



# MID PENN BANCORP. INC.

2017 ANNUAL REPORT TO SHAREHOLDERS

**150 YEARS OF COMMUNITY BANKING**





## A LETTER FROM President and CEO Rory G. Ritrievi & Chairman of the Board Robert C. Grubic

In September of 1868, during the post-Civil War era, Millersburg area businessman A.F. Gilbert founded the Millersburg Bank at 349 Union Street in Millersburg, Pennsylvania. His purpose in establishing the bank was to serve the common person's financial needs. Through the soundness of the institution and the commitment of the residents of upper Dauphin County, the bank persevered through the Great Depression. In 1932, the bank established a Trust Department and was renamed the Millersburg Trust Company. After bank acquisitions in Elizabethville and Dalmatia, the name of the bank was changed to Mid Penn Bank in 1971. Twenty years later the holding company, Mid Penn Bancorp, Inc. ("Mid Penn") was formed. In 1997, the stock of Mid Penn began trading on the American Stock Exchange. At that time, just 20 years ago, the bank had six retail locations and approximately \$250 million in assets.

In the fall of 2018, we will celebrate our 150th birthday! Mid Penn Bank has grown to 29 retail locations and almost \$1.4 billion in total assets. Through good times and bad, Mid Penn has found a way to survive, prosper and deliver a sound return for its shareholders.

In last year's shareholder letter, we wrote that "we operate this company for the benefit of our shareholders." While that should not be a novel concept, it bears repeating here. With many variables to the definition of success for a publicly traded financial institution, ultimately shareholder return should be the focal point. It certainly is at Mid Penn. We followed the 52% total shareholder return in 2016 with a 42% return in 2017. The five-year total shareholder return is now at 240%. In 2017, shareholder return was comprised of stock appreciation of \$9.27 per share, or 39%, and cash dividends of \$0.62 per share. It is part of our mission statement to "be the best bank for our shareholders." Mission accomplished in 2017!

We were able to provide that level of shareholder return through strong core operating performance, which both enhanced tangible book value and provided those valued cash dividends. As you will see in the financials attached, our GAAP reported earnings for 2017 were actually lower than in 2016 due to a one-time noncash charge of \$1,169,000 attributed to the write down of our reported deferred tax asset driven by the signing of the Tax Cuts and Jobs Act on December 22, 2017. With a lower prospective corporate tax rate starting in

2018, the deferred tax asset we had on the books, which was valued based on a higher tax rate, simply had to be revalued. The amount by which we wrote down that asset was deducted from 2017 earnings. Additionally, we had \$619,000 in one-time merger expenses related to the announced acquisition of The Scottdale Bank and Trust Company ("Scottdale") located in Westmoreland and Fayette Counties. Despite these nonrecurring tax and merger charges reducing our 2017 net income, our core operating revenues increased as our net interest income grew by \$2.7 million or almost 8% compared to 2016. Furthermore, we fully expect that both the Tax Cuts and Jobs Act and The Scottdale Bank acquisition will be accretive to net earnings going forward.

The 2017 core performance of Mid Penn's operating subsidiary, Mid Penn Bank, was again strong from an organic growth standpoint. In originating over \$365 million in commercial, consumer and residential loans throughout our footprint, we were able to realize a net increase in total loans of over 11% year-over-year. That was our third consecutive year of a double-digit percentage increase in total loans. To fund those loans, we grew our deposits by over 9%. Mid Penn has proven to be a consistent generator of lower-cost core deposits throughout our footprint. In the last nine years, we have grown our deposit base by almost 180%, with the majority of that increase coming from growth in existing markets.

Those impressive growth numbers were again accomplished by a fine-tuned business development team that focuses on delivering a unique customer experience regardless of the type of customer or the customer's geographic location. Simply put, we are very good at building high quality, deep relationships with borrowers, depositors and trust customers throughout our rapidly expanding footprint. Our team takes pride in providing "best in class" customer service and has set the standard for which customers have come to expect.

While we take pride in the successes we had in loan and deposit growth in 2017, we are even more pleased with our asset quality results. In 2017, for the first time in 23 years, Mid Penn Bank ended the year with net loan recoveries. Put another way, our team was able to collect more dollars on previously charged-off loans than it recorded in new charge-offs. This serves as a testament to both the effectiveness of our work out strategies, the

strength of the loan portfolio and our commitment to preserving strong asset quality metrics.

Along with our balance sheet growth, we have also continued to expand our retail footprint. In 2017, we established new retail locations in New Holland, Lancaster County and Orwigsburg, Schuylkill County. Both of these branches are performing well. In January 2018, we also opened a newly constructed retail location in Halifax, in upper Dauphin County. While we are proud of all of our retail locations, we take considerable pride in reestablishing a retail presence in Halifax. It was important to us and long overdue to have a presence in that great market, and the response so far has been overwhelming. If you are in that neighborhood and want to experience wonderful customer service, we welcome you to stop in and say hello to Branch Manager Nicole Rickert and her staff!

With the organic growth success of 2017, we ended the year with total assets of just under \$1.1 billion. Following the Scottdale merger (completed January 8, 2018), we are closer to \$1.4 billion in assets. Furthermore, if we are successful in our planned merger with First Priority Financial Corp., of Malvern, PA ("First Priority"), we are projecting total assets of approximately \$2.1 billion at year-end 2018. That will equate to asset growth of approximately 265% over a ten-year period, aided by three acquisitions since 2015.

Growth for the sake of growing, however, is not our primary objective. Creating a community bank powerhouse that can serve markets throughout Pennsylvania is the objective. We want to be the bank of choice for any community in Pennsylvania that values the principles of community banking. Those principles include: accepting deposits of any size and providing those deposit customers with needed technology, security and convenience; providing commercial, consumer and residential mortgage loans by a local team of bankers; providing dependable trust and wealth management solutions to any size customer; and, supporting our communities with charitable dollars and service hours. With the success of creating that community bank powerhouse will come long-term benefits to our shareholders.

Even with the increased regulatory burden we and other community banks have faced over the past 10 years, a

difficult economic environment over that same time and unfair competition from federal credit unions, Mid Penn has continued to prosper and create long-term value for our shareholders, long-term support for our customers and communities, and long-term stability for the now 300+ employees who call the bank home. We have been successful by continuing to develop a better operational, administrative and business development infrastructure. We have evolved.

As Mid Penn continues to grow and evolve, its Board of Directors has also grown and evolved. We recently increased the size of our Board of Directors to 13, with the addition of Donald Kiefer. Don was the Chairman, President and CEO of Scottsdale. He was also one of that company's largest shareholders. With his lifetime of experience in banking and unique perspective on Western Pennsylvania, Don will be a very valuable addition to the team. Pending a successful merger with First Priority, we will be adding four more Board members later this year. Our Board will then consist of 17 very qualified members. The last eight new Board members will have joined us through merger deals. Unfortunately, we have been unsuccessful in adding female Board members through those acquisitions. Mid Penn was one of the first banks in Pennsylvania to have a female Board member with Mrs. Anna Woodside. Over 70% of our employees are female. Almost 60% of our exempt employees are female. Over 50% of our calling officers are female. Over 40% of our Senior Management team is female. We are very proud of the accomplishments of our female employees and executives and the role they have played in our success. Consequently, it is a priority of the current Board to add qualified female members to its ranks to provide that perspective.

We would also like to pay tribute to Harvey Hummel. Harvey, a former Board member of Mid Penn and the Tower City National Bank (acquired by Mid Penn in 1985), passed away on March 18, 2018. Harvey fought valiantly for his country in World War II. He was an icon in the Tower City area and a truly special person. He will be missed by many.

As we approach our 150th birthday, we decided to celebrate the best way we know how. Cake for customers and employees for sure, but we also wanted to step up our legacy of giving. In September of 2017, to kick off our 150th year, we announced that we would contribute

\$150,000 and commit at least 1,500 volunteer hours to 150 worthwhile entities. In 2017, we made \$360,000 in corporate donations, contributed 1,900 hours of community service and raised \$33,000 from our employees for charitable causes. Our two premier events for the year were the Fourth of July Millersburg Fireworks - enjoyed by thousands along the banks of the Susquehanna River - and our Celebrity Golf Tournament for Charity. The golf outing raised \$50,000 for the Pennsylvania Breast Cancer Coalition. Celebrity attendees included Ron Jaworski, Mike Quick, Merrill Hoge, Seth Joyner, Todd Herremans, AJ Feeley, Joe Pisarcik, Gerald Henderson and several others. We will again host the Mid Penn Bank Celebrity Golf Tournament for Charity, our fourth, in June 2018. This year, with even more celebrities and additional sponsor support of the event, our goal is to raise \$100,000 - which will be split between support for women going through breast cancer and research to help eradicate the disease.

By the time you read this, we will already be through the first quarter of 2018. While the Tax Cuts and Jobs Act of 2017 negatively impacted fiscal year 2017 earnings as described above, it should significantly increase this year's after tax cash flow to bolster tangible book value, dividends and support growth strategies. As of this writing, the US Senate - with 67 affirmative votes - passed the Economic Growth, Regulatory Relief and Consumer Protection Act (S.2155). That bill is now in the House for its input. The net effect of S.2155, should it be signed by the President, will not be to completely dismantle Dodd-Frank, but will hopefully remove some of Dodd-Frank's more burdensome provisions.

The great Satchel Paige once asked, "How old would you be if you did not know how old you were?" For Mid Penn, we would say our age is reflective of the great knowledge we have earned through time, but with the energy and focus of a startup. The hard work that has put us in a position to celebrate our 150th anniversary is the same hard work we will put forth throughout 2018 and the coming years as we continue to build THE Best Bank in Pennsylvania.

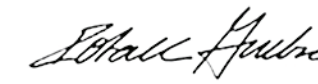
We summarize our view on the future of Mid Penn as being cautiously optimistic. Cautious because there are always external factors that can influence our progress. Optimistic because we feel we have built a company

that truly is capable of becoming THE community bank powerhouse for Pennsylvania. Over the years, we have been faced with roadblocks to progress and prosperity, but we have always evolved and progressed in a manner to overcome those obstacles. To continue building long-term value for our shareholders, we will continue to follow the same type of decision making that has taken us from that little startup bank in 1868 to where we are today, almost 150 years later.

That decision making is all about a fulfillment of our mission statement, "To uphold the values of community banking, in order to be the best bank for our shareholders, customers, employees and the communities we serve."

Thank you for your role in helping us get there!

  
Rory G. Ritrievi  
President and CEO

  
Robert C. Grubic  
Chairman of the Board

Forward-looking Statement under the Private Securities Litigation Reform Act of 1995: Statements in this letter regarding Mid Penn's business, which are not historical facts, are "forward-looking statements" that involves risks and uncertainties. For a discussion of such risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see Mid Penn's filings with the Securities Exchange Commission, including "Item 1A. Risk Factors" in Mid Penn's Annual Report on Form 10-K attached to this letter. These statements speak only as of the date of this letter, even if subsequently made available by Mid Penn on its website or otherwise. Mid Penn undertakes no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this letter.



## OUR MISSION

To uphold the values of community banking, in order to be the best bank for our shareholders, customers, employees and the communities we serve.



MID PENN BANCORP, INC. BOARD OF DIRECTORS

Pictured from left to right (seated): Robert A. Abel, William A. Specht, III (Vice-Chairman), Robert C. Grubic (Chairman), Rory G. Ritrievi and Matthew G. DeSoto. Pictured from left to right (standing): Donald F. Kiefer, Theodore W. Mowery, Robert E. Klinger, John E. Noone, Noble C. Quandel, Jr., Steven T. Boyer, Robert J. Moisey and Gregory M. Kerwin

## THE COMMUNITY BANK DIFFERENCE

The communities we serve have a very strong need for the products, services and community support that our local team delivers.



### QUICK, LOCAL LENDING DECISIONS

When Ed Fetter, Partner of Hershey DTC, LP, began envisioning the up-and-coming Hershey Towne Square project, he knew he could count on Mid Penn Bank Regional President Heather Hall for a customized financing solution. With the support of Mid Penn Bank, the 82,000 square-foot commercial development project is under way with restaurants, shops and corporate offices slated to open in mid-2018.



### A RELATIONSHIP-BASED APPROACH

John Mattis, owner of Graceful Acres, made the decision to become a Mid Penn Bank customer the day the doors opened at our new Halifax branch. The bank has been a proud supporter of Graceful Acres, a therapeutic horseback riding organization, since its early days by providing donations, volunteer efforts and a best-in-class local banking team.

FROM LEFT TO RIGHT: Director of SBA/Guaranteed Lending Natalie Falatek, Senior Regional Retail Manager Tara Sheaffer, Graceful Acres Owner Jon Mattis and Halifax Branch Manager Nicole Rickert.



### COMMUNITY REINVESTMENT

We understand the needs of the communities we serve and proactively provide support through a number of ways. By providing a \$250,000 investment loan to the Local Housing Investment Fund & Trust (LHIFT) of South Central PA, Mid Penn Bank is committed to having quality affordable housing in the region for the benefit of local families and our economy.

FROM LEFT TO RIGHT: Lancaster Housing Opportunity Partnership (LHOP) Board Member Gary Weaver, Spanish American Civic Association CEO Carlos Graupera, LHOP Director of Lending Miriam Soto, LHOP CEO Ray D'Agostino, Residential Mortgage Manager Angela Shifflet and Regional President Joan Dickinson.

**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)*

**349 Union Street  
Millersburg, Pennsylvania**  
*(Address of Principal Executive Offices)*

**25-1666413**  
*(I.R.S. Employer  
Identification Number)*

**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	Name of Each Exchange on Which Registered
Common Stock, \$1.00 par value per share	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	<input type="checkbox"/> Accelerated Filer	<input checked="" type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/> Smaller Reporting Company	<input type="checkbox"/>
	<input type="checkbox"/> Emerging Growth Company	<input type="checkbox"/>

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.

**FORM 10-K**  
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## **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 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 Scottsdale 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:	<u>High</u>	<u>Low</u>	<u>Cash Dividends Paid</u>
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.

