncertainties and risks, including the risks described in the 2015 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 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 the capital stock of Mid Penn or Mid Penn Bank;
- impacts of the capital and liquidity requirements imposed by Basel III standards and other regulatory pronouncements, regulations and rules;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory 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, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- 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 acquisition strategy;
- our acquisition strategy may not be successful in locating advantageous targets or acquiring targets at advantageous prices;
- our ability to successfully integrate any banks, companies, assets, liabilities, customers, systems and management personnel we acquire into our operations 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;
- results of the regulator examination and supervision process;
- 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;

MID PENN BANCORP, INC.

- acts of war or terrorism;
- our ability to maintain compliance with the exchange rules of The NASDAQ Stock Market LLC.;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- disruptions due to flooding, severe weather, or other natural disasters of Acts of God;
- volatilities in the securities markets; and
- slow economic conditions.

This 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.

### 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 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 Corporation considers the accounting judgments relating to the allowance for loan and lease losses, the evaluation of the Corporation's investment securities for other-than-temporary impairment, the valuation of the Corporation'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 for loan and lease losses represents management's estimate of probable incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance for loan and lease losses 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 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

The comparability of the financial condition and results of operations as of and for the three and six months ended June 30, 2016 and 2015, in general, have been impacted by the acquisition of Phoenix.

## Overview

Net income available to common shareholders was \$2,022,000 or \$0.48 per common share, for the quarter ended June 30, 2016, as compared to net income available to common shareholders of \$1,952,000 or \$0.46 per common share, for the quarter ended June 30, 2015. During the six months ended June 30, 2016, net income available to common shareholders was \$3,827,000 or \$0.91 per common share, versus \$2,828,000 or \$0.71 per common share, for the six months ended June 30, 2015. The results for the six months ended June 30, 2015 were impacted by \$762,000 in non-recurring merger-related expenses associated with Mid Penn's acquisition of Phoenix on March 1, 2015.

## MID PENN BANCORP, INC.

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

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2016	2015	2016	2015
Return on average assets	0.82%	0.91%	0.80%	0.71%
Return on average equity	11.28%	11.21%	10.75%	8.89%

## 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%.

Net interest income increased \$47,000 or 0.6% to \$8,533,000 for the quarter ended June 30, 2016 from \$8,486,000 during the quarter ended June 30, 2015. During the six months ended June 30, 2016, net interest income increased \$1,424,000 or 9.2% to \$16,948,000, from \$15,524,000 during the six months ended June 30, 2015. Net interest income in 2016 was positively impacted by core loan growth, as well as a full six months of income on the interest-earning assets from the Phoenix acquisition as compared to four months in 2015.

For the three months ended June 30, 2016, Mid Penn’s taxable-equivalent net interest margin was 3.85% compared to 4.22% for the three months ended June 30, 2015. For the six months ended June 30, 2016, Mid Penn’s taxable-equivalent net interest margin was 3.90%, versus 4.10% for the six months ended June 30, 2015. The higher net interest margin in 2015 was predominantly the result of the recognition of \$452,000 of income in both the three and six months ended June 30, 2015 from the successful resolution of three legacy Phoenix loans acquired with credit deterioration. Also, the investment portfolio had a lower yield during the three and six months ended June 30, 2016, versus the same periods in 2015, as several securities which matured or were called during 2016 had higher yields compared to replacement investments purchased in the persistent lower-yield bond market conditions.

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 the 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 for loan and lease losses 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 for loan and lease losses in accordance with Mid Penn's assessment process, which takes into consideration the risk characteristics of the loan portfolio, the growth in the loan portfolio during the first six months of 2016, and shifting collateral values from December 31, 2015 to June 30, 2016.

Based upon a determination of loan and lease loss allowance adequacy, management recorded a \$395,000 provision for the three months ended June 30, 2016 compared to a provision of \$300,000 for the three months ended June 30, 2015. During the six months ended June 30, 2016, the provision for loan and lease losses was \$735,000, compared to \$600,000 for the six months ended June 30, 2015. The allowance for loan and lease losses as a percentage of total loans was 0.90% at June 30, 2016, compared to 0.83% at December 31, 2015. 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.

