

MID PENN BANCORP INC
Form 10-Q
May 09, 2018

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 March 31, 2018

OR

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

For the transition period from _____ to _____

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

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

Registrant's telephone number, including area code 1.866.642.7736

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

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

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

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

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

As of May 8, 2018, the registrant had 6,122,717 shares of common stock outstanding.

MID PENN BANCORP, INC.

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

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MID PENN BANCORP, INC.

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)	March 31, 2018	December 31, 2017
ASSETS		
Cash and due from banks	\$20,866	\$ 19,795
Interest-bearing balances with other financial institutions	5,346	3,028
Federal funds sold	32,963	691
Total cash and cash equivalents	59,175	23,514
Investment securities available for sale, at fair value	122,342	93,465
Investment securities held to maturity, at amortized cost (fair value \$128,352 and \$100,483)	131,293	101,356
Loans held for sale	1,348	1,040
Loans and leases, net of unearned interest	1,007,138	910,404
Less: Allowance for loan and lease losses	(7,666)	(7,606)
Net loans and leases	999,472	902,798
Bank premises and equipment, net	20,015	16,168
Cash surrender value of life insurance	13,106	13,042
Restricted investment in bank stocks	2,759	4,384
Foreclosed assets held for sale	745	189
Accrued interest receivable	5,079	4,564
Deferred income taxes	3,821	1,888
Goodwill	22,528	3,918
Core deposit and other intangibles, net	5,126	434
Other assets	4,408	3,594
Total Assets	\$1,391,217	\$ 1,170,354
LIABILITIES & SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	\$195,330	\$ 163,714
Interest-bearing demand	355,939	349,241
Money Market	270,489	246,220
Savings	174,920	62,770
Time	215,745	201,623
Total Deposits	1,212,423	1,023,568

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Short-term borrowings	—	34,611
Long-term debt	12,297	12,352
Subordinated debt	17,335	17,338
Accrued interest payable	922	645
Other liabilities	9,116	6,137
Total Liabilities	1,252,093	1,094,651
Shareholders' Equity:		
Common stock, par value \$1.00; authorized 10,000,000 shares; 6,122,717 and 4,242,216 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	6,123	4,242
Additional paid-in capital	103,382	40,970
Retained earnings	33,525	32,565
Accumulated other comprehensive loss	(3,906)	(2,074)
Total Shareholders' Equity	139,124	75,703
Total Liabilities and Shareholders' Equity	\$1,391,217	\$1,170,354

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

MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands, except per share data)	Three Months Ended March 31,	
	2018	2017
INTEREST INCOME		
Interest and fees on loans and leases	\$11,337	\$9,702
Interest on interest-bearing balances	9	2
Interest on federal funds sold	168	51
Interest and dividends on investment securities:		
U.S. Treasury and government agencies	752	445
State and political subdivision obligations, tax-exempt	542	316
Other securities	172	43
Total Interest Income	12,980	10,559
INTEREST EXPENSE		
Interest on deposits	1,780	1,204
Interest on short-term borrowings	12	—
Interest on long-term and subordinated debt	310	180
Total Interest Expense	2,102	1,384
Net Interest Income	10,878	9,175
PROVISION FOR LOAN AND LEASE LOSSES	125	125
Net Interest Income After Provision for Loan and Lease Losses	10,753	9,050
NONINTEREST INCOME		
Income from fiduciary activities	240	196
Service charges on deposits	203	205
Net gain on sales of investment securities	98	8
Earnings from cash surrender value of life insurance	64	65
Mortgage banking income	156	191
ATM debit card interchange income	265	224
Merchant services income	78	74
Net gain on sales of SBA loans	257	284
Other income	286	189
Total Noninterest Income	1,647	1,436
NONINTEREST EXPENSE		
Salaries and employee benefits	5,064	4,230
Occupancy expense, net	797	648
Equipment expense	408	381
Pennsylvania bank shares tax expense	171	170
FDIC Assessment	228	194
Legal and professional fees	224	177
Marketing and advertising expense	189	107
Software licensing	514	329
Telephone expense	147	126
Loss on sale or write-down of foreclosed assets	2	82
Intangible amortization	248	29

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Merger and acquisition expense	1,694	210
Other expenses	1,497	1,119
Total Noninterest Expense	11,183	7,802
INCOME BEFORE PROVISION FOR INCOME TAXES	1,217	2,684
Provision for income taxes	213	690
NET INCOME	\$1,004	\$1,994
PER COMMON SHARE DATA:		
Basic and Diluted Earnings Per Common Share	\$0.17	\$0.47
Cash Dividends Paid	\$0.25	\$0.23