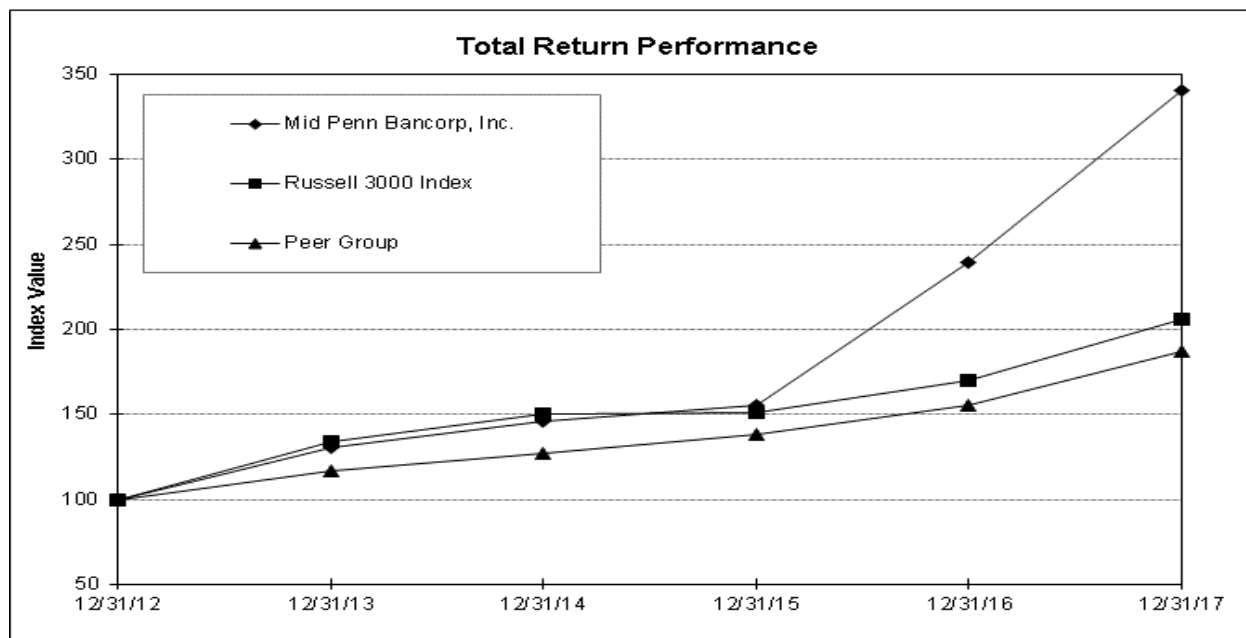
Dividend Reinvestment and Stock Purchases: Shareholders of Mid Penn may acquire additional shares of common stock by reinvesting their cash dividends under the Dividend Reinvestment Plan without paying a brokerage fee. Voluntary cash contributions may also be made under the Plan. For additional information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

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  
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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)*

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
<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
Series A Preferred Stock Dividends and Discount Accretion	—	—	—	—	14
Series B Preferred Stock Dividends and Redemption Premium	—	—	473	350	309
Series C Preferred Stock Dividends	—	—	17	—	—
Net Income Available to Common 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 (BASIC):</b>					
	4,236,616	4,229,284	4,106,548	3,495,705	3,491,653
<b>AVERAGE SHARES OUTSTANDING (FULLY DILUTED):</b>					
	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
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
<b>RATIOS:</b>					
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.

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.

*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.

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**

	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
<i>(Dollars in thousands)</i>									
<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	<u>\$1,103,439</u>			<u>\$1,001,452</u>			<u>\$883,928</u>		
<b>LIABILITIES &amp; 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%
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	<u>\$1,103,439</u>			<u>\$1,001,452</u>			<u>\$883,928</u>		
Net Interest Income		<u>\$38,597</u>			<u>\$36,470</u>			<u>\$33,806</u>	
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.



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)
Investment Securities:						
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>						
Interest Bearing Deposits:						
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.

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.

A summary of charge-offs and recoveries of loans and leases are presented in Table 3.

**TABLE 3: ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES**

(Dollars in thousands)

	Years ended December 31,				
	2017	2016	2015	2014	2013
Balance, beginning of year	\$ 7,183	\$ 6,168	\$ 6,716	\$ 6,317	\$ 5,509
Loans and leases charged off:					
Commercial real estate, construction and land development	322	216	1,569	1,057	936
Commercial, industrial and agricultural	25	820	130	62	183
Real estate - residential	102	4	35	133	167
Consumer	48	67	50	76	187
Total loans and leases charged off	497	1,107	1,784	1,328	1,473
Recoveries on loans and leases previously charged off:					
Commercial real estate, construction and land development	553	211	75	13	286
Commercial, industrial and agricultural	26	4	12	13	193
Real estate - residential	4	26	44	20	23
Consumer	12	11	40	64	92
Total loans and leases recovered	595	252	171	110	596
Net (recoveries) charge-offs	(98)	855	1,613	1,218	877
Provision for loan and lease losses	325	1,870	1,065	1,617	1,685
Balance, end of year	\$ 7,606	\$ 7,183	\$ 6,168	\$ 6,716	\$ 6,317
	Years ended December 31,				
	2017	2016	2015	2014	2013
Ratio of net (recoveries) charge-offs during the year to average loans and leases outstanding during the year, net of unearned discount	-0.01%	0.11%	0.23%	0.22%	0.17%
Allowance for loan and lease losses as a percentage of total loans and leases at December 31	0.84%	0.88%	0.83%	1.18%	1.16%
Allowance for loan and lease losses as a percentage of non-performing assets at December 31	67.26%	124.73%	101.75%	58.36%	49.84%

TABLE 4: NONINTEREST INCOME

	Years ended December 31,		
	2017	2016	2015
(Dollars in thousands)			
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.

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**

	Years ended December 31,		
	2017	2016	2015
<i>(Dollars in thousands)</i>			
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
Other expenses	2,035	1,917	1,408
<b>Total Noninterest Expense</b>	<b>\$ 31,367</b>	<b>\$ 28,818</b>	<b>\$ 26,759</b>

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 Scottsdale, 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.

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)*

	<b>December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Available-for-sale securities:</b>			
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	<u>93,465</u>	<u>133,625</u>	<u>135,721</u>
<b>Held-to-maturity securities:</b>			
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	<u>100,483</u>	<u>—</u>	<u>—</u>
Total	<u>\$ 193,948</u>	<u>\$ 133,625</u>	<u>\$ 135,721</u>

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

**TABLE 7: INVESTMENT MATURITY AND YIELD**

(Dollars in thousands)

<b>As of December 31, 2017</b>	<b>One Year and Less</b>	<b>After One Year thru Five Years</b>	<b>After Five Years thru Ten Years</b>	<b>After Ten Years</b>	<b>Total</b>
<b>Available for sale securities:</b>					
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
	<u>\$ 100</u>	<u>\$ 10,885</u>	<u>\$ 57,118</u>	<u>\$ 25,362</u>	<u>\$ 93,465</u>
<b>Held to maturity securities:</b>					
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	—	—	—	—	—
	<u>\$ 2,001</u>	<u>\$ 9,432</u>	<u>\$ 45,646</u>	<u>\$ 44,277</u>	<u>\$ 101,356</u>
<b>Weighted Average Yields</b>					
<b>Available for sale securities:</b>					
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%
	<u>4.75%</u>	<u>1.93%</u>	<u>2.76%</u>	<u>2.82%</u>	<u>2.69%</u>
<b>Held to maturity securities:</b>					
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	—	—	—	—	—
	<u>1.25%</u>	<u>1.75%</u>	<u>3.09%</u>	<u>2.80%</u>	<u>2.80%</u>

### 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.



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)

	2017		2016		December 31, 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)

<b>As of December 31, 2017</b>	<b>One Year and Less</b>	<b>After One Year thru Five Years</b>	<b>After Five Years</b>	<b>Total</b>
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
Real estate - residential mortgages	6,583	24,903	221,666	253,152
Consumer	76	1,045	2,747	3,868
	<u>\$ 38,150</u>	<u>\$ 121,817</u>	<u>\$ 750,437</u>	<u>\$ 910,404</u>
<b>Rate Sensitivity</b>				
Predetermined rate	\$ 11,204	\$ 66,528	\$ 129,833	\$ 207,565
Floating or adjustable rate	26,946	55,289	620,604	702,839
	<u>\$ 38,150</u>	<u>\$ 121,817</u>	<u>\$ 750,437</u>	<u>\$ 910,404</u>

#### 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	<u>\$ 11,308</u>	<u>\$ 5,818</u>	<u>\$ 6,117</u>	<u>\$ 11,507</u>	<u>\$ 12,675</u>
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.

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

**TABLE 11: PARTIALLY CHARGED OFF LOANS**

<i>(Dollars in thousands)</i>	<b>December 31, 2017</b>	<b>December 31, 2016</b>
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.

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.

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)*

	<b>December 31,</b>				
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
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
	<u>\$ 7,606</u>	<u>\$ 7,183</u>	<u>\$ 6,168</u>	<u>\$ 6,716</u>	<u>\$ 6,317</u>

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.

**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
	<u>\$ 989,533</u>	<u>0.55%</u>	<u>\$ 881,822</u>	<u>0.51%</u>	<u>\$ 741,538</u>	<u>0.53%</u>

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
	<u>\$ 105,741</u>	<u>\$ 86,159</u>	<u>\$ 64,026</u>

#### 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.

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					
	Actual		Minimum Capital Required (1)		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Corporation</b>						
<b>As of December 31, 2017</b>						
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>						
<b>As of December 31, 2017</b>						
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>						
<b>As of December 31, 2016</b>						
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>						
<b>As of December 31, 2016</b>						
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%
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.

Holders 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.



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**

(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
		<u>\$ 233,155</u>	<u>\$ 104,245</u>	<u>\$ 79,294</u>	<u>\$ 28,107</u>	<u>\$ 21,509</u>

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.

**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**

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

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**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  
Rory G. Ritrievi  
President and  
Chief Executive Officer  
March 13, 2018

/s/ Michael D. Peduzzi, CPA  
Michael D. Peduzzi, CPA  
Chief Financial Officer  
March 13, 2018

## 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

## 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)*

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
<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	<u>23,514</u>	<u>45,973</u>
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	<u>902,798</u>	<u>806,741</u>
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	<u>\$ 1,170,354</u>	<u>\$ 1,032,599</u>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Deposits:		
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	<u>1,023,568</u>	<u>935,373</u>
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	<u>1,094,651</u>	<u>962,132</u>
Shareholders' Equity:		
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
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	<u>75,703</u>	<u>70,467</u>
Total Liabilities and Shareholders' Equity	<u>\$ 1,170,354</u>	<u>\$ 1,032,599</u>

*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	<u>43,892</u>	<u>40,212</u>	<u>36,490</u>
<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	<u>5,693</u>	<u>5,924</u>	<u>4,113</u>
<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	<u>31,367</u>	<u>28,818</u>	<u>26,759</u>
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>			
Provision for income taxes	4,500	2,277	1,644
<b>NET INCOME</b>			
Series B preferred stock dividends and redemption premium	—	—	473
Series C preferred stock dividends	—	—	17
<b>NET INCOME AVAILABLE TO COMMON SHAREHOLDERS</b>	<u>\$ 7,089</u>	<u>\$ 7,804</u>	<u>\$ 6,038</u>
<b>PER COMMON SHARE DATA:</b>			
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)*

	<b>Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
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	<u>\$ 8,209</u>	<u>\$ 3,139</u>	<u>\$ 6,827</u>

- (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.*

(Dollars in thousands, except share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b>Balance, January 1, 2015</b>	\$ 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
<b>Balance, December 31, 2015</b>	—	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
<b>Balance, December 31, 2016</b>	—	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)	—
<b>Balance, December 31, 2017</b>	\$ 0	\$ 4,242	\$ 40,970	\$ 32,565	\$ (2,074)	\$ 75,703

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

## 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)
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
<b>Net Cash Provided By Financing Activities</b>	<b>129,443</b>	<b>97,640</b>	<b>29,131</b>
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
<b>Cash and cash equivalents, end of year</b>	<b>\$ 23,514</b>	<b>\$ 45,973</b>	<b>\$ 13,284</b>

**MID PENN BANCORP, INC.**
**Consolidated Statements of Cash Flows**
*(Dollars in thousands)*

	<b>Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<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
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 129,761</u>
<b>Liabilities Assumed:</b>			
Deposits	\$ —	\$ —	\$ 123,238
Accrued interest payable	—	—	32
Long-term debt	—	—	3,570
Other liabilities	—	—	876
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 127,716</u>
<b>Equity Acquired:</b>			
Preferred stock	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,750</u>

*The accompanying notes are an integral part of these 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.

(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.

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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.



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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.

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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.

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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.

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Loans acquired through business combinations that do 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.

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### (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.

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### (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 Scottsdale 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.

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### (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.

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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	<u>143,707</u>
Liabilities assumed:	
Deposits	123,238
FHLB borrowings	3,570
Other liabilities	908
Total liabilities assumed	<u>127,716</u>
Equity acquired:	
Preferred stock	1,750
Total equity acquired and liabilities assumed	<u>129,466</u>
Consideration paid	<u>\$ 14,241</u>
Cash paid	\$ 2,949
Fair value of common stock issued, including replacement equity awards	11,292



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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	<u>\$ 2,902</u>

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	<u>\$ 110,363</u>

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	<u>\$ 2,286</u>

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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)*

	<b>Unrealized (Loss) Gain on Securities</b>		<b>Defined Benefit Plan Liability</b>		<b>Accumulated Other Comprehensive (Loss) Income</b>	
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.

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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)*

<b>December 31, 2017</b>	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
<i>Available for sale securities:</i>				
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	<u>96,198</u>	<u>14</u>	<u>2,747</u>	<u>93,465</u>
<i>Held to maturity securities:</i>				
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	<u>101,356</u>	<u>41</u>	<u>914</u>	<u>100,483</u>
Total	<u>\$ 197,554</u>	<u>\$ 55</u>	<u>\$ 3,661</u>	<u>\$ 193,948</u>

*(Dollars in thousands)*

<b>December 31, 2016</b>	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
<i>Available for sale securities:</i>				
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
	<u>\$ 138,048</u>	<u>\$ 142</u>	<u>\$ 4,565</u>	<u>\$ 133,625</u>

*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.

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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
<b>December 31, 2017</b>									
Available for sale securities:									
U.S. Treasury and U.S. government agencies	3	\$ 5,008	\$ 184	18	\$ 33,722	\$ 1,211	21	\$ 38,730	\$ 1,395
Mortgage-backed U.S. government agencies	4	5,267	75	15	20,497	494	19	25,764	569
State and political subdivision obligations	11	6,144	102	40	19,091	637	51	25,235	739
Corporate debt securities	0	—	—	0	—	—	0	—	—
Equity securities	0	—	—	1	506	44	1	506	44
Total temporarily impaired available for sale securities	18	16,419	361	74	73,816	2,386	92	90,235	2,747
Held to maturity securities:									
U.S. Treasury and U.S. government agencies	0	\$ —	\$ —	4	\$ 10,894	\$ 90	4	\$ 10,894	\$ 90
Mortgage-backed U.S. government agencies	0	—	—	35	52,949	523	35	52,949	523
State and political subdivision obligations	0	—	—	77	29,976	301	77	29,976	301
Corporate debt securities	0	—	—	0	—	—	0	—	—
Equity securities	0	—	—	0	—	—	0	—	—
Total temporarily impaired held to maturity securities	0	—	—	116	93,819	914	116	93,819	914
<b>Total</b>	<b>18</b>	<b>\$ 16,419</b>	<b>\$ 361</b>	<b>190</b>	<b>\$ 167,635</b>	<b>\$ 3,300</b>	<b>208</b>	<b>\$ 184,054</b>	<b>\$ 3,661</b>

(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
<b>December 31, 2016</b>									
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.

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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.

