

MID PENN BANCORP INC  
Form 10-K  
March 13, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2017

OR

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

For the transition period from            to

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania (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

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

Title of Each Class

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

Common Stock, \$1.00 par value per share	Name of Each Exchange on Which Registered The NASDAQ Stock Market LLC
--	--

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

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

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

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

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

Indicate by check mark whether the registrant 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
	Emerging Growth Company

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

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

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates computed by reference to the closing price of the common equity of \$27.00 per share, as reported by The NASDAQ Stock Market LLC ("NASDAQ"), on June 30, 2017, the last business day of the registrant's most recently completed second fiscal quarter was approximately \$114,351,399.

As of March 1, 2018, the registrant had 6,121,043 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be used in connection with the 2018 Annual Meeting of Shareholders is incorporated herein by reference in partial response to Part III, hereof.

---

MID PENN BANCORP, INC.

FORM 10-K

## TABLE OF CONTENTS

	PAGE
PART I	
Item 1 - <u>Business</u>	3
Item 1A - <u>Risk Factors</u>	13
Item 1B - <u>Unresolved Staff Comments</u>	20
Item 2 - <u>Properties</u>	20
Item 3 - <u>Legal Proceedings</u>	20
Item 4 - <u>Mine Safety Disclosures</u>	20
PART II	
Item 5 - <u>Market for Registrant's Common Equity, Related Shareholder Matters And Issuer Purchases of Equity Securities</u>	21
Item 6 - <u>Selected Financial Data</u>	23
Item 7 - <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 7A - <u>Quantitative and Qualitative Disclosure About Market Risk</u>	47
Item 8 - <u>Financial Statements and Supplementary Data</u>	48
Item 9 - <u>Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u>	110
Item 9A - <u>Controls and Procedures</u>	110
Item 9B - <u>Other Information</u>	110
PART III	
Item 10 - <u>Directors, Executive Officers and Corporate Governance</u>	110
Item 11 - <u>Executive Compensation</u>	110
Item 12 - <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	111
Item 13 - <u>Certain Relationships and Related Transactions, and Director Independence</u>	111

Item 14 -	<u>Principal Accounting Fees and Services</u>	111
PART IV		
Item 15 -	<u>Exhibits and Financial Statement Schedules</u>	111
	<u>Signatures</u>	113
EXHIBITS		

MID PENN BANCORP, INC.

## PART I

### ITEM 1. BUSINESS

The disclosures set forth in this Item are qualified by the section captioned “Special Cautionary Notice Regarding Forward-Looking Statements” contained in Part II, Item 7. – “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report and other cautionary statements set forth elsewhere in this report.

Mid Penn Bancorp, Inc.

Mid Penn Bancorp, Inc. is a one-bank holding company, incorporated in the Commonwealth of Pennsylvania in August 1991. Mid Penn Bancorp, Inc. and its wholly owned subsidiaries are collectively referred to herein as “Mid Penn” or the “Corporation.” On December 31, 1991, Mid Penn acquired, as part of the holding company formation, all of the outstanding common stock of Mid Penn Bank (the “Bank”), and the Bank became a wholly owned subsidiary of Mid Penn. Mid Penn’s primary business is to supervise and coordinate the business of its subsidiaries and to provide them with capital and resources.

Mid Penn’s consolidated financial condition and results of operations consist almost entirely of that of Mid Penn Bank, which is managed as a single business segment. At December 31, 2017, Mid Penn had total consolidated assets of \$1,170,354,000 with total deposits of \$1,023,568,000 and total shareholders’ equity of \$75,703,000.

As of December 31, 2017, Mid Penn Bancorp, Inc. did not own or lease any properties. Mid Penn Bank owns or leases the banking offices as identified in Part I, Item 2.

All Mid Penn employees are employed by the Bank, with a shared services agreement to support the holding company. At December 31, 2017, the Bank had 255 full-time and 22 part-time employees. The Bank and its employees are not subject to a collective bargaining agreement, and the Bank believes it enjoys good relations with its personnel.

Mid Penn Insurance Services, LLC, a wholly-owned subsidiary of Mid Penn Bank that provided a wide range of personal and commercial insurance products, ceased operations effective March 1, 2016 due to a lack of activity within this subsidiary.

Mid Penn Bank

Mid Penn Bank was organized in 1868 under a predecessor name, Millersburg Bank, and became a state chartered bank in 1931, obtaining trust powers in 1935, at which time its name was changed to Millersburg Trust Company. In 1971, Millersburg Trust Company adopted the name “Mid Penn Bank”. On March 1, 2015, in connection with the acquisition of Phoenix Bancorp, Inc. (“Phoenix”) by Mid Penn, Phoenix’s wholly-owned banking subsidiary, Miners Bank, was merged with and into the Bank. The Bank was the surviving charter, and Miners Bank’s five branches in Schuylkill and Luzerne Counties, Pennsylvania operate as “Miners Bank, a Division of Mid Penn Bank”. The Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (the “FDIC”) supervise the Bank. Mid Penn’s and the Bank’s legal headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061. The Bank presently has twenty-three full service retail banking properties located in Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties, Pennsylvania.

Mid Penn's primary business consists of attracting deposits and loans from its network of community banking offices operated by the Bank. The Bank engages in full-service commercial banking and trust business, making available to the community a wide range of financial services, including, but not limited to, mortgage and home equity loans, secured and unsecured commercial and consumer loans, lines of credit, construction financing, farm loans, community development and local government loans and various types of time and demand deposits. Deposits of the Bank are insured by the Deposit Insurance Fund (the "DIF") of the FDIC to the maximum extent provided by law. In addition, the Bank provides a full range of trust and retail investment services. The Bank also offers other services such as online banking, telephone banking, cash management services, automated teller services and safe deposit boxes.

### Business Strategy

The Bank's services are provided to small and middle-market businesses, consumers, nonprofit organizations, municipalities, and real estate investors. At December 31, 2017, the Bank operated through twenty-three full service retail banking properties, one loan production office, a corporate administration office, and two operations facilities.

Subsequent to year-end 2017, Mid Penn completed its acquisition of The Scottdale Bank and Trust Company ("Scottdale") through the merger of Scottdale with and into Mid Penn Bank (the "Scottdale Merger"). Effective January 8, 2018, the Scottdale Merger resulted in the addition of five offices in Westmoreland and Fayette Counties in Western Pennsylvania operating as "Scottdale Bank & Trust, a Division of Mid Penn Bank". Additional information related to the Scottdale Merger can be found in Note 26 to the Consolidated Financial Statements contained in Item 8 of this report.

MID PENN BANCORP, INC.

On January 16, 2018, Mid Penn entered into an Agreement and Plan of Merger (the “First Priority Merger Agreement”) with First Priority Financial Corp. (“First Priority”) pursuant to which First Priority will merge with and into Mid Penn (the “First Priority Merger”), with Mid Penn being the surviving corporation in the First Priority Merger. Expected to close in the third quarter of 2018, pending required regulatory and shareholder approvals and the satisfaction of other conditions, the First Priority Merger will broaden our geographic markets into demographically attractive markets predominantly located in the Southeastern Pennsylvania counties of Berks, Bucks, Chester and Montgomery. When completed, the First Priority Merger will result in the addition of approximately \$609.9 million in assets and eight branches in southeastern Pennsylvania. Additional information related to the First Priority Merger can be found in Note 26 to the Consolidated Financial Statements contained in Item 8 of this report.

Also in January 2018, Mid Penn opened a new full-service office in Halifax, PA.

Mid Penn’s primary markets currently, and historically, have lower unemployment than the U.S. as a whole, due in part to a diversified manufacturing and services base and the presence of state government offices, which help shield the markets from national trends. At December 31, 2017, the unadjusted unemployment rate for the Harrisburg/Carlisle and Lancaster areas, two of Mid Penn’s primary markets, were 3.8% and 3.3%, respectively, versus the seasonally adjusted national unemployment rate of 4.1%. The unadjusted unemployment rate for Mid Penn’s Scranton/Wilkes- Barre/Hazleton market area was 5.0% at December 31, 2017.

The Bank emphasizes developing long-term customer relationships, maintaining high quality service, and providing quick responses to customer needs. Mid Penn believes that local relationship building and its conservative approach to lending are important factors in the success and growth of Mid Penn.

The Bank seeks credit opportunities of sound quality within its target market. Creditworthy customers exhibit positive historical repayment trends, stable cash flows and secondary sources of repayment from tangible collateral. The Bank extends credit for the purpose of obtaining and continuing long-term relationships. Lenders are provided with detailed underwriting policies for all types of credit risks accepted by the Bank, and must obtain appropriate approvals for credit extensions. The Bank also maintains strict documentation requirements and extensive credit quality assurance practices in order to identify credit portfolio weaknesses as early as possible so any exposures that are discovered might be mitigated or potential losses reduced.

#### Lending Activities

The Bank offers a variety of loan products to its customers, including loans secured by real estate and commercial and consumer loans. The Bank’s primary lending objectives are as follows:

- to establish a diversified loan portfolio; and
- to provide a satisfactory return to Mid Penn’s shareholders by properly pricing loans to include the cost of funds, administrative costs, bad debts, local economic conditions, competition, customer relationships, the term of the loan, credit risk, collateral quality and a reasonable profit margin.

Credit risk is managed through portfolio diversification, underwriting policies and procedures, and loan monitoring practices. The Bank generally secures its loans with real estate with such collateral values dependent and subject to change based on real estate market conditions within its market area. As of December 31, 2017, the Bank’s highest concentration of credit is in commercial real estate. Most of the Bank’s business activity with customers is located in Central Pennsylvania, specifically in Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties.



Investment Activities

Mid Penn's securities portfolio is used to provide both liquidity and a secondary source of interest earning through investments in higher-yielding assets than overnight funding alternatives, while maintaining asset quality. Mid Penn does not have any significant non-governmental concentrations within its investment securities portfolio.

MID PENN BANCORP, INC.

In addition to an available-for-sale portfolio, during the first quarter of 2017, Mid Penn established a held-to-maturity investment portfolio comprised primarily of lower-risk and lower-yielding U.S. Treasury notes, U.S. agency mortgage-backed securities, and investment-grade municipal securities. The held-to-maturity portfolio was established to support the Bank's growth in public fund deposit pledging requirements. The investments in the held-to-maturity portfolio are recorded on the balance sheet at book value, while the available-for-sale securities are recorded on the balance sheet at fair value. Mid Penn's available-for-sale investments include agency notes, agency mortgage-backed securities, and municipal securities. These debt securities derive fair values relative to investments of the same type and credit profile with similar maturity dates. As the interest rate environment changes, Mid Penn's fair value of securities will change. This difference between the amortized cost and fair value of available-for-sale investment securities, or unrealized loss, amounted to \$2,733,000 as of December 31, 2017. On an after-tax basis, this unrealized loss on available-for-sale securities resulted in a reduction to shareholders' equity, through the accumulated other comprehensive loss component, of \$2,159,000. A majority of the investments are high quality United States and municipal securities that, if held to maturity, are expected to result in no loss to the Bank.

For additional information with respect to Mid Penn's business activities, see Part II, Item 7 of this report, which is incorporated herein by reference.

#### Sources of Funds

The Bank primarily uses retail deposits and, to a lesser extent, wholesale borrowings to finance lending and investment activities. Wholesale borrowing sources include advances from the Federal Home Loan Bank of Pittsburgh (the "FHLB") and overnight borrowings from the Bank's other correspondent banking relationships. All borrowings, except for lines of credit with the Bank's correspondent banks, require collateral in the form of loans or securities. Collateral levels, therefore, limit the extent of borrowings and the available lines of credit extended by the Bank's creditors. As a result, generating and retaining retail deposits remain critical to the future funding and growth of the business. Deposit growth within the banking industry has been subject to strong competition from a variety of financial services companies. This competition may require financial institutions to adjust their product offerings and pricing to maintain and grow deposits.

#### Competition

The banking business is highly competitive, and the profitability of Mid Penn depends principally upon the Bank's ability to compete in its market area. The Bank actively competes with other financial services companies for deposit, loan, and trust business. Competitors include other commercial banks, credit unions, savings banks, savings and loan associations, insurance companies, securities brokerage firms, finance companies, mutual funds, and service alternatives via the Internet. Financial institutions compete primarily on the quality of services rendered, interest rates on loans and deposits, service charges, the convenience of banking facilities, location and hours of operation and, in the case of loans to larger commercial borrowers, relative lending limits.

Many competitors are larger than the Bank and have significantly greater financial resources, personnel and locations from which to conduct business. In addition, the Bank is subject to banking regulations while certain competitors may not be. For more information, see the "Supervision and Regulation", section below and Item 1A. – "Risk Factors".

Mid Penn has been able to compete effectively with other financial institutions by emphasizing customer service. Mid Penn's customer service model is based on convenient hours, efficient and friendly employees, local decision making, and quality products.

Additionally, the safety of traditional bank deposit products has remained an attractive option during periods of market volatility. Mid Penn's ability to attract retail funds in the future will continue to be impacted by the public's appetite for the safety of insured or local investments versus the returns offered by alternative choices as part of their personal investment mix.

## Supervision and Regulation

### General

Bank holding companies and banks are extensively regulated under both federal and state laws. The regulation and supervision of Mid Penn and the Bank are primarily focused on the protection of depositors, the DIF, and the monetary system, and do not prioritize shareholder interests. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance on deposits, the imposition of civil money penalties, and removal and prohibition orders. If a banking regulator takes any enforcement action, the value of an equity investment in Mid Penn could be substantially reduced or eliminated. As of December 31, 2017, the Bank was not subject to any supervisory enforcement actions.

MID PENN BANCORP, INC.

Federal and state banking laws contain numerous provisions affecting various aspects of the business and operations of Mid Penn and the Bank. Mid Penn is subject to, among others, the regulations of the Securities and Exchange Commission (“SEC”) and the Board of Governors of the Federal Reserve System (the “Federal Reserve”), and the Bank is subject to, among others, the regulations of the Pennsylvania Department of Banking and Securities and the FDIC. The descriptions below of, and references to, applicable statutes and regulations are not intended to be complete lists or reflective of all applicable provisions or their effects on Mid Penn or the Bank. They are summaries only and are qualified in their entirety by reference to such statutes and regulations.

#### Holding Company Regulation

Mid Penn is a registered bank holding company subject to supervision and regulation by the Federal Reserve. As such, it is subject to the Bank Holding Company Act of 1956 (“BHCA”) and many of the Federal Reserve’s regulations promulgated thereunder. The Federal Reserve has broad enforcement powers over bank holding companies, including the power to impose substantial fines and civil penalties.

The BHCA requires Mid Penn to file an annual report with the Federal Reserve regarding the holding company and its subsidiary bank. The Federal Reserve Board also makes examinations of the holding company. The Bank is not a member of the Federal Reserve System; however, the Federal Reserve possesses cease-and-desist powers over bank holding companies and their subsidiaries where actions would constitute an unsafe or unsound practice or violation of law. The Federal Reserve Board also makes policy that guides the declaration and distribution of dividends by bank holding companies.

The BHCA restricts a bank holding company’s ability to acquire control of additional banks. In addition, the BHCA restricts the activities in which bank holding companies may engage directly or through non-bank subsidiaries.

#### Gramm-Leach-Bliley Financial Modernization Act

Under the Gramm-Leach-Bliley Financial Modernization Act (“GLB”), bank holding companies, such as Mid Penn, that meet certain management, capital, and Community Reinvestment Act standards, are permitted to become financial holding companies. No prior regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities permitted under GLB. Activities cited by GLB as being financial in nature include:

- securities underwriting, dealing and market making;
- sponsoring mutual funds and investment companies;
- insurance underwriting and agency;
- merchant banking activities; and
- activities that the Federal Reserve has determined to be closely related to banking.

In addition to permitting financial holding companies entry into new lines of business, the law allows companies the freedom to streamline existing operations and to potentially reduce costs. The Act may increase both opportunity as well as competition.

A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized under the FDIC Improvement Act’s prompt corrective action provisions, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act. The required filing is a declaration that the bank holding

company wishes to become a financial holding company and meets all applicable requirements. Many community banks are less able to devote the capital and management resources needed to facilitate broad expansion of financial services including insurance and brokerage services. Mid Penn has not elected to become a financial holding company at this time.

#### Bank Regulation

The Bank, a Pennsylvania-chartered institution, is subject to supervision, regulation and examination by both the Pennsylvania Department of Banking and Securities and the FDIC. The deposits of the Bank are insured by the FDIC to the maximum extent provided by law. The FDIC assesses deposit insurance premiums, the amount of which depends in part on both the asset size and the condition of the Bank. Moreover, the FDIC may terminate deposit insurance of the Bank under certain circumstances. The federal and state banking regulatory agencies have broad enforcement powers over depository institutions under their jurisdiction, including the power to terminate deposit insurance, to impose fines and other civil and criminal penalties, and to appoint a conservator or receiver if any of a number of conditions is met. In addition, the Bank is subject to a variety of local, state and federal laws that affect its operations.

MID PENN BANCORP, INC.

Banking regulations include, but are not limited to, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans, compensation standards, payment of dividends, various bank account and bank service disclosures, and the safety and soundness of banking practices.

### Capital Requirements

Under risk-based capital requirements for bank holding companies, Mid Penn is required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) of eight percent. Through December 31, 2017, at least half of the total capital is to be composed of common equity, retained earnings and qualifying perpetual preferred stock, less goodwill (“Tier 1 Capital”). The remainder may consist of subordinated debt, non-qualifying preferred stock and a limited amount of the loan loss allowance (“Tier 2 Capital”). Combined, the Tier 1 Capital and Tier 2 Capital comprise regulatory “Total Capital”.

In addition, the Federal Reserve has established minimum leverage ratio requirements for bank holding companies. These requirements provide for a minimum leverage ratio of Tier 1 Capital to adjusted average quarterly assets (“leverage ratio”) equal to 3% for bank holding companies that meet certain specified criteria, including having the highest regulatory rating. All other bank holding companies will generally be required to maintain a leverage ratio of at least 4-5%. The requirements also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the requirements indicate that the Federal Reserve will continue to consider a “Tangible Tier 1 Leverage Ratio” (deducting all intangibles) in evaluating proposals for expansion or new activity. The Federal Reserve has not advised Mid Penn of any specific minimum Tier 1 leverage ratio requirement.

The Bank is subject to similar capital requirements adopted by the FDIC. The FDIC has not advised the Bank of any specific minimum leverage ratios.

The capital ratios of Mid Penn and the Bank are described in Note 18 to Mid Penn’s Consolidated Financial Statements, which are included herein.

Banking regulators may further refine capital requirements applicable to banking organizations, including those discussed in the “Regulatory Capital Changes” section below. Changes to capital requirements could materially affect the profitability of Mid Penn or the fair value of Mid Penn stock.

### Prompt Corrective Action

In addition to the required minimum capital levels described above, federal law establishes a system of “prompt corrective actions” which federal banking agencies are required to take, and certain actions which they have discretion to take, based upon the capital category into which a federally regulated depository institution falls. Regulations set forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution, which is not adequately capitalized. Under the rules, an institution will be deemed to be “adequately capitalized” if it exceeds the minimum federal regulatory capital requirements. However, it will be deemed “undercapitalized” if it fails to meet the minimum capital requirements, “significantly undercapitalized” if it has a Total Risk-Based Capital ratio that is less than 6.0%, a Tier 1 Risk-Based Capital ratio that is less than 3.0%, or a leverage ratio that is less than 3.0%, and “critically undercapitalized” if the institution has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

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

MID PENN BANCORP, INC.

## 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 Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The phase-in period for community banking organizations began January 1, 2015. The final rules called for the following minimum capital requirements (which include the impact of the capital conservation buffer effective January 1, 2016):

	Effective January 1, 2018 2019	
Common equity tier 1 capital to risk-weighted assets	6.375%	7.0%
Tier 1 capital to risk-weighted assets	7.875%	8.5%
Total capital to risk-weighted assets	9.875%	10.5%
Leverage ratio	4.0%	4.0%

The final rules established a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it could be subject to certain restrictions on capital distributions and discretionary bonus payments. 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. 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 (beginning at 40% on January 1, 2015, 60% on January 1, 2016 and an additional 20% per year thereafter).

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 implemented these changes in determining and reporting the regulatory ratios of Mid Penn and the Bank. The new rules did not have a material negative effect on Mid Penn's financial condition or capital management activities for any period since the changes were implemented.

#### Safety and Soundness Standards

The federal banking regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards for depository institutions such as the Bank. The guidelines establish general standards relating to management practices, internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, liquidity, capital, earnings, compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies adopted regulations that authorize an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If an institution is not satisfying certain safety and soundness standards and fails to submit to the banking regulatory agency an acceptable compliance plan or fails to implement an accepted plan, the agency may issue an order directing action to correct the deficiency and may issue an order directing other actions be taken, including restricting asset growth, restricting interest rates paid on deposits, and requiring an increase in the institution's ratio of tangible equity to assets. For the periods reported in this Form 10-K and in the period subsequent to December 31, 2017, up to the date of the filing of this Form 10-K, Mid Penn was currently not subject to any such bank regulatory orders.

