



MID PENN BANCORP INC.

2018 ANNUAL REPORT TO SHAREHOLDERS

FOUR COMMUNITIES. ONE POWERFUL BANK.





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

Sitting down to write this shareholder letter on the 210th anniversary of the birth of Abraham Lincoln brought to mind his quote, “The best way to predict the future is to create it.” While we started 2018 with \$1.1 billion in assets and 23 retail locations, we ended the year with \$2.1 billion in assets and 38 retail locations. In 2018, Mid Penn Bancorp, Inc. and its subsidiary Mid Penn Bank had an action-packed year that we predict has laid the groundwork for a future of financial success and shareholder return.

SHAREHOLDER RETURN

In the first quarter of 2018, we paid cash dividends that totaled \$0.25 a share, making that our largest quarterly dividend payout in 14 years. Subsequent quarterly dividends pushed our total payout in 2018 to \$0.70 a share. That is the largest annual dividend we have had since 2008. Our primary objective each year is to provide you, our shareholders, with a great return on your investment. That return comes from those cash dividends and growth in the per share

value of the stock. With strong earnings per share, we are able to pay a healthy dividend while still retaining enough to drive up book value per share, a key metric in stock valuation. Throughout 2018, book value per share increased from \$17.85 at December 31, 2017 to \$26.38 at December 31, 2018, a 47% increase.

EARNINGS

For the 2018 year, we hit a record-high \$10,494,000 in net earnings. While new capital was added through the two acquisitions we completed in 2018 (described in more detail below), the full benefit of the increased capital was not realized until later in the year. As a

“IN THE FIRST QUARTER OF 2018, WE PAID CASH DIVIDENDS THAT TOOK \$0.25 A SHARE, MAKING THAT OUR LARGEST QUARTERLY DIVIDEND PAYOUT IN 14 YEARS.”

result, earnings per share slipped to \$1.48 in 2018 from \$1.67 in 2017. The momentum in earnings, however, grew throughout the year. In fact, the fourth quarter of 2018 was accretive by \$0.42 a share over the fourth quarter of 2017. We are pleased with that trend and encouraged as we enter 2019.

ORGANIC GROWTH

Our 2018 financial success was attained through strong organic growth in consumer, business and municipal relationships throughout our legacy markets in Central Pennsylvania. In those markets, we grew total loans by 17% while improving both net interest margin and asset quality. Throughout the year, we originated \$447 million in new loans, a record level for the bank. Deposit growth was much more challenging due to competitive pricing pressures, but we still managed 3% organic growth. The net interest earned from our organic loan and deposit growth accounted for almost one-third of the 49% increase in net interest income. We also managed to have a great year in noninterest income. Most sources of noninterest income increased year-over-year, including our trust and wealth management revenues, mortgage banking revenues and interchange (or debit and credit card) revenues. The focus we developed on all of those areas a few years ago is beginning to bear fruit in very meaningful ways.

Beyond our organic balance sheet growth, we also expanded our branch presence in existing markets in 2018. In the first quarter of 2018, we opened a new retail location in Halifax, PA and followed that up with a new location in Pillow, PA later in the third quarter. Both of these Upper Dauphin County locations did well in their first year and reinforce our dominance in that region.

ASSET QUALITY

The year we had in asset quality in 2018 was a solid continuation of the good trends experienced over the last few years. For the second consecutive year, we ended with a net recovery instead of a net charge-off. Additionally, our delinquency rate was 0.09% at year end! The high quality of our loan portfolio is something in which we take great pride. In the last 10 years, we have originated over \$2 billion of commercial, residential and consumer loans throughout Central Pennsylvania. In the process of doing so, we completely revamped the loan portfolio and the quality of the loans therein. The company's financial success, to a great extent, goes as the asset quality of the loan portfolio goes. We head into 2019 confident in that asset quality.

MERGERS AND ACQUISITIONS

The organic growth success we had in 2018 is only part of the story. In the first quarter, we finalized the purchase of The Scottdale Bank & Trust Company of Westmoreland and Fayette Counties and successfully converted their customers onto our systems. That acquisition added approximately \$281 million of assets, including \$71 million in loans. It also added \$210 million of core deposits, which was an important source of funding for the organic loan growth mentioned above. The addition of Scottdale gave us both the asset size and additional capital to better serve customers throughout our markets.

**“THE ADDITION OF SCOTSDALE
GAVE US BOTH THE ASSET SIZE AND
ADDITIONAL CAPITAL TO BETTER
SERVE CUSTOMERS THROUGHOUT
OUR MARKETS.”**

Shortly after we completed the acquisition of Scottsdale, we announced the acquisition of First Priority Financial Corporation of Malvern, PA. First Priority was a \$642 million community bank serving Chester, Bucks, Montgomery and Berks Counties. Legal merger close occurred in the third quarter and we successfully converted their customers onto our systems in October. With First Priority, we added \$512 million in loans and \$399 million in core deposits. That acquisition not only gives us access to new and dynamic markets, but also the size to fully serve the needs of customers in those markets. Through this merger we picked up four additional Board members with Joel Frank, Alan Novak, Patrick Smith and David Sparks, all former First Priority Board members.

“WITH FIRST PRIORITY WE ADDED \$512 MILLION IN LOANS AND \$399 MILLION IN CORE DEPOSITS. THAT ACQUISITION NOT ONLY GIVES US ACCESS TO NEW AND DYNAMIC MARKETS, BUT ALSO THE SIZE TO FULLY SERVE THE NEEDS OF THE CUSTOMERS IN THOSE MARKETS.”

We believe both acquisitions were strategically important for Mid Penn. To establish a presence organically in those markets would have taken years of investment without much return. We did, however, pay a premium for each company. That premium has created a significant level of goodwill on our balance sheet and the tangible book value of our stock was consequently diluted. Warren Buffet once said, “It’s far better to buy a wonderful company at a fair price than a fair company at a wonderful price.” We feel Scottsdale and First Priority were wonderful companies that we purchased for a fair price. The dilution to tangible book from those combined transactions, we feel, will be earned back within a reasonable period of time.

COMMUNITY SERVICE

While we almost doubled our size in 2018 and began serving six new counties, we stayed true to our community bank roots. In 2018, Mid Penn contributed \$251,000 to various charitable organizations. We also orchestrated \$460,000 of Earned Income Tax Credit giving, bringing total corporate contributions to \$711,000. Additionally, our employees contributed \$57,000 out of their own pockets and over 3,000 hours of their own time to various charities. Including these contributions from the company and its employees, as well as additional fundraising from outside sources that we coordinated for several of our events, Mid Penn was responsible for over \$865,000 being contributed to the communities, schools, and deserving nonprofit organizations throughout our footprint in 2018. Major company projects for the year included the Fourth of July Fireworks in Millersburg for the tenth straight year, the Mid Penn Bank Celebrity Golf Tournament for Breast Cancer - which raised \$100,000 - and our No Shave November partnership with Penn State Cancer Institute’s Urology Division which raised \$40,000 for prostate cancer research. It was our most charitable year yet as an organization! Strong financial performance while supporting the community is the Mid Penn Bank way.

“IT WAS OUR MOST CHARITABLE YEAR YET AS AN ORGANIZATION! STRONG FINANCIAL PERFORMANCE WHILE SUPPORTING THE COMMUNITY IS THE MID PENN BANK WAY.”

RECOGNITION

As 2018 progressed, we once again received some important industry recognition. For the fifth year in a row, we were recognized as being one of the Top 200 Community Banks in the country by *American Banker* for our performance in return on equity. Also, for the fifth year in a row, we won the “Grow Your Community” Award from the Pennsylvania

Association of Community Bankers for our fundraising efforts with the aforementioned No Shave November campaign. The work we did with our charity golf tournament garnered a “Pink Ribbon Award” from the Pennsylvania Breast Cancer Coalition.