	For the year ended December 31,		
	2017	2016	2015
Realized gains	\$ 246	\$ 1,927	\$ 325
Realized losses	(204)	(881)	—
Net gains	<u>\$ 42</u>	<u>\$ 1,046</u>	<u>\$ 325</u>

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

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>December 31, 2017</b>				
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
	<u>69,250</u>	<u>67,128</u>	<u>47,884</u>	<u>47,534</u>
Mortgage-backed securities	26,398	25,831	53,472	52,949
Equity securities	550	506	—	—
	<u>\$ 96,198</u>	<u>\$ 93,465</u>	<u>\$ 101,356</u>	<u>\$ 100,483</u>

### (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)

<b>December 31, 2017</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Total</b>
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
	<u>\$ 892,622</u>	<u>\$ 2,332</u>	<u>\$ 15,450</u>	<u>\$ —</u>	<u>\$ 910,404</u>

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(Dollars in thousands)

<b>December 31, 2016</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Total</b>
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
	<u>\$ 799,937</u>	<u>\$ 3,071</u>	<u>\$ 10,916</u>	<u>\$ —</u>	<u>\$ 813,924</u>

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

	<u>December 31, 2017</u>			<u>December 31, 2016</u>		
	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>
<i>(Dollars in thousands)</i>						
<u>With no related allowance recorded:</u>						
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	—	—	—	—	—	—
<u>With no related allowance recorded and acquired with credit deterioration:</u>						
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	—	—	—	—	—	—
<u>With an allowance recorded:</u>						
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
Consumer	—	—	—	—	—	—
<u>Total:</u>						
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.

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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:

<i>(Dollars in thousands)</i>	<b>December 31, 2017</b>		<b>December 31, 2016</b>		<b>December 31, 2015</b>	
	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<b><u>With no related allowance recorded:</u></b>						
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	—	—	—	—	—	—
<b><u>With no related allowance recorded and acquired with credit deterioration:</u></b>						
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	—	—	—	—	—	—
<b><u>With an allowance recorded:</u></b>						
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	—	—	—	—	—	—
<b><u>Total:</u></b>						
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:

<i>(Dollars in thousands)</i>	<b>2017</b>	<b>2016</b>
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
	<u>\$ 10,575</u>	<u>\$ 4,658</u>

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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)*

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



**MID PENN BANCORP, INC.**

(Dollars in thousands)

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

**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)

December 31, 2017	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
<b>Allowance for loan and lease losses:</b>									
Beginning balance	\$ 1,580	\$ 4,323	\$ 144	\$ 1	\$ 541	\$ 379	\$ 3	\$ 212	\$ 7,183
Charge-offs	(25)	(322)	—	—	(102)	(20)	(28)	—	(497)
Recoveries	26	553	—	—	4	5	7	—	595
Provisions	214	(119)	34	(1)	(15)	59	21	132	325
Ending balance	1,795	4,435	178	—	428	423	3	344	7,606
Ending balance: individually evaluated for impairment	136	293	100	—	—	—	—	—	529
Ending balance: collectively evaluated for impairment	\$ 1,659	\$ 4,142	\$ 78	\$ -	\$ 428	\$ 423	\$ 3	\$ 344	\$ 7,077
<b>Loans receivable:</b>									
Ending balance	\$ 188,033	\$ 515,012	\$ 62,336	\$ 229	\$ 99,033	\$ 41,893	\$ 3,868	\$ —	\$ 910,404
Ending balance: individually evaluated for impairment	4,434	4,847	487	—	760	260	—	—	10,788
Ending balance: acquired with credit deterioration	—	555	—	—	306	—	—	—	861
Ending balance: collectively evaluated for impairment	\$ 183,599	\$ 509,610	\$ 61,849	\$ 229	\$ 97,967	\$ 41,633	\$ 3,868	\$ —	\$ 898,755

**MID PENN BANCORP, INC.**

(Dollars in thousands)

December 31, 2016	<b>Commercial and industrial</b>	<b>Commercial real estate</b>	<b>Commercial real estate - construction</b>	<b>Lease financing</b>	<b>Residential mortgage</b>	<b>Home equity</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance for loan and lease losses:</b>									
Beginning balance	\$ 1,393	\$ 3,552	\$ 153	\$ 1	\$ 534	\$ 317	\$ 12	\$ 206	\$ 6,168
Charge-offs	(820)	(216)	—	—	(4)	(25)	(42)	—	(1,107)
Recoveries	4	211	—	—	26	-	11	—	252
Provisions	1,003	776	(9)	-	(15)	87	22	6	1,870
Ending balance	1,580	4,323	144	1	541	379	3	212	7,183
Ending balance: individually evaluated for impairment	6	711	72	—	68	1	—	—	858
Ending balance: collectively evaluated for impairment	\$ 1,574	\$ 3,612	\$ 72	\$ 1	\$ 473	\$ 378	\$ 3	\$ 212	\$ 6,325
<b>Loans receivable:</b>									
Ending balance	\$ 172,518	\$ 446,524	\$ 54,376	\$ 425	\$ 99,457	\$ 37,608	\$ 3,016	\$ —	\$ 813,924
Ending balance: individually evaluated for impairment	60	3,246	860	—	916	140	—	—	5,222
Ending balance: acquired with credit deterioration	—	842	—	—	389	—	—	—	1,231
Ending balance: collectively evaluated for impairment	\$ 172,458	\$ 442,436	\$ 53,516	\$ 425	\$ 98,152	\$ 37,468	\$ 3,016	\$ —	\$ 807,471

**MID PENN BANCORP, INC.**

(Dollars in thousands)

<b>December 31, 2015</b>	<b>Commercial and industrial</b>	<b>Commercial real estate</b>	<b>Commercial real estate - construction</b>	<b>Lease financing</b>	<b>Residential mortgage</b>	<b>Home equity</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance for loan and lease losses:</b>									
<b>Beginning</b>									
Balance	\$ 1,393	\$ 3,925	\$ 33	\$ 2	\$ 450	\$ 653	\$ 35	\$ 225	\$ 6,716
Charge-offs	(130)	(1,569)	—	—	(35)	(36)	(14)	—	(1,784)
Recoveries	12	75	—	—	44	29	11	—	171
Provisions	118	1,121	120	(1)	75	(329)	(20)	(19)	1,065
Ending balance	1,393	3,552	153	1	534	317	12	206	6,168
<b>Ending balance:</b>									
individually evaluated for impairment									
	51	429	—	—	23	—	—	—	503
<b>Ending balance:</b>									
collectively evaluated for impairment									
	\$ 1,342	\$ 3,123	\$ 153	\$ 1	\$ 511	\$ 317	\$ 12	\$ 206	\$ 5,665
<b>Loans receivable:</b>									
Ending balance	\$ 160,261	\$ 369,464	\$ 68,068	\$ 727	\$ 100,665	\$ 33,411	\$ 3,917	\$ —	\$ 736,513
<b>Ending balance:</b>									
individually evaluated for impairment									
	127	2,970	—	—	1,361	115	—	—	4,573
<b>Ending balance:</b>									
acquired with credit deterioration									
	—	931	—	—	400	—	—	—	1,331
<b>Ending balance:</b>									
collectively evaluated for impairment									
	\$ 160,134	\$ 365,563	\$ 68,068	\$ 727	\$ 98,904	\$ 33,296	\$ 3,917	\$ —	\$ 730,609

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

(Dollars in thousands)

<b>December 31, 2017</b>	<b>Pre-Modification</b>		<b>Post-Modification</b>	
	<b>Outstanding Investment</b>	<b>Recorded Investment</b>	<b>Outstanding Investment</b>	<b>Recorded Investment</b>
Commercial and industrial	\$ 4,110	\$ 4,460	\$ 4,460	\$ 4,434
Commercial real estate	5,735	5,581	5,581	4,593
Residential mortgage	691	689	689	544
	\$ 10,536	\$ 10,730	\$ 10,730	\$ 9,571

(Dollars in thousands)

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

## MID PENN BANCORP, INC.

At December 31, 2017, Mid Penn's troubled debt restructured loans totaled \$9,571,000, and included four loans, totaling \$544,000, representing accruing impaired loans in compliance with the terms of the modification. Of the \$544,000, three are accruing impaired residential mortgages to unrelated borrowers totaling \$540,000 and the other one is an accruing impaired home equity loan of \$4,000. The remaining \$9,027,000 of troubled debt restructured loans represent fifteen loans among seven relationships, are nonaccrual impaired loans, and resulted in a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$7,284,000 of the \$9,027,000 nonaccrual impaired troubled debt restructured loan total. As a result of the evaluation, a specific allocation and, subsequently, charge-offs have been taken as appropriate. As of December 31, 2017, there was \$66,000 of charge-offs associated with troubled debt restructured loans while under a forbearance agreement. 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. There were also no defaults on troubled debt restructured loans within twelve months of restructure during 2017. One forbearance agreement was negotiated during 2008, six forbearance agreements were negotiated during 2009, one was negotiated during 2013, one was negotiated during 2014, and ten were negotiated during 2017.

At December 31, 2016, Mid Penn's troubled debt restructured loans totaled \$3,515,000, and included five loans, totaling \$877,000, representing accruing impaired loans in compliance with the terms of the modification. Of the \$877,000, four were accruing impaired residential mortgages to unrelated borrowers totaling \$571,000 and the other one was an accruing impaired commercial real estate loan for \$306,000. The remaining \$2,638,000 of troubled debt restructured loans represent ten loans among four relationships, were nonaccrual impaired loans, and resulted in a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$2,170,000 of the \$2,638,000 nonaccrual impaired troubled debt restructured loan total. As a result of the evaluation, a specific allocation and, subsequently, charge-offs have been taken as appropriate. As of December 31, 2016, there were no charge-offs associated with troubled debt restructured loans while under a forbearance agreement. As of December 31, 2016, there were no defaulted troubled debt restructured loans, as all troubled debt restructured loans were current with respect to their associated forbearance agreements. There were also no defaults on troubled debt restructured loans within twelve months of restructure during 2016. One forbearance agreement was negotiated during 2008, eight forbearance agreements were negotiated during 2009, two were negotiated during 2013, one was negotiated during 2014, and three were negotiated during 2016.

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

There were ten loans modified in 2017 and three loans modified in 2016 that resulted in troubled debt restructurings. There were no loans modified in 2015 that resulted in troubled debt restructurings. The following table summarizes the loans whose terms have been modified resulting in troubled debt restructurings during the year ended December 31, 2017.

*(Dollars in thousands)*

	<b>Number of Contracts</b>	<b>Pre- Modification Outstanding Recorded Investment</b>	<b>Post- Modification Outstanding Recorded Investment</b>	<b>Recorded Investment</b>
<b>December 31, 2017</b>				
Commercial and industrial	1	\$ 4,110	\$ 4,460	\$ 4,434
Commercial real estate	9	3,212	3,150	3,140
	10	\$ 7,322	\$ 7,610	\$ 7,574

The following table provides activity for the accretable yield of purchased impaired loans for the year ended December 31, 2017.

*(Dollars in thousands)*

Accretable yield, January 1, 2017	\$ 67
Accretable yield amortized to interest income	(23)
Reclassification from nonaccretable difference (a)	23
Accretable yield, December 31, 2017	\$ 67

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

## MID PENN BANCORP, INC.

The Bank has granted loans to certain of its executive officers, directors, and their related interests. The aggregate amount of these loans was \$15,163,000 and \$17,634,000 at December 31, 2017 and 2016, respectively. During 2017, \$2,178,000 of new loans and advances were extended and repayments totaled \$4,649,000. None of these loans were past due, in nonaccrual status, or restructured at December 31, 2017.

### (9) **Bank Premises and Equipment**

At December 31, 2017 and 2016, bank premises and equipment are as follows:

*(Dollars in thousands)*

	2017	2016
Land	\$ 3,564	\$ 2,315
Buildings	8,632	9,517
Furniture, fixtures, and equipment	8,262	8,184
Leasehold improvements	1,126	1,432
Construction in progress	4,467	89
Total cost	26,051	21,537
Less accumulated depreciation	(9,883)	(10,463)
Net book value of bank premises and equipment	16,168	11,074
Assets held for sale	-	1,894
Total bank premises and equipment	<u>\$ 16,168</u>	<u>\$ 12,968</u>

There were no premises and equipment classified as held for sale as of December 31, 2017. As of December 31, 2016, assets held-for-sale consisted of three full service retail banking properties. These properties were transferred from land and buildings to assets held for sale during 2016 due to Mid Penn's intent to sell them during January 2017. An impairment charge of \$142,000 was recorded on one of the properties at December 31, 2016 and included as a separate component in noninterest expense on the Consolidated Statements of Income. On January 20, 2017, Mid Penn consummated the sale of the three properties for an aggregate purchase price of \$2,240,000, which exceeds Mid Penn's combined carrying value by approximately \$346,000. Two of the properties are being leased back by Mid Penn for a period of at least 15 years, and the respective gains on the sales of those properties will be recognized over the life of the leases.

As of December 31, 2017, construction in process included (i) a commercial building and related improvements in Harrisburg, (ii) two vacant and undeveloped lots adjacent to the commercial building; and (iii) land, building, and improvements related to a newly constructed branch in Halifax, PA. The commercial building and adjacent lots in Harrisburg, PA were being renovated as of December 31, 2017 to serve as an administrative center for the Company, replacing two administrative offices which were previously leased. The renovations were substantially completed in February 2018, and Mid Penn employees took occupancy at that time. The new full-service office in Halifax, PA opened on January 8, 2018.

Depreciation expense was \$1,464,000 in 2017, \$1,658,000 in 2016, and \$1,485,000 in 2015.

#### **Operating Leases:**

As of December 31, 2017, Mid Penn was obligated to utilize certain premises under certain non-cancelable operating leases, which expire at various dates through the year ending December 31, 2035. Many of these leases contain renewal options and certain leases contain escalation clauses calling for rentals to be adjusted for increased real estate taxes and other operating expenses, or proportionately adjusted for increases in consumer or other price indices. Four of Mid Penn's operating leases are with related parties. The rental expense paid to related parties was \$352,000 in 2017, \$348,000 in 2016, and \$279,000 in 2015. The future minimum payments to related parties are \$328,000 (2018), \$304,000 (2019), \$305,000 (2020), \$213,000 (2021), \$182,000 (2022) and \$1,937,000 thereafter.

In 2016, Mid Penn entered into two subleasing agreements with escalation clauses to two unrelated parties. The first sublease agreement began on April 1, 2016, while the second sublease began on July 1, 2016. Both subleases end on March 31, 2021.

## MID PENN BANCORP, INC.

The following summary reflects the future minimum rental payments by year under Mid Penn's operating leases as of December 31, 2017, including a breakdown of the sublease rental income and future minimum payments owed to related parties.

*(Dollars in thousands)*

	<b>Lease Obligation</b>	<b>Sublease Rental Income</b>	<b>Net Rental Expense</b>
2018	1,171	79	1,092
2019	975	81	894
2020	790	81	709
2021	617	20	597
2022	564	—	564
thereafter	5,113	—	5,113
	<u>\$ 9,230</u>	<u>\$ 261</u>	<u>\$ 8,969</u>

Rental expense in connection with leases was \$1,087,000 in 2017, \$716,000 in 2016, and \$627,000 in 2015.