## MID PENN BANCORP, INC.

## Noninterest Income

Noninterest income increased \$305,000 or 27.9% during the second quarter of 2016 versus the same period in 2015. During the six months ended June 30, 2016, noninterest income increased \$588,000 or 28.8%, versus the same period in 2015. The following components of noninterest income showed significant changes:

(Dollars in Thousands)	Three Months Ended June 30,			
	2016	2015	\$ Variance	% Variance
Net gain on sales of investment securities	\$ 213	\$ -	\$ 213	NA
Mortgage banking income	246	153	93	60.8%

(Dollars in Thousands)	Six Months Ended June 30,			
	2016	2015	\$ Variance	% Variance
Net gain on sales of investment securities	\$ 213	\$ 177	\$ 36	20.3%
Mortgage banking income	432	220	212	96.4%
Net gain on sales of SBA loans	265	143	122	85.3%
Other income	466	349	117	33.5%

For the first half of 2016, mortgage banking income favorably increased \$212,000 over the same period in 2015. Increased residential real estate financing activity throughout Mid Penn's footprint, favorably low mortgage market interest rates, and the addition of seasoned loan originators collectively contributed to the increased revenue from this business line.

Mid Penn also experienced increased origination and sales activity in Small Business Administration ("SBA") loans, resulting in an increase of \$122,000 of related loan sale gains during the first six months of 2016 compared to the same period in 2015. More qualified borrowers continue to take advantage of Mid Penn's Preferred Lender status with the SBA.

During the second quarter of 2016, Mid Penn took advantage of increased market values on several securities to reposition some of its investment portfolio, including selling a large volume of longer-term and rate-sensitive collateralized mortgage obligations ("CMOs"), as well as certain municipal bonds and agency notes. Mid Penn realized \$213,000 in securities gains in the first half of 2016 as a result of these investment management activities. In comparison, during the first six months of 2015, Mid Penn realized \$177,000 from gains on sales of securities.

Other noninterest income increased \$117,000 for the six months ended June 30, 2016 compared to the six months ended June 30, 2015, primarily as a result of the \$86,000 gain on the sale of insurance policies upon the dissolution of

Edgar Filing: MID PENN BANCORP INC - Form 10-Q

Mid Penn Insurance Services, LLC, which was a wholly-owned subsidiary of Mid Penn Bank, effective March 1, 2016. The decision was made to liquidate the subsidiary due to the lack of consistent profitability and growth.

Noninterest Expense

Noninterest expense increased \$279,000 or 4.2% during the second quarter of 2016, versus the same period in 2015. During the six months ended June 30, 2016, noninterest expenses increased \$621,000, or 4.7%, versus the same period in 2015. The changes were primarily a result of the following components of noninterest expense:

(Dollars in Thousands)	Three Months Ended June 30,			
	2016	2015	Variance	% Variance
			\$	
Salaries and employee benefits	\$ 3,723	\$ 3,440	\$ 283	8.2%
Pennsylvania Bank Shares tax expense	206	116	90	77.6%

(Dollars in Thousands)	Six Months Ended June 30,			
	2016	2015	Variance	% Variance
			\$	
Salaries and employee benefits	\$ 7,446	\$ 6,760	\$ 686	10.1%
Occupancy expense, net	1,046	950	96	10.1%
Equipment expense	846	735	111	15.1%
Pennsylvania Bank Shares tax expense	409	231	178	77.1%
Loss on sale/write-down of foreclosed assets	132	17	115	676.5%
Merger and acquisition expense	-	762	(762)	-100.0%
Other expenses	2,095	1,955	140	7.2%

MID PENN BANCORP, INC.

Salaries and employee benefit expenses increased \$686,000 during the six months ended June 30, 2016 versus the same period in 2015. The increase primarily was attributable to franchise expansion, including (i) the addition of employees from the Phoenix acquisition on March 1, 2015, (ii) staff added to serve in Mid Penn's branch in the Mechanicsburg, PA market opened in June 2015, and (iii) an increase in lending personnel and credit support staff in alignment with Mid Penn's core banking growth.

In connection with the acquisition of Phoenix in March 2015, Mid Penn incurred \$762,000 of nonrecurring merger-related expenses in the first half of 2015, while no merger expenses were incurred in the first six months of 2016.

Mid Penn realized losses of \$132,000 on the sale/write-down of foreclosed assets during the first half of 2016, as compared to \$17,000 for the same period in 2015, reflecting the workout of certain holdings in the Bank's portfolio of other real estate owned.

Occupancy expenses for the six months ended June 30, 2016 increased by \$96,000 compared to the same period in 2015. This increase was impacted by the inclusion of rent and other occupancy costs from the four acquired Phoenix branches and the addition of the Mechanicsburg, PA branch. Equipment expenses, bank shares tax expense, and other expenses also saw increases for the first six months of 2016 compared to the same period of 2015 related primarily to franchise growth.