MID PENN BANCORP, INC.

### Payment of Dividends and Other Restrictions

Mid Penn is a legal entity separate and distinct from its subsidiary, the Bank. There are various legal and regulatory limitations on the extent to which the Bank can, among other things, finance, or otherwise supply funds to, Mid Penn. Specifically, dividends from the Bank are the principal source of Mid Penn's cash funds, and there are certain legal restrictions under Pennsylvania law and Pennsylvania banking regulations on the payment of dividends by state-chartered banks. The relevant regulatory agencies also have authority to prohibit Mid Penn and the Bank from engaging in what, in the opinion of such regulatory body, constitutes an unsafe or unsound banking practice. The payment of dividends could, depending upon the financial condition of Mid Penn and the Bank, be deemed to constitute such an unsafe or unsound practice. Mid Penn and the Bank were not subject to any such dividend prohibitions as of December 31, 2017.

### Deposit Insurance

The FDIC insures deposits of the Bank through the DIF. The FDIC maintains the DIF by assessing depository institutions an insurance premium. The amount each institution is assessed is based upon a variety of factors that include the level of assets and tangible equity, as well as the degree of risk the institution poses to the insurance fund. The FDIC insures deposits up to \$250,000. The Bank pays an insurance premium into the DIF based on a regulatory defined assessment calculation. The FDIC uses a risk-based premium system that assesses higher rates on those institutions that pose greater risks to the DIF. The FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Subsequently, the rate for each institution within a risk category may be adjusted depending upon different factors that either enhance or reduce the risk the institution poses to the DIF, including the unsecured debt, secured liabilities and brokered deposits related to each institution. Finally, certain risk multipliers may be applied to the adjusted assessment.

Beginning with the second quarter of 2011 and as applicable continuously through to the current period, as mandated by the Dodd-Frank Act, the assessment base that the FDIC uses to calculate assessment premiums is a bank's average assets minus average tangible equity. As the asset base of the banking industry is larger than the deposit base, the range of assessment rates is a low of 2.5 basis points and a high of 45 basis points, per \$100 of assets.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the DIF to achieve a reserve ratio of 1.35% of Insurance Fund insured deposits by September 2020. In addition, the FDIC has established a "designated reserve ratio" of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over \$10 billion in asset size more than banks under that size. These new formulas did not affect the Bank as it was less than \$10 billion in total assets size. Under the Dodd-Frank Act, the FDIC is authorized to make reimbursements from the insurance fund to banks if the reserve ratio exceeds 1.50%, but the FDIC has adopted the "designated reserve ratio" of 2.0% and has announced that any reimbursements from the fund are indefinitely suspended.

### Consumer Protection Laws

A number of laws govern the relationship between the Bank and its customers. For example, the Community Reinvestment Act is designed to encourage lending by banks to persons in low and moderate income areas. The Home Mortgage Disclosure Act and the Equal Credit Opportunity Act attempt to minimize lending decisions based on impermissible criteria, such as race or gender. The Truth-in-Lending Act and the Truth-in-Savings Act require banks

to provide certain disclosure of relevant terms related to loans and savings accounts, respectively. Anti-tying restrictions (which prohibit conditioning the availability or terms of credit on the purchase of another banking product) further restrict the Bank's relationships with its customers. The Bank maintains a comprehensive compliance management program to promote its compliance with these and other applicable consumer protection laws and regulations.

MID PENN BANCORP, INC.

### Privacy Laws

The federal banking regulators have issued a number of regulations governing the privacy of consumer financial and customer information. The regulations limit the disclosure by financial institutions, such as Mid Penn and the Bank, of nonpublic personal information about individuals who obtain financial products or services for personal, family, or household purposes. Subject to certain exceptions allowed by law, the regulations cover information sharing between financial institutions and nonaffiliated third parties. More specifically, the regulations require financial institutions to:

- provide initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal financial information to nonaffiliated third parties and affiliates;
- provide annual notices of their privacy policies to their current customers; and
- provide a reasonable method for consumers to “opt out” of disclosures to nonaffiliated third parties.

### Affiliate Transactions

Transactions between Mid Penn and the Bank and its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An “affiliate” of a bank or savings institution is any company or entity that controls, is controlled by, or is under common control with the bank or savings institution. Generally, a subsidiary of a depository institution that is not also a depository institution is not treated as an affiliate of the bank for purposes of Sections 23A and 23B. Sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

### The USA Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“USA Patriot Act”) broadened the application of anti-money laundering regulations to apply to additional types of financial institutions, such as broker-dealers, and strengthened the ability of the U.S. government to detect and prosecute international money laundering and the financing of terrorism. The principal provisions of Title III of the USA Patriot Act require that regulated financial institutions, including state-chartered banks:

- establish an anti-money laundering program that includes training and audit components;
- comply with regulations regarding the verification of the identity of any person seeking to open an account;
- take additional required precautions with non-U.S. owned accounts; and
- perform certain verification and certification of money laundering risk for their foreign correspondent banking relationships.

The USA Patriot Act also expanded the conditions under which funds in a U.S. interbank account may be subject to forfeiture and increased the penalties for violation of anti-money laundering regulations. Failure of a financial institution to comply with the USA Patriot Act’s requirements could have serious legal and reputational consequences for the institution. The Bank has adopted policies, procedures and controls to address compliance with the requirements of the USA Patriot Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA Patriot Act and implementing regulations.

Anti-Money Laundering and Anti-Terrorism Financing

Under Title III of the USA Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including Mid Penn and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial institutions, regulators, and law enforcement authorities is encouraged for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing. The effectiveness of a financial institution in combating money-laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank.

MID PENN BANCORP, INC.

#### Tax Cuts and Jobs Act

On December 22, 2017, President Donald J. Trump signed into law the Tax Cuts and Jobs Act (the "TCJA"), a tax reform law that included a significant provision reducing the corporate tax rate applicable to Mid Penn, for tax years beginning after 2017, to a flat 21 percent rate. Though the reduced rate will provide tax savings to Mid Penn in future periods after 2017, the reduction resulted in the \$1,169,000 write-down of Mid Penn's deferred tax asset in December 2017, because the deferred tax asset was previously valued based upon the projection of Mid Penn realizing a 34 percent future corporate tax rate benefit. This write-down was included in Mid Penn's income tax provision for the year ended December 31, 2017, as further discussed in Note 17 (Federal Income Taxes) to the consolidated financial statements.

Other significant provisions of the TCJA that could affect Mid Penn include (i) for tax years beginning after Dec. 31, 2017, the corporate AMT is repealed, and (ii) for property placed in service in tax years beginning after Dec. 31, 2017, the maximum amount Mid Penn may expense under Internal Revenue Code Sec. 179 is increased to \$1 million, and the deduction phase-out threshold amount for all qualifying purchases in a year is increased to \$2.5 million (with these amounts being indexed for inflation beginning for tax years after 2018).

#### JOBS Act

In 2012, the Jumpstart Our Business Startups Act (the "JOBS Act") became law. The JOBS Act is aimed at facilitating capital raising by smaller companies, banks, and bank holding companies. Certain changes implemented by the JOBS Act that impact Mid Penn include (i) raising the threshold requiring registration under the Securities Exchange Act of 1934 (the "Exchange Act") for banks and bank holdings companies from 500 to 2,000 holders of record, and (ii) raising the threshold for triggering deregistration under the Exchange Act for banks and bank holding companies from 300 to 1,200 holders of record.

#### Dodd-Frank Act

The Dodd-Frank Act, which became law in July 2010, significantly changed regulation of financial institutions and the financial services industry. Dodd-Frank created a Financial Services Oversight Council to identify emerging systemic risks and improve interagency cooperation, and centralized responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, which is responsible for implementing, examining and enforcing compliance with federal consumer financial laws. Dodd-Frank also permanently raised the current standard maximum deposit insurance amount to \$250,000, established strengthened capital standards for banks, disallowed certain trust preferred securities from qualifying as Tier 1 Capital (subject to certain grandfather provisions for existing trust preferred securities), established new minimum mortgage underwriting standards, granted the Federal Reserve the power to regulate debit card interchange fees, and implemented corporate governance changes.

Effects of Government Policy and Potential Changes in Regulation

Changes in regulations applicable to Mid Penn or the Bank, or shifts in monetary or other government policies, could have a material effect on our business. Mid Penn's and the Bank's business is also affected by the state of the financial services industry in general. As a result of legal and industry changes, management believes that the industry will continue to experience an increased rate of change as the financial services industry strives for greater product offerings, market share and economies of scale.

From time to time, legislation is enacted that has the effect of increasing the compliance and operations requirements and the cost of doing business, changing the tax structure applicable to Mid Penn, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, and before various bank regulatory agencies. Mid Penn cannot predict the likelihood of any major changes or the impact such changes might have on Mid Penn and/or the Bank. Congressional bills and other proposals could result in additional significant changes to the banking system, including but not limited to provisions for limitations on deposit insurance coverage, changing the timing and method financial institutions use to pay for deposit insurance, expanding the power of banks by removing the restrictions on bank underwriting activities, changing the regulation of bank derivatives activities, and allowing commercial enterprises to own banks. As a consequence of the extensive regulation of commercial banking activities in the United States, the Bank's business is particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business. Whether any future legislation will be enacted or additional regulations will be adopted, and how they might impact Mid Penn, cannot be determined at this time.

MID PENN BANCORP, INC.

Mid Penn's earnings are, and will be affected by, domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The monetary policies of the Federal Reserve have had, and will likely continue to have, an impact on the operating results of commercial banks because of the Federal Reserve's power to implement national monetary policy to, among other things, promote employment, control inflation or combat recession. The Federal Reserve has a major impact on the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of, among other things, the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to reasonably predict the nature, amount, frequency, and impact of future changes in monetary and fiscal policies.

#### Environmental Laws

Management does not anticipate that compliance with environmental laws and regulations will have any material effect on Mid Penn's capital, expenditures, earnings, or competitive position. However, environmentally related hazards have become a source of high risk and liability for some financial institutions.

Additionally, the Pennsylvania Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act provides, among other things, protection to lenders from environmental liability and remediation costs under the environmental laws for releases and contamination caused by others. A lender who engages in activities involved in the routine practices of commercial lending, including, but not limited to, the providing of financial services, holding of security interests, workout practices, foreclosure or the recovery of funds from the sale of property shall not be liable under the environmental acts or common law equivalents to the Pennsylvania Department of Environmental Resources or to any other person by virtue of the fact that the lender engages in such commercial lending practice. A lender, however, will be liable if it, its employees or agents, directly cause an immediate release or directly exacerbate a release of regulated substance on or from the property, or known and willfully compelled the borrower to commit an action which caused such release or violate an environmental act. The Pennsylvania Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act does not limit federal liability which still exists under certain circumstances.

#### Corporate Governance

The Sarbanes-Oxley Act of 2002 ("SOX") and related regulations adopted by the SEC and NASDAQ addressed the following issues: corporate governance, auditor independence and accounting standards, executive compensation, insider loans, whistleblower protection, and enhanced and timely disclosure of corporate information. Mid Penn has established policies, procedures, and systems designed to promote compliance with these regulations. Section 404 of SOX requires publicly held companies to document, test and certify that their internal control systems over financial reporting are effective. Effective December 31, 2017, Mid Penn is subject to the independent attestation requirement under Section 404 of the SOX. The Bank remains subject to independent auditor attestation under FDIC regulation 363.3(b), which is a similar independent attestation requirement at the Bank level.

#### Available Information

Mid Penn's common stock is registered under Section 12(b) of the Securities Exchange Act of 1934 and is traded on NASDAQ under the trading symbol MPB. Mid Penn is subject to the informational requirements of the Exchange Act, and, accordingly, files reports, proxy statements and other information with the SEC. The reports, proxy



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

statements and other information filed with the SEC are available for inspection and copying at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Mid Penn is an electronic filer with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's Internet site address is [www.sec.gov](http://www.sec.gov).

Mid Penn's headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061, and its telephone number is 1-866-642-7736. Mid Penn's website is [midpennbank.com](http://midpennbank.com) and Mid Penn makes available through its website, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably possible after filing with the SEC. Mid Penn has adopted a Code of Ethics that applies to all employees. This document is also available on Mid Penn's website. The information included on our website is not considered a part of this document.

MID PENN BANCORP, INC.

## ITEM 1A. RISK FACTORS

Before investing in Mid Penn common stock, an investor should carefully consider the risk factors described below, which are not intended to be all inclusive, and to review other information contained in this report and in our other filings with the SEC. The risks and uncertainties described below are not the only ones facing the Mid Penn. Additional risks and uncertainties that we are not aware of, or that we currently deem less significant, or that we are otherwise not specifically focused on, may also impact our business, results of operations, and our common stock. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition and results of operations could be materially and adversely affected. If this were to happen, the market price of our common stock could decline significantly, and an investor could lose all or part of his or her investment in Mid Penn.

Unless the context otherwise requires, references to “we,” “us,” “our,” “Mid Penn,” or “Mid Penn Bancorp, Inc.,” collectively refer to Mid Penn Bancorp, Inc. and its banking subsidiary, and specific references to the “Bank” refer to Mid Penn Bank, the wholly-owned banking subsidiary of Mid Penn Bancorp, Inc.

### Risks Related to Our Primary Business and Industry

Mid Penn is subject to interest rate risk

Mid Penn’s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities, and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond Mid Penn’s control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest income Mid Penn receives on loans and securities and the amount of interest expense it pays on deposits and borrowings, but such changes could also affect (i) Mid Penn’s ability to originate loans and obtain deposits, (ii) the fair value of Mid Penn’s financial assets and liabilities, and (iii) the average duration of Mid Penn’s mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, Mid Penn’s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and investments fall more quickly than the interest rates paid on deposits and borrowings.

Management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on Mid Penn’s results of operations. Any substantial, unexpected, prolonged, or rapid change in market interest rates could have a material adverse effect on Mid Penn’s financial condition and results of operations.

Mid Penn is subject to credit risk

As of December 31, 2017, approximately 83 percent of Mid Penn’s loan portfolio in Table 8 of Management’s Discussion and Analysis consisted of commercial, industrial and agricultural, construction, and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or secured consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because Mid Penn’s loan portfolio contains a significant number of commercial and industrial, construction and

commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan and lease losses and an increase in loan charge-offs, all of which could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn's allowance for loan and lease losses may be insufficient

Mid Penn maintains an allowance for loan and lease losses, which is a reserve established that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan and lease losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan and lease losses inherently involves a high degree of subjectivity and requires Mid Penn to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem credits and other factors, both within and outside of Mid Penn's control, may require an increase in the allowance. In addition, bank regulatory agencies periodically review Mid Penn's allowance for possible loan and lease losses and may require an increase in the provision for possible loan and lease losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance, Mid Penn may need additional provisions to increase the allowance for possible loan and lease losses. Any increases in the allowance resulting from loan loss provisions will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on Mid Penn's financial condition and results of operations.

MID PENN BANCORP, INC.

Competition from other financial institutions may adversely affect Mid Penn's profitability

Mid Penn's banking subsidiary faces substantial competition in originating both commercial and consumer loans. This competition comes principally from other banks, credit unions, savings institutions, mortgage banking companies and other lenders. Many of its larger competitors who offer loans enjoy advantages, including greater financial resources and higher lending limits, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. This competition could reduce Mid Penn's net income by decreasing the number and size of loans that its banking subsidiary originates and the interest rates it may charge on these loans.

In attracting business and consumer deposits, its banking subsidiary faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of Mid Penn's larger competitors who accept deposits enjoy advantages, including greater financial resources, more aggressive marketing campaigns, better brand recognition, and more convenient branch locations. These competitors may offer higher interest rates than Mid Penn, which could decrease the deposits that Mid Penn attracts or require Mid Penn to increase its rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect Mid Penn's ability to generate the funds necessary for lending operations. As a result, Mid Penn may need to seek other sources of funds that may be more expensive to obtain and could increase its cost of funds.

Mid Penn's banking subsidiary also competes with non-bank providers of financial services, such as brokerage firms, consumer finance companies, credit unions, insurance agencies and governmental organizations, which may offer more favorable terms. Some of its non-bank competitors are not subject to the same extensive and costly regulations that govern its banking operations. As a result, such non-bank competitors may have advantages over Mid Penn's banking subsidiary in providing certain products and services. This competition may reduce or limit Mid Penn's margins on banking services, reduce its market share and adversely affect its earnings and financial condition.

The Basel III capital requirements require us to maintain higher levels of capital, which could reduce our profitability

Basel III targets higher levels of base capital, certain capital buffers, and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements are continuing to be phased in through January 1, 2019, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. The Basel III implementation activities and related regulatory capital targets require additional capital to support our business risk profile prior to final implementation of the Basel III standards. Mid Penn may be required to maintain higher levels of capital, thus potentially reducing opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to Mid Penn, and adversely impact our financial condition and results of operations.

If Mid Penn's information systems are interrupted or sustain a breach in security, those events may negatively affect Mid Penn's financial performance and reputation

In conducting its business, Mid Penn relies heavily on its information systems. Maintaining and protecting those systems and data is difficult and expensive, as is dealing with any failure, interruption, or breach in security of these systems, whether due to acts or omissions by Mid Penn or by a third party, and whether intentional or not. Any such failure, interruption, or breach could result in failures or disruptions in Mid Penn's customer relationship management, general ledger, deposit, loan, and other systems. A breach of Mid Penn's information security may result from

fraudulent activity committed against Mid Penn or its clients, resulting in financial loss to Mid Penn or its clients, or privacy breaches against Mid Penn's clients. Such fraudulent activity may consist of check fraud, electronic fraud, wire fraud, "phishing", social engineering, identity theft, or other deceptive acts. The policies, procedures, and technical safeguards put in place by Mid Penn to prevent or limit the effect of any failure, interruption, or security breach of its information systems and data may be insufficient to prevent or remedy the effects of any such occurrences. The occurrence of any failures, interruptions, or security breaches of Mid Penn's information systems and data could damage Mid Penn's reputation, cause Mid Penn to incur additional expenses, result in online services or other businesses becoming inoperable, subject Mid Penn to regulatory sanctions or additional regulatory scrutiny, or expose Mid Penn to civil litigation and possible financial liability, any of which could have a material adverse effect on Mid Penn's financial condition and results of operations.

MID PENN BANCORP, INC.

Mid Penn's business operations and interaction with customers are increasingly done via electronic means, and this has increased risks related to cyber security

Mid Penn is exposed to the risk of cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. An increased level of attention in the industry is focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, Mid Penn has policies and procedures in place to prevent or limit the effect of the possible security breach of its information systems and it has insurance against some cyber-risks and attacks. While Mid Penn has not incurred any material losses related to cyber-attacks, nor is it aware of any specific or threatened cyber-incidents as of the date of this report, it may incur substantial costs and suffer other negative consequences if it falls victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that cyber-attacks may have caused; deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

Mid Penn's controls and procedures may fail or be circumvented

Management periodically reviews and updates Mid Penn's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on performance by personnel or certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of Mid Penn's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on Mid Penn's business, results of operations, and financial condition.

We are required to make a number of judgments in applying generally accepted accounting standards, and different estimates and assumptions in the application of these accounting standards could result in a decrease in capital and/or other material changes to our reports of financial condition and results of operations

Generally accepted accounting standards involving estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and reserve for unfunded lending commitments, the fair value of certain financial instruments including investment securities, income tax assets or liabilities (including deferred tax assets and any related valuation allowance), and share-based compensation. While we have identified critical accounting policies and have procedures and processes in place to support making the related judgments and estimates, changes to the processes, assumptions, or models in the application of these generally accepted accounting standards, and the impact to the related judgments and estimates could result in a decrease to net income and, possibly, capital and may have a material adverse effect on our financial condition and results of operations. From time to time, the Financial Accounting Standards Board and the SEC issues changes to or updated interpretations of the financial accounting and reporting guidance that governs the preparation of Mid Penn's financial statements. These changes are beyond our control, can be difficult to predict, and could materially impact how we report our financial condition and results of operations. We could be required to apply new or revised guidance retrospectively, which

may result in the revision of prior financial statements by material amounts. The implementation of new or revised guidance could also result in material adverse effects to our reported capital.