### (10) Deposits

At December 31, 2017 and 2016, time deposits amounted to \$201,623,000 and \$182,595,000, respectively. Interest expense on certificates of deposit amounted to \$2,570,000, \$2,156,000, and \$1,920,000 for the years ended December 31, 2017, 2016 and 2015, respectively. The aggregate amount of demand deposit overdrafts that were reclassified as loans were \$136,000 at December 31, 2017, compared to \$285,000 as of December 31, 2016.

Time deposits at December 31, 2017, mature as follows:

*(Dollars in thousands)*

	<b>Time Deposits</b>	
	<b>Less than \$250,000</b>	<b>\$250,000 or more</b>
Maturing in 2018	\$ 74,304	\$ 29,736
Maturing in 2019	38,810	4,811
Maturing in 2020	24,380	885
Maturing in 2021	16,987	309
Maturing in 2022	8,984	1,452
Maturing thereafter	965	—
	<u>\$ 164,430</u>	<u>\$ 37,193</u>

Brokered deposits included in the time deposit totals equaled \$19,447,000 at December 31, 2017 and \$13,567,000 at December 31, 2016. Deposits and other funds from related parties held by Mid Penn at December 31, 2017 and 2016 amounted to \$20,262,000 and \$19,279,000, respectively.

### (11) Short-term Borrowings

Short-term borrowings generally have original terms of less than thirty days. Mid Penn's short-term borrowings totaled \$34,611,000 at December 31, 2017 and consisted entirely of federal funds purchased with a rate of 1.54%. There were no short-term borrowings at December 31, 2016. The Bank also has short-term borrowing capacity from the FHLB 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. The Bank also has unused overnight lines of credit with other correspondent banks amounting to \$15,000,000 at December 31, 2017.

## MID PENN BANCORP, INC.

### (12) Long-term Debt

The Bank is a member of the FHLB and through its membership, the Bank can access a number of credit products, which are utilized to provide liquidity. As of December 31, 2017 and 2016, the Bank had long-term debt outstanding in the amount of \$12,352,000 and \$13,581,000, respectively, consisting of:

<i>(Dollars in thousands)</i>	<b>At December 31,</b>	
	<b>2017</b>	<b>2016</b>
Loans maturing in 2017 at a rate of 3.03%	\$ —	\$ 1,016
Loan maturing in 2019 at a rate of 1.87%	10,000	10,000
Loan maturing in 2026 at a rate of 4.80%	2,295	2,504
Loan maturing in 2027 at a rate of 6.71%	57	61
	<u>\$ 12,352</u>	<u>\$ 13,581</u>

The aggregate principal amounts due on long-term debt subsequent to December 31, 2017 are \$223,000 (2018), \$10,235,000 (2019), \$246,000 (2020), \$258,000 (2021), \$271,000 (2022) and \$1,119,000 thereafter.

### (13) 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 times 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.

Holders 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, its principal banking subsidiary. As of December 31, 2017, related parties held \$1,450,000 of the 2017 Notes.

#### *Subordinated Debt Issued December 2015*

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

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 times be less than 4.0%. Interest will be payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, and began 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.



## MID PENN BANCORP, INC.

Holders of the 2015 Notes may not accelerate the maturity of the 2015 Notes, except upon Mid Penn's or Mid Penn Bank, its principal banking subsidiary's, bankruptcy, insolvency, liquidation, receivership or similar event. As of December 31, 2017, related parties held \$1,930,000 of the 2015 Notes.

### (14) Fair Value Measurement

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

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

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. Fair value measurement and disclosure guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

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

**MID PENN BANCORP, INC.**

There were no transfers of assets between fair value Level 1 and Level 2 for the years ended December 31, 2017 or 2016. The following tables illustrate the assets measured at fair value on a recurring basis segregated by hierarchy fair value levels:

(Dollars in thousands)

	Total carrying value at December 31, 2017	Fair value measurements at December 31, 2017 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
U.S. Treasury and U.S. government agencies	\$ 38,730	\$ —	\$ 38,730	\$ —
Mortgage-backed U.S. government agencies	25,831	—	\$ 25,831	—
State and political subdivision obligations	27,043	—	\$ 27,043	—
Corporate debt securities	1,005	—	\$ 1,005	—
Equity securities	856	856	—	—
	<u>\$ 93,465</u>	<u>\$ 856</u>	<u>\$ 92,609</u>	<u>\$ —</u>

(Dollars in thousands)

	Total carrying value at December 31, 2016	Fair value measurements at December 31, 2016 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
U.S. Treasury and U.S. government agencies	\$ 47,012	\$ 1,864	\$ 45,148	\$ —
Mortgage-backed U.S. government agencies	25,619	—	25,619	—
State and political subdivision obligations	58,838	—	58,838	—
Corporate debt securities	1,000	—	1,000	—
Equity securities	1,156	1,056	100	—
	<u>\$ 133,625</u>	<u>\$ 2,920</u>	<u>\$ 130,705</u>	<u>\$ —</u>

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

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

(Dollars in thousands)

	Total carrying value at December 31, 2017	Fair value measurements at December 31, 2017 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets:</b>				
Impaired Loans	\$ 6,090	\$ —	\$ —	\$ 6,090
Foreclosed Assets Held for Sale	—	—	—	—
Mortgage Servicing Rights	126	—	—	126

**MID PENN BANCORP, INC.**

**Fair value measurements at December 31, 2016  
using:**

(Dollars in thousands)

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

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

(Dollars in thousands)

December 31, 2017	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
Impaired Loans	\$ 6,090	Appraisal of collateral (a)	Appraisal adjustments (b)	6% - 51%	28%
Foreclosed Assets Held for Sale	—	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	0% - 0%	0%
Mortgage Servicing Rights	126	Multiple of annual service fee	Estimated prepayment speed based on rate and term	70% - 100%	98%

(Dollars in thousands)

December 31, 2016	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
Impaired Loans	\$ 2,404	Appraisal of collateral (a)	Appraisal adjustments (b)	11% - 70%	30%
Foreclosed Assets Held for Sale	135	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	26% - 31%	27%
Mortgage Servicing Rights	144	Multiple of annual service fee	Estimated prepayment speed based on rate and term	70% - 100%	98%

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

The following methodologies and assumptions were used to estimate the fair value of certain assets and liabilities:

Cash and Cash Equivalents:

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

Interest-bearing Balances with other Financial Institutions:

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

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### Securities Available for sale:

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

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

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

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate as soon as practically possible of the credit being classified as substandard nonaccrual. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance issues; however, no allowance recommendation will be made until Mid Penn is in receipt of the updated valuation.

In some instances Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide a fair estimate of value based on auction sales or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary. Mid Penn considers the estimates used in its impairment analysis to be Level 3 inputs.

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

### Loans:

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

### Foreclosed Assets Held for Sale:

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

### Accrued Interest Receivable and Payable:

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

### Restricted Investment in Bank Stocks:

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

### Mortgage Servicing Rights:

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

### Deposits:

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

### Short-term Borrowings:

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

### Long-term Borrowings and Subordinated Debt:

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

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Commitments to Extend Credit and Letters of Credit:

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

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

(Dollars in thousands)

	December 31, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 23,514	\$ 23,514	\$ 45,973	\$ 45,973
Available for sale investment securities	93,465	93,465	133,625	133,625
Held to maturity investment securities	101,356	100,483	—	—
Net loans and leases	902,798	917,081	806,741	824,293
Restricted investment in bank stocks	4,384	4,384	2,443	2,443
Accrued interest receivable	4,564	4,564	3,928	3,928
Mortgage servicing rights	126	126	144	144
<b>Financial liabilities:</b>				
Deposits	\$ 1,023,568	\$ 1,026,830	\$ 935,373	\$ 935,075
Short-term borrowings	34,611	34,611	—	—
Long-term debt	12,352	11,692	13,581	13,614
Subordinated debt	17,338	17,358	7,414	7,534
Accrued interest payable	645	645	515	515
<b>Off-balance sheet financial instruments:</b>				
Commitments to extend credit	\$ —	\$ —	\$ —	\$ —
Financial standby letters of credit	—	—	—	—

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of Mid Penn's financial instruments as of December 31, 2017 and 2016. Carrying values approximate fair values for cash and cash equivalents, interest-bearing time balances with other financial institutions, restricted investment in bank stocks, accrued interest receivable and payable, and short-term borrowings. Other than cash and cash equivalents, which are considered Level 1 Inputs, these instruments are Level 2 Inputs. The following tables exclude financial instruments for which the placement in the fair value hierarchy has been disclosed elsewhere or for which the carrying amount approximates fair value.

	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2017</b>					
Financial instruments - assets					
Net loans and leases	\$ 902,798	\$ 917,081	\$ —	\$ —	\$ 917,081
Financial instruments - liabilities					
Deposits	\$1,023,568	\$1,026,830	\$ —	\$ 1,026,830	\$ —
Long-term debt	12,352	11,692	—	11,692	—
Subordinated debt	17,338	17,358	—	—	17,358

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(Dollars in thousands)

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

**(15) Postretirement Benefit Plans**

Mid Penn has an unfunded noncontributory defined benefit plan for directors, which provides defined benefits based on the respective director's years of service.

Mid Penn also has other postretirement healthcare and life insurance benefit plans, which are noncontributory, covering certain full-time employees.

The significant aspects of each of these plans are as follows:

**(a) Health Insurance**

Full-time employees who had at least 10 years of service as of January 1, 2008 and who retire at age 55 or later, after completion of at least 20 years of service, are eligible for medical benefits. Employees who retired prior to December 31, 2015 may elect the least expensive single coverage in the employer's group medical plan. If the retiree becomes eligible for Medicare during the five year duration of coverage, the Bank will pay, at its discretion, premiums for single 65-special coverage or similar supplemental coverage. For those employees who retired between September 18, 2015 and December 31, 2015, the Bank will only pay up to \$5,000 towards such medical coverage. Employees who retired after December 31, 2015 may not participate in the employer's group medical plan. Instead, the Bank will reimburse the retiree for up to \$5,000 in medical costs.

**(b) Life Insurance**

Full-time employees who had at least ten years of service as of January 1, 2008 and retire with the Bank after age 55 and at least 20 years of service are eligible for term life insurance coverage. The insurance amount will be \$50,000 until age 65. After age 65, the insurance amount will decrease by \$5,000 per year until age 74. Thereafter, the insurance amount will be \$5,000.

**(c) Directors' Retirement Plan**

Mid Penn has an unfunded defined benefit retirement plan for directors with benefits based on years of service. The adoption of this plan generated unrecognized prior service cost of \$274,000, which is being amortized over the expected future years of service of active directors. The unamortized balance at December 31, 2017, was \$22,000.

The accrued benefit liability and related income statement impacts of the postretirement healthcare and life insurance benefit plans, as well as the Director's retirement plan, are detailed in the tables below.

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*Health and Life*

The following tables provide a reconciliation of the changes in the plan's health and life insurance benefit obligations and fair value of plan assets for the years ended December 31, 2017 and 2016, and a statement of the funded status at December 31, 2017 and 2016.

*(Dollars in thousands)*

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Change in benefit obligations:		
Benefit obligations, January 1	\$ 540	\$ 572
Service cost	4	4
Interest cost	20	23
Change in experience	(11)	2
Change in assumptions	20	13
Change due to plan amendment	—	—
Benefit payments	(65)	(74)
Benefit obligations, December 31	<u>\$ 508</u>	<u>\$ 540</u>
Change in fair value of plan assets:		
Fair value of plan assets, January 1	\$ —	\$ —
Employer contributions	65	74
Benefit payments	(65)	(74)
Fair value of plan assets, December 31	\$ —	\$ —
Funded status at year end	<u>\$ (508)</u>	<u>\$ (540)</u>

Mid Penn has capped the benefit to future retirees under its post-retirement health benefit plan. Employees who had achieved ten years of service as of January 1, 2008 and subsequently retire after at least 20 years of service are eligible for reimbursement of major medical insurance premiums up to \$5,000, if the employee has not yet reached age 65. Upon becoming eligible for Medicare, Mid Penn will reimburse up to \$5,000 in premiums for Medicare Advantage or a similar supplemental coverage. The maximum reimbursement period will not exceed five years regardless of retirement age and will end upon the participant obtaining other employment where major medical coverage is available or the participant's death.

The amount recognized in the consolidated balance sheets at December 31, 2017 and 2016, is as follows:

*(Dollars in thousands)*

	<b>2017</b>	<b>2016</b>
Accrued benefit liability	\$ 508	\$ 540

The amounts recognized in accumulated other comprehensive loss consist of:

*(Dollars in thousands)*

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Net gain, pretax	\$ (22)	\$ (31)
Net prior service cost, pretax	(174)	(209)

The accumulated benefit obligation for health and life insurance plans was \$508,000 and \$540,000 at December 31, 2017 and 2016, respectively.

There will be \$25,000 in estimated prior service costs amortized from accumulated other comprehensive income into net periodic benefit cost during 2018.

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The components of net periodic postretirement benefit (income) cost for 2017, 2016 and 2015 are as follows:

*(Dollars in thousands)*

	<b>2017</b>	<b>2016</b>	<b>2015</b>
Service cost	\$ 4	\$ 4	\$ 13
Interest cost	20	23	32
Amortization of prior service cost	(35)	(35)	-
Net periodic postretirement benefit (income) cost	<u>\$ (11)</u>	<u>\$ (8)</u>	<u>\$ 45</u>

Assumptions used in the measurement of Mid Penn's benefit obligations at December 31, 2017 and 2016 are as follows:

Weighted-average assumptions:	<b>2017</b>	<b>2016</b>
Discount rate	3.50%	4.00%
Rate of compensation increase	2.50%	3.00%

Assumptions used in the measurement of Mid Penn's net periodic benefit cost for the years ended December 31, 2017, 2016 and 2015 are as follows:

Weighted-average assumptions:	<b>2017</b>	<b>2016</b>	<b>2015</b>
Discount rate	4.00%	4.25%	4.00%
Rate of compensation increase	3.00%	3.25%	3.00%

Assumed health care cost trend rates at December 31, 2017, 2016 and 2015 are as follows:

	<b>2017</b>	<b>2016</b>	<b>2015</b>
Health care cost trend rate assumed for next year	6.00%	6.00%	5.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.40%	5.50%	5.50%
Year that the rate reaches the ultimate trend rate	2024	2018	2016

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. At December 31, 2017, a one-percentage-point change in assumed health care cost trend rates would have the following effects:

*(Dollars in thousands)*

	<b>One-Percentage Point</b>	
	<b>Increase</b>	<b>Decrease</b>
Effect on total of service and interest cost	\$ —	\$ 2
Effect on accumulated postretirement benefit obligation	3	4

Mid Penn expects to contribute \$60,000 to its life and health benefit plans in 2018. The following table shows the estimated benefit payments for future periods.