BOARD DIVERSITY AND SUCCESSION

In last year’s shareholder letter, we identified the importance of diversifying our Board of Directors and building a strong succession plan. As you will see in the proxy materials that accompany this annual report, we have added Kimberly J. Brumbaugh of Lancaster County to our Board. After a fairly exhaustive search, in which we identified many qualified candidates, we were fortunate to have Ms. Brumbaugh accept our invitation. Ms. Brumbaugh is a wealth management professional and business owner who works in Chester County and provides great community support throughout Southeastern Pennsylvania. In the proxy materials that accompany this report, you will see a discussion on our Board diversity goals and the direction we are taking to assure an effective director succession plan. Our Board of Directors is and always has been a valuable asset, and our plan is to make sure that it constantly evolves to meet all of our objectives.

“OUR BOARD OF DIRECTORS IS AND ALWAYS HAS BEEN A VALUABLE ASSET, AND OUR PLAN IS TO MAKE SURE THAT IT CONSTANTLY EVOLVES TO MEET ALL OF OUR OBJECTIVES.”

OUR 2019 PLAN

By the time you read this letter, we will already be one quarter of the way through 2019. That first quarter will be a significant first step in recognizing the benefit of the work we did in 2018. Our plan this year is straightforward. Continue the strong organic growth in loans and deposits we have had in our legacy markets of Dauphin, Cumberland, Schuylkill, Northumberland and Luzerne Counties. Keep building on the success

we have had over the last few years since entering Lancaster County. Complete the cultural integration of our new markets in Westmoreland, Fayette, Chester, Bucks, Montgomery and Berks Counties and actually grow our presence in each of those areas. Make significant progress in earning back the tangible book value dilution of the two mergers completed in 2018 that afforded us these new markets. Continue the development and expansion of noninterest income sources. And, of course, provide that wonderful community support that has become part of our calling card. While 2018 was a milestone year in many ways, the Mid Penn team has already hit the ground running to make 2019 even better.

If the best way to predict our future is to create it, then we are confident that we are creating THE best bank in the state of Pennsylvania. Most importantly, we are building a future of financial success for the benefit of our shareholders, employees, customers and communities.

Thank you for your investment in and support of Mid Penn Bancorp, Inc. and Mid Penn Bank where we predict that the best is yet to come!



Rory G. Ritrievi
President and CEO



Robert C. Grubic
Chairman of the Board

CONTINUED GROWTH

Mid Penn experienced tremendous growth in 2018. We bookended the year with the acquisition of two separate banks: Scottdale Bank & Trust in western Pennsylvania and First Priority Bank in southeastern Pennsylvania. These acquisitions increased shareholder value and expanded Mid Penn's growing footprint to include 12 counties and 38 retail locations across the state of Pennsylvania, creating a powerful bank holding company to serve four distinct communities.

Scottdale Bank & Trust

We completed our merger with the Scottdale Bank & Trust Company, based in Westmoreland & Fayette counties, on January 8, 2018 with a full systems conversion occurring in late February. There are five branches spread across the two counties operating as "Scottdale Bank & Trust, a division of Mid Penn Bank."

First Priority Bank

We completed our merger with First Priority Bank, with eight retail locations across Berks, Bucks, Chester & Montgomery counties, in August 2018 and a full systems conversion in October. First Priority Bank operates as "First Priority Bank, a division of Mid Penn Bank" and, like Scottdale, provides us with the opportunity to serve a brand-new community with our full range of community banking products and services.

HALIFAX OPENING, JANUARY 12, 2018



PILLOW OPENING, SEPTEMBER 10, 2018



Branch Openings

On January 12, 2018 we opened our newly-constructed retail location in Halifax, PA. The new office has been well-received by the community and has provided an additional level of convenience to Upper Dauphin County residents and organizations.

In the midst of finalizing the acquisition of First Priority Bank, we opened a new retail location in Pillow, PA on September 10, 2018. As Mid Penn continues to expand throughout the state of Pennsylvania, we also remain focused on fulfilling the banking needs of the Upper Dauphin County community, who we have proudly served for more than 150 years.

**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, 2018

OR

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

For the transition period from _____ to _____

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania
*(State or Other Jurisdiction of
Incorporation or Organization)*
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

Common Stock, \$1.00 par value per share

Name of Each Exchange on Which Registered

The NASDAQ Stock Market LLC

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|--------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated Filer | <input checked="" type="checkbox"/> |
| Non-accelerated Filer | <input type="checkbox"/> | Smaller Reporting Company | <input checked="" 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 \$34.90 per share, as reported by The NASDAQ Stock Market LLC ("NASDAQ"), on June 30, 2018, the last business day of the registrant's most recently completed second fiscal quarter was approximately \$213,745,643.

As of March 1, 2019, the registrant had 8,459,918 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be used in connection with the 2019 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, 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 Bank subsidiary and its divisions, and to provide them with capital and resources.

Mid Penn’s consolidated financial condition and results of operations consist almost entirely of that of the Bank, which is managed as a single business segment. At December 31, 2018, Mid Penn had total consolidated assets of \$2,077,981,000 with total deposits of \$1,726,026,000 and total shareholders’ equity of \$223,209,000. Mid Penn currently does not own or lease any real property. 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 operation of the holding company. At December 31, 2018, the Bank had 372 full-time and 34 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 and obtained 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”. Mid Penn’s and the Bank’s legal headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061.

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”.

On January 8, 2018, 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”). The Scottdale Merger resulted in the addition of five branches in Western Pennsylvania operating as “Scottdale Bank & Trust, a Division of Mid Penn Bank”.

On July 31, 2018, Mid Penn completed its acquisition of First Priority Financial Corp. (“First Priority”) pursuant to which First Priority was merged with and into Mid Penn (the “First Priority Merger”), with Mid Penn being the surviving corporation in the First Priority Merger. As part of this acquisition, First Priority’s banking subsidiary, First Priority Bank, was merged with and into Mid Penn Bank. The First Priority Merger resulted in the addition of eight offices in Southeastern Pennsylvania operating as “First Priority Bank, a Division of Mid Penn Bank”.

Additional information related to the Scottdale and First Priority Mergers can be found in Notes 4 and 5 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, and in September 2018, opened a new full-service office in Pillow, PA. After the opening of these two branches and adding thirteen from the two acquisitions that occurred during 2018, the Bank now has thirty-eight full service retail banking properties located in Berks, Bucks, Chester, Cumberland, Dauphin, Fayette, Lancaster, Luzerne, Montgomery, Northumberland, Schuylkill and Westmoreland Counties within Pennsylvania.

MID PENN BANCORP, INC.

Mid Penn's primary business consists of attracting deposits and loans from the Bank's network of community banking offices. 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. The Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (the "FDIC") supervise the Bank. Deposits of the Bank are insured by the FDIC's Deposit Insurance Fund (the "DIF") 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 provides services to commercial businesses and real estate investors, consumers, nonprofit organizations, and municipalities through thirty-eight full service retail banking properties, one loan production office, a corporate administration office, and one operations facility which are all based in Pennsylvania. Mid Penn's primary markets reflect a diversified manufacturing and services base across twelve Pennsylvania counties, including having several offices in and around the state capital region of Harrisburg. 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.

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 relationships with creditworthy customers who exhibit positive historical repayment trends, stable cash flows and secondary sources of repayment from tangible collateral;
- 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. 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. 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, 2018, the Bank's highest concentration of credit is in commercial real estate.