Mid Penn's profitability depends significantly on economic conditions in Pennsylvania

Unlike larger or regional financial institutions that are more geographically diversified, Mid Penn's success is dependent to a significant degree on economic conditions in Pennsylvania, especially in the central part of the State including Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties, which were the counties and markets primarily served by Mid Penn in the years up to and including 2017. In addition, with the acquisition of The Scottdale Bank and Trust Company effective January 8, 2018, Mid Penn has begun to serve customers in Western Pennsylvania with five offices located in Westmoreland and Fayette Counties. The banking industry is affected by general economic conditions including the effects of inflation, recession, unemployment, real estate values, trends in national and global economics, and other factors beyond our control. An economic recession or a delayed recovery over a prolonged period of time in Pennsylvania, or more specific to the areas in the State served by Mid Penn, could cause an increase in the level of the Bank's non-performing assets and loan and lease losses, thereby causing operating losses, impairing liquidity, and eroding capital. Mid Penn cannot assure that adverse changes in the local economy would not have a material adverse effect on Mid Penn's consolidated financial condition, results of operations, and cash flows.

MID PENN BANCORP, INC.

Mid Penn may not be able to attract and retain skilled personnel

Mid Penn's success depends, in large part, on its ability to attract and retain qualified, key personnel. Competition for the best personnel in most activities engaged in by Mid Penn can be intense, and Mid Penn may not be able to hire or retain them. The unexpected loss of services of one or more of Mid Penn's key personnel could have a material adverse impact on Mid Penn's business because of their skills, knowledge of Mid Penn's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

Mid Penn is subject to claims and litigation pertaining to fiduciary responsibility

From time to time, customers may make claims and take legal action pertaining to Mid Penn's performance of its fiduciary responsibilities. Whether customer claims and legal action related to Mid Penn's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to Mid Penn, the claims or related litigation processes may result in significant financial expense and liability, and/or adversely affect the market perception of Mid Penn and its products and services, as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on Mid Penn's business, which, in turn, could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn operates in a highly regulated environment and may be adversely affected by changes in federal, state and local laws and regulations

Mid Penn is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal, state or local legislation could have a substantial impact on Mid Penn and its operations. Additional legislation and regulations that could significantly affect Mid Penn's powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on its financial condition and results of operations. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on Mid Penn's results of operations and financial condition.

The potential exists for additional federal or state laws and regulations, or changes in policy, or changes in supervisory activities, to affect many aspects of Mid Penn's operations, including capital levels, lending and funding practices, and liquidity standards. New laws and regulations may increase costs of regulatory compliance and of doing business and otherwise affect operations, and may significantly affect the markets in which Mid Penn does business, the markets for and value of Mid Penn's loans and investments, the ability to attract deposits at a reasonable cost, the fees charged, and ongoing operations, costs and profitability.

The soundness of other financial institutions may adversely affect Mid Penn

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. Mid Penn has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose Mid Penn to credit risk in the event of a default by a counterparty or client. In addition, Mid Penn's credit risk may be exacerbated when the collateral held by Mid Penn cannot be readily realized or liquidated at prices sufficient to recover the full amount of the credit or derivative exposure due to Mid Penn. Any such losses could have a material adverse effect on Mid Penn's financial condition



and results of operations.

Prior levels of market volatility were unprecedented and future volatility may have materially adverse effects on our liquidity and financial condition

In the recent past, the capital and credit markets experienced extreme volatility and disruption. In some cases, the markets exerted downward pressure on stock prices, security prices, and credit availability for certain issuers without regard to their underlying financial strength. If such levels of market disruption and volatility return, there can be no assurance that Mid Penn will not experience adverse effects, which may materially affect its liquidity, financial condition, and profitability.

MID PENN BANCORP, INC.

Mid Penn's banking subsidiary may be required to pay higher FDIC insurance premiums or special assessments which may adversely affect its earnings

Poor economic conditions and the resulting bank failures from the most recent recession have stressed the DIF and increased the costs of Mid Penn's FDIC insurance assessments. Additional bank failures may prompt the FDIC to increase its premiums above the recently increased levels or to issue special assessments. Mid Penn generally is unable to control the amount of premiums or special assessments that its banking subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on our results of operations, financial condition, and our ability to continue to pay dividends on our common stock at the current rate or at all.

If we conclude that the decline in the value of any of our investment securities is other than temporary, we are required to write down the value of that security through a charge to earnings

Mid Penn reviews its investment securities portfolio at each quarter-end reporting period to determine whether the fair value of individual securities or the portfolio as a whole is below the current carrying value. When the fair value of any of its investment securities has declined below its carrying value, Mid Penn is required to assess whether the decline is other than temporary. If Mid Penn concludes that the decline is other than temporary, it is required to write down the value of that security through a charge to earnings. Changes in the expected cash flows of these securities and/or prolonged price declines may result in Mid Penn concluding that impairment of these securities is other than temporary, which would require a charge to earnings to write down these securities to their fair value. Due to the complexity of the calculations and assumptions used in determining whether an asset is impaired, the impairment disclosed, or lack thereof, may not accurately reflect the actual impairment in the future.

Mid Penn is subject to environmental liability risk associated with lending activities

A significant portion of Mid Penn's loan portfolio is secured by real property. During the ordinary course of business, Mid Penn may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, Mid Penn may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require Mid Penn to incur substantial expenses and may materially reduce the affected property's value or limit Mid Penn's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws, may increase Mid Penn's exposure to environmental liability. Although Mid Penn has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn's financial performance may suffer if its information technology is unable to keep pace with its growth or industry developments

Effective and competitive delivery of Mid Penn's products and services is increasingly dependent upon information technology resources and processes, both those provided internally as well as those provided through third party vendors. In addition to better serving customers, the effective use of technology increases efficiency and enables Mid Penn to reduce costs. Mid Penn's future success will depend, in part, upon its ability to address the needs of its customers by using technology to provide products and services to enhance customer convenience, as well as to create additional efficiencies in its operations. Many of Mid Penn's competitors have greater resources to invest in

technological improvements. Additionally, as technology in the financial services industry changes and evolves, keeping pace becomes increasingly complex and expensive for Mid Penn. There can be no assurance that Mid Penn will be able to effectively, and could adversely affect its financial condition and results of operations.

#### Growing By Acquisition Entails Certain Risks

On January 8, 2018, we completed a merger acquisition The Scottdale Bank & Trust Company and on January 16, 2018, we entered into an agreement providing for the acquisition of First Priority Financial Corp., which transaction is expected to close in the third quarter of 2018, pending receipt of required regulatory and shareholder approvals and the satisfaction of other conditions. Growth by acquisition involves risks. The success of our acquisitions may depend on, among other things, our ability to realize anticipated cost savings and to combine the businesses of the acquired company with our businesses in a manner that does not result in decreased revenues resulting from disruption of existing customer relationships of the acquired company. If we are not able to achieve these objectives, the anticipated benefits of an acquisition may not be realized fully or at all or may take longer to realize than planned.

MID PENN BANCORP, INC.

Further, the asset quality or other financial characteristics of a company we plan to acquire may deteriorate between the date a merger or other acquisition agreement is entered into and the transaction is completed. Depending upon the terms we negotiate in the related merger or acquisition agreement, the deterioration may not allow us to fail to close the proposed transaction, such that we may be required to close the proposed transaction with such a company to the detriment of our future financial condition.

Additionally, if a pending acquisition is not completed due to the failure to satisfy certain conditions or otherwise, expenses incurred in connection therewith could have a material adverse impact on our financial condition because we would not have realized the expected benefits.

Difficulties in integrating past or future acquisitions could adversely affect our business

We have spent and may continue to spend significant resources identifying businesses to acquire. The efficient and effective integration of any businesses we acquire into our organization is critical to our growth. The Scottdale Merger, the First Priority Merger, and any future mergers or acquisitions, involve numerous risks including difficulties in integrating the culture, operations, technologies and personnel of the acquired companies, the diversion of management's attention from other business concerns and the potential loss of customers. Failure to successfully integrate the operations of Scottdale and First Priority could also harm our business, results of operations and cash flows.

We plan to pursue a growth strategy and there are risks associated with rapid growth

We intend to pursue a growth plan consistent with our prior business strategy, including growth by acquisition, as well as leveraging our existing branch network and adding new branch locations in current and adjacent markets we choose to serve. The Scottdale Merger and First Priority Merger were part of our growth strategy.

Our ability to manage growth successfully will depend on our ability to attract qualified personnel and maintain cost controls and asset quality while attracting additional loans and deposits on favorable terms, as well as on factors beyond our control, such as economic conditions and competition. If we grow too quickly and are not able to attract qualified personnel, control costs and maintain asset quality, this continued rapid growth could materially adversely affect our financial performance.

The interest rate on our subordinated notes will remain fixed until December 2020, when some will begin to float to Prime plus 0.50%

The per annum interest rate on the \$7.5 million of our subordinated notes issued in December 2015 is fixed at 5.15%, until December 2020 when the interest rate will float at the Wall Street Journal's Prime rate plus 0.50%, provided that the interest rate applicable will at no time be less than 4.0%. The per annum interest rate on the \$10 million of our subordinated notes issued in December 2017 is fixed at 5.25% until December 2022, when it will float at the Wall Street Journal's Prime rate plus 0.50%, provided that the interest rate applicable will at no time be less than 5.0%. Depending on Mid Penn's financial condition at the time of these rates changing from fixed to variable, an increase in the interest rate on our subordinated debt could have a material adverse effect on Mid Penn's liquidity and results of operations.

Risks Related to Mid Penn Common Stock

The trading volume in Mid Penn's common stock is less than that of other larger financial services companies

Mid Penn's common stock is listed for trading on NASDAQ; however, the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of Mid Penn's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which Mid Penn has no control. Given the generally lower trading volume of Mid Penn's common stock, significant sales of Mid Penn's common stock, or the expectation of these sales, could cause Mid Penn's stock price to fall.

The market price of Mid Penn common stock may fluctuate significantly, and this may make it difficult for investors to resell shares of common stock owned by them at times or at prices they find attractive

The market price of our common stock as reported on NASDAQ is subject to constant change during business trading hours. We expect that the market price of Mid Penn common stock will continue to fluctuate and there can be no assurance about the stability or trend of market prices for Mid Penn common stock. Stock price volatility may make it difficult for investors to resell their Mid Penn common stock when they want and at times or prices that they find attractive. Mid Penn's stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond our control. These factors include those described elsewhere in this entire "Risk Factors" section, in this document, and our other filings with the SEC.

MID PENN BANCORP, INC.

Mid Penn's ability to pay dividends on its common stock, and principal and interest on its subordinated notes, depends primarily on dividends from its banking subsidiary, which is subject to regulatory limits

Mid Penn is a bank holding company and its operations are conducted by its subsidiaries, primarily the Bank. Its ability to pay dividends on its common stock and principal and interest on its subordinated notes depends on its receipt of dividends from the Bank. Dividend payments from its banking subsidiary are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. The ability of the Bank to pay dividends is also subject to profitability, financial condition, liquidity, and capital management limits. There is no assurance that Mid Penn's subsidiaries will be able to pay dividends in the future or that Mid Penn will generate adequate cash flow to pay dividends in the future. Federal Reserve policy, which applies to Mid Penn as a registered bank holding company, also provides that dividends by bank holding companies should generally be paid out of earnings from both the current period and a designated look-back period. Mid Penn's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

Mid Penn may need to, or be required to, raise additional capital in the future, and capital may not be available when needed and on terms favorable to current stockholders

Federal banking regulators require Mid Penn and its subsidiary bank to maintain adequate levels of capital to support their operations. These capital levels are determined and dictated by law, regulation, and banking regulatory agencies. In addition, capital levels are also determined by Mid Penn's management and board of directors, based on capital levels that they believe are necessary to support Mid Penn's business operations.

If Mid Penn raises capital through merger and acquisition activities, or through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and could dilute the per share book value and earnings per share of its common stock. Furthermore, a capital raise through issuance of additional shares may have an adverse impact on Mid Penn's stock price. New investors also may have rights, preferences and privileges senior to Mid Penn's current common stockholders, which may adversely impact its current common stockholders.

Mid Penn's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside of its control, and on its financial performance. Accordingly, Mid Penn cannot be certain of its ability to raise additional capital on acceptable terms and acceptable time frames or to raise additional capital at all. If Mid Penn cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect Mid Penn's financial condition and results of operations.

Offerings of debt, which would be senior to our common stock upon liquidation, and/or preferred equity securities which may be senior to our common stock for purposes of dividend distributions or upon liquidation, may adversely affect the market price of our common stock

We may attempt to increase our capital resources or, if our or the Bank's capital ratios fall below the required minimums, we or the Bank could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings are likely to receive distributions of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or

both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

Our board of directors is authorized to issue one or more classes or series of preferred stock from time to time without any action on the part of the shareholders. Our board of directors also has the power, without shareholder approval, to set the terms of any such classes or series of preferred stock that may be issued, including voting rights, dividend rights, and preferences over our common stock with respect to dividends or upon our dissolution, winding up and liquidation and other terms. If we issue preferred stock in the future that has a preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.

MID PENN BANCORP, INC.

Pennsylvania Business Corporation Law and various anti-takeover provisions under our articles of incorporation and bylaws could impede the takeover of Mid Penn

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire Mid Penn, even if the acquisition would be advantageous to shareholders. In addition, we have various anti-takeover measures in place under our articles of incorporation and bylaws, including a supermajority vote requirement for mergers, the staggered election of Mid Penn's board of directors, and the absence of cumulative voting. Any one or more of these laws or measures may impede the takeover of Mid Penn without the approval of our board of directors and may prevent our shareholders from taking part in a transaction in which they could realize a premium over the current market price of our common stock.

Our common stock is not insured by any governmental entity

Although Mid Penn and the Bank are regulated by governmental agencies, Mid Penn common stock is not a deposit account or other obligation of the Bank or any other bank and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, any other governmental entity or by any other public or private entity. Investment in Mid Penn common stock is inherently risky for the reasons described elsewhere in this entire "Risk Factors" section, in this document, and our other filings with the SEC. Mid Penn common stock is also subject to the same market forces that affect the price of common stock in any other public traded company. As a result, investors who acquire Mid Penn common stock may lose some or all of their investment.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None

#### ITEM 2. PROPERTIES

The Bank owns a building in Millersburg, Pennsylvania, located at 349 Union Street, which serves as its headquarters and the executive and administrative offices of Mid Penn and the Bank. The Bank also owns one building in Halifax, Pennsylvania that serves as an operational support facility. In addition, the Bank leases two buildings in Harrisburg, Pennsylvania that serve as additional administrative and operational support offices. Administrative space is also leased in Pottsville, Lancaster, and Chambersburg, Pennsylvania. The Bank's retail office network is comprised of twenty-three full service locations and two ATM only sites at December 31, 2017. Eleven retail banking locations are located in Dauphin County, five in Schuylkill County, three in Cumberland County, three in Lancaster County, one in Northumberland County, and one in Luzerne County. As of December 31, 2017, retail banking facilities at twelve locations were owned, while eleven were leased. All real estate owned is free and clear of encumbrances. Mid Penn's operating leases expire at various dates through the year 2035 and generally include options to renew. For additional information regarding the lease commitments, refer to Part II, Item 8, Note 9 "Bank Premises and Equipment" in the Notes to Consolidated Financial Statements.



Subsequent to year-end 2017, Mid Penn acquired The Scottdale Bank and Trust Company effective January 8, 2018, and added five additional offices in Westmoreland and Fayette Counties in Western Pennsylvania operating as “Scottdale Bank & Trust, a Division of Mid Penn Bank”, all of which are owned free and clear of encumbrances. Also in January 2018, Mid Penn opened a new full-service office in Halifax, PA.

ITEM 3. LEGAL PROCEEDINGS

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Corporation. Mid Penn and the Bank have 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, the Bank, or any of its properties.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

MID PENN BANCORP, INC.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation's common stock is traded on NASDAQ under the symbol MPB. The following table shows the range of high and low closing prices for one share of the Corporation's common stock and cash dividends paid per share for the quarters indicated.

Quarter Ended:	High	Low	Cash Dividends Paid
March 31, 2017	\$28.95	\$23.15	\$ 0.23
June 30, 2017	27.95	25.10	0.13
September 30, 2017	29.96	25.71	0.13
December 31, 2017	35.75	29.00	0.13
March 31, 2016	\$16.99	\$14.70	\$ 0.22
June 30, 2016	16.23	14.88	0.12
September 30, 2016	19.49	15.72	0.12
December 31, 2016	24.00	18.50	0.12

Transfer Agent: Computershare, Attn: Shareholder Services, P.O. Box 30170, College Station, TX 77842-3170. Phone: 1-800-368-5948.

Number of Shareholders: As of March 1, 2018, there were approximately 1,862 shareholders of record of Mid Penn's common stock.

Dividends: In 2017, cash dividends of \$0.62 were paid, while cash dividends of \$0.77 were declared. A special cash dividend of \$0.10 was declared on November 21, 2017 and paid on January 5, 2018. Cash dividends of \$0.58 and \$0.68 were paid and declared, respectively, in 2016. Cash dividends paid and declared were \$0.44 in 2015. The declaration of cash dividends on Mid Penn's common stock is at the discretion of its Board of Directors, and any decision to declare a dividend is based on a number of factors, including, but not limited to, earnings, prospects, financial condition, regulatory capital levels, applicable covenants under any credit agreements and other contractual restrictions, Pennsylvania law, federal and Pennsylvania bank regulatory law, and other factors deemed relevant.

Dividend Reinvestment and Stock Purchases: Shareholders of Mid Penn may acquire additional shares of common stock by reinvesting their cash dividends under the Dividend Reinvestment Plan without paying a brokerage fee. Voluntary cash contributions may also be made under the Plan. For additional information about the Plan, contact the Transfer Agent.

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

Annual Meeting: The Annual Meeting of the Shareholders of Mid Penn is expected to be held at 10:00 a.m. on Tuesday, May 8, 2018, at the Halifax Area Ambulance and Rescue Association Building located at 31 Bunker Hill Road, Halifax, PA 17032.

Accounting, Auditing and Internal Control Complaints: Information on how to report a complaint regarding accounting, internal accounting controls or auditing matters is available at Mid Penn's website: [www.midpennbank.com](http://www.midpennbank.com).

MID PENN BANCORP, INC.

## Stock Performance Graph

Index	Period Ending					
	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
Mid Penn Bancorp, Inc.	100.00	130.80	146.01	155.37	239.20	340.28
Russell 3000	100.00	133.55	150.32	151.04	170.28	206.26
Mid-Atlantic Custom Peer Group*	100.00	117.06	126.84	137.95	154.90	186.90

\* Mid-Atlantic Custom Peer Group consists of Mid-Atlantic commercial banks with assets less than \$1B.

Source: SNL Financial, an offering of S&P Global Market Intelligence

© 2017

www.snl.com

A detailed list of the Banks comprising the Mid-Atlantic Custom Peer Group is incorporated herein by reference to Exhibit 99.1, which is filed with this Annual Report on Form 10-K.

## MID PENN BANCORP, INC.

## ITEM 6. SELECTED FINANCIAL DATA

## Summary of Selected Financial Data

(Dollars in thousands, except per share data)	2017	2016	2015	2014	2013
<b>INCOME:</b>					
Total Interest Income	\$43,892	\$40,212	\$36,490	\$30,627	\$28,983
Total Interest Expense	6,304	5,367	4,607	4,427	5,057
Net Interest Income	37,588	34,845	31,883	26,200	23,926
Provision for Loan and Lease Losses	325	1,870	1,065	1,617	1,685
Noninterest Income	5,693	5,924	4,113	3,284	3,290
Noninterest Expense	31,367	28,818	26,759	20,704	19,391
Income Before Provision for Income Taxes	11,589	10,081	8,172	7,163	6,140
Provision for Income Taxes	4,500	2,277	1,644	1,462	1,201
Net Income	7,089	7,804	6,528	5,701	4,939
<b>Series A Preferred Stock Dividends and</b>					
Discount Accretion	—	—	—	—	14
<b>Series B Preferred Stock Dividends and</b>					
Redemption Premium	—	—	473	350	309
<b>Series C Preferred Stock Dividends</b>					
	—	—	17	—	—
<b>Net Income Available to Common</b>					
Shareholders	7,089	7,804	6,038	5,351	4,616
<b>COMMON STOCK DATA PER SHARE:</b>					
Earnings Per Common Share (Basic)	\$ 1.67	\$ 1.85	\$ 1.47	\$ 1.53	\$ 1.32
Earnings Per Common Share (Fully Diluted)	1.67	1.85	1.47	1.53	1.32
Cash Dividends Declared	0.77	0.68	0.44	0.45	0.25
Cash Dividends Paid	0.62	0.58	0.44	0.45	0.25
Book Value Per Common Share	17.85	16.65	16.58	15.48	13.71
Tangible Book Value Per Common Share (a)	16.82	15.59	15.49	15.13	13.35
<b>AVERAGE SHARES OUTSTANDING</b>					
(BASIC):	4,236,616	4,229,284	4,106,548	3,495,705	3,491,653
<b>AVERAGE SHARES OUTSTANDING</b>					
(FULLY DILUTED):	4,236,616	4,229,284	4,106,548	3,495,705	3,491,653
<b>AT YEAR-END:</b>					
Available-For-Sale Investment Securities	\$93,465	\$ 133,625	\$ 135,721	\$ 141,634	\$ 122,803

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

Held-to-Maturity Investment Securities	101,356	—	—	—	—
Loans and Leases, Net of Unearned Interest	910,404	813,924	736,513	571,533	546,462
Allowance for Loan and Lease Losses	7,606	7,183	6,168	6,716	6,317
Total Assets	1,170,354	1,032,599	931,638	755,657	713,125
Total Deposits	1,023,568	935,373	777,043	637,922	608,130
Short-term Borrowings	34,611	—	31,596	578	23,833
Long-term Debt	12,352	13,581	40,305	52,961	23,145
Subordinated Debt	17,338	7,414	7,414	—	—
Shareholders' Equity	75,703	70,467	70,068	59,130	52,916

RATIOS:

Return on Average Assets	0.64	%	0.78	%	0.74	%	0.78	%	0.71	%
Return on Average Shareholders' Equity	9.48	%	10.71	%	9.16	%	9.95	%	9.37	%
Cash Dividend Payout Ratio	37.13	%	31.35	%	29.93	%	29.41	%	18.94	%
Allowance for Loan and Lease Losses to										
Loans and Leases at Year End	0.84	%	0.88	%	0.83	%	1.18	%	1.16	%
Average Shareholders' Equity to Average										
Assets for the Year	6.78	%	7.28	%	8.06	%	7.80	%	7.56	%

- (a) Tangible Book Value Per Common Share excludes goodwill and core deposits and other intangibles, net

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain of the matters discussed in this document 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," "anticipate," "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;
- the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, the value of investment securities, and interest rate protection agreements;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn's market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- 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 bank regulatory agencies;
- 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, the SEC, and other accounting and reporting standard setters;
- 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 ability to successfully expand our franchise, including acquiring institutions or establishing new offices at advantageous prices
- our ability to successfully integrate any banks, companies, offices, 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 regulatory 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;
- our ability to maintain compliance with the listing rules of NASDAQ;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;

•volatility in the securities markets;  
•disruptions due to flooding, severe weather, or other natural disasters or Acts of God; and  
•acts of war or terrorism.