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

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MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(Dollars in thousands)	Three Months Ended March 31,	
	2018	2017
Net income	\$1,004	\$1,994
Other comprehensive (loss) income:		
Unrealized (losses) gains arising during the period on available-for-sale securities, net of income tax impact of (\$475) and \$195, respectively	(1,788)	379
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income tax impact of \$20 and \$3, respectively (a)	(78)	(5)
Change in defined benefit plans, net of income tax impact of \$0 and (\$1), respectively (b)	(1)	(3)
Total other comprehensive (loss) income	(1,867)	371
Total comprehensive (loss) income	\$(863)	\$2,365

(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 Three Months Ended March 31, 2018 and 2017

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, January 1, 2018	\$ 4,242	\$ 40,970	\$ 32,565	\$ (2,074)	\$ 75,703
Impact of adoption of new accounting standard (a)	—	—	(44)	35	(9)
Balance at January 1, 2018, adjusted	4,242	40,970	32,521	(2,039)	75,694
Net income	—	—	1,004	—	1,004
Total other comprehensive loss, net of taxes	—	—	—	(1,867)	(1,867)
Common stock issued to Scottsdale shareholders (1,878,827 shares)	1,879	62,302	—	—	64,181
Employee Stock Purchase Plan (736 shares)	1	23	—	—	24
Director Stock Purchase Plan (938 shares)	1	29	—	—	30
Restricted stock activity	—	58	—	—	58
Balance, March 31, 2018	\$ 6,123	\$ 103,382	\$ 33,525	\$ (3,906)	\$ 139,124
Balance, January 1, 2017	\$ 4,233	\$ 40,688	\$ 28,399	\$ (2,853)	\$ 70,467
Net income	—	—	1,994	—	1,994
Total other comprehensive income, net of taxes	—	—	—	371	371
Employee Stock Purchase Plan (1,264 shares)	1	26	—	—	27
Common stock dividends	—	—	(551)	—	(551)
Restricted stock activity	—	19	—	—	19
Balance, March 31, 2017	\$ 4,234	\$ 40,733	\$ 29,842	\$ (2,482)	\$ 72,327

(a) Represents the impact of adopting Accounting Standard Update ASU 2016-01. See Note 13 to the consolidated financial statements for more information.

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

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)	Three Months Ended March 31,	
	2018	2017
Operating Activities:		
Net Income	\$1,004	\$1,994
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	125	125
Depreciation	423	363
Amortization of intangibles	248	29
Net amortization (accretion) of security discounts/premiums	199	(1,554)
Gain on sales of investment securities	(98)	(8)
Earnings on cash surrender value of life insurance	(64)	(65)
Mortgage loans originated for sale	(10,152)	(11,076)
Proceeds from sales of mortgage loans originated for sale	10,000	11,191
Gain on sale of mortgage loans	(156)	(191)
SBA loans originated for sale	(3,114)	(3,795)
Proceeds from sales of SBA loans originated for sale	3,371	4,079
Gain on sale of SBA loans	(257)	(284)
Loss on disposal of property, plant, and equipment	—	26
Loss on sale or write-down of foreclosed assets	2	82
Stock compensation expense	58	19
Deferred income tax benefit	(826)	(43)
Decrease in accrued interest receivable	474	27
(Increase) decrease in other assets	(52)	256
Increase in accrued interest payable	261	106
Increase in other liabilities	1,437	1,914
Net Cash Provided By Operating Activities	2,883	3,195
Investing Activities:		
Proceeds from the sale of available-for-sale securities	97,218	17,931
Proceeds from the maturity or call of available-for-sale securities	5,806	1,107
Purchases of available-for-sale securities	(20,708)	(3,538)
Proceeds from the maturity or call of held-to-maturity securities	2,346	—
Purchases of held-to-maturity securities	(32,396)	(48,926)
Net cash received from acquisition	65,025	—
Redemptions (purchases) of restricted investment in bank stock	1,722	(32)
Net increase in loans and leases	(26,814)	(19,984)
Proceeds from the sale of bank premises and equipment held for sale	—	2,201
Purchases of bank premises and equipment	(2,774)	(770)
Proceeds from the sale of foreclosed assets	154	15
Net Cash Provided by (Used In) Investing Activities	89,579	(51,996)
Financing Activities:		
Net (decrease) increase in deposits	(21,126)	36,514

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Net decrease in short-term borrowings	(34,611)	—
Common stock dividends paid	(1,060)	(551)
Employee Stock Purchase Plan	24	27
Director Stock Purchase Plan	30	—
Long-term debt repayment	(58)	(55)
Net Cash (Used In) Provided By Financing Activities	(56,801)	35,935
Net increase (decrease) in cash and cash equivalents	35,661	(12,866)
Cash and cash equivalents, beginning of period	23,514	45,973
Cash and cash equivalents, end of period	\$59,175	\$33,107