#### Income Taxes

The provision for income taxes was \$593,000 for both the three months ended June 30, 2016 and the three months ended June 30, 2015. The effective tax rate for the three months ended June 30, 2016 was 22.7% compared to 22.5% for the three months ended June 30, 2015. The provision for income taxes for the six months ended June 30, 2016 was \$1,113,000, compared to \$677,000 during the same period in 2015. The effective tax rate for the six months ended June 30, 2016 was 22.5%, compared to 18.4% for the six months ended June 30, 2015. The lower provision for the six months ended June 30, 2015 was caused by the \$762,000 in merger-related expenses, of which \$101,000 was deemed a nondeductible expense.

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



## Financial Condition

## Overview

Mid Penn's total assets increased \$81,246,000 or 8.7% to \$1,012,884,000 at June 30, 2016 from \$931,638,000 at December 31, 2015. The increase in total assets was impacted by strong deposit growth, particularly in new retail customers, and nonprofit and government deposits. Total deposits increased \$116,397,000 to \$893,440,000 at June 30, 2016 from \$777,043,000 at December 31, 2015. Growth in public fund deposits required Mid Penn to purchase additional investments for pledging purposes, contributing to the increase in the investment portfolio during the first half of 2016. In addition, these deposits helped fund loan growth and allowed Mid Penn to payoff short-term borrowings in 2016.

## Loans

During the first six months of 2016, Mid Penn experienced an increase in gross loans outstanding of \$29,962,000 or 4.1%, mainly in the commercial real estate category, which accounted for the majority of Mid Penn's loan growth as noted in the table below.

(Dollars in thousands)	June 30, 2016		December 31, 2015	
	Amount	%	Amount	%
Commercial and industrial	\$ 160,278	20.8%	\$ 160,261	21.7%
Commercial real estate	410,786	53.4%	369,464	50.0%
Commercial real estate - construction	56,074	7.3%	68,068	9.2%
Lease financing	565	0.1%	727	0.1%
Residential mortgage	103,822	13.5%	103,343	14.0%
Home equity	34,579	4.5%	33,411	4.5%
Consumer	3,049	0.4%	3,917	0.5%
	\$ 769,153	100.0%	\$ 739,191	100.0%

MID PENN BANCORP, INC.

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

During the first six months of 2016, Mid Penn had net recoveries of \$9,000 compared to net charge-offs of \$465,000 during the same period of 2015. Loans charged off during the first six months of 2016 totaled \$185,000 and included eight commercial real estate loans among six relationships totaling \$150,000, one home equity loan for \$25,000 and one consumer loan for \$4,000. Additional charge-offs of \$6,000 were predominantly comprised of deposit account charge-offs, as well as one residential mortgage. 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.

Changes in the allowance for loan and lease losses for the six months ended June 30, 2016 and 2015 are summarized as follows:

(Dollars in thousands)	Six Months Ended	
	June 30,	
	2016	2015
Balance, beginning of period	\$ 6,168	\$ 6,716
Loans charged off during period	(185)	(546)
Recoveries of loans previously charged off	194	81
Net recoveries (charge-offs)	9	(465)
Provision for loan and lease losses	735	600
Balance, end of period	\$ 6,912	\$ 6,851
Ratio of net loans charged off to average loans outstanding (annualized)	0.00%	0.14%
Ratio of allowance for loan losses to net loans at end of period	0.90%	0.97%

Other than as described herein, Mid Penn does not believe there are any trends, events or uncertainties 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 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.

## MID PENN BANCORP, INC.

At June 30, 2016, total nonperforming loans amounted to \$4,927,000 or 0.64% of loans and leases net of unearned income, compared to levels of \$4,877,000 or 0.66% at December 31, 2015, and \$8,574,000 or 1.22% at June 30, 2015.

(Dollars in thousands)

	June 30, 2016	December 31, 2015	June 30, 2015
<b>Nonperforming Assets:</b>			
Nonaccrual loans	\$ 3,995	\$ 4,418	\$ 6,636
Accruing troubled debt restructured loans	932	459	1,938
Total nonperforming loans	4,927	4,877	8,574
Foreclosed real estate	540	1,185	767
Other repossessed property	1	-	-
Total non-performing assets	5,468	6,062	9,341
Accruing loans 90 days or more past due	73	55	52
Total risk elements	\$ 5,541	\$ 6,117	\$ 9,393
Nonperforming loans as a % of total loans outstanding	0.64%	0.66%	1.22%
Nonperforming assets as a % of total loans outstanding and other real estate	0.71%	0.82%	1.32%
Ratio of allowance for loan losses to nonperforming loans	140.28%	126.46%	79.90%