MID PENN BANCORP, INC. Management's Discussion and Analysis

All written or oral forward-looking statements attributable to Mid Penn are expressly qualified in their entirety by these cautionary factors.

This Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of Mid Penn's consolidated financial statements and should be read in conjunction with the Consolidated Financial Statements of the Corporation and Notes thereto and other detailed information appearing elsewhere in this Annual Report on Form 10-K. The comparability of the results of operations for the years ended 2017 and 2016, compared to 2015, in general, have been impacted by the acquisition of Phoenix, which closed on March 1, 2015. For comparative purposes, some 2016 and 2015 balances have been reclassified to conform to the 2017 presentation. Such reclassifications had no impact on net income available to common shareholders or shareholders' equity.

Mid Penn is not aware of any current trends, events, uncertainties or any current recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on Mid Penn's liquidity, capital resources, or operations.

#### Critical Accounting Estimates

Mid Penn's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and conform to general practices within the banking industry for smaller reporting public companies. 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 reported 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 values based upon 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 the timing and amount of 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.

## Financial Summary

### 2017 versus 2016

Mid Penn's net income available to common shareholders ("earnings") of \$7,089,000 for the year 2017 reflects a decrease of \$715,000 or 9 percent, as compared to earnings of \$7,804,000 for the year 2016. This represents earnings in 2017 of \$1.67 per common share, basic and diluted, compared to \$1.85 per common share basic and diluted in 2016. Earnings for the year 2017 were negatively impacted by a non-cash reduction in the value of Mid Penn's deferred tax asset, which resulted in a charge of \$1,169,000 included in the provision for income taxes. This income tax adjustment was a result of the Tax Cuts and Jobs Act (TCJA) enacted on December 22, 2017, which lowered Mid Penn's future maximum corporate tax rate from 34 percent to 21 percent. Though the reduced rate will provide tax savings to Mid Penn in future periods, the reduction resulted in the \$1,169,000 write-down of Mid Penn's deferred tax asset, which was previously valued based upon the projection of a 34 percent future tax benefit.

Total assets of Mid Penn grew \$137,755,000 or 13 percent, in 2017 to close the year at \$1,170,354,000 compared to total assets of \$1,032,599,000 at the end of 2016. Mid Penn realized favorable loan growth, primarily in commercial relationships, of \$96,480,000 or over 11 percent since December 31, 2016. This asset and loan growth was principally funded by an increase in deposits of \$88,195,000 or over 9 percent since year-end 2016, with \$40,903,000 of the deposit growth being in noninterest-bearing accounts. Mid Penn was in a short-term borrowing position of \$34,611,000 at December 31, 2017, while it was in a Federal Funds Sold position of \$30,477,000 at December 31, 2016.

During the year ended December 31, 2017, long-term debt decreased by \$1,229,000 or 9 percent, to \$12,352,000 by the end of the year as previous higher-cost borrowings matured and Mid Penn was able to replace them with lower-cost funding sources.

Mid Penn's return on average shareholders' equity ("ROE"), a widely recognized performance indicator in the financial industry, was 9.48% in 2017 and 10.71% in 2016. Return on average assets ("ROA"), another performance indicator, was 0.64% in 2017 and 0.78% in 2016.

Net interest margin was 3.68% in 2017 versus 3.82% in 2016. Net interest income on a tax equivalent basis increased to \$38,597,000 in 2017 from \$36,470,000 in 2016. The decrease in the net interest margin for 2017 compared to 2016 was primarily the result of a lower realized yield on the relatively shorter-term and lower-risk securities in the held-to-maturity investment portfolio established in 2017. Included in net interest income for the year ended December 31, 2016 was \$167,000 in income from the successful resolution of two legacy Phoenix loans acquired with credit deterioration. The income was the result of recognizing the remaining accretable and nonaccretable discounts on these loans. Further discussion of net interest margin can be found in the Net Interest Income section below.

Total nonperforming assets increased \$5,549,000 from \$5,759,000 at the end of 2016 to \$11,308,000 at the end of 2017. The increase in nonperforming assets is primarily due to two loan relationships totaling \$7.3 million, with a combined \$136,000 specific allowance allocation, being placed on nonaccrual status during the latter six months of 2017. Further discussion of these components can be found in the Credit Quality, Credit Risk, and Allowance for

Loan and Lease Losses section below.

Mid Penn had net loan recoveries of \$98,000 for the twelve months ended December 31, 2017, compared to net loan charge-offs of \$855,000 during the same period of 2016. The net recoveries were a result of Mid Penn's successful collection and workout efforts on previously impaired loan relationships. Gross charge-offs decreased \$610,000 from \$1,107,000 in 2016 to \$497,000 in 2017. Mid Penn decreased the provision for loan and lease losses from \$1,870,000 in 2016 to \$325,000 in 2017. The significant net principal recoveries during the twelve months ended December 31, 2017 added \$98,000 to the allowance for loan loss balance. Also, as a result of favorable workout activities of certain impaired credits, the amount of required specific allocations in the allowance was reduced as of December 31, 2017 as compared to the prior year end. Further discussion of these issues can be found in the Provision for Loan and Lease Losses section below.

Mid Penn's regulatory capital measures of Tier 1 Capital (to risk weighted assets) of \$74,417,000 or 8.4%, and Total Capital (to risk weighted assets) of \$99,466,000 or 11.3%, at December 31, 2017, are above the regulatory "well capitalized" requirements. Tier 1 Capital consists primarily of Mid Penn's shareholders' equity net of the accumulated other comprehensive income/loss component. Total Capital includes the Tier 1 Capital as well as Mid Penn's qualifying subordinated debt and the allowance for loan and lease losses, within permitted limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

## 2016 versus 2015

The comparability of the results of operations for the years ended 2016 and 2015, in general, have been impacted by the acquisition of Phoenix. The reported results for the year ended December 31, 2015 included only ten months of operating results related to the Phoenix acquisition, which closed on March 1, 2015, versus 2016 including twelve months of Phoenix-related results.

Mid Penn's earnings of \$7,804,000 for the year 2016 reflects an increase of \$1,766,000 or 29 percent, over earnings of \$6,038,000 for the year 2015. This represents earnings in 2016 of \$1.85 per common share, basic and diluted, compared to \$1.47 per common share basic and diluted in 2015.

Total assets of Mid Penn grew \$100,961,000 or 11 percent, in 2016 to close the year at \$1,032,599,000 compared to total assets of \$931,638,000 at the end of 2015. This increase was impacted by strong growth in the loan portfolio, as well as in deposits, which led to an increase in Federal Funds Sold. For the year ended December 31, 2016, total deposits increased \$158,330,000 or 20 percent to \$935,373,000 while the loan portfolio increased \$77,411,000 or 11 percent, to \$813,924,000 at December 31, 2016. Over the last twelve months, all deposit categories increased, mainly due to both strong retail branch deposit growth and cash management sales efforts. Mid Penn was in a Federal Funds Sold position of \$30,477,000 at December 31, 2016, while it was in a short-term borrowing position of \$31,596,000 at December 31, 2015.

During the year ended December 31, 2016, long-term debt decreased by \$26,724,000 or 66 percent, to \$13,581,000 by the end of the year. Mid Penn was able to take advantage of the growth in deposits as a lower cost funding source. The growth in deposits also allowed Mid Penn the opportunity to prepay \$16,500,000 in long-term FHLB Advances in 2016.

Mid Penn's ROE was 10.71% in 2016 and 9.16% in 2015. ROA was 0.78% in 2016 and 0.74% in 2015.

Net interest margin was 3.82% in 2016 versus 4.03% in 2015. Net interest income on a tax equivalent basis increased to \$36,470,000 in 2016 from \$33,806,000 in 2015. Included in net interest income for the year ended December 31, 2016 was \$167,000 in income from the successful resolution of two legacy Phoenix loans acquired with credit deterioration and \$558,000 in income for the year ended December 31, 2015 from the successful resolution of six legacy Phoenix loans acquired with credit deterioration. The income was the result of recognizing the remaining accretable and nonaccretable discounts on these loans. Further discussion of net interest margin can be found in the Net Interest Income section below.

Total nonperforming assets decreased \$303,000 from \$6,062,000 at the end of 2015 to \$5,759,000 at the end of 2016. The decline of \$961,000 in foreclosed real estate held for sale from \$1,185,000 at December 31, 2015 to \$224,000 at December 31, 2016 was the leading source of improvement in nonperforming assets. Further discussion of these components can be found in the Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses section below.

Net charge-offs decreased to \$855,000 in 2016 from \$1,613,000 during 2015. Gross charge-offs decreased \$677,000 from \$1,784,000 in 2015 to \$1,107,000 in 2016. Mid Penn increased the provision for loan and lease losses from \$1,065,000 in 2015 to \$1,870,000 in 2016. The increase in the loan loss provision for 2016 compared to 2015 was largely driven by the growth in the loan portfolio, as well as an increase in specific allocations on impaired loans. Further discussion of these issues can be found in the Provision for Loan and Lease Losses section below.

Mid Penn's Tier 1 Capital (to risk weighted assets) of \$70,431,000 or 9.1%, and Total Capital (to risk weighted assets) of \$85,148,000 or 11.0%, at December 31, 2016, are above the regulatory requirements. Tier 1 Capital consists primarily of Mid Penn's shareholders' equity. Total Capital also includes Mid Penn's qualifying subordinated debt and the allowance for loan and lease losses, within permitted limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

## Net Interest Income

Net interest income, Mid Penn's primary source of earnings, represents the difference between interest income received on loans, investments, and overnight funds, and interest expense paid on deposits and short- and long-term borrowings. Net interest income is affected by changes in interest rates and changes in average balances (volume) in the various interest-sensitive assets and liabilities.

TABLE 1: AVERAGE BALANCES, EFFECTIVE INTEREST DIFFERENTIAL AND INTEREST YIELDS

(Dollars in thousands)	Income and Rates on a Taxable Equivalent Basis for Years Ended								
	December 31, 2017			December 31, 2016			December 31, 2015		
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates
<b>ASSETS:</b>									
Interest Bearing Balances	\$2,621	\$18	0.69%	\$2,559	\$12	0.47%	\$6,377	\$44	0.69%
Investment Securities:									
Taxable	121,050	2,376	1.96%	79,277	1,515	1.91%	67,382	1,604	2.38%
Tax-Exempt	52,919	1,687 (a)	3.19%	80,451	3,130 (a)	3.89%	69,996	3,031 (a)	4.33%
Total Securities	173,969	4,063	2.34%	159,728	4,645	2.91%	137,378	4,635	3.37%
Federal Funds Sold	11,220	115	1.02%	16,848	82	0.49%	535	2	0.37%
Loans and Leases, Net	857,259	40,591 (b)	4.73%	772,877	36,963 (b)	4.78%	689,870	33,483 (b)	4.85%
Restricted Investment in									
Bank Stocks	2,955	114	3.86%	2,751	135	4.91%	3,751	249	6.64%
Total Earning Assets	1,048,024	44,901	4.28%	954,763	41,837	4.38%	837,911	38,413	4.58%
Cash and Due from									
Banks	20,323			12,791			13,263		
Other Assets	35,092			33,898			32,754		
Total Assets	\$1,103,439			\$1,001,452			\$883,928		
<b>LIABILITIES &amp;</b>									
<b>SHAREHOLDERS' EQUITY:</b>									
Interest-bearing									
Demand	\$335,859	1,410	0.42%	\$293,745	1,009	0.34%	\$238,141	804	0.34%
Money Market	247,337	1,448	0.59%	235,561	1,315	0.56%	208,693	1,122	0.54%
Savings	62,500	35	0.06%	59,615	34	0.06%	52,895	31	0.06%

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

Time	197,154	2,570	1.30%	172,657	2,156	1.25%	154,335	1,932	1.25%
Total Interest-bearing									
Deposits	842,850	5,463		761,578	4,514		654,064	3,889	
Short-term Borrowings	7,961	111	1.39%	2,370	15	0.63%	13,184	47	0.36%
Long-term Debt	13,321	318	2.39%	28,474	442	1.55%	50,642	648	1.28%
Subordinated Debt	7,746	412	5.32%	7,431	396	5.33%	625	23	3.68%
Total Interest-bearing									
Liabilities	871,878	6,304	0.72%	799,853	5,367	0.67%	718,515	4,607	0.64%
Noninterest-bearing									
Demand	146,683			120,244			87,474		
Other Liabilities	10,094			8,462			6,691		
Shareholders' Equity	74,784			72,893			71,248		
Total Liabilities & Shareholders' Equity	\$1,103,439			\$1,001,452			\$883,928		
Net Interest Income		\$38,597			\$36,470			\$33,806	
Total Yield on Earning Assets			4.28%			4.38%			4.58%
Rate on Supporting Liabilities			0.72%			0.67%			0.64%
Average Interest Spread			3.56%			3.71%			3.94%
Net Interest Margin			3.68%			3.82%			4.03%

(a) includes tax equivalent adjustments of \$574,000, \$1,064,000, and \$1,031,000 for the years 2017, 2016, and 2015, respectively, resulting from tax-free municipal securities in the investment portfolio.

(b) includes tax equivalent adjustments of \$435,000, \$561,000, and \$643,000 for the years 2017, 2016, and 2015, respectively, resulting from the tax-free municipal loans in the commercial loan portfolio.



## MID PENN BANCORP, INC. Management's Discussion and Analysis

Interest and average rates in Table 1 above are presented on a fully taxable-equivalent basis, using an effective tax rate of 34%. For purposes of calculating loan yields, average loan balances include nonaccrual loans. Loan fees of \$921,000, \$1,097,000, and \$666,000 are included with loan interest income in Table 1 above for the years 2017, 2016, and 2015, respectively.

TABLE 2: VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

(Dollars in thousands on a Taxable Equivalent Basis)	2017 Compared to 2016			2016 Compared to 2015		
	Increase (Decrease)			Increase (Decrease)		
	Due to Change In:			Due to Change In:		
	Volume	Rate	Net	Volume	Rate	Net
<b>INTEREST INCOME:</b>						
Interest Bearing Balances	\$1	\$5	\$6	\$(26 )	\$(6 )	\$(32 )
<b>Investment Securities:</b>						
Taxable	798	63	861	283	(372 )	(89 )
Tax-Exempt	(1,071)	(372 )	(1,443)	453	(354 )	99
Total Securities	(273 )	(309 )	(582 )	736	(726 )	10
Federal Funds Sold	(27 )	60	33	61	19	80
Loans and Leases, Net	4,036	(408 )	3,628	4,029	(549 )	3,480
Restricted Investment Bank Stocks	10	(31 )	(21 )	(66 )	(48 )	(114 )
Total Interest Income	3,747	(683 )	3,064	4,734	(1,310)	3,424
<b>INTEREST EXPENSE:</b>						
<b>Interest Bearing Deposits:</b>						
Interest Bearing Demand	145	256	401	188	17	205
Money Market	66	67	133	145	48	193
Savings	—	1	1	—	3	3
Time	306	108	414	229	(5 )	224
Total Interest Bearing Deposits	517	432	949	562	63	625
Short-term Borrowings	35	61	96	(39 )	7	(32 )
Long-term Debt	(235 )	111	(124 )	(284 )	78	(206 )
Subordinated Debt	17	(1 )	16	250	123	373
Total Interest Expense	334	603	937	489	271	760
<b>NET INTEREST INCOME</b>	<b>\$3,413</b>	<b>\$(1,286)</b>	<b>\$2,127</b>	<b>\$4,245</b>	<b>\$(1,581)</b>	<b>\$2,664</b>

The effect of changing volume and rate which cannot be segregated has been allocated entirely to the rate column. Tax-exempt income is shown on a tax equivalent basis assuming a federal income tax rate of 34%.

During 2017, taxable equivalent net interest income increased \$2,127,000 or 6 percent compared to 2016. During 2016, taxable equivalent net interest income increased \$2,664,000 or 8 percent compared to 2015. The average balances, effective interest differential, and interest yields for the years ended December 31, 2017, 2016, and 2015 and

the components of net interest income, are presented in Table 1. Table 2 provides a comparative presentation of the changes in net interest income for 2017 compared to 2016, and 2016 compared to 2015. Table 2 presents the changes in interest income and interest expense caused by the volume and rate components of interest earning assets and interest bearing liabilities.

The yield on earning assets decreased to 4.28% in 2017 from 4.38% in 2016. The yield on earning assets for 2015 was 4.58%. The decline in the yield on earning assets in 2017 was softened by the increase in both investment and loan volume. The increased volume helped offset the impact of the decline in the average rate. The average rate on loans decreased from 4.78% in 2016 to 4.73% in 2017. The average rates on investment securities also declined from 2016 to 2017 as a decrease in the yield on tax-exempt investments from 3.89% to 3.19% more than offset the impact of the yield on taxable investments increasing slightly from 1.91% to 1.96%. This decline in investment yields was generally the result of matured, called, and sold bond proceeds being reinvested at less favorable market rates and from held-to-maturity purchases of lower-risk and lower-yielding bonds.

MID PENN BANCORP, INC. Management's Discussion and Analysis

Interest expense increased by \$937,000 or 17 percent in 2017, as compared to 2016. For the year ending December 31, 2016, interest expense increased \$760,000 or 16 percent, compared to 2015. The cost of interest bearing liabilities increased to 0.72% in 2017 from 0.67% in 2016. The cost of interest bearing liabilities for 2015 was 0.64%. While the continued low interest rate environment, along with Mid Penn's ability to replace higher-cost time deposits with lower-cost demand deposits, aided in maintaining a low cost of interest bearing liabilities in 2017, the increase in the volume of interest bearing liabilities of \$72,025,000 for the year ended December 31, 2017 led to the overall increase in interest expense.

Included in the net interest income for the year ended December 31, 2016 was \$167,000 in income from the successful resolution of two legacy Phoenix loans acquired with credit deterioration. The income was the result of recognizing the remaining accretable and nonaccretable discounts on these loans.

Net interest margin, on a tax equivalent basis, was 3.68% in 2017 compared to 3.82% in 2016 and 4.03% in 2015. The decrease in the net interest margin for 2017 compared to 2016, and from 2016 compared to 2015, was primarily the result of a lower realized yield on securities purchased for the investment portfolio, including the impact of the lower-risk and lower yielding held-to-maturity portfolio established in 2017. Further changes to the future mix of the loan, investment, and deposit products in the Bank's portfolios, and the volume of variable rate and fixed rate instruments based upon new loan originations and investment purchases, may significantly change the net interest margin and the yields on earning-assets and the costs of interest-bearing liabilities. In addition, our net interest income may be impacted by further interest rate actions of the Federal Reserve. Management continues to monitor the net interest margin closely.

#### Provision for Loan and Lease 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 actual and potential charge-offs and recoveries, and assess general economic conditions in the markets we serve.