*(Dollars in thousands)*

1/1/2018 to 12/31/2018	\$ 60
1/1/2019 to 12/31/2019	61
1/1/2020 to 12/31/2020	55
1/1/2021 to 12/31/2021	31
1/1/2022 to 12/31/2022	32
1/1/2023 to 12/31/2027	160



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*Retirement Plan*

The following tables provide a reconciliation of the changes in the directors' defined benefit plan's benefit obligations and fair value of plan assets for the years ended December 31, 2017 and 2016, and a statement of the status at December 31, 2017 and 2016. This Plan is unfunded.

*(Dollars in thousands)*

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Change in benefit obligations:		
Benefit obligations, January 1	\$ 1,122	\$ 1,150
Service cost	35	34
Interest cost	43	46
Actuarial gain (loss)	6	(13)
Change in assumptions	2	(4)
Benefit payments	(92)	(91)
Benefit obligations, December 31	<u>\$ 1,116</u>	<u>\$ 1,122</u>
Change in fair value of plan assets:		
Fair value of plan assets, January 1	\$ —	\$ —
Employer contributions	92	91
Benefit payments	(92)	(91)
Fair value of plan assets, December 31	<u>\$ —</u>	<u>\$ —</u>
Funded status at year end	<u>\$ (1,116)</u>	<u>\$ (1,122)</u>

Amounts recognized in the consolidated balance sheet at December 31, 2017 and 2016 are as follows:

*(Dollars in thousands)*

	<b>2017</b>	<b>2016</b>
Accrued benefit liability	\$ 1,116	\$ 1,122

Amounts recognized in accumulated other comprehensive loss consist of:

*(Dollars in thousands)*

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Net prior service cost, pretax	\$ 22	\$ 43
Net loss, pretax	67	60

The accumulated benefit obligation for the retirement plan was \$1,116,000 at December 31, 2017 and \$1,122,000 at December 31, 2016.

The estimated prior service costs that will be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2018 is \$22,000.

The components of net periodic retirement cost for 2017, 2016 and 2015 are as follows:

*(Dollars in thousands)*

	<b>2017</b>	<b>2016</b>	<b>2015</b>
Service cost	\$ 35	\$ 34	\$ 33
Interest cost	43	46	45
Amortization of prior-service cost	22	22	22
Net periodic retirement cost	<u>\$ 100</u>	<u>\$ 102</u>	<u>\$ 100</u>

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Assumptions used in the measurement of Mid Penn's benefit obligations at December 31, 2017 and 2016 are as follows:

Weighted-average assumptions:	2017	2016
Discount rate	3.50%	4.00%
Change in consumer price index	1.50%	2.00%

Assumptions used in the measurement of Mid Penn's net periodic benefit cost for the years ended December 31, 2017, 2016 and 2015 are as follows:

Weighted-average assumptions:	2017	2016	2015
Discount rate	4.00%	4.25%	4.00%
Change in consumer price index	2.00%	2.25%	2.25%

Mid Penn expects to contribute \$95,000 to its retirement plan in 2018. The following table shows the estimated benefit payments for future periods.

*(Dollars in thousands)*

1/1/2018 to 12/31/2018	\$ 95
1/1/2019 to 12/31/2019	95
1/1/2020 to 12/31/2020	96
1/1/2021 to 12/31/2021	107
1/1/2022 to 12/31/2022	104
1/1/2023 to 12/31/2027	413

The Bank is the owner and beneficiary of insurance policies on the lives of certain officers and directors, which informally fund the retirement plan obligation. The aggregate cash surrender value of these policies was \$3,905,000 and \$3,834,000 at December 31, 2017 and 2016, respectively.

### (16) Other Benefit Plans

#### (a) 401(k) Plan

The Bank has a 401(k) plan that covers substantially all full-time employees. The plan allows employees to contribute a portion of their salaries and wages to the plan and provides for the Bank to match a portion of employee-elected salary deferrals, subject to certain percentage maximums of their salaries and wages. The Bank's contribution to the 401(k) Plan was \$383,000, \$362,000, and \$321,000 for the years ending December 31, 2017, 2016, and 2015, respectively.

#### (b) Defined-Contribution Plan

The Bank has a funded contributory defined-contribution plan covering substantially all employees. The Bank did not contribute to the plan in 2017, 2016, or 2015.

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### (c) Deferred Compensation Plans

The Bank has an executive deferred compensation plan, which allows executive officers to defer compensation for a specified period in order to provide future retirement income. The only participant in the Plan is a former executive officer. The Bank accrued a liability for the plan of approximately \$125,000 at December 31, 2017 and \$143,000 at December 31, 2016. The expense related to the plan was \$5,000 in 2017, \$6,000 in 2016, and \$9,000 in 2015.

The Bank also has a directors' deferred compensation plan, which allows directors to defer receipt of director fees for a specified period in order to provide future retirement income. At December 31, 2017 and 2016, the Bank accrued a liability of \$683,000 and \$606,000, respectively, for this plan. The expense related to the plan was \$25,000 in 2017, \$21,000 in 2016, and \$17,000 in 2015.

### (d) Salary Continuation Agreement

The Bank maintains a Salary Continuation Agreement ("Agreement") for a former executive officer. The Agreement provides the former executive officer with a fixed annual benefit. The benefit is payable beginning at age 65 for a period of 15 years. At December 31, 2017 and 2016, the Bank accrued a liability of approximately \$246,000 and \$254,000, respectively, for the Agreement. The expense related to the Agreement was \$17,000 for 2017, \$17,000 for 2016, and \$16,000 for 2015.

The Bank is the owner and beneficiary of an insurance policy on the life of the participating former executive officer, which supports the funding of the benefit obligation. The aggregate cash surrender value of this policy was approximately \$1,317,000 and \$1,284,000 at December 31, 2017 and 2016, respectively.

### (e) Split Dollar Life Insurance Arrangements

At December 31, 2017 and 2016, the Bank had Split Dollar Life Insurance arrangements with two former executives for which the aggregate collateral assignment and cash surrender values are approximately \$1,375,000 and \$1,360,000, respectively. Mid Penn also acquired Phoenix's Split Dollar Life Insurance arrangements in 2015 on select employees, which had aggregate cash surrender value of \$3,924,000 at December 31, 2017 and \$3,838,000 at December 31, 2016.

### (f) Employee Stock Purchase Plan

Mid Penn has an Employee Stock Purchase Plan ("ESPP") in which all employees are eligible to participate. The plan allows employees to use a portion of their salaries and wages to purchase common shares of Mid Penn stock at the market value of shares at the end of each calendar quarter.

	<u>2017</u>	<u>2016</u>	<u>2015</u>
ESPP shares purchased	3,578	4,465	4,162
Average purchase price per share	\$29.027	\$18.520	\$15.865

### (g) Director Stock Purchase Plan

On May 24, 2017, the Board of Directors of Mid Penn approved the Director Stock Purchase Plan ("DSPP"). The purpose of the Plan is to provide non-employee directors of Mid Penn with a convenient means to purchase Corporation common stock at fair market value on the last day of each calendar quarter. The plan was effective beginning July 1, 2017. Participants purchased 1,345 shares at an average purchase price per share of \$31.136 during the year ended December 31, 2017.

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**(17) Federal Income Taxes**

The following temporary differences gave rise to the net deferred tax asset at December 31, 2017 and 2016.

<i>(Dollars in thousands)</i>	<b>2017</b>	<b>2016</b>
Deferred tax assets:		
Allowance for loan and lease losses	\$ 1,597	\$ 2,442
Loan fees	105	82
Deferred compensation	221	341
Benefit plans	320	565
Unrealized loss on securities	574	1,504
Nonaccrual interest	—	955
Business combination adjustments	358	720
Sale/leaseback adjustment	72	—
Other	108	177
	<u>3,355</u>	<u>6,786</u>
Deferred tax liabilities:		
Depreciation	(619)	(1,175)
Bond accretion	(9)	(117)
Goodwill and intangibles	(329)	(500)
Prepaid expenses	(333)	(312)
Business combination adjustments	(176)	(367)
Other	(1)	(29)
	<u>(1,467)</u>	<u>(2,500)</u>
Deferred tax asset, net	<u>\$ 1,888</u>	<u>\$ 4,286</u>

In assessing the realizability of federal or state deferred tax assets, management considers whether it is more likely than not some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and prudent, feasible and permissible as well as available tax planning strategies in making this assessment. Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that Mid Penn will realize the benefits of these deferred tax assets.

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law reducing the federal tax rate to 21% beginning on January 1, 2018. The revaluation of net deferred tax assets as of December 22, 2017 resulted in \$1,169,000 of additional tax expense on the date of enactment included in deferred expense in the tables below.

The provision for income taxes consists of the following:

<i>(Dollars in thousands)</i>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Current expense	\$ 2,672	\$ 2,613	\$ 647
Deferred expense (benefit)	1,828	(336)	997
Total provision for income taxes	<u>\$ 4,500</u>	<u>\$ 2,277</u>	<u>\$ 1,644</u>

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A reconciliation of income tax at the statutory rate of 34% to Mid Penn's effective rate is as follows:

<i>(Dollars in thousands)</i>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Provision at the expected statutory rate	\$ 3,940	\$ 3,428	\$ 2,779
Effect of tax-exempt income	(668)	(1,089)	(1,105)
Effect of investment in life insurance	(89)	(90)	(91)
Nondeductible interest	30	41	37
Nondeductible merger and acquisition expense	191	—	34
Rate change adjustment	1,169	—	—
Other items	(73)	(13)	(10)
Provision for income taxes	<u>\$ 4,500</u>	<u>\$ 2,277</u>	<u>\$ 1,644</u>

Mid Penn has no unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods. Mid Penn does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

No amounts for interest and penalties were recorded in income tax expense in the consolidated statement of income for the years ended December 31, 2017, 2016, or 2015. There were no amounts accrued for interest and penalties at December 31, 2017 or 2016.

Mid Penn and its subsidiaries are subject to U.S. federal income tax and income tax for the state of Pennsylvania. With limited exceptions, Mid Penn is no longer subject to examination by taxing authorities for years before 2014.

### (18) Regulatory Matters

Mid Penn Bancorp, Inc., is a bank holding company and, as such, chooses to maintain a well-capitalized status in its bank subsidiary. Quantitative measures established by regulation to ensure capital adequacy require Mid Penn to maintain minimum amounts and ratios (set forth below) of Tier 1 Capital to average assets and of Total Capital (as defined in the regulations) to risk-weighted assets. As of December 31, 2017 and December 31, 2016, Mid Penn met all capital adequacy requirements to which the Bank is subject, and the Bank is considered "well-capitalized". However, future changes in regulations could increase capital requirements and may have an adverse effect on capital resources.

The federal banking agencies have substantially amended the regulatory risk-based capital rules applicable to Mid Penn. The amendments implemented the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The amended rules included new minimum risk-based capital and leverage ratios, which became effective in January 2015, with certain requirements to be phased in beginning in 2016, and refined the definition of what constitutes "capital" for purposes of calculating those ratios.

The new minimum capital level requirements applicable to Mid Penn include: (i) a new common equity Tier I capital ratio of 4.5%; (ii) a Tier I capital ratio of 6.0% (increased from 4.0 %); (iii) a Total Capital ratio of 8.0% (unchanged from current rules); and (iv) a Tier I leverage ratio of 4.0% for all institutions. The amended rules also establish a "capital conservation buffer" of 2.5% above the new regulatory minimum capital ratios, and would result in the following minimum ratios: (i) a common equity Tier I capital ratio of 7.0%; (ii) a Tier I capital ratio of 8.5%; and (iii) a Total Capital ratio of 10.5%. The new capital conservation buffer requirement was phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions.

**MID PENN BANCORP, INC.**

Certain restrictions exist regarding the ability of the Bank to transfer funds to the Corporation in the form of cash dividends, loans, or advances. The amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years. At December 31, 2017, \$5,259,000 of undistributed earnings of the Bank included in the consolidated shareholders' equity was available for distribution to the Corporation as dividends without prior regulatory approval, subject to regulatory capital requirements below.

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

*(Dollars in thousands)*

	<b>Capital Adequacy</b>					
	<b>Actual</b>		<b>Minimum Capital Required (1)</b>		<b>To Be Well-Capitalized Under Prompt Corrective Action Provisions</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
<b><u>Corporation</u></b>						
<b>As of December 31, 2017</b>						
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><u>Bank</u></b>						
<b>As of December 31, 2017</b>						
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><u>Corporation</u></b>						
<b>As of December 31, 2016</b>						
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><u>Bank</u></b>						
<b>As of December 31, 2016</b>						
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%
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.

## **MID PENN BANCORP, INC.**

### **(19) Concentration of Risk and Off-Balance Sheet Risk**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for direct, funded loans.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The term of these standby letters of credit is generally one year or less. The amount of the liability as of December 31, 2017 and 2016 for guarantees under letters of credit issued is not material.

As of December 31, 2017, commitments to extend credit amounted to \$199,240,000 and standby letters of credit amounted to \$20,496,000. As of December 31, 2016, commitments to extend credit amounted to \$201,749,000 and standby letters of credit amounted to \$14,000,000.

Additionally, Mid Penn has sold loans to the FHLB as part of its Mortgage Partnership Finance Program ("Program). Under the terms of the Program, there is limited recourse back to Mid Penn for loans that do not perform in accordance with the terms of the loan agreement. Each loan that is sold under the Program is "credit enhanced" such that the individual loan's rating is raised to "BBB", as determined by the FHLB. The Program can be terminated by either the FHLB or Mid Penn, without cause, by giving notice to the other party. The FHLB has no obligation to commit to purchase any mortgage through, or from, Mid Penn. The total balance of loans sold under the Program was \$7,314,000 and \$9,206,000 for the years ended December 31, 2017 and 2016.

Significant concentration of credit risk may occur when obligations of parties engaged in similar activities occur and accumulate in significant amounts.

In analyzing the Bank's exposure to significant concentration of credit risk, management set a parameter of 10% or more of the Bank's total net loans outstanding as the threshold in determining whether the obligations of the same or affiliated parties would be classified as significant concentration of credit risk. Concentrations by industry, product line, type of collateral, etc., are also considered. U.S. Treasury securities, obligations of U.S. government agencies and corporations, and any assets collateralized by the same were excluded.

As of December 31, 2017, commercial real estate financing was the only similar activity that met the requirements to be classified as a significant concentration of credit risk. However, there is a geographical concentration in that most of the Bank's business activity is with customers located in Central Pennsylvania, specifically within the Bank's trading area made up of Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties.

The Bank's highest concentrations of credit within the loan portfolio is in commercial real estate financing (51.1 %) as of December 31, 2017.

### **(20) Contingencies**

#### **Litigation:**

Mid Penn is subject to lawsuits and claims arising out of its normal conduct of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial condition of Mid Penn.

## MID PENN BANCORP, INC.

### (21) Common Stock

#### Dividend Reinvestment Plan

Under Mid Penn's amended and restated dividend reinvestment plan ("DRIP"), 330,750 shares of Mid Penn's authorized but unissued common stock are reserved for issuance. The DRIP also allows for voluntary cash payments, within specified limits, to be used for the purchase of additional shares.