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued)

(Dollars in thousands)	Three Months Ended	
	March 31, 2018	2017
Supplemental Disclosures of Cash Flow Information:		
Interest paid	\$1,825	\$1,278
Income taxes paid	\$—	\$—
Supplemental Noncash Disclosures:		
Loan transfers to foreclosed assets held for sale	\$701	\$—

Assets, Liabilities, and Equity in Connection with Merger:

(Dollars in thousands)	Three Months Ended March 31,	
	2018	2017
Assets Acquired:		
Securities	\$114,039	\$-
Loans	70,686	-
Restricted stock	97	-
Property and equipment	1,496	-
Foreclosed assets	11	-
Deferred income taxes	621	-
Accrued interest receivable	989	-
Core deposit intangible	4,940	-
Other assets	266	-
	\$193,145	\$-
Liabilities Assumed:		
Deposits	\$209,981	\$-
Accrued interest payable	16	-
Other liabilities	2,602	-
	\$212,599	\$-

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

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

(1)Basis of Presentation

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

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 March 31, 2017 and December 31, 2017 balances have been reclassified, when, and if necessary, to conform to the 2018 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. In the opinion of management, all adjustments necessary for fair presentation of the periods presented have been reflected in the accompanying consolidated financial statements. All such adjustments are of a normal, recurring nature. 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, 2017.

On January 8, 2018, Mid Penn completed its acquisition of The Scottdale Bank & Trust Company (“Scottdale”), a Pennsylvania bank and trust company, through the merger of Scottdale with and into Mid Penn Bank pursuant to that certain previously announced Agreement and Plan of Merger, dated as of March 29, 2017, among Mid Penn, Mid Penn Bank and Scottdale. Refer to Note 2, Merger, as well as the Form 8-K filed on January 8, 2018, for more information. The comparability of the financial condition and results of operations as of and for the three months ended March 31, 2018 and 2017, in general, have been impacted by the acquisition of Scottdale.

On January 16, 2018, Mid Penn entered into an Agreement and Plan of Merger with First Priority Financial Corp. (“First Priority”) pursuant to which First Priority will merge with and into Mid Penn (the “Merger”), with Mid Penn being the surviving corporation in the Merger. Refer to Note 13, Agreement and Plan of Merger, as well as the Form 8-K filed on January 16, 2018, for more information.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of March 31, 2018, 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)Merger

On January 8, 2018, The Scottdale Bank & Trust Company, (“Scottdale”) merged with and into Mid Penn Bank, with Mid Penn Bank continuing as the surviving entity.

Pursuant to the Merger Agreement, each share of Scottdale common stock issued and outstanding immediately prior to January 8, 2018 converted into the right to receive (i) \$1,166 in cash without interest or (ii) 38.88 shares of Mid Penn common stock. As a result, Mid Penn issued 1,878,827 shares of Mid Penn common stock with an acquisition

date fair value of approximately \$64,181,000, based on the closing stock price of Mid Penn's common stock on January 8, 2018 of \$34.16, and cash of \$2,792,000. Including an insignificant amount of cash paid in lieu of fractional shares, the fair value of total consideration paid was \$66,973,000.

The assets and liabilities of Scottdale were recorded on the consolidated balance sheet of the Company at their estimated fair value as of January 8, 2018, and their results of operations have been included in the consolidated income statement of the Company since such date. Scottdale has been fully integrated into Mid Penn, therefore the amount of revenue and earnings of Scottdale included in the consolidated

income statement since the acquisition date is impracticable to provide.

Included in the purchase price was goodwill of \$18,610,000 and a core deposit intangible of \$4,940,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' 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 related to the Scottdale acquisition for the five years beginning 2018 through 2022 is estimated to be \$898,000, \$808,000, \$719,000, \$629,000, and \$539,000 per year, respectively, and \$1,347,000 in total for the five years after 2022.

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	\$67,817
Investment securities	114,039
Restricted stock	97
Loans	70,686
Goodwill	18,610
Core deposit intangible	4,940
Premises and equipment	1,496
Foreclosed assets	11
Deferred income taxes	621
Accrued interest receivable	989
Other assets	266
Total assets acquired	279,572
Liabilities assumed:	
Deposits	209,981
Accrued interest payable	16
Other liabilities	2,602
Total liabilities assumed	212,599
Consideration paid	\$66,973
Cash paid	\$2,792
Fair value of common stock issued	64,181

Accounting Standards Codification (“ASC”) Topic 805, Business Combinations, allows for adjustments to goodwill for a period of up to one year after the merger date for information that becomes available that reflects circumstances at the merger date. The following table summarizes the preliminary estimated fair value of the assets acquired and liabilities and equity assumed.