Investment Activities

Mid Penn's securities portfolio is a source for both liquidity and interest earnings, and serves to support pledging requirements on public funds deposits through investments in primarily higher-quality fixed-income debt securities. Mid Penn does not have any significant non-governmental concentrations within its investment securities portfolio.

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 deposits which require pledging. The investments in the held-to-maturity portfolio are recorded on the balance sheet at book value (amortized cost), 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 \$4,103,000 as of December 31, 2018. 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 \$3,242,000. A majority of the investments are high quality United States and municipal securities that, if held to maturity, are expected to result in no realized loss to the Bank.

MID PENN BANCORP, INC.

Deposits and Other 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 remains 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.

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.

Competition

The banking business is highly competitive, and the profitability of Mid Penn depends principally upon the Bank’s ability to successfully 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, convenient hours, efficient and friendly employees, local decision making, and quality products.

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 that may be imposed by federal and state banking regulators 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, 2018, the Bank was not subject to any supervisory enforcement actions.

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”). 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 of the more significant laws and regulations and are qualified in their entirety by reference to the complete provisions of 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.

MID PENN BANCORP, INC.

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 applies to 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 certain financial 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 by regulation 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 GLB may increase both opportunity and 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, such as 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.

Banking regulations affect a wide range of the Bank's activities and operations, including, but 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. 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". As of December 31, 2018, Mid Penn complied with these risk-based capital requirements.

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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. As of December 31, 2018, Mid Penn has met these leverage requirements, and 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, and as of December 31, 2018, the Bank’s capital levels were sufficient to be considered “well-capitalized”. 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 19 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 limited exceptions, that the institution be placed in receivership.

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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 final rules established a common equity tier 1 capital conservation buffer with a multi-year phase in to an eventual 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 applicable capital conservation buffer for a given year, the bank 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 and were phased-in over a three-year period. The final rules called for the following minimum capital requirements, including the capital conservation buffer, effective at both January 1, 2018 and 2019).

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

The final rules permanently 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 former 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 and the Bank have complied throughout the phase-in period, and currently remain in compliance, with all the regulatory capital requirements. Accordingly, 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, restricting dividend payments to shareholders, 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, 2018, up to the date of the filing of this Form 10-K, Mid Penn was not subject to any such bank regulatory orders.

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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. Depending upon the financial condition of Mid Penn and the Bank, the payment of dividends could be deemed by a regulatory agency to constitute such an unsafe or unsound practice. Mid Penn and the Bank were not subject to any such dividend prohibitions during the years ended December 31, 2018, 2017, and 2016.

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, and the condition of the Bank (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.

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 services, investments, and lending activities 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.

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;
- annual notices of their privacy policies to their current customers; and
- a reasonable method for consumers to "opt out" of disclosures to nonaffiliated third parties.

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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, Anti-Money Laundering and Anti-Terrorism Financing

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. 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. 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.

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 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 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.

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.

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. The reduction resulted in a one-time \$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 18 (Federal Income Taxes) to the consolidated financial statements.

Other significant provisions of the TCJA 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).

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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 impacted Mid Penn included (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, economic, and competitive changes, management believes that the Bank and the financial services industry will continue to experience an increased rate of change from both the opportunities and competitive challenges resulting from greater product and service offerings, technological advancements, and business combinations.

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 or change Mid Penn's and the Bank's competitive landscape. 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'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 loan and deposit rates offered by the Bank and its competitors, and 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.

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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 knew and willfully compelled the borrower to commit an action which caused such release or to 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 for year-end financial reports beginning with 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 Exchange Act 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. 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.

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 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.

ITEM 1A. RISK FACTORS

Before investing in Mid Penn common stock, an investor should carefully read and 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 Mid Penn and the Bank. 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 the Bank’s 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

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the interest income the Bank receives on loans and securities and the amount of interest expense it pays on deposits and borrowings, but such changes could also affect (i) the Bank's ability to originate loans and obtain deposits, (ii) the fair value of financial assets and liabilities, and (iii) the average duration of mortgage-backed securities in the Bank's investment 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 the Bank's net interest income and Mid Penn's financial condition and results of operations.

Mid Penn is subject to credit risk

As of December 31, 2018, approximately 79 percent of the Bank's loan portfolio in Table 8 of Management's Discussion and Analysis consisted of commercial, industrial, and agricultural 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 the 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. 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. An increase in non-performing loans or collateral value deficiencies 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.

The 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.

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 over the Bank, 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, the Bank faces substantial competition from other insured depository institutions such as other commercial 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 also enjoy advantages over the Bank, 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 the Bank attracts or require an increase in rates and interest expense 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.

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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 expected discontinuance of LIBOR presents risks to the financial instruments originated, issued or held by Mid Penn that use LIBOR as a reference rate

LIBOR is used as a reference rate for many of Mid Penn's transactions, which means it is the base on which relevant interest rates are determined. Transactions include those in which Mid Penn lends and borrows money; issues, purchases and sells securities; and enters into derivatives to manage Mid Penn's and its customers' risk. LIBOR is the subject of recent national and international regulatory guidance and proposals for reform. The United Kingdom Financial Conduct Authority, which regulates the process for setting LIBOR, announced in July 2017 that it intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. While there are ongoing efforts to establish an alternative reference rate to LIBOR, as of the date of this report, no such rate has been accepted or is considered ready to be implemented.

If another rate does not achieve wide acceptance as the alternative to LIBOR, there likely will be disruption to all of the markets relying on the availability of a broadly accepted reference rate. Even if another reference rate ultimately replaces LIBOR, risks will remain for Mid Penn with respect to outstanding loans, derivatives or other instruments using LIBOR. Those risks arise in connection with transitioning those instruments to a new reference rate and the corresponding value transfer that may occur in connection with that transition. Risks related to transitioning instruments to a new reference rate or to how LIBOR is calculated and its availability include impacts on the yield on loans or securities held by Mid Penn, amounts paid on securities Mid Penn has issued, or amounts received and paid on derivative instruments Mid Penn has entered into. The value of loans, securities, or derivative instruments tied to LIBOR and the trading market for LIBOR-based securities could also be impacted upon its discontinuance or if it is limited. Further, it is possible that LIBOR quotes will become unavailable prior to 2021 if sufficient banks decline to make submissions to the LIBOR administrator. In that case, the risks associated with the transition to an alternative reference rate will be accelerated and magnified. These risks may also be increased due to the shorter timeframe for preparing for the transition.

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

Basel III established higher levels of base capital, certain capital buffers, and a migration toward common equity as the key source of regulatory capital. Although these capital requirements have been phased in and met by Mid Penn, the Basel III requirements signal 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 required additional capital to support our business risk profile. Maintaining higher levels of capital potentially reduces opportunities to leverage interest-earning assets, which could limit the net interest income and profitability of 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 technology and electronic delivery channels, 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 certain security systems and 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 principles involve certain estimates and processes that are particularly susceptible to significant change, including those related 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 principles, 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 twelve counties and markets primarily served by Mid Penn. 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 communities in the Pennsylvania 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 and state economy supporting its market area 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 and the Bank are subject to extensive regulation, supervision and examination by federal and state banking authorities. The potential exists for additional or amended federal or state laws and regulations, or changes in supervisory policies or activities, to materially 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. Further, 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. Also, 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. Any changes in applicable regulations or federal, state or local legislation, or the exercise of bank regulatory authority, may have a negative impact on Mid Penn's results of operations, financial condition, and its ability to pay dividends on common stock.

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 and losses in the event of a default by a counterparty or client. Any such losses could have a material adverse effect on Mid Penn's financial condition and results of operations.