Mid Penn has maintained the allowance for loan and lease losses in accordance with Mid Penn's portfolio credit risk and potential loss assessment process, which took into consideration the risk characteristics of the loan and lease portfolio and shifting collateral values from December 31, 2016 to December 31, 2017. For the year ended December 31, 2017, the provision for loan and lease losses was \$325,000 compared to \$1,870,000 for the year ended December 31, 2016. The allowance for loan and lease losses as a percentage of total loans was 0.84% at December 31, 2017, compared to 0.88% at December 31, 2016 and 0.83% at December 31, 2015.

For the year ended December 31, 2017, Mid Penn had net recoveries of \$98,000 compared to net charge-offs of \$855,000 during the year ended December 31, 2016. Loans charged off during 2017 were comprised of eight commercial real estate loans among five relationships totaling \$322,000 and two commercial and industrial loans for \$25,000. In addition, there were charge-offs for three consumer loans to unrelated borrowers totaling \$4,000, one home equity loan for \$20,000, and five residential real estate loans among four relationships totaling \$102,000. The remaining \$24,000 was comprised of deposit account charge-offs. These charge-offs were more than offset by total recoveries of \$595,000 realized during 2017, primarily comprised of three commercial real estate loans among two relationships totaling \$454,000.

Several factors contributed to the decrease in the loan loss provision expense in 2017 compared to 2016. The significant net principal recoveries during the twelve months ended December 31, 2017 added \$98,000 to the allowance for loan loss balance. Additionally, during the year ended December 31, 2017, Mid Penn had favorable workouts of certain impaired credits, which reduced the amount of required specific allocations in the allowance as compared to the prior year end.

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.





TABLE 4: NONINTEREST INCOME

(Dollars in thousands)	Years ended December 31,		
	2017	2016	2015
Income from fiduciary activities	\$845	\$481	\$466
Service charges on deposits	721	684	690
Net gain on sales of investment securities	42	1,046	325
Earnings from cash surrender value of life insurance	262	264	269
Mortgage banking income	872	922	456
ATM debit card interchange income	937	844	741
Merchant services income	335	317	235
Net gain on sales of SBA loans	800	470	252
Other income	879	896	679
Total Noninterest Income	\$5,693	\$5,924	\$4,113

#### Noninterest Income

##### 2017 versus 2016

During the twelve months ended December 31, 2017, noninterest income (excluding net securities gains of \$42,000) increased \$773,000 or 16 percent, versus the twelve months ended December 31, 2016 (excluding net security gains of \$1,046,000). Items of particular note are detailed below.

Mid Penn increased its origination and sales activities related to SBA loans, resulting in gains of \$800,000 from related loan sales during the year ended December 31, 2017, an increase of \$330,000 or 70 percent compared to SBA loan sales gains of \$470,000 for the twelve months ended December 31, 2016. More qualified small business borrowers continue to take advantage of Mid Penn's Preferred Lender status with the SBA.

Income from fiduciary activities was \$845,000 for the twelve months ended December 31, 2017, an increase of \$364,000 or 76 percent compared to fiduciary income of \$481,000 for the year ended December 31, 2016. These additional revenues were attributed to trust assets under management significantly increasing over the past twelve months as a result of successful business development efforts by Mid Penn's expanded team of trust and retail investment officers.

ATM debit card interchange income was \$937,000 for the twelve months ended December 31, 2017, an increase of \$93,000 or 11 percent compared to interchange income of \$844,000 for the same period in 2016. The additional income is a result of an increased volume of transactional checking accounts and an increase in Mid Penn Bank ATM debit card transactions across our market area.

Net gains on sales of securities were \$42,000 for the twelve months ended December 31, 2017, a decrease of \$1,004,000 or 96 percent compared to net gains on sales of securities of \$1,046,000 during the year ended December 31, 2016. During 2016, Mid Penn took advantage of favorable fixed income investment market conditions and increased fair values on several securities to reposition some of its investment portfolio, including selling a large volume of longer-term and rate-sensitive CMOs, as well as certain municipal bonds and agency notes.

Other noninterest income decreased \$17,000 for the twelve months ended December 31, 2017 compared to the twelve months ended December 31, 2016. Included in 2016 other income was \$86,000 from the gain on the sale of insurance policies upon the dissolution of Mid Penn Insurance Services, LLC, a then 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.

#### 2016 versus 2015

During the twelve months ended December 31, 2016, noninterest income (excluding net securities gains of \$1,046,000) increased \$1,090,000 or 29 percent, versus the twelve months ended December 31, 2015 (excluding net security gains of \$325,000). Items of particular note are detailed below.

During 2016, Mid Penn took advantage of increased market values on securities to reposition some of its investment portfolio, including selling a large volume of longer-term and rate-sensitive CMOs, as well as certain municipal bonds and agency notes. Mid Penn realized \$1,046,000 in net securities gains during 2016 as a result of these investment management activities. In comparison, during 2015, Mid Penn realized \$325,000 from net gains on sales of securities.



## MID PENN BANCORP, INC. Management's Discussion and Analysis

Mortgage banking income more than doubled to \$922,000 during the twelve months ended December 31, 2016, as compared to \$456,000 for 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 gains of \$470,000 from related loan sale gains during the twelve months of 2016, an increase of \$218,000 or 87 percent compared to SBA loan sales gains of \$252,000 for the same period in 2015. More qualified borrowers continue to take advantage of Mid Penn's Preferred Lender status with the SBA.

Mid Penn also recognized \$317,000 in merchant services income during the twelve months ended December 31, 2016, an increase of \$82,000 or 35 percent compared to \$235,000 of merchant services income for the same period in 2015. This increase reflects the efforts of the commercial and retail sales team to continue enrolling new participating merchants throughout Mid Penn's markets.

Other noninterest income increased \$217,000 for the twelve months ended December 31, 2016 compared to the twelve months ended December 31, 2015. Included in 2016 other income was \$86,000 from the gain on the sale of insurance policies upon the dissolution of Mid Penn Insurance Services, LLC, a then 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.

TABLE 5: NONINTEREST EXPENSE

(Dollars in thousands)	Years ended December 31,		
	2017	2016	2015
Salaries and employee benefits	\$16,929	\$15,564	\$14,043
Occupancy expense, net	2,512	2,064	1,947
Equipment expense	1,536	1,689	1,477
Pennsylvania Bank Shares tax expense	451	648	408
FDIC Assessment	792	688	613
Legal and professional fees	802	711	588
Marketing and advertising expense	516	500	533
Software licensing	1,458	1,380	1,472
Telephone expense	497	548	569
Loss on sale/write-down of foreclosed assets	88	217	111
Intangible amortization	104	126	114
Merger and acquisition expense	619	-	762
ATM debit card processing expense	448	440	334
Internet banking expense	593	528	429
Director fees and benefits expense	465	340	363
Loan collection costs	148	178	306
Meals, travel, and lodging expense	544	428	399
Data processing	420	341	346
Insurance	216	178	186
OREO expense	79	248	255
Investor services	115	85	96

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

Other expenses	2,035	1,917	1,408
Total Noninterest Expense	\$31,367	\$28,818	\$26,759

## Noninterest Expense

### 2017 versus 2016

During the year ended December 31, 2017, noninterest expenses totaled \$31,367,000, an increase of \$2,549,000 or 9 percent compared to \$28,818,000 for the year ended December 31, 2016.

Salaries and employee benefits expense increased \$1,365,000 or 9 percent during the twelve months ended December 31, 2017, versus the same period in 2016, with the increase attributable to (i) the addition of commercial lending personnel and credit support staff in alignment with Mid Penn's core banking growth and expanding markets, (ii) retail staff additions at the New Holland and Orwigsburg locations, which opened in 2017, and the Oregon Pike location, which opened in late 2016, and (iii) an increased volume of covered employees and healthcare claims as Mid Penn maintains a self-funded medical plan as part of a consortium.

In connection with the acquisition of Scottdale, Mid Penn incurred \$619,000 of merger related expenses during 2017, while no merger related expenses were incurred in 2016.

Occupancy expenses increased \$448,000 or 22 percent during the year ended December 31, 2017 compared to the same period in 2016. In the twelve months since December 31, 2016, Mid Penn added facility operating costs associated with opening the above-noted three new branch offices, as well as incurring full-year costs for loan production offices opened during 2016 in Lancaster and Franklin Counties in Pennsylvania.

Mid Penn's FDIC assessment costs were \$792,000 during the twelve months ended December 31, 2017, an increase of \$104,000 or 15 percent compared to the FDIC assessment of \$688,000 for the twelve months ended December 31, 2016. The increase is due to Mid Penn's growth in deposits and assets, which increased the base amount used to determine the FDIC insurance assessment.

Legal and professional fees for the twelve months ended December 31, 2017 increased by \$91,000 or 13 percent compared to the same period in 2016 due to increased third-party services for wealth management, audit, and public relations activities.

Pennsylvania bank shares tax expense decreased \$197,000 or 30 percent during the twelve months ended December 31, 2017 versus the same period in 2016, due to the additional Pennsylvania-eligible tax credits generated from Mid Penn's increased level of charitable donations to support education and community development organizations throughout the markets it serves. The increased amount of charitable contributions supported part of the increase in Other Expenses.

2016 versus 2015

During the year ended December 31, 2016, noninterest expenses totaled \$28,818,000, an increase of \$2,059,000 or 8 percent compared to \$26,759,000 for the year ended December 31, 2015.

Salaries and employee benefit expenses increased \$1,521,000 during the twelve months ended December 31, 2016 versus the same period in 2015. The increase primarily was attributable to franchise expansion, including (i) the addition of employees from the March 1, 2015 Phoenix acquisition, (ii) staff added to serve in Mid Penn's branch in the Mechanicsburg, PA market, which opened in June 2015, and (iii) an increase in lending personnel, credit support staff, and executive management in alignment with Mid Penn's core banking growth.

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

Pennsylvania bank shares tax expense increased \$240,000 during the twelve months ended December 31, 2016 versus the same period in 2015 due to the Phoenix acquisition and the resultant increase in the capital base used to determine the annual shares tax.

Occupancy and Equipment expenses increased \$329,000 during 2016 versus 2015. The increase is primarily attributable to both added facilities from the Phoenix acquisition, newer offices in Mechanicsburg, PA and Lancaster County, PA, and increased depreciation expense on information technology related enhancements.

Mid Penn benefited from lower loan collection costs in 2016, which are reported in other expenses. These loan collection costs were \$306,000 during 2015, but decreased \$128,000 or 42 percent to \$178,000 during 2016 as the pool of nonperforming credits continued to decrease.

Included in other expenses in 2016 was a \$142,000 impairment charge recorded on an asset held for sale and \$17,000 in prepayment penalties on long-term FHLB Advances, while there were no impairment charges or prepayment penalties recorded in 2015.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

## Investments

Mid Penn's investment portfolio is utilized primarily to provide liquidity and collateral, while also being managed to provide additional interest income within reasonable risk parameters.

During 2017, Mid Penn added a held-to-maturity pool to its overall investment portfolio, and as of December 31, 2017, had \$101,356,000 of held-to-maturity securities recorded at amortized cost. No securities were designated as held-to-maturity at December 31, 2016. Mid Penn's total available-for-sale securities portfolio decreased \$40,160,000 or 30 percent, from \$133,625,000 at December 31, 2016 to \$93,465,000 at December 31, 2017, as some available-for-sale investments were sold to fund both the held-to-maturity pool and loan growth. Mid Penn's available for sale portfolio is recorded at fair value, meaning the investments are valued at a market price relative to investments of the same type with similar maturity dates. As the interest rate environment of these securities changes, the fair value of securities changes accordingly.

At December 31, 2017, the unrealized loss on available-for-sale investment securities resulted in a decrease in shareholders' equity of \$2,159,000 (unrealized loss on securities of \$2,733,000 less deferred income tax benefit of \$574,000). At December 31, 2016, the unrealized losses on available-for-sale investment securities resulted in a decrease in shareholders' equity of \$2,919,000 (unrealized loss on securities of \$4,423,000 less a deferred income tax benefit of \$1,504,000). Mid Penn does not have any significant concentrations of non-governmental securities within its investment portfolio. Table 6 provides a summary of our investment securities.

TABLE 6: FAIR VALUE OF INVESTMENT SECURITIES

(Dollars in thousands)	December 31,		
	2017	2016	2015
Available-for-sale securities:			
U.S. Treasury and U.S. government agencies	\$38,730	\$47,012	\$26,990
Mortgage-backed U.S. government agencies	25,831	25,619	38,804
State and political subdivision obligations	27,043	58,838	66,617
Corporate debt securities	1,005	1,000	2,070
Equity securities	856	1,156	1,240
Total available-for-sale securities	93,465	133,625	135,721
Held-to-maturity securities:			
U.S. Treasury and U.S. government agencies	\$10,894	\$—	\$—
Mortgage-backed U.S. government agencies	52,949	—	—
State and political subdivision obligations	36,640	—	—
Corporate debt securities	—	—	—
Equity securities	—	—	—
Total held-to-maturity securities	100,483	—	—
Total	\$193,948	\$133,625	\$135,721

## MID PENN BANCORP, INC. Management's Discussion and Analysis

Maturity and yield information relating to debt securities is shown in Table 7.

TABLE 7: INVESTMENT MATURITY AND YIELD

(Dollars in thousands)	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
As of December 31, 2017					
Available for sale securities:					
U.S. Treasury and U.S. government agencies	\$—	\$10,570	\$28,160	\$—	\$38,730
Mortgage-backed U.S. government agencies	—	65	11,334	14,432	25,831
State and political subdivision obligations	—	—	16,619	10,424	27,043
Corporate debt securities	—	—	1,005	—	1,005
Equity securities	100	250	—	506	856
	\$100	\$10,885	\$57,118	\$25,362	\$93,465
Held to maturity securities:					
U.S. Treasury and U.S. government agencies	\$2,001	\$8,983	\$—	\$—	\$10,984
Mortgage-backed U.S. government agencies	—	—	9,706	43,766	53,472
State and political subdivision obligations	—	449	35,940	511	36,900
Corporate debt securities	—	—	—	—	—
Equity securities	—	—	—	—	—
	\$2,001	\$9,432	\$45,646	\$44,277	\$101,356
Weighted Average Yields					
	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
Available for sale securities:					
U.S. Treasury and U.S. government agencies	—	1.93 %	2.14 %	—	2.08 %
Mortgage-backed U.S. government agencies	—	4.11 %	2.97 %	2.57 %	2.75 %
State and political subdivision obligations	—	—	3.56 %	3.18 %	3.41 %
Corporate debt securities	—	—	4.75 %	—	4.75 %
Equity securities	4.75 %	1.50 %	—	2.72 %	2.60 %
	4.75 %	1.93 %	2.76 %	2.82 %	2.69 %
Held to maturity securities:					
U.S. Treasury and U.S. government agencies	1.25 %	1.67 %	—	—	1.59 %
Mortgage-backed U.S. government agencies	—	—	3.01 %	2.78 %	2.82 %
State and political subdivision obligations	—	3.38 %	3.11 %	4.15 %	3.13 %
Corporate debt securities	—	—	—	—	—

Equity securities	—	—	—	—	—
	1.25 %	1.75 %	3.09 %	2.80 %	2.80 %

Loans

Total loans at December 31, 2017 were \$910,404,000 compared to \$813,924,000 at December 31, 2016, an increase of \$96,480,000 or over 11 percent. The majority of Mid Penn’s loan portfolio and growth continues to be in commercial loans, including both commercial and industrial financing, and commercial real estate credits.

At December 31, 2017 and 2016, loans, net of unearned income, represented 83 percent of earning assets, compared to 84 percent on December 31, 2015.

The Bank's loan portfolio is diversified among individuals and small and medium-sized businesses generally located within the Bank's primary market area of Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties. Commercial real estate, construction, and land development loans are collateralized mainly by mortgages on the income-producing real estate or land involved. Commercial, industrial, and agricultural loans are primarily made to business entities and may be secured by business assets, including commercial real estate, or may be unsecured. Residential real estate loans are secured by liens on the residential property. Consumer loans include installment loans, lines of credit and home equity loans. The Bank has no significant concentration of credit to any one borrower. The Bank’s highest concentration of credit by loan type is in commercial real estate financings.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

A distribution of the Bank's loan portfolio according to major loan classification is shown in Table 8.

TABLE 8: LOAN PORTFOLIO

(Dollars in thousands)	December 31, 2017		2016		2015		2014		2013	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial real estate, construction and land development	\$465,122	51.1	\$397,547	48.8	\$355,339	48.1	\$289,378	50.6	\$274,279	50.2
Commercial, industrial and agricultural	188,262	20.7	171,985	21.1	160,988	21.8	120,326	21.0	107,492	19.7
Real estate - residential	253,152	27.8	240,418	29.5	216,269	29.6	159,004	27.8	160,294	29.3
Consumer	3,954	0.4	4,132	0.6	4,204	0.5	3,018	0.6	4,646	0.8
<b>Total Loans</b>	<b>910,490</b>	<b>100.0</b>	<b>814,082</b>	<b>100.0</b>	<b>736,800</b>	<b>100.0</b>	<b>571,726</b>	<b>100.0</b>	<b>546,711</b>	<b>100.0</b>
Unearned income	(86 )		(158 )		(287 )		(193 )		(249 )	
Loans net of unearned discount	910,404		813,924		736,513		571,533		546,462	
Allowance for loan and lease losses	(7,606 )		(7,183 )		(6,168 )		(6,716 )		(6,317 )	
<b>Net loans</b>	<b>\$902,798</b>		<b>\$806,741</b>		<b>\$730,345</b>		<b>\$564,817</b>		<b>\$540,145</b>	

Mid Penn's maturity and rate sensitivity information related to the loan portfolio is reflected in Table 9.

TABLE 9: LOAN MATURITY AND INTEREST SENSITIVITY

(Dollars in thousands)	After			
	One Year and Less	One Year thru Five Years	After Five Years	Total
As of December 31, 2017				
Commercial real estate, construction and land development	\$23,027	\$41,047	\$401,048	\$465,122
Commercial, industrial and agricultural	8,464	54,822	124,976	188,262



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

Real estate - residential mortgages	6,583	24,903	221,666	253,152
Consumer	76	1,045	2,747	3,868
	\$38,150	\$121,817	\$750,437	\$910,404

Rate Sensitivity

Predetermined rate	\$11,204	\$66,528	\$129,833	\$207,565
Floating or adjustable rate	26,946	55,289	620,604	702,839
	\$38,150	\$121,817	\$750,437	\$910,404

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

Other than as described herein, Mid Penn does not believe there are any current significant credit-related trends, events or uncertainties relating to its loan portfolio that are reasonably expected to have a material impact on future results of operations, liquidity, or capital resources. Mid Penn recognizes 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 the financial strength of borrowers constantly and 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, or perform commercial real estate or other type of loan workouts whereby an existing loan was restructured into multiple new loans. Also, Mid Penn does not extend loans at maturity solely due to the existence of guarantees, without recognizing the credit as impaired. While the existence of a guarantee may be a mitigating factor in determining the proper level of allowance once impairment has been identified, the guarantee does not affect the impairment analysis.

TABLE 10: NONPERFORMING ASSETS

(Dollars in thousands)	December 31,				
	2017	2016	2015	2014	2013
Nonperforming Assets:					
Nonaccrual loans	\$10,575	\$4,658	\$4,418	\$8,907	\$10,877
Accruing troubled debt restructured loans	544	877	459	2,035	833
Total nonperforming loans	11,119	5,535	4,877	10,942	11,710
Foreclosed real estate	189	224	1,185	565	965
Total nonperforming assets	11,308	5,759	6,062	11,507	12,675
Accruing loans 90 days or more past due	—	59	55	—	—
Total risk elements	\$11,308	\$5,818	\$6,117	\$11,507	\$12,675
Nonperforming loans as a % of total loans outstanding	1.22 %	0.68 %	0.66 %	1.91 %	2.14 %
Nonperforming assets as a % of total loans outstanding and other real estate	1.24 %	0.71 %	0.82 %	2.01 %	2.32 %
Ratio of allowance for loan losses to nonperforming loans	68.41 %	129.78 %	126.46 %	61.37 %	53.94 %

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. During 2017, nonperforming loans increased \$5,584,000 from \$5,535,000 at December 31, 2016, to \$11,119,000 at December 31, 2017, while foreclosed real estate declined \$35,000 to \$189,000 at December 31, 2017. The increase in nonperforming loans caused total nonperforming assets to increase by \$5,490,000 to \$11,308,000 at December 31, 2017 from \$5,818,000 at December 31, 2016. The increase in nonperforming assets is primarily due to two loan relationships totaling \$7,311,000 being placed on nonaccrual status during the latter six months of 2017. These loans account for 66 percent of the nonperforming assets total and are discussed in more detail below.