(Dollars in thousands)

Total purchase price	\$66,973
Net assets acquired:	
Cash and cash equivalents	67,817
Investment securities	114,039
Restricted stock	97
Loans	70,686
Core deposit intangible	4,940

Premises and equipment	1,496
Foreclosed assets	11
Deferred income taxes	621
Accrued interest receivable	989
Other assets	266
Deposits	(209,981)
Accrued interest payable	(16)
Other liabilities	(2,602)
	48,363
Goodwill	\$18,610

In general, factors contributing to goodwill recognized as a result of the Scottsdale acquisition include expected cost savings from combined operations, opportunities to expand into several new markets, and growth and profitability potential from the repositioning of short-term investments into higher-yielding loans. The goodwill acquired as a result of the Scottsdale acquisition is not tax deductible.

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 \$70,686,000. 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 January 8, 2018	\$71,809
Market rate adjustment	601
Credit fair value adjustment on pools of homogeneous loans	(1,078)
Credit fair value adjustment on impaired loans	(646)
Fair value of purchased loans at January 8, 2018	\$70,686

The market rate adjustment represents the movement in market interest rates, irrespective of credit adjustments, compared to the contractual 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 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 Scottsdale impaired loan portfolio as of January 8, 2018 is as follows:

(Dollars in thousands)

Contractually required principal and interest at acquisition	\$2,587
Contractual cash flows not expected to be collected (nonaccretable discount)	(1,010)
Expected cash flows at acquisition	1,577
Interest component of expected cash flows (accretable discount)	(305)
Fair value of acquired loans	\$1,272

The following table presents pro forma information as if the merger between Mid Penn and Scottsdale had been completed on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn merged with Scottsdale at the beginning of 2017. The supplemental pro forma earnings for 2018 reflect actual first quarter earnings, as the amount of Scottsdale related income for eight days is immaterial, adjusted to exclude \$1,273,000 of merger related costs incurred for the Scottsdale acquisition. The results for the three months ended March 31, 2017 were adjusted to include the \$1,273,000 of merger related costs. 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.

(Dollars in thousands, except per share data)	Three Months	
	Ended March 31, 2018	2017
Net interest income after loan loss provision	\$10,753	\$10,498
Noninterest income	1,647	1,585
Noninterest expense	9,910	10,346
Net income	2,054	1,268
Net income per common share	0.34	0.21

(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, pledging requirements, and other factors related to effective portfolio management. Securities to be held to maturity are carried at amortized cost.

For available-for-sale debt securities, 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 debt securities are based on the difference between the amortized cost and fair value of each security as of the respective reporting date. Unrealized gains and losses are credited or charged to other comprehensive income, whereas realized gains and losses flow through Mid Penn's consolidated statements of income for the respective period.

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

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

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

Mid Penn had no securities considered by management to be other-than-temporarily impaired as of March 31, 2018, December 31, 2017, or March 31, 2017, and did not record any securities impairment charges in the respective periods ended on these dates. Mid Penn does not consider the securities with unrealized losses on the respective dates to be other-than-temporarily impaired as the unrealized losses were deemed to relate to changes in interest rates, and not erosion of credit quality.

Beginning January 1, 2018, upon adoption of ASU 2016-01, equity securities with readily determinable fair values are stated at fair value within other assets on the balance sheet, with realized and unrealized gains and losses reported in other expense on the income statement. For periods prior to January 1, 2018, equity securities were classified as available-for-sale and stated at fair value within investment securities available-for-sale on the balance sheet, with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax. Equity securities without readily determinable fair values are recorded at cost less any impairment.

The amortized cost, fair value, and unrealized gains and losses on investment securities at March 31, 2018 and December 31, 2017 are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
March 31, 2018				
Available-for-sale debt securities:				
U.S. Treasury and U.S. government agencies	\$ 40,604	\$ 3	\$ 2,082	\$ 38,525
Mortgage-backed U.S. government agencies	45,710	6	1,077	44,639
State and political subdivision obligations	38,222	34	1,941	36,315
Corporate debt securities	2,848	15	—	2,863
Total available-for-sale debt securities	127,384	58	5,100	122,342
Held-to-maturity debt securities:				
U.S. Treasury and U.S. government agencies	10,984	—	174	10,810
Mortgage-backed U.S. government agencies	69,901	18	1,345	68,575
State and political subdivision obligations	50,408	36	1,477	48,967
Corporate debt securities	—	—	—	—
Total held-to-maturity debt securities	131,293	54	2,996	128,352
Total	\$ 258,677	\$ 112	\$ 8,096	\$ 250,694