Volatility in financial markets and the economy may have materially adverse effects on our liquidity and financial condition

In the recent past, the capital and credit markets experienced extreme volatility and economic disruption. Adverse financial market and economic conditions can exert downward pressure on stock prices, security prices, and credit availability for certain issuers without regard to their underlying financial strength. If such levels of financial market and economic 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'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 stressed the DIF and increased the costs of the Bank's FDIC insurance assessments. Future 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 the results of Mid Penn's operations and financial condition.

MID PENN BANCORP, INC.

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 process, inputs, calculations and assumptions used in determining whether an investment is impaired, Mid Penn's assessment of or disclosure of the impairment status of investments 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 provided both internally and 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, attract customers who prefer technological delivery channels, and 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 keep pace with these technological advancements or the related substantial costs and investments required, which could adversely affect its financial condition and results of operations.

Growing by acquisition entails certain risks, and difficulties in integrating past or future acquisitions could adversely affect our business

During 2018, Mid Penn completed acquisitions of both The Scottdale Bank & Trust Company and First Priority Financial Corp. Growth by acquisition involves substantial risks, as the ultimate success of such acquisitions may depend on, among other things, the ability to realize anticipated cost savings and to integrate the acquired companies and operation in a manner that does not result in decreased revenues resulting from excessive acquisition costs, conversion costs, or disruption of existing customer relationships in both the acquired companies and legacy markets. If we are not able to successfully achieve the financial efficiencies or integration and growth objectives of acquisitions, the anticipated benefits of an acquisition may not be realized fully, or at all, or may take longer to realize than planned.

Further, the asset quality or other financial characteristics of an acquired company may deteriorate from the date a merger or other acquisition agreement is entered into and when the transaction is completed or the post-merger period.

MID PENN BANCORP, INC.

Mid Penn has spent and may continue to spend significant resources identifying companies and businesses to acquire. The efficient and effective integration of any companies and businesses we acquire and integrate into our organization is critical to our growth. The Scottsdale 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 Scottsdale and First Priority, or those of future acquisition targets, could harm Mid Penn's business, financial condition, 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 or adding new branch locations in current and adjacent markets we choose to serve. The Scottsdale Merger and First Priority Merger were part of our growth strategy.

Our ability to manage growth successfully will depend on our ability to attract or retain qualified personnel, maintain cost controls and efficiencies, and ensure our areas of growth continue to meet our high asset quality standards, while attracting additional loans and deposits on favorable terms, as well as on factors beyond our control, such as economic conditions and competition in existing and new markets. 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 by Mid Penn 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%.

The per annum interest rate on the \$9.5 million of subordinated notes assumed in the First Priority acquisition is fixed at 7.00% and the notes are non-callable through November 2020. These notes include provisions for redemption pricing between 101.5% and 100.5% of the total of \$9.5 million, plus accrued but unpaid interest thereon up to but excluding the redemption date, if called after five years but prior to the maturity date of November 2025.

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 primarily by its banking subsidiary. Mid Penn's 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 respective regulatory agencies that supervise the Bank. 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 banking subsidiary or other subsidiaries established in the future will be able to pay dividends, or that Mid Penn itself 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 ability to pay dividends on its common stock, or the amount of any dividends paid, 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 Mid Penn's 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

Mid Penn may attempt to increase its capital resources or, if its or the Bank's capital ratios fall below the required minimums, Mid Penn or the Bank could be required 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. If a future liquidation of Mid Penn occurs, holders of debt securities and shares of preferred stock and lenders with respect to other borrowings are likely to receive distributions of available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of existing shareholders or reduce the market price of our common stock, or both. Holders of Mid Penn common stock are not entitled to preemptive rights or other protections against dilution.

Also, Mid Penn's 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. The 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 common stock with respect to dividends or upon our dissolution, winding up and liquidation and other terms. If Mid Penn issues preferred stock in the future that has a preference over its common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up, or if preferred stock is issued with voting rights that dilute the voting power of common stock, the rights of holders of Mid Penn's common stock or the market price of the 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, Mid Penn has various anti-takeover measures in place under its 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 and may prevent its shareholders from taking part in a transaction in which they could realize a premium over the current market price of its common stock.

Mid Penn's 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 "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 publicly 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 primary 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 and 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 thirty-eight full service locations and one loan production office at December 31, 2018. Twelve retail banking locations are located in Dauphin County, five in Schuylkill County, four in Berks County, three in Westmoreland County, three in Cumberland County, three in Lancaster County, two in Fayette County, two in Chester County, and one location in each of Northumberland, Luzerne, Montgomery, and Bucks Counties. As of December 31, 2018, retail banking facilities at twenty-four locations were owned, while fourteen branch facilities and the loan production office 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 10 "Bank Premises and Equipment" in the Notes to Consolidated Financial Statements.

ITEM 3. LEGAL PROCEEDINGS

There has been no change to the information disclosed in Item 1, Part II of Mid Penn's Quarterly Report or Form 10-Q for the period ended June 30, 2018, which is incorporated by reference. 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.

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 8, 2019, there were approximately 2,334 shareholders of record of Mid Penn's common stock.

Dividends: Cash dividends of \$0.70 and \$0.45 were paid and declared, respectively, in 2018. 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. 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.

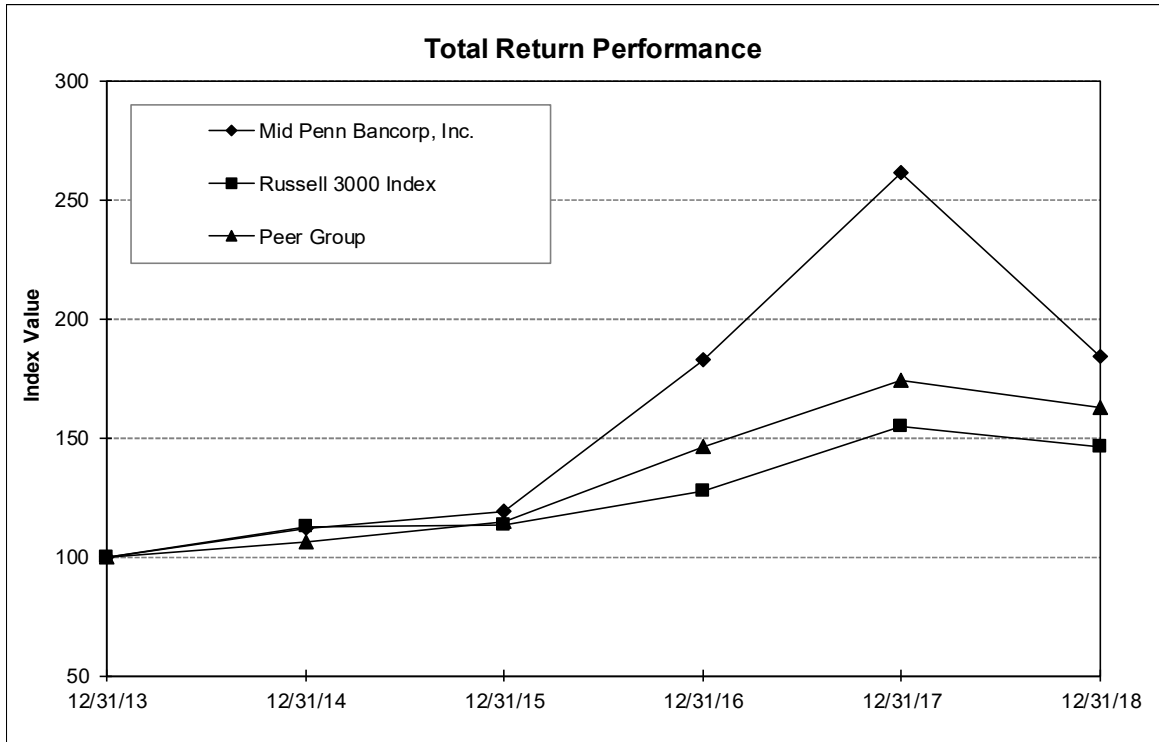
Annual Meeting: The Annual Meeting of the Shareholders of Mid Penn is expected to be held at 10:00 a.m. on Tuesday, May 14, 2019, at the West Shore Country Club, 100 Brentwater Road, Camp Hill, PA 17011.