Loan no. 1 – At December 31, 2017, the outstanding principal balance of this loan relationship was \$4,461,000. A \$136,000 specific allowance allocation was assigned to this relationship. As part of the workout process this loan has been modified as a troubled debt restructured loan during 2017. Management is pursuing diligent workout efforts, including proceeds from the sale of pledged collateral not associated with the primary operation of the business to restore the loan to current status and to collect the remaining outstanding balance.

Loan no. 2 – At December 31, 2017, the outstanding principal balance of this loan relationship was \$2,850,000 and was comprised of eight loans collateralized primarily by commercial real estate, as well as certain machinery and equipment. Given that the fair value of the collateral exceeds the outstanding principal balance, no specific allowance

allocation has been assigned to this relationship. As part of the workout process, this loan was modified as a troubled debt restructured loan during 2017. Management expects to recover the remaining outstanding balance through the sale of real estate collateral pledged in support of the loans.

Mid Penn's troubled debt restructured loans at December 31, 2017 totaled \$9,571,000 of which \$544,000 were accruing loans in compliance with the terms of the modification and \$9,027,000 are included in nonaccrual loans. As a result of the evaluation, a specific allocation, and subsequently, charge-offs have been taken as appropriate. Further discussion of troubled debt restructured loans can be found in Note 8 to Mid Penn's Consolidated Financial Statements, which are included in Item 8. As of December 31, 2017, there were no defaulted troubled debt restructured loans as all troubled debt restructured loans were current with respect to their associated forbearance agreements.

Mid Penn entered into forbearance agreements on all loans currently classified as troubled debt restructured loans, and these agreements have resulted in additional principal repayment. The terms of these forbearance agreements vary and may include reductions in principal payments, reductions in interest rates, and/or repayment of the loan as collateral is sold.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

The following table provides additional analysis of partially charged off loans:

TABLE 11: PARTIALLY CHARGED OFF LOANS

(Dollars in thousands)	December 31, 2017	December 31, 2016	
Period ending total loans outstanding (net of unearned income)	\$ 910,404	\$ 813,924	
Allowance for loan and lease losses	7,606	7,183	
Total Nonperforming loans	11,119	5,535	
Nonperforming and impaired loans with partial charge-offs	1,701	1,604	
Ratio of nonperforming loans with partial charge-offs to total loans	0.19	% 0.20	%
Ratio of nonperforming loans with partial charge-offs to total nonperforming loans	15.30	% 28.97	%
Coverage ratio net of nonperforming loans with partial charge-offs	80.76	% 182.71	%
Ratio of total allowance to total loans less nonperforming loans with partial charge-offs	0.84	% 0.88	%

Mid Penn has not experienced any additional charge-offs on loans for which a partial charge-off had originally been taken during the periods presented.

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, 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 likely be considered collateral dependent as the discounted cash flow ("DCF") method would indicate no operating income is available for evaluating the collateral position; therefore, most impaired loans are deemed to be collateral dependent.

Mid Penn evaluates loans for charge-off on a monthly basis. Policies that govern the recommendation for charge-off are unique to the type of loan being considered. Commercial loans rated as nonaccrual or lower will first have a collateral evaluation completed in accordance with the guidance on impaired loans. Once the collateral evaluation has

been completed, a specific allocation of allowance is made based upon the results of the evaluation. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. Commercial real estate loans rated as impaired will also have an initial collateral evaluation completed in accordance with the guidance on impaired loans. An updated real estate valuation is ordered and the collateral evaluation is modified to reflect any variation in value. A specific allocation of allowance is made for any anticipated collateral shortfall. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans are recommended for charge-off after reaching delinquency of 90 days and the loan is not 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.

MID PENN BANCORP, INC. Management's Discussion and Analysis

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 practicable following the credit being classified as substandard non-accrual. 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 as 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 practicable following being placed on nonaccrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation, despite significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

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

Mid Penn had \$11,649,000 in loans deemed impaired at December 31, 2017. Excluding \$861,000 in loans acquired with credit deterioration from the Phoenix acquisition, Mid Penn had certain loan relationships deemed impaired with an aggregate carrying balance of \$10,788,000. Impaired loans included a group of loans with an aggregate carrying balance of \$6,344,000 for which specific allocations totaling \$529,000 were included within the loan loss reserve for these loans. The remaining \$4,444,000 of loans required no specific allocation within the loan loss reserve. Of the \$10,788,000 of impaired loan relationships, excluding the loans acquired with credit deterioration from the Phoenix acquisition, \$4,847,000 were commercial real estate relationships, \$4,434,000 were commercial and industrial relationships, \$760,000 were residential relationships, \$487,000 were commercial real estate-construction relationships, and \$260,000 were home equity relationships. There were specific loan loss reserve allocations of \$293,000 against the commercial real estate relationships, \$136,000 against the commercial and industrial relationships, and \$100,000 against the commercial real estate-construction relationships. Management currently believes that the specific reserves are adequate to cover probable future losses related to these relationships.

The allowance for loan 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 as 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.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

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 \$7,606,000 as of December 31, 2017 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.

The allocation of the allowance for loan and lease losses among the major classifications is shown in Table 12 as of December 31 of each of the past five years.

TABLE 12: ALLOCATION OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES

(Dollars in thousands)	December 31,				
	2017	2016	2015	2014	2013
Commercial real estate, construction and land development	\$4,613	\$4,467	\$3,705	\$3,958	\$4,015
Commercial, industrial and agricultural	1,795	1,581	1,394	1,395	1,187
Real estate - residential	428	541	534	450	581
Consumer	426	382	329	688	513
Unallocated	344	212	206	225	21
	\$7,606	\$7,183	\$6,168	\$6,716	\$6,317

The growth in the loan portfolio during 2017, as well as an increase in specific allocations on impaired loans, resulted in a larger allowance in 2017. See also the discussion in the Provision for Loan and Lease Losses section.



The allowance for loan and lease losses at December 31, 2017 was \$7,606,000 or 0.84% of total loans (less unearned discount), as compared to \$7,183,000 or 0.88% at December 31, 2016, and \$6,168,000 or 0.83% at December 31, 2015.

#### Deposits and Other Funding Sources

Mid Penn's primary source of funds are deposits. Total deposits at December 31, 2017 increased by \$88,195,000 or 9 percent over December 31, 2016, which increased by \$158,330,000 or 20 percent over December 31, 2015. During 2017, non-interest bearing demand, interest bearing demand, savings, and time deposit categories increased, more than offsetting a small decrease in money market deposits. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2017, 2016, and 2015 are presented in Table 13.

Short-term borrowings, consisting of federal funds purchased, totaled \$34,611,000 as of December 31, 2017. As of December 31, 2016, Mid Penn had no short-term borrowings outstanding.

At December 31, 2017, the Bank had \$19,447,000 in brokered time deposits, an increase of \$5,880,000 or 43 percent over December 31, 2016, which increased by \$2,399,000 or 21 percent over 2015.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

TABLE 13: DEPOSITS BY MAJOR CLASSIFICATION

(Dollars in thousands)	Years Ended December 31,						
	2017		2016		2015		
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate	
Noninterest-bearing demand deposits	\$ 146,683	0.00	% \$ 120,244	0.00	% \$ 87,474	0.00	%
Interest-bearing demand deposits	335,859	0.42	293,745	0.34	238,141	0.34	
Money market	247,337	0.59	235,561	0.56	208,693	0.54	
Savings	62,500	0.06	59,615	0.06	52,895	0.06	
Time	197,154	1.30	172,657	1.25	154,335	1.25	
	\$ 989,533	0.55	% \$ 881,822	0.51	% \$ 741,538	0.53	%

The maturity distribution of time deposits of \$100,000 or more is reflected in Table 14.

TABLE 14: MATURITY OF TIME DEPOSITS \$100,000 OR MORE

(Dollars in thousands)	December 31,		
	2017	2016	2015
Three months or less	\$ 38,563	\$ 16,083	\$ 8,986
Over three months to twelve months	27,295	28,254	17,807
Over twelve months	39,883	41,822	37,233
	\$ 105,741	\$ 86,159	\$ 64,026

### Capital Resources

Shareholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The detailed computation of Mid Penn's regulatory capital ratios can be found in Note 18 of Item 8, Notes to Consolidated Financial Statements. 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 in 2017 by \$5,236,000 or 7 percent, following an increase in 2016 of \$399,000 or 1 percent, and an increase in 2015 of \$1,938,000 or 18 percent. In 2017, capital was positively impacted by the net income available to common shareholders of \$7,089,000 and other comprehensive income of \$1,120,000. These increases were partially offset by dividend declarations of \$3,264,000. Capital was positively impacted in 2016 by the net income available to common shareholders of \$7,804,000 but this increase was offset by the other comprehensive loss of \$4,665,000 and dividend declarations of \$2,875,000. The primary source of Mid Penn's other comprehensive loss in 2016 was the change in unrealized losses on available-for-sale investments held primarily to support public deposit pledging requirements. These unrealized losses are not other-than-temporary-impairments, but relate to the price changes of securities from significant yield curve increases which occurred during the fourth quarter of 2016. In 2015 capital was positively impacted by the issuance of 723,851 shares of common stock valued at \$11,292,000 as

merger consideration in the Phoenix acquisition, as well as an increase in retained earnings from the normal operations of Mid Penn. Also in 2015, Mid Penn used the net proceeds from the issuance and sale of \$7,500,000 of subordinated notes to redeem all of (i) its Series B Preferred Stock for an aggregate redemption price of \$5,123,000, including declared but unpaid dividends and (ii) Series C Preferred Stock for an aggregate redemption price of \$1,750,000. These redemptions negatively impacted total shareholders' equity in 2015.

Mid Penn's current intent for dividend payout is to provide reasonable quarterly cash returns to shareholders while still retaining sufficient earnings to finance future growth and maintain sound capital levels. For additional information, see "Part II – Item 5 - Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Repurchases of Equity Securities – Dividends". The dividends paid and declared on common shares totaled \$0.62 and \$0.77, respectively, for the year ended December 31, 2017. Dividends paid and declared, respectively, totaled \$0.58 and \$0.68, respectively, for the year ended December 31, 2016, and \$0.44 and \$0.44 for the year ended December 31, 2015. The dividend payout ratio, which represents the percentage of annual net income returned to shareholders in the form of cash dividends, was 37.13% for 2017 and 31.35% for 2016.

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

MID PENN BANCORP, INC. Management's Discussion and Analysis

Mid Penn maintained regulatory capital levels, leverage ratios, and risk-based capital ratios as of December 31, 2017, and 2016, as follows:

(Dollars in thousands)	Capital Adequacy				To Be	
	Actual Amount	Ratio	Minimum Capital Required (1) Amount	Ratio	Well-Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
<b>Corporation</b>						
As of December 31, 2017						
Tier 1 Capital (to Average Assets)	\$74,417	6.5 %	\$45,857	4.00 %	\$ N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted						
Assets)	74,417	8.4 %	50,661	5.75 %	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	74,417	8.4 %	63,877	7.25 %	N/A	N/A
Total Capital (to Risk Weighted Assets)	99,466	11.3 %	81,498	9.25 %	N/A	N/A
<b>Bank</b>						
As of December 31, 2017						
Tier 1 Capital (to Average Assets)	\$88,294	7.7 %	\$45,846	4.00 %	\$ 57,308	5.0 %
Common Equity Tier 1 Capital (to Risk Weighted						
Assets)	88,294	10.0 %	50,661	5.75 %	57,269	6.5 %
Tier 1 Capital (to Risk Weighted Assets)	88,294	10.0 %	63,877	7.25 %	70,485	8.0 %
Total Capital (to Risk Weighted Assets)	96,005	10.9 %	81,498	9.25 %	88,106	10.0 %
<b>Corporation</b>						
As of December 31, 2016						
Tier 1 Capital (to Average Assets)	\$70,431	6.8 %	\$41,595	4.00 %	\$ N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted						
Assets)	70,431	9.1 %	39,641	5.125 %	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	70,431	9.1 %	51,244	6.625 %	N/A	N/A
Total Capital (to Risk Weighted Assets)	85,148	11.0 %	66,714	8.625 %	N/A	N/A
<b>Bank</b>						
As of December 31, 2016						
Tier 1 Capital (to Average Assets)	\$77,026	7.4 %	\$41,568	4.00 %	\$ 51,960	5.0 %
Common Equity Tier 1 Capital (to Risk Weighted						
Assets)	77,026	10.0 %	39,611	5.125 %	50,239	6.5 %

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

Tier 1 Capital (to Risk Weighted Assets)	77,026	10.0 %	51,205	6.625 %	61,832	8.0 %
Total Capital (to Risk Weighted Assets)	84,329	10.9 %	66,663	8.625 %	77,291	10.0 %

(1) Minimum amounts and ratios as of December 31, 2017 include the second year phase in of the capital conservation buffer of 1.25 percent required by the Basel III framework. At December 31, 2016, the minimum amounts and ratios included the first year phase in of the capital conservation buffer of 0.625 percent required by the Basel III framework.

Series B Preferred Stock

Between September 26, 2012 and January 3, 2013, Mid Penn issued, via a 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. On December 9, 2015, Mid Penn, used a portion of the proceeds from an offering of the subordinated notes described below, to redeem 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 declared but unpaid dividends on December 9, 2015, for a total redemption price of \$5,123,000.

### Small Business Lending Fund Preferred Shares

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 ("SBLF") 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 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 subordinated notes described below, redeemed all of the outstanding SBLF Preferred Shares held by the Treasury for an aggregate redemption price of \$1,754,000 including accrued but unpaid dividends.

### Subordinated Debt

#### Subordinated Debt Issued December 2017

On December 19, 2017, Mid Penn entered into agreements with investors to purchase \$10,000,000 aggregate principal amount of its Subordinated Notes due 2028 (the "2017 Notes"). The 2017 Notes are intended to be treated as Tier 2 capital for regulatory capital purposes. The offering closed in December 2017.

The 2017 Notes will bear interest at a rate of 5.25% per year for the first five years and then float at the Wall Street Journal's Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 5.0%. Interest will be payable semi-annually in arrears on January 15 and July 15 of each year, beginning on July 15, 2018, for the first five years after issuance and will be payable quarterly in arrears thereafter on January 15, April 15, July 15, and October 15. The 2017 Notes will mature on January 1, 2028 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 21, 2022, and prior to January 1, 2028. Additionally, Mid Penn may redeem the 2017 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 2017 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2017 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 the event of a redemption described in the previous sentence, Mid Penn will redeem the 2017 Notes at 100% of the principal amount of the 2017 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holder of the 2017 Notes may not accelerate the maturity of the 2017 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar event of Mid Penn or Mid Penn Bank.

Subordinated Debt Issued December 2015

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

The 2015 Notes bear interest at a rate of 5.15% per year for the first five years and then float at the Wall Street Journal’s Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 4.0%. Interest is paid quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, beginning on January 1, 2016. The 2015 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 2015 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 2015 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2015 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 2015 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holders of the 2015 Notes may not accelerate the maturity of the 2015 Notes, except upon Mid Penn’s or Mid Penn Bank’s bankruptcy, insolvency, liquidation, receivership, or similar event.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

## Federal Income Taxes

Federal income tax expense for 2017 was \$4,500,000 compared to \$2,277,000 in 2016 and \$1,644,000 in 2015. During the year ended December 31, 2017, federal income tax expense was negatively impacted by a non-cash reduction in the value of Mid Penn's deferred tax asset, which resulted in a charge of \$1,169,000. This income tax adjustment was a result of the Tax Cuts and Jobs Act (TCJA) enacted on December 22, 2017, which lowered Mid Penn's future maximum corporate tax rate from 34 percent to 21 percent. Though the reduced rate will provide tax savings to Mid Penn in future periods, the reduction resulted in the \$1,169,000 write-down of Mid Penn's deferred tax asset, which was previously valued based upon the projection of a 34 percent future tax benefit. The effective tax rate (excluding the one-time deferred tax adjustment) was 29% in 2017, 23% in 2016 and 20% in 2015. The increased effective tax rate was due to the majority of merger-related expenses being nondeductible, higher pre-tax earnings and a lower level of tax exempt interest income in 2017 when compared to 2016 and 2015.

## Liquidity

Mid Penn's asset-liability management policy addresses the management of Mid Penn's liquidity position and its ability to raise sufficient funds to meet deposit withdrawals, fund loan growth and meet other operational needs. Mid Penn utilizes its investments as a source of liquidity, along with deposit growth and increases in borrowings. For additional information, see Deposits and Other Funding Sources, which appears earlier in this discussion. Liquidity from investments is provided primarily through investment calls and sales, and from investments and interest-bearing balances with maturities of one year or less.

The Bank has short-term borrowing capacity with the FHLB for overnight borrowings up to the Bank's unused borrowing capacity of \$436,821,000 at December 31, 2017, upon satisfaction of any stock purchase requirements of the FHLB. This line is collateralized by certain qualifying loans and investment securities of the Bank. The Bank also has unused lines of credit with correspondent banks amounting to \$15,000,000 at December 31, 2017.

Major sources of cash in 2017 came from the increase in deposits of \$88,195,000, \$52,932,000 of proceeds from the sales of investments securities and \$34,611,000 from the increase in short-term borrowings.

Major uses of cash in 2017 were the purchases of investment securities of \$124,738,000 and the increase in loans of \$96,570,000.

Major sources of cash in 2016 came from the \$111,390,000 proceeds from the sales of investments securities and the increase in deposits of \$158,330,000.

Major uses of cash in 2016 were the purchases of investment securities of \$142,861,000 and the increase in loans of \$77,795,000.

## Aggregate Contractual Obligations

Table 15 represents Mid Penn's on-and-off balance sheet aggregate contractual obligations to make future payments as of December 31, 2017.

## TABLE 15: AGGREGATE CONTRACTUAL OBLIGATIONS



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

(Dollars in thousands)

	Financial Statements	Note Reference	Total	Payments Due by Period			
				One Year or Less	One to Three Years	Three to Five Years	More than Five Years
Operating lease obligations	9		\$9,230	\$1,171	\$1,765	\$1,181	\$5,113
Certificates of deposit	10		201,623	104,040	68,886	27,732	965
Long-term debt	12		12,352	—	10,000	—	2,352
Subordinated debt	13		17,500	—	—	—	17,500
Payments under benefit plans	15		1,309	155	307	274	573
Executive compensation payments	16		371	50	101	101	119
			\$233,155	\$104,245	\$79,294	\$28,107	\$21,509

We are not aware of any other commitments or contingent liabilities which may have a material adverse impact on Mid Penn's liquidity or capital resources.

### Effects of Inflation

A bank's asset and liability structure is substantially different from that of an industrial company in that virtually all assets and liabilities of a bank are monetary in nature. Management believes the impact of inflation on its financial results depends principally upon Mid Penn's ability to manage the balance sheet sensitivity to changes in interest rates and, by such reaction, mitigate the inflationary impact on performance. Interest rates do not necessarily move in the same direction or at the same magnitude as the prices of other goods and services. As discussed previously, management seeks to manage the relationship between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

Information included elsewhere in this Report will assist in the understanding of how Mid Penn is positioned to react to changing interest rates and inflationary trends. In particular, the summary of net liabilities, as well as the composition of loans, investments and deposits, should be considered.

### Off-Balance Sheet Items

Mid Penn makes contractual commitments to extend credit and extends lines of credit, which are subject to Mid Penn's credit approval and monitoring procedures.

As of December 31, 2017, commitments to extend credit amounted to \$199,240,000 compared to \$201,749,000 as of December 31, 2016.

Mid Penn also issues standby letters of credit to its customers. The risk associated with standby letters of credit is essentially the same as the credit risk involved in loan extensions to customers. Standby letters of credit increased to \$20,496,000 at December 31, 2017, from \$14,000,000 at December 31, 2016.

## MID PENN BANCORP, INC. Management's Discussion and Analysis

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a financial institution, Mid Penn's primary source of market risk is interest rate risk. Interest rate risk is the exposure to fluctuations in Mid Penn's future earnings (earnings at risk) resulting from changes in interest rates. This exposure or sensitivity is a function of the repricing characteristics of Mid Penn's portfolio of assets and liabilities. Each asset and liability reprices either at maturity or during the life of the instrument. Interest rate sensitivity is measured as the difference between the volume of assets and liabilities that are subject to repricing in a future period of time.

The principal purpose of asset-liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is increased by increasing the net interest margin and by volume growth. Thus, the goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

Mid Penn utilizes an asset-liability management model to measure the impact of interest rate movements on its interest rate sensitivity position. Mid Penn's management also reviews the traditional maturity gap analysis regularly. Mid Penn does not always attempt to achieve an exact match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of Mid Penn's profitability.

Modeling techniques and simulation analysis involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of Mid Penn's interest rate risk position over time.

Management reviews interest rate risk on a quarterly basis. This analysis includes earnings scenarios whereby interest rates are increased and decreased by 100, 200, and 300 basis points. These scenarios, detailed in Table 16, indicate that Mid Penn would experience enhanced net interest income over a one-year time frame due to upward interest rate changes, while a reduction in interest rates would result in a decline in net interest income over a one-year time frame; however, actual results could vary significantly from the calculations prepared by management. At December 31, 2017, all interest rate risk levels according to the model were within the tolerance limits of the Board-approved policy.