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(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2017				
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	\$ 40,125	\$ —	\$ 1,395	\$ 38,730
Mortgage-backed U.S. government agencies	26,398	2	569	25,831
State and political subdivision obligations	27,775	7	739	27,043
Corporate debt securities	1,350	5	—	1,355
Total available-for-sale debt securities	95,648	14	2,703	92,959
Available-for-sale equity securities:				
Equity securities	550	—	44	506
Total available-for-sale equity securities	550	—	44	506
Held-to-maturity securities:				
U.S. Treasury and U.S. government agencies	10,984	—	90	10,894
Mortgage-backed U.S. government agencies	53,472	—	523	52,949
State and political subdivision obligations	36,900	41	301	36,640
Corporate debt securities	—	—	—	—
Total held-to-maturity debt securities	101,356	41	914	100,483
Total	\$ 197,554	\$ 55	\$ 3,661	\$ 193,948

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

Estimated fair values of debt securities are based on quoted market prices, where applicable. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, adjusted for differences between the quoted instruments and the instruments being valued. Please refer to Note (5) – Fair Value Measurement, for more information on the fair value of investment securities.

Equity securities consist of Community Reinvestment Act funds and, as of March 31, 2018 and December 31, 2017, Mid Penn had \$496,000 and \$506,000 respectively in equity securities recorded at fair value. Prior to January 1, 2018, equity securities were stated at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax. At December 31, 2017, net unrealized gains of \$44,000 had been recognized in accumulated other comprehensive loss. On January 1, 2018, these unrealized gains and losses were reclassified out of accumulated other comprehensive loss and into retained earnings and subsequent changes in fair value are now recognized in net income. No equity securities were sold during the three months ended March 31, 2018.

Investment securities having a fair value of \$146,897,000 at March 31, 2018 and \$141,465,000 at December 31, 2017 were pledged to secure public deposits and certain other borrowings.

Gross realized gains and losses on sales of available-for-sale debt securities for the three months ended March 31, 2018 and 2017 are shown in the table below.

	Three Months Ended	
	March 31,	
	2018	2017
Realized gains	\$ 100	\$ 123
Realized losses	(2)	(115)
Net gains	\$ 98	\$ 8

The following tables present gross unrealized losses and fair value of debt security investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2018 and December 31, 2017.

(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
March 31, 2018									
Available-for-sale debt securities:									
U.S. Treasury and U.S. government	3	\$4,925	\$ 267	18	\$33,110	\$ 1,815	21	\$38,035	\$ 2,082

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agencies									
Mortgage-backed U.S. government agencies	13	20,127	258	15	19,597	819	28	39,724	1,077
State and political subdivision obligations	14	8,049	338	41	18,521	1,603	55	26,570	1,941
Total temporarily impaired available-for-sale debt securities	30	33,101	863	74	71,228	4,237	104	104,329	5,100
Held-to-maturity debt securities:									
U.S. Treasury and U.S. government agencies	3	8,822	161	1	1,988	13	4	10,810	174
Mortgage-backed U.S. government agencies	37	55,999	1,299	2	2,065	46	39	58,064	1,345
State and political subdivision obligations	103	40,903	1,477	0	-	-	103	40,903	1,477
Total temporarily impaired held-to-maturity debt securities	143	105,724	2,937	3	4,053	59	146	109,777	2,996
Total	173	\$ 138,825	\$ 3,800	77	\$ 75,281	\$ 4,296	250	\$ 214,106	\$ 8,096

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

(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, 2017									
Available-for-sale securities:									
U.S. Treasury and U.S. government agencies	3	\$5,008	\$ 184	18	\$33,722	\$ 1,211	21	\$38,730	\$ 1,395
Mortgage-backed U.S. government agencies	4	5,267	75	15	20,497	494	19	25,764	569
State and political subdivision obligations	11	6,144	102	40	19,091	637	51	25,235	739
Corporate debt securities	0	—	—	0	—	—	0	—	—
Equity securities	0	—	—	1	506	44	1	506	44
Total temporarily impaired available-for-sale securities	18	\$16,419	\$ 361	74	\$73,816	\$ 2,386	92	\$90,235	\$ 2,747
Held-to-maturity securities:									
U.S. Treasury and U.S. government agencies	0	—	—	4	10,894	90	4	10,894	90
Mortgage-backed U.S. government agencies	0	—	—	35	52,949	523	35	52,949	523
State and political subdivision obligations	0	—	—	77	29,976	301	77	29,976	301
Corporate debt securities	0	—	—	0	—	—	0	—	—
Equity securities	0	—	—	0	—	—	0	—	—
Total temporarily impaired held to maturity securities	0	—	—	116	93,819	914	116	93,819	914
Total	18	\$16,419	\$ 361	190	\$167,635	\$ 3,300	208	\$184,054	\$ 3,661

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

anticipated recovery, and (c) whether management expects to recover the entire amortized cost basis. For equity securities, management considers the intent and ability to hold securities until recovery of unrealized losses.