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.

MID PENN BANCORP, INC.

Stock Performance Graph

The following five-year performance graph compares the cumulative total shareholder return (including reinvestment of dividends) on Mid Penn Bank’s common stock to the Russell 3000 Index and Mid Penn’s Peer Group, which includes Mid-Atlantic commercial banks with assets between \$1 billion and \$2 billion as of September 30, 2018. The stock performance graph assumes that \$100 was invested on December 31, 2013, and the cumulative return is measured as of each subsequent fiscal year end.



| <i>Index</i> | <i>Period Ending</i> | | | | | |
|---------------------------------|----------------------|----------|----------|----------|----------|----------|
| | 12/31/13 | 12/31/14 | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 |
| Mid Penn Bancorp, Inc. | 100.00 | 111.63 | 118.78 | 182.87 | 260.95 | 184.14 |
| Russell 3000 | 100.00 | 112.56 | 113.10 | 127.50 | 154.44 | 146.34 |
| Mid-Atlantic Custom Peer Group* | 100.00 | 106.27 | 114.85 | 145.90 | 174.30 | 162.33 |

* *Peer Group consists of Mid-Atlantic commercial banks with assets between \$1 billion and \$2 billion as of September 30, 2018.*

**Source: 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

(Dollars in thousands, except per share data)

| | <u>2018</u> | <u>2017</u> | <u>2016</u> | <u>2015</u> | <u>2014</u> |
|---|-------------|-------------|-------------|-------------|-------------|
| INCOME: | | | | | |
| Total Interest Income | \$ 68,654 | \$ 43,892 | \$ 40,212 | \$ 36,490 | \$ 30,627 |
| Total Interest Expense | 12,720 | 6,304 | 5,367 | 4,607 | 4,427 |
| Net Interest Income | 55,934 | 37,588 | 34,845 | 31,883 | 26,200 |
| Provision for Loan and Lease Losses | 500 | 325 | 1,870 | 1,065 | 1,617 |
| Noninterest Income | 7,462 | 5,693 | 5,924 | 4,113 | 3,284 |
| Noninterest Expense | 50,171 | 31,367 | 28,818 | 26,759 | 20,704 |
| Income Before Provision for Income Taxes | 12,725 | 11,589 | 10,081 | 8,172 | 7,163 |
| Provision for Income Taxes | 2,129 | 4,500 | 2,277 | 1,644 | 1,462 |
| Net Income | 10,596 | 7,089 | 7,804 | 6,528 | 5,701 |
| Series B Preferred Stock Dividends and Redemption Premium | — | — | — | 473 | 350 |
| Series C Preferred Stock Dividends | — | — | — | 17 | — |
| Series D Preferred Stock Dividends | 102 | — | — | — | — |
| Net Income Available to Common Shareholders | 10,494 | 7,089 | 7,804 | 6,038 | 5,351 |
| COMMON STOCK DATA PER SHARE: | | | | | |
| Earnings Per Common Share (Basic) | \$ 1.48 | \$ 1.67 | \$ 1.85 | \$ 1.47 | \$ 1.53 |
| Earnings Per Common Share (Fully Diluted) | 1.48 | 1.67 | 1.85 | 1.47 | 1.53 |
| Cash Dividends Declared | 0.45 | 0.77 | 0.68 | 0.44 | 0.45 |
| Cash Dividends Paid | 0.70 | 0.62 | 0.58 | 0.44 | 0.45 |
| Book Value Per Common Share | 26.38 | 17.85 | 16.65 | 16.58 | 15.48 |
| Tangible Book Value Per Common Share (a) | 18.10 | 16.82 | 15.59 | 15.49 | 15.13 |
| AVERAGE SHARES OUTSTANDING FOR THE YEAR (BASIC): | | | | | |
| | 7,071,091 | 4,236,616 | 4,229,284 | 4,106,548 | 3,495,705 |
| AVERAGE SHARES OUTSTANDING FOR THE YEAR (FULLY DILUTED): | | | | | |
| | 7,071,091 | 4,236,616 | 4,229,284 | 4,106,548 | 3,495,705 |
| AT YEAR-END: | | | | | |
| Available-For-Sale Investment Securities | \$ 111,923 | \$ 93,465 | \$ 133,625 | \$ 135,721 | \$ 141,634 |
| Held-to-Maturity Investment Securities | 168,370 | 101,356 | — | — | — |
| Loans and Leases, Net of Unearned Interest | 1,624,067 | 910,404 | 813,924 | 736,513 | 571,533 |
| Allowance for Loan and Lease Losses | 8,397 | 7,606 | 7,183 | 6,168 | 6,716 |
| Total Assets | 2,077,981 | 1,170,354 | 1,032,599 | 931,638 | 755,657 |
| Total Deposits | 1,726,026 | 1,023,568 | 935,373 | 777,043 | 637,922 |
| Short-term Borrowings | 43,100 | 34,611 | - | 31,596 | 578 |
| Long-term Debt | 48,024 | 12,352 | 13,581 | 40,305 | 52,961 |
| Subordinated Debt | 27,082 | 17,338 | 7,414 | 7,414 | — |
| Shareholders' Equity | 223,209 | 75,703 | 70,467 | 70,068 | 59,130 |
| RATIOS: | | | | | |
| Return on Average Assets | 0.63% | 0.64% | 0.78% | 0.74% | 0.78% |
| Return on Average Shareholders' Equity | 5.98% | 9.48% | 10.71% | 9.16% | 9.95% |
| Cash Dividend Payout Ratio | 47.30% | 37.18% | 31.35% | 29.93% | 29.41% |
| Allowance for Loan and Lease Losses to Loans and Leases at Year End | 0.52% | 0.84% | 0.88% | 0.83% | 1.18% |
| Average Shareholders' Equity to Average Assets for the Year | 10.54% | 6.78% | 7.28% | 8.06% | 7.80% |

(a) Tangible Book Value Per Common Share is a non-GAAP measure as it excludes goodwill and core deposits and other intangibles, net; see Reconciliation of Non-GAAP Measure below

MID PENN BANCORP, INC.