#### Restricted Stock Plan

On June 25, 2014, the 2014 Restricted Stock Plan was registered under which awards shall not exceed, in the aggregate, 100,000 shares of common stock. The Plan was established for employees and directors of Mid Penn and the Bank, selected by the Compensation Committee of the Board of Directors, to advance the best interest of Mid Penn and its shareholders. The plan provides those persons who have a responsibility for its growth with additional incentives by allowing them to acquire an ownership interest in Mid Penn and thereby encouraging them to contribute to the success of the company. As of December 31, 2017, 26,955 shares have been granted under the Plan. During 2017, Mid Penn granted 10,440 restricted shares, 6,040 of which were granted to employees while 4,400 were granted to directors. Mid Penn granted 7,540 restricted shares to employees in 2016 and 5,475 restricted shares to employees in 2015. In 2016, 470 of the granted shares were forfeited to Mid Penn due to the termination of employment of a plan participant.

Share-based compensation expense relating to restricted stock is recognized on a straight-line basis over the vesting periods of the awards and is a component of salaries and benefits expense. Restricted shares granted to employees vest in equal amounts on the anniversary of the grant date over a four year vesting period. Restricted shares granted to directors have a twelve month vesting period. The following table presents compensation expense and related tax benefits for restricted stock awards recognized on the consolidated statement of income.

<i>(Dollars in thousands)</i>	2017	2016	2015
Compensation expense	\$ 145	\$ 53	\$ 28
Tax benefit	(49)	(18)	(10)
Net income effect	<u>\$ 96</u>	<u>\$ 35</u>	<u>\$ 18</u>

At December 31, 2017, there was \$440,000 of unrecognized compensation cost related to all non-vested share-based compensation awards. This cost is expected to be recognized through July 2021. Mid Penn recognizes the impact of forfeitures as of the forfeiture date.

The following table presents information regarding the non-vested restricted stock for the year ended December 31, 2017.

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at January 1, 2017	13,055	\$ 17.66
Vested	(3,996)	17.38
Cancelled	—	—
Granted	10,440	26.65
Non-vested at December 31, 2017	<u>19,499</u>	<u>22.54</u>

### (22) Preferred Stock

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



**MID PENN BANCORP, INC.**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 and issued 1,750 shares of its own SBLF Preferred Shares that had a \$1,000 liquidation preference per share, to the Treasury. The SBLF Preferred Shares qualified as Tier 1 Capital and had terms and conditions identical to those shares of preferred stock issued by Phoenix to the Treasury. Mid Penn paid noncumulative dividends payable quarterly on January 1, April 1, July 1, and October 1. The dividend rate was 1.00% per annum for payment dates up to January 19, 2016.

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

**(23) Parent Company Statements****CONDENSED BALANCE SHEETS***(Dollars in thousands)*

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 4,686	\$ 780
Equity investments	—	545
Investment in subsidiaries	89,581	77,029
Other assets	—	40
Total assets	<u>\$ 94,267</u>	<u>\$ 78,394</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Subordinated debt	\$ 17,338	\$ 7,414
Other liabilities	1,226	513
Shareholders' equity	75,703	70,467
Total liabilities and shareholders' equity	<u>\$ 94,267</u>	<u>\$ 78,394</u>

**CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME***(Dollars in thousands)*

	<b>For Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Income</b>			
Dividends from subsidiaries	\$ 9,657	\$ 2,871	\$ 5,662
Other income	19	33	19
Total Income	<u>9,676</u>	<u>2,904</u>	<u>5,681</u>
<b>Expense</b>			
Other expenses	(1,899)	(606)	(695)
Total Expense	<u>(1,899)</u>	<u>(606)</u>	<u>(695)</u>
Income before income tax and equity in undistributed (loss) earnings of subsidiaries	7,777	2,298	4,986
Equity in undistributed (loss) earnings of subsidiaries	(1,136)	5,311	1,346
Income before income tax	6,641	7,609	6,332
Income tax benefit	448	195	196
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	<u>\$ 7,089</u>	<u>\$ 7,804</u>	<u>\$ 6,038</u>
Comprehensive income	<u>\$ 8,209</u>	<u>\$ 3,139</u>	<u>\$ 6,827</u>

**MID PENN BANCORP, INC.**

**CONDENSED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	<b>For Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 7,089	\$ 7,804	\$ 6,528
Equity in undistributed loss (earnings) of subsidiaries	1,136	(5,311)	(1,346)
Decrease (increase) in other assets	240	59	(14)
Increase (decrease) in other liabilities	626	457	(665)
Net cash provided by operating activities	<u>9,091</u>	<u>3,009</u>	<u>4,503</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Net cash paid for acquisition	—	—	(2,949)
Proceeds from the sale of investment securities	618	—	—
Investment in subsidiary	(12,600)	—	—
Net cash used in investing activities	<u>(11,982)</u>	<u>—</u>	<u>(2,949)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Dividends paid	(3,264)	(2,875)	(2,175)
Series B preferred stock redemption premium	—	—	(100)
Series B preferred stock redemption	—	—	(5,000)
Series C preferred stock redemption	—	—	(1,750)
Employee Stock Purchase Plan	104	82	66
Director Stock Purchase Plan	42	—	—
Deferred financing fees paid for subordinated debt issuance	(85)	—	(85)
Subordinated debt issuance	10,000	—	7,500
Net cash provided by (used in) financing activities	<u>6,797</u>	<u>(2,793)</u>	<u>(1,544)</u>
Net increase in cash and cash equivalents	3,906	216	10
Cash and cash equivalents, beginning of year	780	564	554
Cash and cash equivalents, end of year	<u>\$ 4,686</u>	<u>\$ 780</u>	<u>\$ 564</u>

**(24) Recent Accounting Pronouncements**

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

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

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

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

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

Mid Penn has early adopted this standard, and the financial statements as of and for the year ended December 31, 2017 reflect the impact of premium amortization on callable debt securities to the earliest call date. The adoption of this ASU did not have a material impact on Mid Penn’s consolidated financial statements.

## MID PENN BANCORP, INC.

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

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

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

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

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

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

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

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

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

Mid Penn adopted this ASU in the first quarter of 2018. The adoption will not have a material impact on its consolidated financial statements as Mid Penn typically does not engage in partial sale transactions.

## MID PENN BANCORP, INC.

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

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

The ASU eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment, and if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. Therefore, the same impairment assessment applies to all reporting units. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary.

An entity should apply the amendments in this Update on a prospective basis. A public business entity should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

Mid Penn early adopted this ASU for its annual goodwill impairment test as of year-end 2017 by comparing its fair value to its carrying value at that time. The adoption of this ASU did not have a material impact on Mid Penn's consolidated financial statements.

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

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

- Cash payments for debt prepayment or extinguishment costs will be classified in financing activities.
- Upon settlement of zero-coupon bonds and bonds with insignificant cash coupons, the portion of the payment attributable to imputed interest will be classified as an operating activity, while the portion of the payment attributable to principal will be classified as a financing activity.
- Cash paid by an acquirer that isn't soon after a business combination for the settlement of a contingent consideration liability will be separated between financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date will be classified in financing activities; any excess will be classified in operating activities. Cash paid soon after the business combination will be classified in investing activities.
- Cash proceeds received from the settlement of insurance claims will be classified on the basis of the related insurance coverage (that is, the nature of the loss). Cash proceeds from lump-sum settlements will be classified based on the nature of each loss included in the settlement.
- Cash proceeds received from the settlement of corporate-owned life insurance ("COLI") and BOLI policies will be classified as cash inflows from investing activities. Cash payments for premiums on COLI and BOLI may be classified as cash outflows for investing, operating, or a combination of both.
- A transferor's beneficial interest obtained in a securitization of financial assets will be disclosed as a noncash activity, and cash received from beneficial interests will be classified in investing activities.
- Distributions received from equity method investees will be classified using either a cumulative earnings approach or a look-through approach as an accounting policy election.

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

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

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

## MID PENN BANCORP, INC.

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

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

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (“PCD assets”) should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

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

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

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

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

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

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

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

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

## MID PENN BANCORP, INC.

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

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

The new leases standard requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing U.S. GAAP. Classification depends on the same five criteria used by lessees plus certain additional factors. The subsequent accounting treatment for all three lease types is substantially equivalent to existing U.S. GAAP for sales-type leases, direct financing leases, and operating leases. However, the new standard updates certain aspects of the lessor accounting model to align it with the new lessee accounting model, as well as with the new revenue standard under Topic 606.

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

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

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

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

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

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

As of December 31, 2017, Mid Penn held \$856,000 of equity investments (excluding restricted investments in bank stocks). Mid Penn does not expect to make significant increases in the volume of its equity investments; therefore, the adoption of this ASU is not expected to be material to Mid Penn’s consolidated financial statements.

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

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

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

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

## MID PENN BANCORP, INC.

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

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

In November 2017, the FASB issued ASU 2017-14, *Income Statement – Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606) – Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 116 and SEC Release No. 33-10403*. The ASU adds guidance to the existing Staff Bulletin No. 116 stating that SAB Topic 13 (Revenue Recognition) and SAB Topic 8 (Retail Companies) are no longer applicable once a registrant adopts Topic 606.

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

Mid Penn completed its internal assessment procedure related to this Standard during the fourth quarter of 2017 and fully adopted the standard in the first quarter of 2018. Through our assessment, we identified certain non-interest income financial statement line items that met the criteria of this Standard and worked through the five step assessment process for each line item within the scope of the Standard. Mid Penn has concluded that the adoption of the Standard using the modified retrospective approach will have no financial statement impact as the current financial statement line items within the scope of this Standard are in compliance with the new guidance, however, we expect the adoption will require additional qualitative and quantitative disclosure requirements related to revenue recognition within our quarterly and annual reports. We will continue to evaluate any prospective impact as additional guidance is issued and will update our internal assessment at least annually, or more frequently if necessary.

**ASU 2018-02:** The FASB issued ASU No. 2018-02, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*.

This ASU provides guidance related to the stranded income tax effects in accumulated other comprehensive income caused by the Tax Cuts and Jobs Act by providing financial statement preparers with the option to reclassify stranded tax effects in accumulated other comprehensive income to retained earnings in every period wherein the impact of the new corporate income tax rate in the new tax law (or portion thereof) is recognized.

As a result of the new guidance, financial statement preparers must provide a description of the accounting policy for reclassifying income tax effects from accumulated other comprehensive income. Preparers are also required to disclose whether they will reclassify the stranded income tax effects from tax reform, and provide information on the other reclassified tax effects.

Mid Penn has early adopted ASU 2018-02 effective December 31, 2017. Mid Penn had \$341,000 of stranded income tax effects in accumulated other comprehensive loss within the capital section on the balance sheet as a result of the Tax Cuts and Jobs Act. The majority of this amount was derived from the accumulated other comprehensive loss on available-for-sale investment securities, while the remaining balance is attributable to Mid Penn's post-retirement benefit plans. The adoption of ASU 2018-02 resulted in the transfer of the \$341,000 of stranded income tax effects out of accumulated other comprehensive income and into retained earnings with no impact to total shareholders' equity or net income.

**MID PENN BANCORP, INC.**

**(25) Summary of Quarterly Consolidated Financial Data (Unaudited)**

The following table presents summarized quarterly financial data for 2017 and 2016.

*(Dollars in thousands, except per share data)*

	<b>2017 Quarter Ended</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
Interest Income	\$ 10,559	\$ 10,879	\$ 11,150	\$ 11,304
Interest Expense	1,384	1,469	1,634	1,817
Net Interest Income	9,175	9,410	9,516	9,487
Provision for Loan and Lease Losses	125	100	—	100
Net Interest Income After Provision for Loan Losses	9,050	9,310	9,516	9,387
Noninterest Income	1,436	1,362	1,564	1,331
Noninterest Expense	7,802	7,558	7,960	8,047
Income Before Provision for Income Taxes	2,684	3,114	3,120	2,671
Provision for Income Taxes	690	769	871	2,170
Net Income Available to Common Shareholders	<u>\$ 1,994</u>	<u>\$ 2,345</u>	<u>\$ 2,249</u>	<u>\$ 501</u>
<b>Per Share Data:</b>				
Basic Earnings Per Common Share	\$ 0.47	\$ 0.55	\$ 0.53	\$ 0.12
Cash Dividends Declared	0.13	0.13	0.13	0.38

*(Dollars in thousands, except per share data)*

	<b>2016 Quarter Ended</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
Interest Income	\$ 9,697	\$ 9,859	\$ 10,125	\$ 10,531
Interest Expense	1,282	1,316	1,367	1,402
Net Interest Income	8,415	8,543	8,758	9,129
Provision for Loan and Lease Losses	340	395	585	550
Net Interest Income After Provision for Loan Losses	8,075	8,148	8,173	8,579
Noninterest Income	1,232	1,398	1,419	1,875
Noninterest Expense	6,982	6,931	7,165	7,740
Income Before Provision for Income Taxes	2,325	2,615	2,427	2,714
Provision for Income Taxes	520	593	526	638
Net Income Available to Common Shareholders	<u>\$ 1,805</u>	<u>\$ 2,022</u>	<u>\$ 1,901</u>	<u>\$ 2,076</u>
<b>Per Share Data:</b>				
Basic Earnings Per Common Share	\$ 0.43	\$ 0.48	\$ 0.45	\$ 0.49
Cash Dividends Declared	0.22	0.12	0.12	0.22



## **MID PENN BANCORP, INC.**

### **(26) Subsequent Events**

#### *The Scottsdale Bank & Trust Company*

On January 8, 2018, Mid Penn completed its acquisition of The Scottsdale Bank & Trust Company, a Pennsylvania bank and trust company (“Scottsdale”), through the merger of Scottsdale with and into Mid Penn Bank pursuant to that certain previously announced Agreement and Plan of Merger, dated as of March 29, 2017, among Mid Penn, Mid Penn Bank and Scottsdale. Pursuant to the Merger Agreement, each share of Scottsdale common stock issued and outstanding immediately prior to January 8, 2018 converted into the right to receive (i) \$1,166 in cash without interest or (ii) 38.88 shares of Mid Penn common stock. As a result, Mid Penn issued approximately 1.9 million shares of Mid Penn common stock and cash of approximately \$2.8 million. The transaction was valued at approximately \$66,972,000. At December 31, 2017, and eight days prior to the acquisition transaction, Scottsdale reported total assets of \$260,735,000, total loans of \$69,328,000, and total deposits of \$210,658,000 on a Call Report filed with federal banking regulators.

Given that the initial purchase accounting for the acquisition in accordance with generally accepted accounting principles for this business combination is not yet completed, Mid Penn is not yet able to disclose the preliminary fair value of the Scottsdale assets acquired and liabilities assumed.