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

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, 2016	December 31, 2015
Period ending total loans outstanding (net of unearned interest)	\$ 769,153	\$ 739,191
Allowance for loan and lease losses	6,912	6,168
Total Nonperforming loans	4,927	4,877
Nonperforming and impaired loans with partial charge-offs	1,710	1,869
Ratio of nonperforming loans with partial charge-offs to total loans	0.22%	0.25%
Ratio of nonperforming loans with partial charge-offs to total nonperforming loans	34.71%	38.32%
Coverage ratio net of nonperforming loans with partial charge-offs	214.86%	205.05%
Ratio of total allowance to total loans less nonperforming loans with partial charge-offs	0.90%	0.84%

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 in the process of 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 BANCORP, INC.

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 in the process of 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.

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.

Excluding \$1,321,000 in loans acquired with credit deterioration from the Phoenix acquisition, Mid Penn had several loan relationships deemed impaired with an aggregate carrying balance of \$4,630,000. This pool of loans was further broken down into a group of loans with an aggregate carrying balance of \$2,798,000 for which specific allocations totaling \$774,000 were included within the loan loss reserve for these loans. The remaining \$1,832,000 of loans required no specific allocation within the loan loss reserve. The \$4,630,000 of impaired loan relationships were comprised of \$3,657,000 in commercial real estate relationships, \$824,000 in residential relationships, \$81,000 in home equity relationships, and \$68,000 in commercial and industrial relationships. There were specific loan loss reserve allocations of \$769,000 against the commercial real estate relationships, \$3,000 against the commercial and industrial relationships, and \$2,000 against home equity relationships. Management currently believes that the specific reserves are adequate to cover probable future losses related to these relationships.

MID PENN BANCORP, INC.

The allowance for loan and lease losses 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 for loan and lease losses 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 for loan and lease losses 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.

While the allowance for loan and lease losses 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. Changes in these estimates



may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance for loan and lease losses of \$6,912,000 is adequate as of June 30, 2016 is adequate 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 major source 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 BANCORP, INC.

Major sources of cash received in the first six months of 2015 came from the sale of investment securities of \$16,091,000, the \$14,403,000 increase in short-term borrowings, and the net cash received from the Phoenix acquisition of \$8,095,000.

Major uses of cash in the first six months of 2015 were the increase in net loans and leases of \$24,202,000, the purchases of investment securities of \$8,312,000, and the decrease in deposits of \$7,235,000.

Mid Penn believes its core deposits are 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.

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 times 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 debt issuance costs associated with the Notes were \$91,000 at June 30, 2016 and \$86,000 at December 31, 2015.

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% level. A summary of the payout restrictions based on the capital conservation buffer is as follows:

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

## MID PENN BANCORP, INC.

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 effective January 1, 2016):

	As of January 1,				
	2015	2016	2017	2018	2019
Minimum common equity Tier 1 capital ratio	4.5%	4.5%	4.5%	4.5%	4.5%
Common equity Tier 1 capital conservation buffer	N/A	0.625%	1.25%	1.875%	2.5%
Minimum common equity Tier 1 capital ratio plus capital conservation buffer	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of most deductions from common equity Tier 1 capital	40%	60%	80%	100%	100%
Minimum Tier 1 capital ratio	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Tier 1 capital ratio plus capital conservation buffer	N/A	6.625%	7.25%	7.875%	8.5%
Minimum total capital ratio	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum total capital ratio plus capital conservation buffer	N/A	8.625%	9.25%	9.875%	10.5%

The final rules allow 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 grandfather 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 replace 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.

Mid Penn has assessed the impact of these changes on the regulatory ratios of Mid Penn and the Bank on the capital, operations, liquidity and earnings of Mid Penn and the Bank, and 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. The buildup makes it difficult for a corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital adequacy has been, and will continue to be, of paramount importance.

Shareholders' equity increased during the six months ended June 30, 2016 by \$4,406,000 or 6.3% from December 31, 2015. Capital was positively impacted by positive earnings of \$3,827,000 and an increase in AOCI of \$1,964,000. Capital was reduced by the payment of \$1,437,000 in common stock dividends during the first half of 2016. All of Mid Penn's investment securities are classified as available for sale, making accumulated other comprehensive income sensitive to the changing market value of investments.