RECONCILIATION OF NON-GAAP MEASURE:

This Annual Report contains financial information determined by methods other than in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). For tangible book value, the most directly comparable financial measure calculated in accordance with GAAP is our book value. Management of Mid Penn believes that this measure is important to many investors in the marketplace who are interested in changes from period to period in book value per common share exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing total book value while not increasing our tangible book value. Income tax effects of non-GAAP adjustments are calculated using the applicable statutory tax rate for the jurisdictions in which the charges (benefits) are incurred, while taking into consideration any valuation allowances or non-deductible portions of the non-GAAP adjustments. This non-GAAP disclosure has limitations as an analytical tool, should not be viewed as a substitute for financial measures determined in accordance with GAAP, and should not be considered in isolation or as a substitute for analysis of Mid Penn's results and financial condition as reported under GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies. Management believes that this non-GAAP supplemental information will be helpful in understanding Mid Penn's ongoing operating results. This supplemental presentation should not be construed as an inference that Mid Penn's future results will be unaffected by similar adjustments to be determined in accordance with GAAP.

| <i>(Dollars in thousands, except per share data)</i> | 2018 | 2017 | December 31, 2016 | 2015 | 2014 |
|--|--------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Shareholder's Equity | \$ 223,209 | \$ 75,703 | \$ 70,467 | \$ 70,068 | \$ 59,130 |
| Less: Preferred Stock | — | — | — | — | 5,000 |
| Less: Goodwill | 62,840 | 3,918 | 3,918 | 3,918 | 1,016 |
| Less: Core Deposit and Other Intangibles | 7,221 | 434 | 539 | 665 | 187 |
| Tangible Equity | <u>\$ 153,148</u> | <u>\$ 71,351</u> | <u>\$ 66,010</u> | <u>\$ 65,485</u> | <u>\$ 52,927</u> |
| | | | | | |
| Common Shares Issued and Outstanding | <u>8,459,918</u> | <u>4,242,216</u> | <u>4,233,297</u> | <u>4,226,717</u> | <u>3,497,829</u> |
| | | | | | |
| Tangible Book Value per Common Share | <u>\$ 18.10</u> | <u>\$ 16.82</u> | <u>\$ 15.59</u> | <u>\$ 15.49</u> | <u>\$ 15.13</u> |

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 or the Bank 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, the Bank, and their markets and 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, or 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 regulatory examination and supervision processes;
- the failure of assumptions underlying the establishment of reserves for loan and lease losses, the assessment of potential impairment of investment securities, 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 year ended 2018, compared to 2017 and 2016, in general, have been materially impacted by the acquisition of The Scottsdale Bank and Trust Company, which closed on January 8, 2018, and the acquisition of First Priority Financial Corp., which closed on July 31, 2018. For comparative purposes, some 2017 and 2016 balances have been reclassified to conform to the 2018 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 or the Bank'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 used in applying these principles 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 have been 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 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 adjusted for qualitative factors, 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 of securities, management must assess whether there are any declines where the fair value is below the carrying value of any investments such that the decline should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of a loss in the consolidated statement of income.

Certain intangible assets generated in connection with acquisitions are periodically assessed for impairment. Goodwill is tested annually for impairment, and 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. Similarly, the amortized basis of the core deposit intangible asset and trade name intangible are periodically assessed for impairment. There are inherent uncertainties related to these factors and Mid Penn's judgment in applying them to the analysis of core deposit intangible, trade name intangible, and goodwill impairment. Future changes in economic and operating conditions could result in goodwill or core deposit intangible or trade name intangible impairment in subsequent 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*2018 versus 2017*

As noted above, the comparability of the results of operations for the years ended 2018 and 2017, in general, have been materially impacted by the acquisitions of Scottdale, which closed on January 8, 2018, and First Priority, which closed on July 31, 2018.

Mid Penn's net income available to common shareholders ("earnings") was \$10,494,000 or \$1.48 per common share basic and diluted for the year ended December 31, 2018, compared to earnings of \$7,089,000 or \$1.67 per common share basic and diluted for the year ended December 31, 2017. The results for the year ended December 31, 2018 included merger and acquisition expenses resulting from Mid Penn's acquisitions of First Priority and Scottdale. Earnings for the year ended December 31, 2017 included certain merger-related costs for the Scottdale acquisition, and were also impacted by a one-time 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 TCJA, which lowered Mid Penn's maximum corporate tax rate from 34 percent in 2017 and prior periods to 21 percent in 2018 and future periods.

Total assets of Mid Penn grew \$907,627,000 or 78 percent, in 2018 to close the year at \$2,077,981,000, compared to total assets of \$1,170,354,000 at the end of 2017. Asset growth during the year ended December 31, 2018 includes the acquired loans, investments, cash, facilities, goodwill and core deposit intangibles recorded from the legal closing of the Scottdale and First Priority transactions, as well as organic growth from our legacy markets.

Increases in short-term debt, long-term debt and subordinated debt during the year ended December 31, 2018 were a result of both (i) \$50 million of shorter-term FHLB fixed-rate borrowings obtained in late November 2018, and (ii) \$15.5 million of combined long-term FHLB borrowings and subordinated debt assumed in the First Priority acquisition. Scottdale had no borrowings that were assumed by Mid Penn in that acquisition.

Mid Penn's return on average shareholders' equity ("ROE"), a widely recognized performance indicator in the financial industry, was 5.98% in 2018 and 9.48% in 2017. The reduction in this indicator was significantly impacted by the material costs incurred in 2018 with the two acquisitions, and from the impact of additional common equity issued in conjunction with both transactions. Return on average assets ("ROA"), another performance indicator, was 0.63% in 2018 and 0.64% in 2017.

Net interest margin was 3.67% in 2018 versus 3.68% in 2017. Net interest income on a tax equivalent basis increased to \$56,824,000 in 2018 from \$38,597,000 in 2017. Increases in yields on earning assets and increases in noninterest-bearing deposits during 2018 were offset by the impact of both (i) the rising cost of both deposit and borrowed funds as a result of market pricing in response to recent Federal Open Market Committee ("FOMC") rate increases, and (ii) the increase in wholesale funding and related interest costs, including the assumption of some higher-cost brokered time deposits, FHLB borrowings, and subordinated debt in the First Priority transaction. Further discussion of net interest margin can be found in the Net Interest Income section below.

Mid Penn's allowance for loan and lease losses at December 31, 2018 was \$8,397,000 or 0.52% of total loans (less unearned discount), as compared to \$7,606,000 or 0.84% at December 31, 2017. During 2018, Mid Penn had net loan recoveries of \$291,000 compared to net recoveries of \$98,000 during the same period of 2017. The primary reason for the favorable net recovery amount during 2018 was Mid Penn's workout and recovery of \$777,000 of principal from a commercial real estate relationship that was subject to a restructuring and partial charge-off in 2009. Mid Penn's net recovery position for the year ended December 31, 2017 was primarily attributed to the recovery of \$318,000 of principal from the successful workout of a different commercial real estate relationship that was partially charged-off in 2010. Further discussion of these items can be found in the Provision for Loan and Lease Losses section below.

Total nonperforming assets increased \$975,000 from \$11,308,000 at the end of 2017 to \$12,283,000 at the end of 2018. Further discussion of the components of nonperforming assets can be found in the Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses section below.

Mid Penn's regulatory capital measures of Tier 1 Capital (to risk weighted assets) of \$155,662,000 or 10.0%, and Total Capital (to risk weighted assets) of \$191,300,000 or 12.3%, at December 31, 2018, are above the regulatory "well capitalized" requirements. Tier 1 Capital consists primarily of Mid Penn's shareholders' equity less the value of goodwill and other intangible assets, and excluding the impact 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 regulatory limits. Risk-weighted assets are determined by assigning various levels of risk, in accordance with regulatory risk-weighting definitions, to different categories of assets and off-balance sheet activities.

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 under the TCJA, which resulted in a charge of \$1,169,000 included in the provision for income taxes.