TABLE 16: EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES

December 31, 2017			December 31, 2016		
% Change in Net			% Change in Net		
Change in Basis Points	Interest Income	Policy Risk Limit	Change in Basis Points	Interest Income	Policy Risk Limit
300	7.83%	≥ -20%	300	11.19%	≥ -20%
200	5.12%	≥ -15%	200	7.35%	≥ -15%

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

100	2.41%	≥ -10%	100	3.50%	≥ -10%
0			0		
(100)	-1.49%	≥ -10%	(100)	-4.75%	≥ -10%
(200)	-6.19%	≥ -15%	(200)	-10.79%	≥ -15%
(300)	-11.37%	≥ -20%	(300)	-16.63%	≥ -20%

MID PENN BANCORP, INC.

ITEM 8. FINANCIAL STATEMENTS

The following audited financial statements are set forth in this Annual Report on Form 10-K on the following pages:

Index to Financial Statements

<u>Management Report on Internal Control Over Financial Reporting</u>	49
<u>Reports of Independent Registered Public Accounting Firm</u>	50
<u>Consolidated Balance Sheets</u>	52
<u>Consolidated Statements of Income</u>	53
<u>Consolidated Statements of Comprehensive Income</u>	54
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	55
<u>Consolidated Statements of Cash Flows</u>	56
<u>Notes to Consolidated Financial Statements</u>	58

MID PENN BANCORP, INC.

### Management Report on Internal Controls Over Financial Reporting

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in SEC Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2017, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2017, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013). Based on this assessment, management concluded that, as of December 31, 2017, the Corporation's internal control over financial reporting is effective based on those criteria.

The effectiveness of the Corporation's internal control over financial reporting has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in their report which is included herein.

/s/ Rory G. Ritrievi

/s/ Michael D. Peduzzi, CPA

Rory G. Ritrievi  
President and  
Chief Executive Officer

Michael D. Peduzzi, CPA  
Chief Financial Officer



Report of Independent Registered Public Accounting Firm

Shareholders and Board of Directors

Mid Penn Bancorp, Inc.

Millersburg, Pennsylvania

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Mid Penn Bancorp, Inc. and subsidiaries (the "Corporation") as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Corporation and subsidiaries at December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Corporation's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and our report dated March 13, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on the Corporation's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Corporation in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Corporation's auditor since 2013.

Harrisburg, Pennsylvania



March 13, 2018

50

---

Report of Independent Registered Public Accounting Firm

Shareholders and Board of Directors

Mid Penn Bancorp, Inc.

Millersburg, Pennsylvania

Opinion on Internal Control over Financial Reporting

We have audited Mid Penn Bancorp, Inc. and subsidiaries' (the "Corporation's") internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Corporation and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2017 and the related notes and our report dated March 13, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Item 9A, Management Report on Internal Controls over Financial Reporting". Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Corporation in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding

prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Harrisburg, Pennsylvania

March 13, 2018

## MID PENN BANCORP, INC. Consolidated Balance Sheets

(Dollars in thousands)	December 31, 2017	December 31, 2016
<b>ASSETS</b>		
Cash and due from banks	\$ 19,795	\$ 13,493
Interest-bearing balances with other financial institutions	3,028	2,003
Federal funds sold	691	30,477
Total cash and cash equivalents	23,514	45,973
Investment securities available for sale	93,465	133,625
Investment securities held to maturity, at amortized cost (fair value \$100,483 and \$0)	101,356	—
Loans held for sale	1,040	1,959
Loans and leases, net of unearned interest	910,404	813,924
Less: Allowance for loan and lease losses	(7,606 )	(7,183 )
Net loans and leases	902,798	806,741
Bank premises and equipment, net	16,168	11,074
Bank premises and equipment held for sale	—	1,894
Cash surrender value of life insurance	13,042	12,780
Restricted investment in bank stocks	4,384	2,443
Foreclosed assets held for sale	189	224
Accrued interest receivable	4,564	3,928
Deferred income taxes	1,888	4,286
Goodwill	3,918	3,918
Core deposit and other intangibles, net	434	539
Other assets	3,594	3,215
Total Assets	\$ 1,170,354	\$ 1,032,599
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
<b>Deposits:</b>		
Noninterest-bearing demand	\$ 163,714	\$ 122,811
Interest-bearing demand	349,241	317,533
Money Market	246,220	252,271
Savings	62,770	60,163
Time	201,623	182,595
Total Deposits	1,023,568	935,373
Short-term borrowings	34,611	—
Long-term debt	12,352	13,581
Subordinated debt	17,338	7,414
Accrued interest payable	645	515
Other liabilities	6,137	5,249
Total Liabilities	1,094,651	962,132
<b>Shareholders' Equity:</b>		
Common stock, par value \$1.00; authorized 10,000,000 shares; 4,242,216 and 4,233,297 shares issued and outstanding at December 31, 2017 and December 31, 2016, respectively	4,242	4,233

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

Additional paid-in capital	40,970	40,688
Retained earnings	32,565	28,399
Accumulated other comprehensive loss	(2,074 )	(2,853 )
Total Shareholders' Equity	75,703	70,467
Total Liabilities and Shareholders' Equity	\$ 1,170,354	\$ 1,032,599

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

## MID PENN BANCORP, INC. Consolidated Statements of Income

(Dollars in thousands, except per share data)	Years Ended December 31,		
	2017	2016	2015
<b>INTEREST INCOME</b>			
Interest and fees on loans and leases	\$40,156	\$36,402	\$32,840
Interest on interest-bearing balances	18	12	44
Interest and dividends on investment securities:			
U.S. Treasury and government agencies	2,273	1,346	1,222
State and political subdivision obligations, tax-exempt	1,113	2,066	2,000
Other securities	217	304	382
Interest on federal funds sold	115	82	2
Total Interest Income	43,892	40,212	36,490
<b>INTEREST EXPENSE</b>			
Interest on deposits	5,463	4,514	3,889
Interest on short-term borrowings	111	15	47
Interest on long-term and subordinated debt	730	838	671
Total Interest Expense	6,304	5,367	4,607
Net Interest Income	37,588	34,845	31,883
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>			
Net Interest Income After Provision for Loan and Lease Losses	37,263	32,975	30,818
<b>NONINTEREST INCOME</b>			
Income from fiduciary activities	845	481	466
Service charges on deposits	721	684	690
Net gain on sales of investment securities	42	1,046	325
Earnings from cash surrender value of life insurance	262	264	269
Mortgage banking income	872	922	456
ATM debit card interchange income	937	844	741
Merchant services income	335	317	235
Net gain on sales of SBA loans	800	470	252
Other income	879	896	679
Total Noninterest Income	5,693	5,924	4,113
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits	16,929	15,564	14,043
Occupancy expense, net	2,512	2,064	1,947
Equipment expense	1,536	1,689	1,477
Pennsylvania Bank Shares Tax expense	451	648	408
FDIC Assessment	792	688	613
Legal and professional fees	802	711	588
Marketing and advertising expense	516	500	533
Software licensing	1,458	1,380	1,472
Telephone expense	497	548	569
Loss on sale or write-down of foreclosed assets	88	217	111
Intangible amortization	104	126	114
Merger and acquisition expense	619	-	762
Other expenses	5,063	4,683	4,122
Total Noninterest Expense	31,367	28,818	26,759
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>11,589</b>	<b>10,081</b>	<b>8,172</b>

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

Provision for income taxes	4,500	2,277	1,644
NET INCOME	7,089	7,804	6,528
Series B preferred stock dividends and redemption premium	—	—	473
Series C preferred stock dividends	—	—	17
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$7,089	\$7,804	\$6,038
PER COMMON SHARE DATA:			
Basic and Diluted Earnings Per Common Share	\$1.67	\$1.85	\$1.47
Cash Dividends Declared	\$0.77	\$0.68	\$0.44

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

## MID PENN BANCORP, INC. Consolidated Statements of Comprehensive Income

(Dollars in thousands)	Years Ended December		
	31, 2017	2016	2015
Net income	\$7,089	\$7,804	\$6,528
Other comprehensive income (loss):			
Unrealized gains (losses) arising during the period on available for sale			
securities, net of income taxes of \$589, (\$1,954), and \$80, respectively	1,143	(3,794)	154
Reclassification adjustment for net gain on sales of available for sale			
securities included in net income, net of income taxes of (\$14), (\$356),			
and (\$110), respectively (a)	(28 )	(690 )	(215 )
Change in defined benefit plans, net of income taxes of \$3, (\$93), and \$185,			
respectively (b)	5	(181 )	360
Total other comprehensive income (loss)	1,120	(4,665)	299
Total comprehensive income	\$8,209	\$3,139	\$6,827

(a) Amounts are included in net gain on sales of investment securities on the Consolidated Statements of Income as a separate component 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

(Dollars in thousands, except share data)

	Preferred	Common	Additional	Retained	Accumulated	Total
	Stock	Stock	Paid-in	Earnings	Other	Shareholders'
			Capital		Comprehensive	Equity
					Income	
					(Loss)	
Balance, January 1, 2015	\$ 5,000	\$ 3,498	\$ 29,902	\$ 19,217	\$ 1,513	\$ 59,130
Net income	—	—	—	6,528	—	6,528
Total other comprehensive income, net of taxes	—	—	—	—	299	299
Common stock dividends	—	—	—	(1,785 )	—	(1,785 )
Employee Stock Purchase Plan (4,162 shares)	—	4	62	—	—	66
Series B preferred stock dividends	—	—	—	(373 )	—	(373 )
Series B preferred stock redemption	(5,000 )	—	—	—	—	(5,000 )
Series B preferred stock redemption premium	—	—	—	(100 )	—	(100 )
Series C preferred stock in connection with						
Phoenix acquisition	1,750	—	—	—	—	1,750
Series C preferred stock dividends	—	—	—	(17 )	—	(17 )
Series C preferred stock redemption	(1,750 )	—	—	—	—	(1,750 )
Common stock issued to Phoenix shareholders						
(723,851 shares)	—	724	10,568	—	—	11,292
Restricted stock activity (875 shares)	—	1	27	—	—	28
Balance, December 31, 2015	—	4,227	40,559	23,470	1,812	70,068
Net income	—	—	—	7,804	—	7,804
Total other comprehensive loss, net of taxes	—	—	—	—	(4,665 )	(4,665 )
Common stock dividends	—	—	—	(2,875 )	—	(2,875 )
Employee Stock Purchase Plan (4,465 shares)	—	4	78	—	—	82
Restricted stock activity (2,115 shares)	—	2	51	—	—	53
Balance, December 31, 2016	—	4,233	40,688	28,399	(2,853 )	70,467
Net income	—	—	—	7,089	—	7,089
Total other comprehensive income, net of taxes	—	—	—	—	1,120	1,120
Common stock dividends	—	—	—	(3,264 )	—	(3,264 )
Employee Stock Purchase Plan (3,578 shares)	—	4	100	—	—	104
Director Stock Purchase Plan (1,345 shares)	—	1	41	—	—	42
Restricted stock activity (3,996 shares)	—	4	141	—	—	145
Tax rate adjustment impact	—	—	—	341	(341 )	—

Balance, December 31, 2017	\$ 0	\$ 4,242	\$ 40,970	\$ 32,565	\$ (2,074	) \$ 75,703
----------------------------	------	----------	-----------	-----------	-----------	-------------

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

55

---

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

(Dollars in thousands)	Years Ended December 31,		
	2017	2016	2015
<b>Operating Activities:</b>			
Net Income	\$7,089	\$7,804	\$6,528
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	325	1,870	1,065
Depreciation	1,464	1,658	1,485
Amortization of intangibles	105	126	100
Net amortization of security premiums	1,280	11,709	4,251
Gain on sales of investment securities	(42 )	(1,046 )	(325 )
Earnings on cash surrender value of life insurance	(262 )	(264 )	(269 )
Mortgage loans originated for sale	(44,010 )	(42,888 )	(26,083 )
Proceeds from sales of mortgage loans originated for sale	45,801	43,810	26,539
Gain on sale of mortgage loans	(872 )	(922 )	(456 )
SBA loans originated for sale	(10,282 )	(5,872 )	(3,484 )
Proceeds from sales of SBA loans originated for sale	11,082	6,342	3,736
Gain on sale of SBA loans	(800 )	(470 )	(252 )
Loss on write-down/disposal of property, plant, and equipment	14	142	—
Loss on sale / write-down of foreclosed assets	88	217	111
Restricted stock compensation expense	145	53	27
Deferred income tax expense (benefit)	1,828	(336 )	997
Increase in accrued interest receivable	(636 )	(115 )	(367 )
(Increase) decrease in other assets	(380 )	(99 )	333
Increase in accrued interest payable	130	125	9
(Decrease) increase in other liabilities	(172 )	4	(771 )
<b>Net Cash Provided By Operating Activities</b>	<b>11,895</b>	<b>21,848</b>	<b>13,174</b>
<b>Investing Activities:</b>			
Net decrease in interest-bearing time deposits with other financial institutions	—	4,317	1,455
Proceeds from the maturity of investment securities	11,062	16,110	11,940
Proceeds from the sale of investment securities	52,932	111,390	37,142
Purchases of investment securities	(124,738)	(142,861)	(35,858)
Net cash received from acquisition	—	—	8,095
(Purchases) redemptions of restricted investment in bank stocks	(1,941 )	1,823	(576 )
Net increase in loans and leases	(96,570 )	(77,795 )	(60,043)
Purchases of bank premises and equipment	(6,879 )	(775 )	(1,461 )
Proceeds from sale of bank premises and equipment	2,201	—	—
Proceeds from sale of foreclosed assets	136	992	403
<b>Net Cash Used In Investing Activities</b>	<b>(163,797)</b>	<b>(86,799 )</b>	<b>(38,903)</b>
<b>Financing Activities:</b>			
Net increase in deposits	88,195	158,330	15,883
Net increase (decrease) in short-term borrowings	34,611	(31,596 )	31,018
Series B preferred stock dividends and redemption premium paid	—	—	(473 )
Series B preferred stock redemption	—	—	(5,000 )
Series C preferred stock dividends paid	—	—	(17 )

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

Series C preferred stock redemption	—	—	(1,750 )
Common stock dividends paid	(2,204 )	(2,452 )	(1,785 )
Employee Stock Purchase Plan share issuance	104	82	66
Director Stock Purchase Plan share issuance	42	—	—
Long-term debt repayment	(1,220 )	(26,724 )	(16,226)
Deferred financing fees paid for subordinated debt issuance	(85 )	—	(85 )
Subordinated debt issuance	10,000	—	7,500
Net Cash Provided By Financing Activities	129,443	97,640	29,131
Net (decrease) increase in cash and cash equivalents	(22,459 )	32,689	3,402
Cash and cash equivalents, beginning of year	45,973	13,284	9,882
Cash and cash equivalents, end of year	\$23,514	\$45,973	\$13,284

MID PENN BANCORP, INC. Consolidated Statements of Cash Flows

(Dollars in thousands)	Years Ended December 31,		
	2017	2016	2015
<b>Supplemental Disclosures of Cash Flow Information:</b>			
Interest paid	\$6,174	\$5,242	\$4,566
Income taxes paid	\$3,890	\$1,700	\$1,130
<b>Supplemental Noncash Disclosures:</b>			
Loan transfers to foreclosed assets held for sale	\$189	\$248	\$1,135
Asset transfers to bank premises and equipment held for sale	\$—	\$1,894	\$—
Common stock issued to Phoenix shareholders	\$—	\$—	\$11,292

Assets, Liabilities,  
and Equity in  
Connection with  
the Phoenix  
Bancorp, Inc.  
Merger:

(Dollars in  
thousands)

<b>Assets Acquired:</b>			
Securities	\$ —	\$ —	\$ 11,331
Loans	—	—	110,363
Restricted stock	—	—	509
Property and equipment	—	—	1,792
Deferred income taxes	—	—	503
Accrued interest receivable	—	—	388
Core deposit and other intangible assets	—	—	578
Bank-owned life insurance	—	—	3,673
Other assets	—	—	624
	\$ —	\$ —	\$ 129,761
<b>Liabilities Assumed:</b>			
Deposits	\$ —	\$ —	\$ 123,238
Accrued interest payable	—	—	32

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

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.

MID PENN BANCORP, INC. Notes to Consolidated Financial Statements

(1) Basis of Presentation

The accompanying consolidated financial statements include the accounts of Mid Penn Bancorp, Inc. and its wholly-owned subsidiary Mid Penn Bank (the “Bank”), and the Bank’s former wholly-owned subsidiary Mid Penn Insurance Services, LLC, which was closed, effective March 1, 2016 (collectively, “Mid Penn”). All material intercompany accounts and transactions have been eliminated in consolidation.

Each of Mid Penn’s lines of business are part of the same reporting segment, community banking, whose operating results are regularly reviewed and managed by a centralized executive management group. As a result, Mid Penn has only one reportable segment for financial reporting purposes.

The comparability of the results of operations for the year ended 2017 compared to 2016 and 2015, in general, have been impacted by the acquisition activities of Mid Penn as further described in Note 4. For comparative purposes, the 2016 and 2015 balances have been reclassified to conform to the 2017 presentation. Such reclassifications had no impact on net income.

(2) Nature of Business

Mid Penn, through operations conducted by the Bank, engages in a full-service commercial banking and trust business, making available to the community a wide range of financial services, including, but not limited to, mortgage and home equity loans, secured and unsecured commercial and consumer loans, lines of credit, construction financing, farm loans, community development loans, loans to non-profit entities and local government loans and various types of time and demand deposits, including but not limited to, checking accounts, savings accounts, clubs, money market deposit accounts, certificates of deposit, and IRAs. In addition, the Bank provides a full range of trust services through its Trust Department. Deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) to the extent provided by law.

The financial services are provided to individuals, partnerships, non-profit organizations, and corporations through its 23 retail banking offices located in Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties.

A former subsidiary of the Bank, Mid Penn Insurance Services, LLC, was closed effective March 1, 2016 due to a lack of activity within the subsidiary. Mid Penn Insurance Services, LLC was an immaterial subsidiary of the Bank, and was immaterial to Mid Penn’s consolidated results.

(3) Summary of Significant Accounting Policies

The accounting and reporting policies of Mid Penn conform with accounting principles generally accepted in the United States of America (“GAAP”) and to general practice within the financial industry. The following is a description of the more significant accounting policies.

(a) Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses, the assessment of other-than-temporary impairment of investment securities, the valuation of

the goodwill for impairment, and the valuation of assets acquired and liabilities assumed in business combinations.

(b) Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, balances due from banks, and federal funds sold, all of which mature within ninety days.

(c) Interest-bearing Time Deposits with Other Financial Institutions

Interest-bearing time deposits with other financial institutions consist of certificates of deposits in other financial institutions with maturities within one year.



MID PENN BANCORP, INC.

(d) Investment Securities

Available-for-sale securities include debt and equity securities which are reported at fair value, with unrealized holding gains and losses excluded from earnings being reported, net of deferred income taxes, as a component of accumulated other comprehensive income (loss) within shareholders' equity.

During 2017, Mid Penn added a held-to-maturity pool to its overall investment portfolio of debt securities, which are reported at amortized cost. Unrealized holding gains and losses on held-to-maturity securities are excluded from earnings, and are not a component of accumulated other comprehensive income (loss) within shareholders' equity. As of December 31, 2017, Mid Penn had \$101,356,000 of held-to-maturity securities recorded at amortized cost. Mid Penn had no held-to-maturity securities in 2016 and 2015.

Premiums and discounts on debt securities are amortized as an adjustment to interest income using the interest method. Realized gains and losses on sales of investment securities are computed on the basis of specific identification of the cost of each security. Net gains on sales of investment securities were \$42,000 in 2017, \$1,046,000 in 2016, and \$325,000 in 2015.

(e) Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are included in loans held for sale and are carried at fair value, as determined by outstanding commitments from investors. Gains and losses on sales of mortgage loans are included in the Consolidated Statements of Income in mortgage banking income. Mortgage banking income was \$872,000 in 2017, \$922,000 in 2016, and \$456,000 in 2015.

(f) 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. Residential loans held for sale are carried at fair value and are included in loans held for sale on the balance sheet. 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 six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

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.

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 typically 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.

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 the allowance for loan and lease losses and 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. Mid Penn also estimates a reserve for unfunded lending commitments, which 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 loan commitments was \$105,000 at December 31, 2017 and \$120,000 at December 31, 2016. 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 ("DCF"), 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, and shifting industry or portfolio concentrations.

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.

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 DCF 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 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.



## MID PENN BANCORP, INC.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. 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 credit risks and uncertainties, not 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 unexpected changes to specific-credit or general portfolio cash flows and collateral values which could negatively impact unimpaired portfolio loss factors.