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

## MID PENN BANCORP, INC.

Mid Penn and Mid Penn Bank maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios as of June 30, 2016 and December 31, 2015:

(Dollars in thousands)	Capital Adequacy				To Be Well-Capitalized Under Prompt Corrective Action Provisions:	
	Actual: Amount	Ratio	Minimum Capital Required: Amount	Ratio	Amount	Ratio
<b>Corporation</b>						
As of June 30, 2016:						
Tier 1 Capital (to Average Assets)	\$ 67,873	6.9%	\$ 39,402	4.0%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	67,873	9.2%	37,649	5.125%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	67,873	9.2%	48,669	6.625%	N/A	N/A
Total Capital (to Risk Weighted Assets)	82,311	11.2%	63,361	8.625%	N/A	N/A
<b>Bank</b>						
As of June 30, 2016:						
Tier 1 Capital (to Average Assets)	\$ 74,343	7.6%	\$ 39,229	4.0%	\$ 49,036	5.0%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	74,343	10.1%	37,618	5.125%	47,710	6.5%
Tier 1 Capital (to Risk Weighted Assets)	74,343	10.1%	48,628	6.625%	58,721	8.0%
Total Capital (to Risk Weighted Assets)	81,372	11.1%	63,308	8.625%	73,401	10.0%
<b>Corporation</b>						
As of December 31, 2015:						
Tier 1 Capital (to Average Assets)	\$ 64,089	7.1%	\$ 35,098	4.0%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	64,089	9.1%	31,731	4.5%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	64,089	9.1%	42,308	6.0%	N/A	N/A
Total Capital (to Risk Weighted Assets)	77,852	11.0%	56,410	8.0%	N/A	N/A
<b>Bank</b>						
As of December 31, 2015:						
Tier 1 Capital (to Average Assets)	\$ 70,351	7.8%	\$ 36,245	4.0%	\$ 45,306	5.0%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	70,351	10.0%	31,698	4.5%	45,786	6.5%
Tier 1 Capital (to Risk Weighted Assets)	70,351	10.0%	42,264	6.0%	56,352	8.0%
Total Capital (to Risk Weighted Assets)	76,614	10.9%	56,352	8.0%	70,440	10.0%

## Series B Preferred Stock Redemption

Between September 26, 2012 and January 3, 2013, Mid Penn issued, via a private placement, 5,000 shares of its Series B Preferred Stock, resulting in total gross proceeds of \$5,000,000.

On December 9, 2015, Mid Penn, using a portion of the proceeds from the offering of the Notes previously described on page 49, redeemed all of its issued and outstanding shares of Series B Preferred Stock at a price equal to \$1,024.67 per share, which is equal to \$1,020 per share plus an amount equal to declared but unpaid dividends on December 9, 2015, for a total redemption price of \$5,123,000.

#### Small Business Lending Fund Program Redemption

On March 1, 2015, Mid Penn assumed all of the issued and outstanding shares of Phoenix with respect to 1,750 shares of Phoenix's preferred stock issued to the Treasury in connection with the Small Business Lending Fund and issued 1,750 shares of Mid Penn's SBLF Preferred Shares, having a \$1,000 liquidation preference per share, to the Treasury. The SBLF Preferred Shares qualify as Tier 1 Capital and have terms and conditions identical to those shares of preferred stock issued by Phoenix to Treasury. Mid Penn paid noncumulative dividends payable quarterly on January 1, April 1, July 1, and October 1. The dividend rate was 1.00% per annum for payment dates up to its redemption.

On December 15, 2015, Mid Penn, using a portion of the proceeds from the offering of the Notes previously described on page 42, redeemed all of the outstanding shares of its SBLF Preferred Shares, which were held by the Treasury for an aggregate redemption price of \$1,754,000, including accrued but unpaid dividends.

MID PENN BANCORP, INC.

### ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no material change in market risk since December 31, 2015, as reported in Mid Penn's Form 10-K filed with the SEC on March 17, 2016.

### 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, 2016, 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, 2016, 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.



MID PENN BANCORP, INC.

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, 2015, to determine if there were material changes applicable to the three and six months ended June 30, 2016. There are no material changes from the risk factors as previously disclosed in the 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 3(i) – The Registrant’s amended Articles of Incorporation (Incorporated by reference to Exhibit 3.1 to Registrant’s Registration Statement on Form S-4 (File No. 333-199740) filed with the Securities and Exchange Commission 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 Securities and Exchange Commission 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.
- 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.LAB – XBRL Taxonomy Extension Label Linkbase
- Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase
- 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



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 12, 2016

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

Date: August 12, 2016