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 ROE was 9.48% in 2017 and 10.71% in 2016. ROA 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 regulatory limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

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

| | Income and Rates on a Taxable Equivalent Basis for Years Ended | | | | | | | | |
|--|--|------------------|---------------|--------------------|------------------|---------------|--------------------|------------------|---------------|
| | December 31, 2018 | | | December 31, 2017 | | | December 31, 2016 | | |
| | Average Balance | Average Interest | Average Rates | Average Balance | Average Interest | Average Rates | Average Balance | Average Interest | Average Rates |
| ASSETS: | | | | | | | | | |
| Interest Bearing Balances | \$ 4,983 | \$ 75 | 1.51% | \$ 2,621 | \$ 18 | 0.69% | \$ 2,559 | \$ 12 | 0.47% |
| Investment Securities: | | | | | | | | | |
| Taxable | 165,422 | 3,838 | 2.32% | 121,050 | 2,376 | 1.96% | 79,277 | 1,515 | 1.91% |
| Tax-Exempt | 102,656 | 2,940 (a) | 2.86% | 52,919 | 1,687 (a) | 3.19% | 80,451 | 3,130 (a) | 3.89% |
| Total Securities | 268,078 | 6,778 | 2.53% | 173,969 | 4,063 | 2.34% | 159,728 | 4,645 | 2.91% |
| Federal Funds Sold | 25,745 | 451 | 1.75% | 11,220 | 115 | 1.02% | 16,848 | 82 | 0.49% |
| Loans and Leases, Net | 1,243,987 | 61,965 (b) | 4.98% | 857,259 | 40,591 (b) | 4.73% | 772,877 | 36,963 (b) | 4.78% |
| Restricted Investment in Bank Stocks | 3,567 | 275 | 7.71% | 2,955 | 114 | 3.86% | 2,751 | 135 | 4.91% |
| Total Earning Assets | 1,546,360 | 69,544 | 4.50% | 1,048,024 | 44,901 | 4.28% | 954,763 | 41,837 | 4.38% |
| Cash and Due from Banks | 29,408 | | | 20,323 | | | 12,791 | | |
| Other Assets | 89,953 | | | 35,092 | | | 33,898 | | |
| Total Assets | <u>\$1,665,721</u> | | | <u>\$1,103,439</u> | | | <u>\$1,001,452</u> | | |
| LIABILITIES & SHAREHOLDERS' EQUITY: | | | | | | | | | |
| Interest-bearing Demand | \$ 371,873 | 2,447 | 0.66% | \$ 335,859 | 1,410 | 0.42% | \$ 293,745 | 1,009 | 0.34% |
| Money Market | 309,705 | 2,990 | 0.97% | 247,337 | 1,448 | 0.59% | 235,561 | 1,315 | 0.56% |
| Savings | 191,686 | 540 | 0.28% | 62,500 | 35 | 0.06% | 59,615 | 34 | 0.06% |
| Time | 324,853 | 4,907 | 1.51% | 197,154 | 2,570 | 1.30% | 172,657 | 2,156 | 1.25% |
| Total Interest-bearing Deposits | 1,198,117 | 10,884 | 0.91% | 842,850 | 5,463 | 0.65% | 761,578 | 4,514 | 0.59% |
| Short-term Borrowings | 8,833 | 207 | 2.34% | 7,961 | 111 | 1.39% | 2,370 | 15 | 0.63% |
| Long-term Debt | 17,292 | 462 | 2.67% | 13,321 | 318 | 2.39% | 28,474 | 442 | 1.55% |
| Subordinated Debt | 21,324 | 1,167 | 5.47% | 7,746 | 412 | 5.32% | 7,431 | 396 | 5.33% |
| Total Interest-bearing Liabilities | 1,245,566 | 12,720 | 1.02% | 871,878 | 6,304 | 0.72% | 799,853 | 5,367 | 0.67% |
| Noninterest-bearing Demand | 232,562 | | | 146,683 | | | 120,244 | | |
| Other Liabilities | 12,030 | | | 10,094 | | | 8,462 | | |
| Shareholders' Equity | 175,563 | | | 74,784 | | | 72,893 | | |
| Total Liabilities & Shareholders' Equity | <u>\$1,665,721</u> | | | <u>\$1,103,439</u> | | | <u>\$1,001,452</u> | | |
| Net Interest Income (taxable equivalent basis) | | \$56,824 | | | \$38,597 | | | \$36,470 | |
| Taxable Equivalent Adjustment | | (890) | | | (1,009) | | | (1,625) | |
| Net Interest Income | | <u>\$55,934</u> | | | <u>\$37,588</u> | | | <u>\$34,845</u> | |
| Total Yield on Earning Assets | | | 4.50% | | | 4.28% | | | 4.38% |
| Rate on Supporting Liabilities | | | 1.02% | | | 0.72% | | | 0.67% |
| Average Interest Spread | | | 3.48% | | | 3.56% | | | 3.71% |
| Net Interest Margin | | | 3.67% | | | 3.68% | | | 3.82% |

(a) Includes tax equivalent adjustments (calculated using statutory rates of 21% for 2018 and 34% for 2017 and 2016) of \$617,000, \$574,000, and \$1,064,000 for the years 2018, 2017, and 2016, respectively, resulting from tax-free municipal securities in the investment portfolio.

(b) Includes tax equivalent adjustments (calculated using statutory rates of 21% for 2018 and 34% for 2017 and 2016) of \$273,000, \$435,000, and \$561,000 for the years 2018, 2017, and 2016, respectively, resulting from tax-free municipal loans in the commercial loan portfolio.

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. Interest and average rates in Table 1 above are presented on a fully taxable-equivalent basis. Tax-equivalent adjustments were calculated using statutory corporate tax rates of 21 percent for the year ended December 31, 2018, and 34 percent for the years ended December 31, 2017 and 2016. For purposes of calculating loan yields, average loan balances include nonaccrual loans. Loan fees of \$1,038,000, \$921,000 and \$1,097,000 are included with loan interest income in Table 1 above for the years ended December 31, 2018, 2017, and 2016, respectively.

TABLE 2: VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

| | 2018 Compared to 2017 | | | 2017 Compared to 2016 | | |
|-----------------------------------|-----------------------|---------------|------------------|-----------------------|-------------------|-----------------|
| | Increase (Decrease) | | | Increase (Decrease) | | |
| | Due to Change In: | | | Due to Change In: | | |
| | Volume | Rate | Net | Volume | Rate | Net |
| INTEREST INCOME: | | | | | | |
| Interest Bearing Balances | \$ 16 | \$ 41 | \$ 57 | \$ 1 | \$ 5 | \$ 6 |
| Investment Securities: | | | | | | |
| Taxable | 871 | 591 | 1,462 | 798 | 63 | 861 |
| Tax-Exempt | 1,586 | (333) | 1,253 | (1,071) | (372) | (1,443) |
| Total Securities | 2,457 | 258 | 2,715 | (273) | (309) | (582) |
| Federal Funds Sold | 149 | 187 | 336 | (27) | 60 | 33 |
| Loans and Leases, Net | 18,311 | 3,063 | 21,374 | 4,036 | (408) | 3,628 |
| Restricted Investment Bank Stocks | 24 | 137 | 161 | 10 | (31) | (21) |
| Total Interest Income | 20,957 | 3,686 | 24,643 | 3,747 | (683) | 3,064 |
| INTEREST EXPENSE: | | | | | | |
| Interest Bearing Deposits: | | | | | | |
| Interest Bearing Demand | 151 | 886 | 1,037 | 145 | 256 | 401 |
| Money Market | 365 | 1,177 | 1,542 | 66 | 67 | 133 |
| Savings | 72 | 433 | 505 | — | 1 | 1 |
| Time | 1,665 | 672 | 2,337 | 306 | 108 | 414 |
| Total Interest Bearing Deposits | 2,253 | 3,168 | 5,421 | 517 | 432 | 949 |
| Short-term Borrowings | 12 | 84 | 96 | 35 | 61 | 96 |
| Long-term Debt | 95 | 49 | 144 | (235) | 111 | (124) |
| Subordinated Debt | 722 | 33 | 755 | 17 | (1) | 16 |
| Total Interest Expense | 3,082 | 3,334 | 6,416 | 334 | 603 | 937 |
| NET INTEREST INCOME | \$ 17,875 | \$ 352 | \$ 18,227 | \$ 3,413 | \$ (1,286) | \$ 2,127 |

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 using statutory corporate tax rates of 21 percent for the year ended December 31, 2018, and 34 percent for the years ended December 31, 2017 and 2016.