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 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 Accounting Standard Codification (“ASC”) 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows will require 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.

MID PENN BANCORP, INC.

Loans acquired through business combinations that do not 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.

(g) Bank Premises and Equipment

Land is carried at cost. Buildings, furniture, fixtures, equipment, land improvements, and leasehold improvements are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method over the estimated useful lives of the assets. Building assets are depreciated using an estimated useful life of five to fifty years. Furniture, fixtures, and equipment are depreciated using an estimated useful life of three to ten years. Land improvements are depreciated over an estimated useful life of ten to twenty years. Leasehold improvements are depreciated using an estimated useful life that is the lesser of the remaining life of the lease or ten to thirty years. Maintenance and normal repairs are charged to expense when incurred, while major additions and improvements are capitalized. Gains and losses on disposals are reflected in current operations. Bank premises and equipment designated as held for sale are carried at the lower of cost or market value.

(h) Restricted Investments in Bank Stocks

Restricted investments in bank stocks represent required investments in the common stock of correspondent banks. As a member of the FHLB and Atlantic Community Bankers Bank (“ACBB”), the Bank is required to own restricted stock investments in these correspondent banks, which is carried at cost. The total amount of these restricted stock investments was \$4,384,000 December 31, 2017 and \$2,443,000 at December 31, 2016. This increase was attributed to Mid Penn’s shift from a short-term selling position to a short-term borrowing position in 2017. Total dividends received in 2017 and 2016 totaled \$114,000 and \$135,000, respectively.

(i) Foreclosed Assets Held for Sale

Foreclosed assets held for sale consist primarily of real estate acquired through, or in lieu of, foreclosure in settlement of debt, and are recorded at fair value less cost to sell at the date of transfer, establishing a new cost basis. Any valuation adjustments required at the date of transfer are charged to the allowance for loan losses. Subsequent to acquisition, foreclosed assets are carried at fair value less costs of disposal, based upon periodic evaluations that consider changes in market conditions and development and disposal costs. Operating results from assets acquired in satisfaction of debt, including rental income less operating costs and gains or losses on the sale of, or the periodic evaluation of foreclosed assets, are recorded in noninterest expense. As of December 31, 2017, Mid Penn had \$42,000 of residential real estate held in other real estate owned. There was \$308,000 in loans for which formal foreclosure proceedings were in process at December 31, 2017. As of December 31, 2016, Mid Penn had \$57,000 of

residential real estate held in other real estate owned. There was \$426,000 in loans for which formal foreclosure proceedings were in process at December 31, 2016.

MID PENN BANCORP, INC.

(j) Mortgage Servicing Rights

Mortgage servicing rights are recognized as assets upon the sale of a mortgage loan. A portion of the cost of the loan is allocated to the servicing right based upon relative fair value. The fair value of servicing rights is based on the present value of estimated future cash flows of mortgages sold, stratified by rate and maturity date. Assumptions that are incorporated in the valuation of servicing rights include assumptions about prepayment speeds on mortgages and the cost to service loans. Servicing rights are reported in core deposit and other intangibles in the Consolidated Balance Sheets and are amortized over the estimated period of future servicing income to be received on the underlying mortgage loans. The carrying amount of mortgage servicing rights was \$126,000 and \$144,000 at December 31, 2017 and 2016, respectively. Amortization expense is reflected in the Consolidated Statements of Income in other income and was \$18,000, \$30,000, and \$24,000 for the years 2017, 2016, and 2015, respectively. Servicing rights are evaluated for impairment based upon estimated fair value as compared to unamortized carrying value.

(k) Investment in Limited Partnership

Mid Penn is a limited partner in a partnership that provides low-income housing in Enola, Pennsylvania. The carrying value of Mid Penn's investment in the limited partnership was \$277,000 at December 31, 2017 and \$321,000 at December 31, 2016, net of amortization, using the straight-line method and is reported in other assets on the Consolidated Balance Sheets. Mid Penn's maximum exposure to loss is limited to the carrying value of its investment. The partnership received \$46,000 in low-income housing tax credits during 2017, 2016 and 2015.

(l) Income Taxes

Mid Penn accounts for income taxes in accordance with income tax accounting guidance ASC Topic 740, Income Taxes.

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

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Mid Penn accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50%; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

Mid Penn recognizes interest and penalties on income taxes, if any, as a component of income tax expense.

On December 22, 2017, President Donald J. Trump signed into law the Tax Cuts and Jobs Act (the “TCJA”), a tax reform law that included a significant provision reducing the corporate tax rate applicable to Mid Penn, for tax years beginning after 2017, to a flat 21 percent rate. Though the reduced rate will provide tax savings to Mid Penn in future periods after 2017, the reduction resulted in the \$1,169,000 write-down of Mid Penn’s deferred tax asset in December 2017, because the deferred tax asset was previously valued based upon the projection of Mid Penn realizing a 34 percent future corporate tax rate benefit. This write-down was included in Mid Penn’s income tax provision for the year ended December 31, 2017, as further discussed in Note 17 (Federal Income Taxes) to the consolidated financial statements.

MID PENN BANCORP, INC.

(m) Core Deposit Intangible

Core deposit intangible is a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangible is being amortized over a ten-year period using a sum of the year's digits basis. The core deposit intangible is subject to impairment testing whenever events or changes in circumstances indicate such testing.

(n) Goodwill

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with past business acquisitions, including the 2015 Phoenix acquisition. The recorded value of goodwill as of December 31, 2017, does not include any amount related to the acquisition of The Scottdale Bank and Trust Company as the legal close of that acquisition did not occur until January 8, 2018. Goodwill is evaluated annually for impairment; however, if certain events occur, which indicate goodwill might be impaired between annual tests, goodwill must be tested when such events occur. In making this goodwill potential impairment 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. Mid Penn did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2017 using a qualitative analysis. In addition, Mid Penn did not identify any impairment in 2016 using a qualitative analysis or in 2015 using a qualitative and quantitative analyses in accordance with ASC 350.

(o) Bank Owned Life Insurance

Mid Penn is the owner and beneficiary of bank-owned life insurance ("BOLI") policies on current and former directors, as well as select Miners Bank employees, which were acquired through the Phoenix acquisition. The earnings from the BOLI policies are an asset that can be liquidated, if necessary, with associated tax costs. However, Mid Penn intends to hold these policies and, accordingly, Mid Penn has not provided deferred income taxes on the earnings from the increase in cash surrender value.

Mid Penn is also party to certain Split-Dollar Life Insurance Arrangements, and in accordance with GAAP, has accrued a liability related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement, and a liability for the future death benefit.

(p) Marketing and Advertising Costs

Marketing and advertising costs are expensed as incurred.

(q) Postretirement Benefit Plans

Mid Penn follows the guidance in ASC Topic 715, Compensation-Retirement Benefits, related to postretirement benefit plans. This guidance requires additional disclosures about defined benefit pension plans and other postretirement defined benefit plans.

(r) Other Benefit Plan

A funded contributory defined-contribution plan is maintained for substantially all employees. The cost of the Mid Penn defined contribution plan is charged to current operating expenses and is funded annually.

(s) Trust Assets and Income

Assets held by the Bank in a fiduciary or agency capacity for customers of the Trust Department are not included in the consolidated financial statements since such items are not assets of the Bank. Trust income is recognized on the

cash basis, which is not materially different than if it were reported on the accrual basis.



## MID PENN BANCORP, INC.

## (t) Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes changes in unrealized gains and losses on securities available for sale arising during the period and reclassification adjustments for realized gains and losses on securities available for sale included in net income. Mid Penn has an unfunded noncontributory defined benefit Plan for directors and other postretirement benefit Plans covering full-time employees. These Plans utilize assumptions and methods to calculate the fair value of Plan assets and recognizing the overfunded and underfunded status of the Plans on its consolidated balance sheet. Gains and losses, prior service costs and credits are recognized in other comprehensive income (loss), net of tax, until they are amortized, or immediately upon curtailment.

## (u) Restricted Stock

Mid Penn provides members of senior management who have a responsibility for its growth with additional incentives by allowing them to acquire an ownership interest in Mid Penn through its Restricted Stock Plan. The restricted stock is non-voting and non-participating until the granted shares vest. Once the shares vest, the recipient would have full voting rights and be entitled to any common stock dividends.

## (v) Earnings Per 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 share.

(Dollars in thousands, except per share data)

	2017	2016	2015
Net Income	\$7,089	\$7,804	\$6,528
Less:			
Dividends on Series B preferred stock	—	—	373
Redemption premium on Series B preferred stock	—	—	100
Dividends on Series C preferred stock	—	—	17
Net income available to common shareholders	\$7,089	\$7,804	\$6,038
Weighted average common shares outstanding	4,236,616	4,229,284	4,106,548
Basic earnings per common share	\$1.67	\$1.85	\$1.47

Mid Penn had no dilutive instruments outstanding during the periods ended December 31, 2017, 2016, and 2015.

## (4) Mergers and Acquisitions

On January 8, 2018, Mid Penn announced the successful completion of the acquisition of The Scottsdale Bank & Trust Company (“Scottsdale”). On January 16, 2018, Mid Penn entered into an Agreement and Plan of Merger with First Priority Financial Corp. (“First Priority”). More information on these transactions can be found in Item 1 – Business and Note 26 – Subsequent Events.

Phoenix Bancorp, Inc.

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 Mid Penn 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 Mid Penn 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 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.

## MID PENN BANCORP, INC.

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 Treasury ("Treasury") in connection with the Small Business Lending Fund and issued 1,750 shares of its own Senior Non-Cumulative Perpetual Preferred Stock, Series C that had 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.

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 that 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 is not taxable and will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense projected for the next five years beginning in 2018 is estimated to be \$75,000, \$65,000, \$54,000, \$44,000, and \$33,000 per year, respectively, and \$37,000 in total for years after 2022.

The allocation of the purchase price of the Phoenix acquisition 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



## MID PENN BANCORP, INC.

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

(Dollars in thousands)

Total purchase price	\$ 14,241
Net assets acquired:	
Cash and cash equivalents	11,044
Investment securities	11,331
Restricted stock	509
Loans	110,363
Bank owned life insurance	3,673
Premises and equipment	1,792
Deferred income taxes	503
Accrued interest receivable	388
Core deposit and other intangibles	578
Other assets	624
Deposits	(123,238)
FHLB borrowings	(3,570 )
Accrued interest payable	(32 )
Other liabilities	(876 )
Preferred stock	(1,750 )
	11,339
Goodwill	\$ 2,902

The fair value of the financial assets acquired from Phoenix 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 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 loans accounted for under ASC 310-30 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

## MID PENN BANCORP, INC.

The following table presents unaudited pro forma information about the merger between Mid Penn and Phoenix. 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 2015. Supplemental pro forma earnings for 2015 were adjusted to exclude \$762,000 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. The pro forma data is intended for informational purposes and is not indicative of the future results of operations.

The following table presents the unaudited pro forma information for the year ended December 31, 2015, as if the merger between Mid Penn and Phoenix had been completed on January 1, 2014.

(Dollars in thousands, except per share data)

Net interest income after loan loss provision	\$31,454
Noninterest income	4,152
Noninterest expense	27,817
Net income available to common shareholders	5,811
Net income per common share	1.38

The amount of total revenue, consisting of interest income plus noninterest income specifically related to Phoenix for the period beginning March 1, 2015, included in the consolidated statements of income of Mid Penn for the year ended December 31, 2015, was \$4,244,000. The net income specifically related to Phoenix for the period beginning March 1, 2015, included in the consolidated statements of income of Mid Penn for the year ended December 31, 2015, was \$747,000.

## (5) Accumulated Other Comprehensive (Loss) Income

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

(Dollars in thousands)	Unrealized (Loss)		Defined Benefit	Accumulated Other Comprehensive (Loss) Income
	Gain on	Securities		
Balance - December 31, 2017	\$ (2,159 )	\$ 85		\$ (2,074 )
Balance - December 31, 2016	\$ (2,919 )	\$ 66		\$ (2,853 )

## (6) Restrictions on Cash and Due from Bank Accounts

The Bank is required to maintain reserve balances with the Federal Reserve Bank of Philadelphia. There was no required reserve balance at December 31, 2017 and December 31, 2016 because the Bank had sufficient vault cash available.

(7) 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. Securities to be held to maturity are carried at amortized cost.

Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value 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 book value and fair value of each security. These gains and losses are credited or charged to other comprehensive income (loss), whereas realized gains and losses flow through Mid Penn's consolidated statements of income.

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



## MID PENN BANCORP, INC.

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 (loss).

In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intent and ability to hold the securities until recovery of unrealized losses. Mid Penn had no other-than-temporary impaired debt or equity securities in 2017, 2016, and 2015.

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

(Dollars in thousands)

December 31, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
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	1,000	5	—	1,005
Equity securities	900	—	44	856
Total available for sale securities	96,198	14	2,747	93,465
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	—	—	—	—
Equity securities	—	—	—	—
Total held to maturity securities	101,356	41	914	100,483
Total	\$ 197,554	\$ 55	\$ 3,661	\$ 193,948

(Dollars in thousands)

December 31, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available for sale securities:				
U.S. Treasury and U.S. government agencies	\$ 48,520	\$ 34	\$ 1,542	\$ 47,012
Mortgage-backed U.S. government agencies	26,181	17	579	25,619
State and political subdivision obligations	61,079	91	2,332	58,838
Corporate debt securities	1,000	—	—	1,000

Equity securities	1,268	—	112	1,156
	\$ 138,048	\$ 142	\$ 4,565	\$ 133,625

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

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 \$141,465,000 at December 31, 2017, and \$131,469,000 at December 31, 2016, were pledged primarily to secure public deposits.

## MID PENN BANCORP, INC.

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 December 31, 2017 and 2016.

(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	0	—	—	35	52,949	523	35	52,949	523
U.S. government									

agencies

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

(Dollars in thousands)

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

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

Management evaluates securities for other-than-temporary impairment on 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.

## MID PENN BANCORP, INC.

The majority of the investment portfolio is comprised of mortgage-backed 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, and the contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment.

At December 31, 2017, the majority of the unrealized losses on securities in an unrealized loss position were attributed to state and political subdivision obligations and mortgage-back U.S. government agencies. At December 31, 2016, the majority of the unrealized losses on securities in an unrealized loss position were attributed to state and political subdivision obligations and U.S. Treasury and government agencies. Because Mid Penn does not intend to sell these investments and it is not likely it will be required to sell these investments before a recovery of fair value, which may be maturity, Mid Penn does not consider the securities with unrealized losses to be other-than-temporarily impaired as losses relate to changes in interest rates and not erosion of credit quality.

Gross realized gains and losses on sales of available-for-sale securities for the years ended December 31, 2017, 2016, and 2015 are shown in the table below.

(Dollars in thousands)	For the year ended		
	December 31,		
	2017	2016	2015
Realized gains	\$246	\$1,927	\$325
Realized losses	(204)	(881)	—
Net gains	\$42	\$1,046	\$325

The table below is the maturity distribution of investment securities at amortized cost and fair value at December 31, 2017.

(Dollars in thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2017				
Due in 1 year or less	\$100	\$100	\$2,001	\$1,989
Due after 1 year but within 5 years	12,072	11,825	9,431	9,357
Due after 5 years but within 10 years	46,307	44,779	35,941	35,679
Due after 10 years	10,771	10,424	511	509
	69,250	67,128	47,884	47,534
Mortgage-backed securities	26,398	25,831	53,472	52,949
Equity securities	550	506	—	—
	\$96,198	\$93,465	\$101,356	\$100,483

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

The classes of the loan portfolio, summarized by the aggregate pass rating, net of deferred fees and costs of \$464,000 and \$196,000 as of December 31, 2017 and 2016, respectively, and the classified ratings of special mention, substandard, and doubtful within Mid Penn's internal risk rating system as of December 31, 2017 and 2016, are noted below:

(Dollars in thousands)

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	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 BANCORP, INC.

(Dollars in thousands)

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

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

(Dollars in thousands)	December 31, 2017			December 31, 2016		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	\$—	\$ 13	\$ —	\$4	\$ 9	\$ —
Commercial real estate	3,424	4,056	—	726	1,792	—
Commercial real estate - construction	—	—	—	618	618	—
Lease financing	—	—	—	—	—	—
Residential mortgage	760	877	—	848	882	—
Home equity	260	295	—	111	129	—
Consumer	—	—	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:						
Commercial and industrial	\$—	\$—	\$ —	\$—	\$—	\$ —
Commercial real estate	555	555	—	842	842	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	306	306	—	389	389	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial and industrial	\$4,434	\$ 4,460	\$ 136	\$56	\$ 62	\$ 6
Commercial real estate	1,423	1,589	293	2,520	2,646	711
Commercial real estate - construction	487	492	100	242	242	72
Lease financing	—	—	—	—	—	—
Residential mortgage	—	—	—	68	68	68
Home equity	—	—	—	29	49	1



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

Consumer	—	—	—	—	—	—
<b>Total:</b>						
Commercial and industrial	\$4,434	\$ 4,473	\$ 136	\$60	\$ 71	\$ 6
Commercial real estate	5,402	6,200	293	4,088	5,280	711
Commercial real estate - construction	487	492	100	860	860	72
Lease financing	—	—	—	—	—	—
Residential mortgage	1,066	1,183	—	1,305	1,339	68
Home equity	260	295	—	140	178	1

\*Loans acquired with credit deterioration are presented net of credit fair value adjustment.

## MID PENN BANCORP, INC.

The average recorded investment of impaired loans and related interest income recognized for the years ended December 31, 2017, 2016, and 2015 are summarized as follows:

(Dollars in thousands)	December 31, 2017		December 31, 2016		December 31, 2015	
	Average Investment	Interest Recognized	Average Investment	Interest Recognized	Average Investment	Interest Recognized
With no related allowance recorded:						
Commercial and industrial	\$15	\$ —	\$9	\$ —	\$19	\$ —
Commercial real estate	1,915	279	820	—	1,051	14
Commercial real estate - construction	164	—	124	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	890	18	821	21	816	8
Home equity	218	6	75	—	107	—
Consumer	—	—	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:						
Commercial and industrial	\$—	\$ —	\$—	\$ —	\$—	\$ 205
Commercial real estate	651	110	810	164	926	350
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	332	—	378	4	400	—
Home equity	—	—	—	—	—	3
Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial and industrial	\$1,779	\$ —	\$59	\$ —	\$123	\$ —
Commercial real estate	1,446	—	2,177	—	1,721	—
Commercial real estate - construction	488	—	48	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	—	—	14	—	25	—
Home equity	—	—	32	—	—	—
Consumer	—	—	—	—	—	—
Total:						
Commercial and industrial	\$1,794	\$ —	\$68	\$ —	\$142	\$ 205
Commercial real estate	4,012	389	3,807	164	3,698	364
Commercial real estate - construction	652	—	172	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	1,222	18	1,213	25	1,241	8
Home equity	218	6	107	—	107	3

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

(Dollars in thousands)

	2017	2016
Commercial and industrial	\$4,434	\$4
Commercial real estate	4,902	2,939
Commercial real estate - construction	487	860
Residential mortgage	492	715
Home equity	260	140
	\$10,575	\$4,658

## MID PENN BANCORP, INC.

If nonaccrual loans and leases had been current in accordance with their original terms and had been outstanding throughout the period or since origination, if held for part of the period, Mid Penn would have recorded interest income on these loans of \$780,000, \$778,000, and \$798,000, in the years ended December 31, 2017, 2016, and 2015, respectively. Mid Penn has no commitments to lend additional funds to borrowers with impaired or nonaccrual loans.

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 December 31, 2017 and 2016 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	Loans Receivable > 90 Days and Accruing
December 31, 2017							
Commercial and industrial:							
Commercial and industrial	\$4,439	\$16	\$—	\$4,455	\$183,578	\$188,033	\$ —
Commercial real estate:							
Commercial real estate	—	—	3,669	3,669	510,788	514,457	—
Acquired with credit deterioration	500	—	55	555	-	555	—
Commercial real estate - construction:							
Commercial real estate - construction	—	—	487	487	61,849	62,336	—
Lease financing:							
Lease financing	—	—	—	—	229	229	—
Residential mortgage:							
Residential mortgage	310	467	177	954	97,773	98,727	—
Acquired with credit deterioration	—	31	193	224	82	306	—
Home equity:							
Home equity	54	98	250	402	41,491	41,893	—
Consumer:							
Consumer	3	—	—	3	3,865	3,868	—
Total	\$5,306	\$612	\$4,831	\$10,749	\$899,655	\$910,404	\$ —

## MID PENN BANCORP, INC.

(Dollars in thousands)

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

MID PENN BANCORP, INC.

Activity in the allowance for loan and lease losses for the years ended December 31, 2017, 2016, and 2015, and the recorded investment in loans receivable as of December 31, 2017, 2016, and 2015 are as follows:

(Dollars in thousands)