The majority of the investment portfolio is comprised of securities issued by U.S. government agencies and state and political subdivision obligations. For the investment securities with an unrealized loss, Mid Penn has concluded, based on its analysis, that the unrealized losses were primarily caused by the movement of interest rates and not due to an erosion of credit quality of the underlying issuers.

At both March 31, 2018 and December 31, 2017, the majority of the unrealized losses on both available-for-sale securities and held-to-maturity securities in an unrealized loss position were attributed to obligations of state and political subdivisions, U.S. Treasury and agency securities, and mortgage-backed U.S. government agencies.

The table below illustrates the maturity distribution of investment securities at amortized cost and fair value as of March 31, 2018.

(Dollars in thousands)	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
March 31, 2018				
Due in 1 year or less	\$ 10,428	\$ 10,453	\$ 2,001	\$ 1,988
Due after 1 year but within 5 years	12,758	12,414	10,025	9,859
Due after 5 years but within 10 years	48,223	45,478	46,560	45,162
Due after 10 years	10,265	9,358	2,806	2,768
	81,674	77,703	61,392	59,777
Mortgage-backed securities	45,710	44,639	69,901	68,575
	\$ 127,384	\$ 122,342	\$ 131,293	\$ 128,352

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

(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, 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 generally is discontinued when the contractual payment of principal or interest has become 90 days or more past due, or management has serious doubts about further collectability of principal or interest even though the loan is currently performing. A loan past due 90 days or more may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest is credited to income. Interest received on nonaccrual loans, including impaired loans, is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Nonaccrual loans may be restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally, at least nine consecutive months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Commercial and industrial

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

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

Commercial and industrial loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself, which, in turn, is likely to be dependent

upon the general economic environment. Mid Penn's commercial and industrial loans are usually, but not always, secured by business assets and personal guarantees. However, the collateral securing the loans may depreciate over time, may be difficult to appraise, and may fluctuate in value based on the success of the business.

Commercial real estate and commercial real estate - construction

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

Residential mortgage

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

In underwriting residential mortgage loans, the Bank evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by Mid Penn are appraised by independent fee appraisers. The Bank generally requires borrowers to obtain title insurance and fire and property insurance (including flood insurance, if necessary) in an

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

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 junior lien mortgages on principal residences. The Bank will lend amounts, which, together with all prior liens, typically may be up to 85 percent of the appraised value of the property securing the loan. Home equity term loans may have maximum terms up to 20 years, while home equity lines of credit generally have maximum terms of five years.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards employed by the Bank for consumer loans include an application, a determination of the applicant’s payment history on other debts, and an assessment of ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount.

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

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

Allowance for Loan and Lease Losses

The allowance for credit losses (“allowance”) consists of (i) the allowance for loan and lease losses, and (ii) the reserve for unfunded lending commitments. The allowance for loan and lease losses represents management’s estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for

unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated balance sheet. The reserve for unfunded lending commitments was \$107,000 at March 31, 2018 and \$105,000 at December 31, 2017. The allowance is increased by the provision for loan and lease losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan.

The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss

exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include changes in economic conditions, fluctuations in loan quality measures, changes in collateral values, changes in the experience of the lending staff and loan review systems, changes in lending policies and procedures (including underwriting standards), changes in the mix and volume of loans originated, the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio, shifting industry or portfolio concentrations, and other relevant factors.