#### *First Priority Financial Corp.*

On January 16, 2018, Mid Penn entered into an Agreement and Plan of Merger (the “Merger Agreement”) with First Priority Financial Corp. (“First Priority”) pursuant to which First Priority will merge with and into Mid Penn (the “Merger”), with Mid Penn being the surviving corporation in the Merger. The acquisition will expand Mid Penn’s footprint into southeastern Pennsylvania, including Chester, Berks, Montgomery, and Bucks counties. On a pro forma basis, the combined company will have over \$2 billion in total assets. Under the terms of the Merger Agreement, shareholders of First Priority will receive 0.3481 shares of Mid Penn common stock for each share of First Priority common stock they own. Subject to customary closing conditions including regulatory and shareholder approvals, it is expected that the Merger will be completed in the third quarter of 2018.

**MID PENN BANCORP, INC.**

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Mid Penn carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of December 31, 2017. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded, as of December 31, 2017, that Mid Penn's disclosure controls and procedures were effective in recording, processing, summarizing, and reporting information required to be disclosed by Mid Penn within the time periods specified in the SEC's rules and forms, and such information is accumulated and communicated to management to allow timely decisions regarding required disclosures.

Management's Report on Internal Controls over Financial Reporting is located on page 49 of this report, and is incorporated herein by reference.

Our independent registered public accounting firm, BDO USA, LLP, also attested to, and reported on, the effectiveness of Mid Penn's internal control over financial reporting as of December 31, 2017. BDO USA, LLP's attestation report appears in Part II, Item 8, "Financial Statements and Supplemental Data."

**Changes in Internal Controls over Financial Reporting**

There have been no changes in Mid Penn's internal control over financial reporting during the fourth quarter of 2017 that have materially affected, or are reasonably likely to materially affect, Mid Penn's internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item, relating to directors, executive officers, and control persons is set forth under the captions "Executive Officers", "Information Regarding Director Nominees and Continuing Directors", "Section 16(a) Beneficial Ownership Reporting Compliance", "Audit Committee Report", and "Governance of the Corporation" in Mid Penn's definitive proxy statement to be used in connection with the 2018 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

The Corporation has adopted a Code of Ethics that applies to directors, officers and employees of the Corporation and the Bank. The Corporation amended the Code of Ethics on March 17, 2013. A copy is posted under Governance Documents in the Corporate Information section under the Investors link on the Corporation's website, [www.midpennbank.com](http://www.midpennbank.com). The Corporation's Code of Ethics may be viewed on the Mid Penn website at [www.midpennbank.com](http://www.midpennbank.com) or requested from the Corporate Secretary by telephone at 1-866-642-7736.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item, relating to executive compensation, is set forth under the captions "Compensation Discussion and Analysis", "Executive Compensation", "Potential Payments Upon Termination or Change In Control", "Information Regarding Director Nominees and Continuing Directors", "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" of Mid Penn's definitive proxy statement to be used in connection with the 2018 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

## MID PENN BANCORP, INC.

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS**

The information required by this Item, relating to beneficial ownership of Mid Penn's common stock, is set forth under the caption "Beneficial Ownership of Mid Penn Bancorp's Stock Held By Principal Shareholders and Management" of Mid Penn's definitive proxy statement to be used in connection with the 2018 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

The following table provides information related to equity compensation plans as of December 31, 2017:

<u>Plan Category</u>	<u>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights</u>	<u>Weighted-average Exercise Price of Outstanding Options, Warrants, and Rights</u>	<u>Number of Securities Remaining for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))</u>
	(a)	(b)	(c)
Equity compensation plans approved by security holders	19,499	— (1)	73,515
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>19,499</b>	<b>—</b>	<b>73,515</b>

- (1) All awards under the Mid Penn Bancorp, Inc. 2014 Restricted Stock Plan are in the form of restricted stock. Accordingly, they were not included in calculating the weighted-average exercise price because the shares of common stock will be issued for no consideration.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item, relating to transactions with management and others, certain business relationships and indebtedness of management, is set forth under the captions "Certain Relationships and Related Transactions" and "Governance of the Corporation" of Mid Penn's definitive proxy statement to be used in connection with the 2018 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item, relating to the fees and services provided by Mid Penn's principal accountant, is set forth under the caption "Audit Committee Report" and "Proposal No. 3: Ratification of the Appointment of BDO USA, LLP as the Corporation's Independent Registered Public Accounting Firm for 2018" of Mid Penn's definitive proxy statement to be used in connection with the 2018 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

## **PART IV**

### **ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

- (a) Financial statements are incorporated by reference in Part II, Item 8 hereof.

Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income

Consolidated Statements of Changes in Shareholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

- (b) The financial statement schedules, required by Regulation S-X, are omitted because the information is either not applicable or is included elsewhere in the consolidated financial statements.

## MID PENN BANCORP, INC.

(c) The following Exhibits are filed as part of this filing on Form 10-K, or incorporated by reference hereto:

- 2(i) Agreement and Plan of Merger, dated as of March 29, 2017, by and among Mid Penn Bancorp, Inc., Mid Penn Bank, and The Scottdale Bank and Trust Company (Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K (File No. 001-13677) filed with the SEC on March 30, 2017.)
- 2(ii) Agreement and Plan of Merger, dated as of January 16, 2018, by and between Mid Penn Bancorp, Inc. and First Priority Financial Corp. (Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K (File No. 001-13677) filed with the SEC on January 16, 2018.)
- 3(i) The Registrant's amended Articles of Incorporation. (Incorporated by reference to Exhibit 3(i) of Registrant's Registration Statement on Form S-4 (File No. 333-199740) filed with the SEC on October 31, 2014.)
- 3(ii) The Registrant's By-laws. (Incorporated by reference to Exhibit 3(ii) of Registrant's Current Report on Form 8-K filed with the SEC on August 30, 2010.)
- 10.1 Mid Penn Bank's Retirement Plan. (Incorporated by reference to Exhibit 10.1 of Registrant's Annual Report on form 10-K filed with the SEC on March 10, 2008.)\*
- 10.2 The Registrant's Dividend Reinvestment Plan, as amended and restated. (Incorporated by reference to Exhibit 99.1 of Registrant's Registration Statement on Form S-3, filed with the SEC on October 12, 2005.)
- 10.3 Mid Penn Bancorp, Inc. 2014 Restricted Stock Plan. (Incorporated by reference to Appendix A of Registrant's Definitive Proxy Statement on Schedule 14A as filed with the SEC on March 27, 2014.)\*
- 10.4 Form of Mid Penn Bancorp, Inc. Restricted Stock Agreement.\*
- 10.5 Form of Change in Control Agreement (Incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on November 4, 2016.)\*
- 10.6 The Registrant's Director Stock Purchase Plan (Incorporated by reference to Exhibit 99.1 of Registrant's Registration Statement on Form S-8, filed with the SEC on June 8, 2017.)
- 10.7 Employment Agreement, dated November 3, 2016, among Mid Penn Bancorp, Inc., Mid Penn Bank and Rory G. Ritrievi. (Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed on November 4, 2016.)\*
- 10.8 Offer letter, dated March 4, 2016, between Michael D. Peduzzi and Mid Penn Bank. (Incorporated by reference to Exhibit 10.7 of the Registrant's Annual Report on Form 10-K filed with the SEC on March 23, 2017.)\*
- 11 Statement re: Computation of Per Share Earnings. (Incorporated by reference to Part II, Item 8 of this Annual Report on Form 10-K.)
- 21 Subsidiaries of Registrant.
- 23 Consent of BDO USA, LLP.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer.
- 32 Principal Executive and Financial Officer's §1350 Certifications.
- 99.1 Listing of Mid-Atlantic Custom Peer Group Banks.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase.
- 101.LAB XBRL Taxonomy Extension Label Linkbase.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase.

\* Denotes a management contract or compensatory plan or arrangement.

**MID PENN BANCORP, INC.**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MID PENN BANCORP, INC.**

(Registrant)

By: /s/ Rory G. Ritrievi

Rory G. Ritrievi

President and

Chief Executive Officer

(Principal Executive Officer)

Date: March 13, 2018

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Rory G. Ritrievi March 13, 2018

Rory G. Ritrievi

President, Chief Executive Officer and

Director (Principal Executive Officer)

By: /s/ Michael D. Peduzzi, CPA March 13, 2018

Michael D. Peduzzi, CPA

Chief Financial Officer

By: /s/ Robert A. Abel March 13, 2018

Robert A. Abel, Director

By: /s/ Steven T. Boyer March 13, 2018

Steven T. Boyer, Director

By: /s/ Matthew G. DeSoto March 13, 2018

Matthew G. DeSoto, Director

By: /s/ Robert C. Grubic March 13, 2018

Robert C. Grubic, Director

By: /s/ Gregory M. Kerwin March 13, 2018

Gregory M. Kerwin, Director

By: /s/ Donald F. Kiefer March 13, 2018

Donald F. Kiefer, Director

By: /s/ Robert E. Klinger March 13, 2018

Robert E. Klinger, Director

By: /s/ Robert J. Moisey March 13, 2018

Robert J. Moisey, Director

By: /s/ Theodore W. Mowery March 13, 2018

Theodore W. Mowery, Director

By: /s/ John E. Noone March 13, 2018

John E. Noone, Director

By: /s/ Noble C. Quandel, Jr. March 13, 2018

Noble C. Quandel, Jr., Director

By: /s/ William A. Specht, III March 13, 2018

William A. Specht, Director

**MID PENN BANCORP, INC. RESTRICTED STOCK AGREEMENT**

THIS AGREEMENT, dated as of \_\_\_\_\_, \_\_\_\_ (“Grant Date”) by and between Mid Penn Bancorp, Inc. (“Company”), and \_\_\_\_\_ (“Participant”), is entered into as follows:

WHEREAS, the Company has established The Mid Penn Bancorp, Inc. 2014 Restricted Stock Plan (“Plan”), which Plan is hereby incorporated herein by reference and made a part hereof;

WHEREAS, Participant is a member of the Corporation’s and the Corporation’s wholly-owned subsidiaries, Mid Penn Bank’s (“Bank”), board of directors or an employee of the Bank; and

WHEREAS, the Compensation Committee of the Board of Directors of the Company (“Committee”) determined that it is in the best interest of the Company to grant \_\_\_\_ shares of Common Stock of the Company (“Stock”) to the Participant subject to the restrictions stated below.

NOW, THEREFORE, intending to be legally bound, the parties hereby agree as follows:

- 1. Grant of Stock.** Subject to the terms and conditions of this Agreement and of the Plan, the Company hereby grants to the Participant \_\_\_\_\_ shares of Stock (“Grant”).
- 2. Vesting Schedule.** The interest of the Participant in the Stock shall vest as follows:
  - the Participant shall become vested in 100% of the Grant which equals \_\_\_\_ shares on \_\_\_\_\_, 20\_\_;
  - a. Each date of vesting shall be the “Vesting Date.” Upon the Participant’s death, the Participant shall become fully vested in the unvested tranche or portion of the Grant that was scheduled to vest in the calendar year of his or her death. The remaining unvested tranches or portions of the Grant shall be forfeited.
  - b. Before any restricted stock grant shares vest, the recipient will not be entitled to vote the shares or receive any common stock dividends declared. After any shares vest, the recipient would then have full voting rights and be entitled to any common stock dividends.
- 3. Restrictions.**
  - a. The stock or rights granted hereunder may not be sold, pledged or otherwise transferred until the Stock becomes vested in accordance with Section 2. The period

of time between the date hereof and the date the Stock becomes vested is referred to herein as the "Restriction Period."

- b. If the Participant's service as a Director is terminated by the Corporation or Bank, or if the Participant's employment with the Company is terminated by the Company, or voluntarily by the Participant, the Stock subject to the provisions of this Agreement which have not vested at the time of the Participant's termination of service shall be forfeited by the Participant and transferred back to the Corporation.

**4. Legend.** All certificates representing any shares of Stock of the Corporation subject to the provisions of this Agreement shall have endorsed thereon the following legend:

"The shares represented by this certificate are subject to an agreement between Mid Penn Bancorp, Inc. and the registered holder, a copy of which is on file at the principal office of Mid Penn Bancorp, Inc."

**5. Escrow.** The certificate or certificates evidencing the Stock subject hereto shall be delivered to and deposited with Registrar and Transfer Company as Escrow Agent in this transaction. The Stock may also be held in a restricted book entry account in the name of the Participant.

**6. No Participant Shareholder Rights.** During the Restriction Period, the Participant shall not have any rights of a shareholder with respect to the Stock including but not limited to dividend and voting rights.

**7. Changes in Stock.** In the event that as a result of any stock dividend, stock split or other change in the Stock, and by virtue of any such change the Participant shall in his or her capacity as owner of unvested shares of Stock which have been awarded to him or her (the "Prior Stock") be entitled to new or additional or different shares of securities, such new or additional or different shares or securities shall thereupon be considered to be unvested Stock and shall be subject to all of the conditions and restrictions which were applicable to the Prior Stock pursuant to this Agreement.

**8. Death of Participant.** In the event of the Participant's death prior to the payment of Stock, said Stock shall be paid to the Participant's estate or designated beneficiary.

**9. Taxes.** The Participant shall be liable for any and all taxes arising out of this grant or the vesting of Stock hereunder. The Participant hereby authorizes the Bank to withhold the appropriate taxes from the Participant's compensation.

**10. Miscellaneous.**

(a) The Corporation shall not be required (i) to transfer on its books any shares of Stock of the Corporation which shall have been sold or transferred in violation of any of the provisions set forth in this Agreement, or (ii) to treat as owner of such shares or to accord the right to vote as such owner or to pay dividends to any transferee to whom such shares shall have been so transferred.

(b) The parties agree to execute such further instruments and to take such action as may reasonably be necessary to carry out the intent of this Agreement.

(c) Any notice required or permitted hereunder shall be given in writing and shall be deemed effective upon delivery to the Participant at his or her address on file with the Corporation.

(d) Neither the Plan nor this Agreement nor any provisions under either shall be construed so as to grant the Participant any right to remain on the Board of Directors of the Corporation or Bank.

ATTEST:

MID PENN BANCORP, INC.

\_\_\_\_\_

\_\_\_\_\_

President & CEO

WITNESS:

\_\_\_\_\_

\_\_\_\_\_

Participant



**SUBSIDIARIES OF REGISTRANT**

**Name**

**State of Incorporation**

Mid Penn Bank

Pennsylvania

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Mid Penn Bancorp, Inc.  
Millersburg, Pennsylvania

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-197024, 333-170833, and 333-218592), Form S-3 (No. 333-156759), Form S-3D (No. 333-128958), and Form S-3/A (No. 333-39341) of Mid Penn Bancorp, Inc. of our reports dated March 13, 2018, relating to the consolidated financial statements and the effectiveness of Mid Penn Bancorp, Inc.'s internal control over financial reporting, which appear in this Form 10-K.

/s/ BDO USA, LLP

Harrisburg, Pennsylvania  
March 13, 2018

CERTIFICATION

I, Rory G. Ritrievi, certify that:

1. I have reviewed this annual report on Form 10-K of Mid Penn Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Rory G. Ritrievi  
President and CEO

Date: March 13, 2018

CERTIFICATION

I, Michael D. Peduzzi, certify that:

1. I have reviewed this annual report on Form 10-K of Mid Penn Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

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

Date: March 13, 2018

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND  
PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADDED BY SECTION 906 OF THE  
SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Mid Penn Bancorp, Inc. (the "Corporation") on Form 10-K for the period ending December 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Rory G. Ritrievi, President and CEO, and I, Michael D. Peduzzi, Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as added pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934.
2. To my knowledge, the information contained in the Report fairly presents, in all material respects the financial condition and results of operations of Mid Penn Bancorp, Inc. as of the dates and for the periods expressed in the Report.

By: /s/ Rory G. Ritrievi  
President and CEO

Date: March 13, 2018

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

Date: March 13, 2018

## Mid-Atlantic Custom Peer Group

Company	City	State	Company	City	State
1st Colonial Bancorp, Inc.	Cherry Hill	NJ	First Keystone Corporation	Berwick	PA
Absecon Bancorp	Absecon	NJ	First National Bank of Groton	Groton	NY
American Bank Incorporated	Allentown	PA	First Priority Financial Corp.	Malvern	PA
Apollo Bancorp, Inc.	Apollo	PA	First Resource Bank	Exton	PA
Ballston Spa Bancorp, Inc.	Ballston Spa	NY	Fleetwood Bank Corporation	Fleetwood	PA
Bancorp of New Jersey, Inc.	Fort Lee	NJ	FNB Bancorp, Inc.	Newtown	PA
Bank of Akron	Akron	NY	Frederick County Bancorp, Inc.	Frederick	MD
Bay Bancorp, Inc.	Columbia	MD	FSB Bancorp, Inc.	Fairport	NY
Brunswick Bancorp	New Brunswick	NJ	Glen Burnie Bancorp	Glen Burnie	MD
BV Financial, Inc. (MHC)	Baltimore	MD	Glenville Bank Holding Company, Inc.	Scotia	NY
Calvin B. Taylor Bankshares, Inc.	Berlin	MD	Gold Coast Bancorp, Inc.	Islandia	NY
Capital Bank of New Jersey	Vineland	NJ	Gouverneur Bancorp, Inc. (MHC)	Gouverneur	NY
Carroll Bancorp, Inc.	Sykesville	MD	Greater Hudson Bank	Bardonia	NY
Carver Bancorp, Inc.	New York	NY	Hamilton Bancorp, Inc.	Towson	MD
CB Financial Services, Inc.	Carmichaels	PA	Hamlin Bank and Trust Company	Smethport	PA
CCFNB Bancorp, Inc.	Bloomsburg	PA	Harford Bank	Aberdeen	MD
Centric Financial Corporation	Harrisburg	PA	Harleysville Financial Corporation	Harleysville	PA
Chesapeake Bancorp	Chestertown	MD	Highlands Bancorp, Inc.	Vernon	NJ
Clarion County Community Bank	Clarion	PA	Honat Bancorp, Inc.	Honesdale	PA
Colombo Bank	Rockville	MD	HV Bancorp, Inc.	Huntingdon Valley	PA
Commercial National Financial Corporation	Latrobe	PA	IBW Financial Corporation	Washington	DC
Delanco Bancorp, Inc.	Delanco	NJ	Jeffersonville Bancorp	Jeffersonville	NY
Delhi Bank Corp.	Delhi	NY	Jonestown Bank and Trust Co.	Jonestown	PA
Delmar Bancorp	Salisbury	MD	JTNB Bancorp, Inc.	Jim Thorpe	PA
Delmarva Bancshares, Inc.	Cambridge	MD	Juniata Valley Financial Corp.	Mifflintown	PA
Dimeco, Inc.	Honesdale	PA	Kinderhook Bank Corporation	Kinderhook	NY
Elmer Bancorp, Inc.	Elmer	NJ	Kish Bancorp, Inc.	Belleville	PA
Elmira Savings Bank	Elmira	NY	Lake Shore Bancorp, Inc. (MHC)	Dunkirk	NY
Embassy Bancorp, Inc.	Bethlehem	PA	Landmark Bancorp, Inc.	Pittston	PA
Emclaire Financial Corp	Emlenton	PA	Liberty Bell Bank	Marlton	NJ
Empire Bancorp Inc.	Islandia	NY	Lincoln Park Bancorp (MHC)	Lincoln Park	NJ
Enterprise Bank N.J.	Kenilworth	NJ	Magyar Bancorp, Inc. (MHC)	New Brunswick	NJ
ES Bancshares, Inc.	Newburgh	NY	Mars Bancorp, Inc.	Mars	PA
Esquire Financial Holdings, Inc.	Jericho	NY	Mauch Chunk Trust Financial Corp.	Jim Thorpe	PA
Farmers and Merchants Bancshares, Inc.	Hampstead	MD	MB Bancorp, Inc.	Forest Hill	MD
Fidelity D & D Bancorp, Inc.	Dunmore	PA	Mercersburg Financial Corporation	Mercersburg	PA
First American International Corp.	Brooklyn	NY	Meridian Bank	Malvern	PA

**MID PENN BANCORP, INC.****Mid-Atlantic Custom Peer Group (continued)**

<b>Company</b>	<b>City</b>	<b>State</b>
MNB Corporation	Bangor	PA
MSB Financial Corp.	Millington	NJ
Muncy Bank Financial, Inc.	Muncy	PA
National Bank of Coxsackie	Coxsackie	NY
National Capital Bank of Washington	Washington	DC
Neffs Bancorp, Inc.	Neffs	PA
New Jersey Community Bank	Freehold	NJ
New Tripoli Bancorp, Inc.	New Tripoli	PA
NorthEast Community Bancorp, Inc. (MHC)	White Plains	NY
Northumberland Bancorp	Northumberland	PA
Orange County Bancorp, Inc.	Middletown	NY
Pathfinder Bancorp, Inc.	Oswego	NY
PDL Community Bancorp (MHC)	Bronx	NY
Peoples Bancorp, Inc.	Chestertown	MD
Peoples Limited	Wyalusing	PA
Prudential Bancorp, Inc.	Philadelphia	PA
Putnam County National Bank of Carmel	Carmel	NY
Quaint Oak Bancorp, Inc.	Southampton	PA
Riverview Financial Corporation	Harrisburg	PA
Scottdale Bank & Trust Company	Scottdale	PA
Seneca Financial Corp. (MHC)	Baldwinsville	NY
Seneca-Cayuga Bancorp, Inc. (MHC)	Seneca Falls	NY
Severn Bancorp, Inc.	Annapolis	MD
Shore Community Bank	Toms River	NJ
Solvay Bank Corporation	Solvay	NY
Standard AVB Financial Corp.	Monroeville	PA
Steuben Trust Corporation	Hornell	NY
Stewardship Financial Corporation	Midland Park	NJ
Sunnyside Bancorp, Inc.	Irvington	NY
Susquehanna Community Financial, Inc.	West Milton	PA
Sussex Bancorp	Rockaway	NJ



## Community Giving

Mid Penn is committed to our core values as a community bank. Through major giving campaigns, community events, employee volunteerism and giving, educational outreach and corporate donations, the bank and our team of employees are highly engaged in giving back to our local communities.

### 2017 GIVING HIGHLIGHTS

- \$360,000 given in corporate donations
- 1,900 hours of volunteer time given by our employees
- \$33,000 raised by our employees for charitable causes

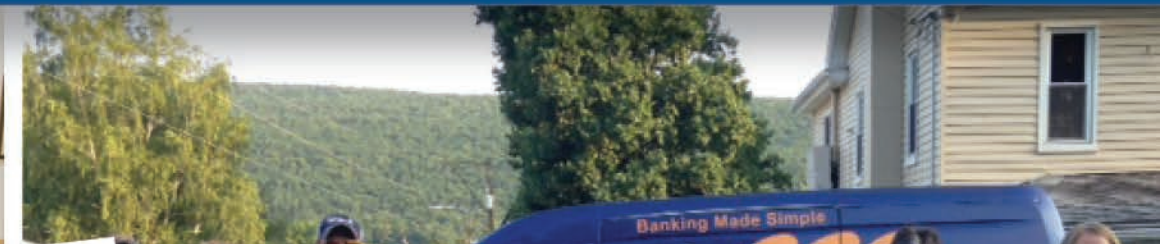
For the fourth consecutive year in a row, Mid Penn was the recipient of the "Grow Your Community Award" by the Pennsylvania Association of Community Bankers, demonstrating our ongoing commitment to the communities we call home.







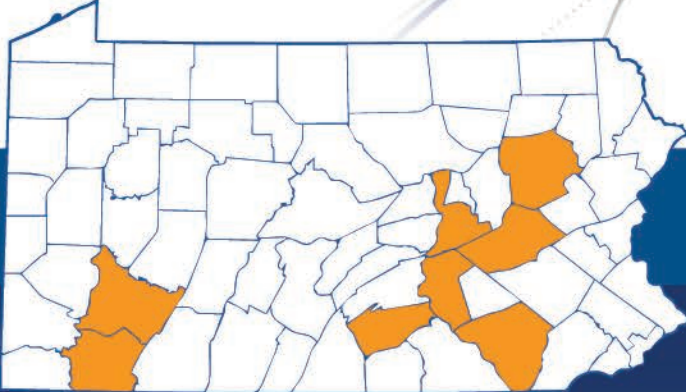
**1868** Millersburg Bank Established | **1931** Millersburg Bank becomes Millersburg Trust Company | **1962** Acquires Lykens Valley Bank | **1971** Acquires Farmers State Bank of Dalmatia; becomes Mid Penn Bank | **1985** Acquires Tower City National Bank | **1990** Enters Harrisburg market with Derry Street Office | **1991** Mid Penn Bancorp, Inc. formed | **1998** Acquires Miners Bank of Lykens | **2008** Receives \$10MM in CPP Funds from U.S. Treasury | **2009** Rory Ritrievi becomes President & CEO | **2012** Repays \$10MM in CPP Funds to U.S. Treasury; Issues \$5MM in Preferred Stock | **2015** Acquires Phoenix Bancorp, Inc. | **2018** Acquires Scottsdale Bank & Trust; announces intent to merge with First Priority financial Corp.



**150 Years of Community Banking**

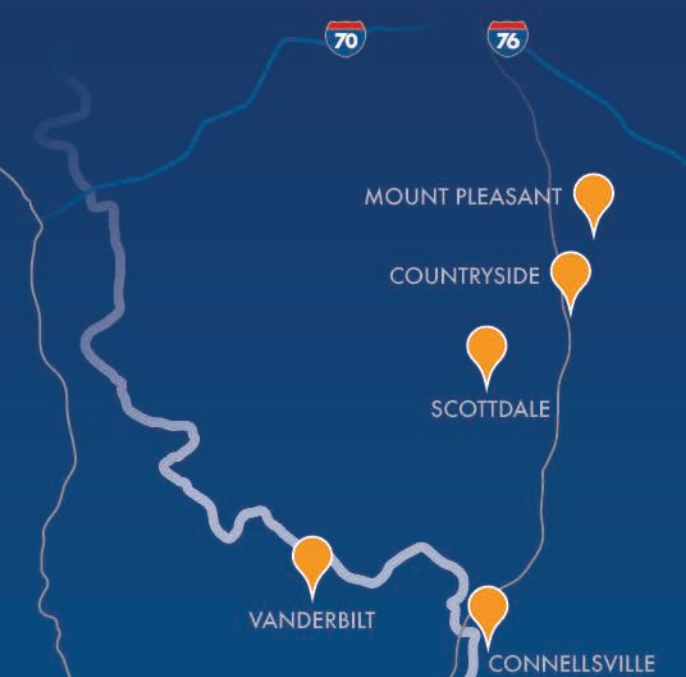


## Continued Growth



### SCOTSDALE BANK & TRUST

We completed our merger with The Scottdale Bank & Trust Company, based in western Pennsylvania, on January 8, 2018. The systems conversion was completed in late February. This transition has provided an enhanced set of products, services and technological solutions to Scottdale customers, while also increasing shareholder value. Mid Penn's growing footprint now includes five branches in Westmoreland and Fayette counties operating as "Scottdale Bank & Trust, a division of Mid Penn Bank."



### HALIFAX BRANCH

On January 12, 2018, we opened our newly-constructed branch office in Halifax Township, located at 3663 Peters Mountain Road. The new office is intended to enhance the level of convenience, products and service delivery provided to the upper Dauphin County community. The Halifax branch further expands Mid Penn's footprint to include 29 branches in Pennsylvania, five of which are located in upper Dauphin County.

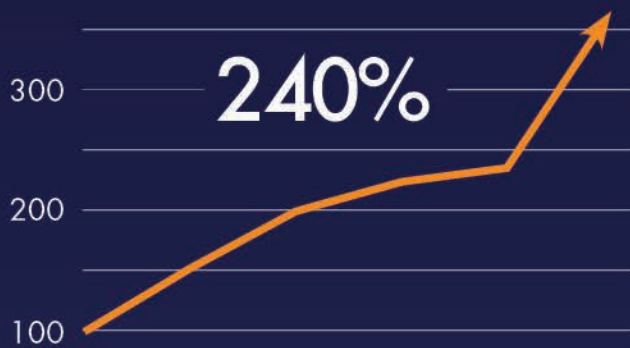
### ORWIGSBURG & NEW HOLLAND BRANCHES

As the groundwork was being laid to merge with Scottdale Bank & Trust and to construct and open the Halifax branch, we also remained focused on our continued organic growth. On May 1, 2017, we opened our third Lancaster County retail office, located in New Holland. This community was identified as an ideal fit for the Mid Penn brand of community banking with great opportunity to grow our business, consumer and agricultural customer bases in Lancaster County. We also demonstrated our commitment to the Schuylkill County community by opening our Orwigsburg branch on June 7, 2017. As our fifth retail location in Schuylkill County, the office is operating under the "Miners Bank, a division of Mid Penn Bank" name.



As our brand of community banking continues to grow, we understand that our employee culture largely influences our success. In 2017, we were honored to be recognized as one of the "Best Banks to Work For" by American Banker magazine.

## 5-YEAR SHAREHOLDER RETURN



## 2017 TOTAL SHAREHOLDER RETURN



2017 RETURN ON EQUITY  
**9.48%**

**\$1.4 BILLION**

\$1.4 BILLION IN TOTAL ASSETS IN 2017

“In 2017, shareholder return was comprised of stock appreciation of \$9.27 per share, or 39%, and cash dividends of \$0.62 per share. It is part of our mission statement to ‘be the best bank for our shareholders.’ Mission accomplished in 2017!”

—PRESIDENT AND CEO RORY G. RITRIEVI

FOR THE FOURTH CONSECUTIVE YEAR,  
MID PENN WAS INCLUDED IN AMERICAN BANKER MAGAZINE'S  
RANKING OF THE "TOP 200 COMMUNITY BANKS" IN THE COUNTRY.  
WE WERE RANKED NUMBER 122, A SIGNIFICANT MOVE  
FROM LAST YEAR'S RANKING OF 145, DUE TO OUR  
**3-YEAR RETURN ON AVERAGE EQUITY (ROAE) OF 9.95%.**