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

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

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

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

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

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

As noted above, Mid Penn assesses a specific allocation for commercial loans and commercial real estate loans. The remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In addition, Mid Penn takes a preemptive step when any commercial loan becomes classified under its internal classification system. A preliminary collateral evaluation, in accordance with the guidance on impaired loans, is

prepared using the existing collateral information in the loan file. This process allows Mid Penn to review both the credit and documentation files to determine the status of the information needed to make a collateral evaluation. This collateral evaluation is preliminary, but allows Mid Penn to determine if any potential collateral shortfalls exist.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate as soon as practically possible following 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 following the credit being placed on nonaccrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

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

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

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

Loans whose terms are modified are classified as troubled debt restructurings if the borrowers have been granted concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for nine consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

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

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

Acquired Loans

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

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

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

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

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

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 \$515,000 as of March 31, 2018 and \$464,000 as of December 31, 2017), and the classified ratings of special mention and substandard within Mid Penn's internal risk rating system as of March 31, 2018 and December 31, 2017, are as follows:

(Dollars in thousands)		Special		
March 31, 2018	Pass	Mention	Substandard	Total
Commercial and industrial	\$192,713	\$ 793	\$ 5,277	\$198,783
Commercial real estate	548,118	1,532	11,126	560,776
Commercial real estate - construction	73,092	177	487	73,756
Lease financing	194	—	—	194
Residential mortgage	122,185	153	1,355	123,693
Home equity	44,794	100	271	45,165
Consumer	4,771	—	—	4,771
	\$985,867	\$ 2,755	\$ 18,516	\$1,007,138

(Dollars in thousands)		Special		
December 31, 2017	Pass	Mention	Substandard	Total
Commercial and industrial	\$182,168	\$ 453	\$ 5,412	\$188,033
Commercial real estate	505,397	1,435	8,180	515,012
Commercial real estate - construction	61,667	182	487	62,336
Lease financing	229	—	—	229
Residential mortgage	97,814	157	1,062	99,033
Home equity	41,479	105	309	41,893
Consumer	3,868	—	—	3,868
	\$892,622	\$ 2,332	\$ 15,450	\$910,404

Mid Penn had no loans classified as doubtful as of March 31, 2018 and December 31, 2017.

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

Impaired loans by loan portfolio class as of March 31, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)	March 31, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	\$—	\$ 12	\$ —	\$—	\$ 13	\$ —
Commercial real estate	3,588	4,233	—	3,424	4,056	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	669	790	—	760	877	—
Home equity	183	294	—	260	295	—
Consumer	—	—	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:						
Commercial and industrial	\$23	\$ 23	\$ —	\$—	\$ —	\$ —
Commercial real estate	1,443	1,443	—	555	555	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	689	689	—	306	306	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial and industrial	\$4,374	\$ 4,460	\$ 265	\$4,434	\$ 4,460	\$ 136
Commercial real estate	1,389	1,577	281	1,423	1,589	293
Commercial real estate - construction	487	492	93	487	492	100
Lease financing	—	—	—	—	—	—
Residential mortgage	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total Impaired Loans:						
Commercial and industrial	\$4,397	\$ 4,495	\$ 265	\$4,434	\$ 4,473	\$ 136
Commercial real estate	6,420	7,253	281	5,402	6,200	293
Commercial real estate - construction	487	492	93	487	492	100
Lease financing	—	—	—	—	—	—
Residential mortgage	1,358	1,479	—	1,066	1,183	—
Home equity	183	294	—	260	295	—

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 months ended March 31, 2018 and 2017 are summarized as follows:

(Dollars in thousands)	Three Months Ended			
	March 31, 2018		March 31, 2017	
	Average Interest Recorded Investment	Income Recognized	Average Interest Recorded Investment	Income Recognized
With no related allowance recorded:				
Commercial and industrial	\$-	\$ -	\$2	\$ -
Commercial real estate	3,506	-	403	279
Commercial real estate - construction	-	-	617	-
Lease financing	-	-	-	-
Residential mortgage	714	-	864	11
Home equity	222	-	122	2
Consumer	-	-	-	-
With no related allowance recorded and acquired with credit deterioration:				
Commercial and industrial	17	-	-	-
Commercial real estate	936	-	831	-
Commercial real estate - construction	-	-	-	-
Lease financing	-	-	-	-
Residential mortgage	443	-	373	-
Home equity	-	-	-	-
Consumer	-	-	-	-
With an allowance recorded:				
Commercial and industrial	\$4,404	\$ -	\$35	\$ -
Commercial real estate	1,406	-	2,676	-
Commercial real estate - construction	487	-	241	-
Lease financing	-	-	-	-
Residential mortgage	-	-	67	-
Home equity	-	-	-	-
Consumer	-	-	-	-
Total Impaired Loans:				
Commercial and industrial	\$4,421	\$ -	\$37	\$ -
Commercial real estate	5,848	-	3,910	279
Commercial real estate - construction	487	-	858	-
Lease financing	-	-	-	-
Residential mortgage	1,157	-	1,304	11
Home equity	222	-	122	2

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

Nonaccrual loans by loan portfolio class as of March 31, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)	March 31, 2018	December 31, 2017
Commercial and industrial	\$ 4,397	\$ 4,434
Commercial real estate	5,914	4,902
Commercial real estate - construction	487	487
Residential mortgage	1,352	492
Home equity	183	260
	\$ 12,333	\$ 10,575

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. As of March 31, 2018 and December 31, 2017 Mid Penn had no accruing loans past due greater than 90 days. The classes of the loan portfolio summarized by the past due status as of March 31, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
March 31, 2018						
Commercial and industrial	\$4,378	\$ -	\$-	\$4,378	\$194,382	\$198,760
Commercial real estate	544	-	960	1,504	557,829	559,333
Commercial real estate - construction	-	-	487	487	73,269	73,756
Lease financing	-	-	-	-	194	194
Residential mortgage	458	12	651	1,121	121,883	123,004
Home equity	201	-	174	375	44,790	45,165
Consumer	6	9	-	15	4,756	4,771
Loans acquired with credit deterioration:						
Commercial and industrial	-	-	23	23	-	23
Commercial real estate	506	-	909	1,415	28	1,443
Commercial real estate - construction	-	-	-	-	-	-
Lease financing	-	-	-	-	-	-
Residential mortgage	183	-	389	572	117	689
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	\$6,276	\$ 21	\$3,593	\$9,890	\$997,248	\$1,007,138

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

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
December 31, 2017						
Commercial and industrial	\$4,439	\$ 16	\$-	\$4,455	\$183,578	\$ 188,033
Commercial real estate	-	-	3,669	3,669	510,788	514,457
Commercial real estate - construction	-	-	487	487	61,849	62,336
Lease financing	-	-	-	-	229	229
Residential mortgage	310	467	177	954	97,773	98,727
Home equity	54	98	250	402	41,491	41,893
Consumer	3	-	-	3	3,865	3,868
Loans acquired with credit deterioration:						
Commercial and industrial	-	-	-	-	-	-
Commercial real estate	500	-	55	555	-	555
Commercial real estate - construction	-	-	-	-	-	-
Lease financing	-	-	-	-	-	-
Residential mortgage	-	31	193	224	82	306
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	\$5,306	\$ 612	\$4,831	\$10,749	\$899,655	\$ 910,404

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

(Dollars in thousands)	Commercial		Commercial		Residential		Home		Consumer		Unallocated		Total
As of, and for the	and	real	real	Lease	mortgage	equity	equity	equity	equity	equity	equity	equity	equity
three months ended,	industrial	estate -	estate -	financing	financing	financing	financing	financing	financing	financing	financing	financing	financing
the	and	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction
March 31, 2018	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial
Allowance for loan and lease losses:	industrial	real estate	real estate	real estate	real estate	real estate	real estate	real estate	real estate	real estate	real estate	real estate	real estate
Beginning balance,	and	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction
January 1, 2018	and	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction	construction
January 1, 2018	\$ 1,795	\$4,435	\$ 178	\$ -	\$428	\$423	\$ 3	\$ 344	\$7,606				
Charge-offs	-	-	-	-	(2)	(76)	(6)	-	(84)				
Recoveries	-	17	-	-	-	-	2	-	19				

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Provisions	182	201	5	-	26	44	5	(338)	125
Ending balance, March 31, 2018	1,977	4,653	183	-	452	391	4	6	7,666
Ending balance: individually evaluated for impairment	265	281	93	-	-	-	-	-	639
Ending balance: collectively evaluated for impairment	\$ 1,712	\$ 4,372	\$ 90	\$ -	\$ 452	\$ 391	\$ 4	\$ 6	\$ 7,027
Loans receivables: Ending balance	\$ 198,783	\$ 560,776	\$ 73,756	\$ 194	\$ 123,693	\$ 45,165	\$ 4,771	\$ -	\$ 1,007,138
Ending balance: individually evaluated for impairment	4,374	4,977	487	-	669	183	-	-	10,690
Ending balance: acquired with credit deterioration	23	1,443	-	-	689	-	-	-	2,155
Ending balance: collectively evaluated for impairment	\$ 194,386	\$ 554,356	\$ 73,269	\$ 194	\$ 122,335	\$ 44,982	\$ 4,771	\$ -	\$ 994,293

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

(Dollars in thousands)

	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
December 31, 2017									
Allowance for loan and lease losses:									
Ending balance	\$ 1,795	\$ 4,435	\$ 178	\$ -	\$ 428	\$ 423	\$ 3	\$ 344	\$ 7,606
Ending balance: individually evaluated for impairment	136	293	100	-	-	-	-	-	529
Ending balance: collectively evaluated for impairment	\$ 1,659	\$ 4,142	\$ 78	\$ -	\$ 428	\$ 423	\$ 3	\$ 344	\$ 7,077

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