During 2018, taxable equivalent net interest income increased \$18,227,000 or 47 percent compared to 2017. During 2017, taxable equivalent net interest income increased \$2,127,000 or 6 percent compared to 2016. The average balances, effective interest differential, and interest yields for the years ended December 31, 2018, 2017, and 2016 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 2018 compared to 2017, and 2017 compared to 2016, by reflecting 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 increased to 4.50% in 2018 from 4.28% in 2017. The yield on earning assets for 2016 was 4.38%. The increase in the yield on earning assets in 2018 was largely due to increases in both rate and volume of loan and investments. The average rate on loans increased to 4.98% in 2018 from 4.73% in 2017. The average rates on investment securities also increased from 2017 to 2018 as a decrease in the yield on tax-exempt investments from 3.19% to 2.86% was more than offset by the impact of an increase in the yield on taxable investments from 1.96% to 2.32%. The increase in investment yields in 2018 was affected by both yields on purchases, and from yields on securities added to the investment portfolio as a result of the two 2018 acquisitions.

Interest expense increased by \$6,416,000 or 102 percent in 2018, as compared to 2017. For the year ending December 31, 2017, interest expense increased \$937,000 or 17 percent, compared to 2016. The cost of interest bearing liabilities increased to 1.02% in 2018 from 0.72% in 2017. The cost of interest bearing liabilities for 2016 was 0.67%. The increase in the cost of interest bearing liabilities was due to both (i) the rising cost of both deposit and borrowed funds as a result of market pricing in response to recent FOMC rate increases, and (ii) the increase in wholesale funding, including the assumption of some higher-cost brokered time deposits, FHLB borrowings, and subordinated debt in the First Priority transaction.

Net interest margin, on a tax equivalent basis, was 3.67% in 2018 compared to 3.68% in 2017 and 3.82% in 2016. Increases in yields on earning assets and increases in noninterest-bearing deposits were offset by the higher cost of interest bearing liabilities when comparing 2018 to 2017. The decrease in the net interest margin for 2017 compared to 2016 was primarily the result of a lower realized yield on the investment portfolio, including the impact of purchases of lower-risk and lower-yielding held-to-maturity portfolio securities 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, 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, shifting collateral values, and the assessment of other relevant qualitative factors from December 31, 2017 to December 31, 2018. For the year ended December 31, 2018, the provision for loan and lease losses was \$500,000 compared to \$325,000 for the year ended December 31, 2017. The increase in loan loss provision expense year-over-year was necessary to support the allowance for loan loss given the organic loan growth within Mid Penn's loan portfolio since December 31, 2017, though the required provision for both years was favorably impacted by the net recoveries for the respective year. The allowance for loan and lease losses as a percentage of total loans was 0.52% at December 31, 2018, compared to 0.84% at December 31, 2017 and 0.88% at December 31, 2016.

For the year ended December 31, 2018, Mid Penn favorably had net recoveries of \$291,000 compared to net recoveries of \$98,000 during the same period of 2017. Loans charged off during 2018 were comprised of two commercial and industrial loans for \$142,000, four commercial real estate loans among two relationships totaling \$64,000 and one commercial real estate – construction loan of \$40,000. In addition, there were charge-offs for three home equity loans for \$185,000, three residential real estate loans totaling \$60,000, and four consumer loans to unrelated borrowers totaling \$14,000. The remaining \$23,000 was comprised of deposit account charge-offs. These charge-offs were more than offset by total recoveries of \$819,000 realized during 2017, primarily comprised of one commercial real estate loan totaling \$777,000.

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 or other relevant qualitative factors differ 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, | | | | |
|---|--------------------------|-----------------|-----------------|-----------------|-----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Balance, beginning of year | \$ 7,606 | \$ 7,183 | \$ 6,168 | \$ 6,716 | \$ 6,317 |
| Loans and leases charged off: | | | | | |
| Commercial real estate, construction and land development | 104 | 322 | 216 | 1,569 | 1,057 |
| Commercial, industrial and agricultural | 142 | 25 | 820 | 130 | 62 |
| Real estate - residential | 60 | 102 | 4 | 35 | 133 |
| Consumer | 222 | 48 | 67 | 50 | 76 |
| Total loans and leases charged off | <u>528</u> | <u>497</u> | <u>1,107</u> | <u>1,784</u> | <u>1,328</u> |
| Recoveries on loans and leases previously charged off: | | | | | |
| Commercial real estate, construction and land development | 808 | 553 | 211 | 75 | 13 |
| Commercial, industrial and agricultural | 1 | 26 | 4 | 12 | 13 |
| Real estate - residential | - | 4 | 26 | 44 | 20 |
| Consumer | 10 | 12 | 11 | 40 | 64 |
| Total loans and leases recovered | <u>819</u> | <u>595</u> | <u>252</u> | <u>171</u> | <u>110</u> |
| Net (recoveries) charge-offs | (291) | (98) | 855 | 1,613 | 1,218 |
| Provision for loan and lease losses | 500 | 325 | 1,870 | 1,065 | 1,617 |
| Balance, end of year | <u>\$ 8,397</u> | <u>\$ 7,606</u> | <u>\$ 7,183</u> | <u>\$ 6,168</u> | <u>\$ 6,716</u> |

| | Years ended December 31, | | | | |
|---|--------------------------|---------------|----------------|----------------|---------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Ratio of net (recoveries) charge-offs during the year to average loans and leases outstanding during the year, net of unearned discount | <u>-0.02%</u> | <u>-0.01%</u> | <u>0.11%</u> | <u>0.23%</u> | <u>0.22%</u> |
| Allowance for loan and lease losses as a percentage of total loans and leases at December 31 | <u>0.52%</u> | <u>0.84%</u> | <u>0.88%</u> | <u>0.83%</u> | <u>1.18%</u> |
| Allowance for loan and lease losses as a percentage of non-performing assets at December 31 | <u>68.37%</u> | <u>67.26%</u> | <u>124.73%</u> | <u>101.75%</u> | <u>58.36%</u> |

TABLE 4: NONINTEREST INCOME*(Dollars in thousands)*

| | Years ended December 31, | | |
|--|--------------------------|-----------------|-----------------|
| | 2018 | 2017 | 2016 |
| Income from fiduciary activities | \$ 1,155 | \$ 845 | \$ 481 |
| Service charges on deposits | 933 | 721 | 684 |
| Net gain on sales of investment securities | 137 | 42 | 1,046 |
| Earnings from cash surrender value of life insurance | 286 | 262 | 264 |
| Mortgage banking income | 751 | 872 | 922 |
| ATM debit card interchange income | 1,253 | 937 | 844 |
| Merchant services income | 347 | 335 | 317 |
| Net gain on sales of SBA loans | 561 | 800 | 470 |
| Other income | 2,039 | 893 | 918 |
| Total Noninterest Income | <u>\$ 7,462</u> | <u>\$ 5,707</u> | <u>\$ 5,946</u> |

Noninterest Income*2018 versus 2017*

For the year ended December 31, 2018, noninterest income totaled \$7,462,000, an increase of \$1,755,000 or 31 percent, compared to noninterest income of \$5,707,000 for the year ended December 31, 2017. Several components of noninterest income were affected by higher account and transaction volume, when comparing 2018 to the prior year, due to both the First Priority and Scottsdale acquisitions that closed during 2018.

Income from fiduciary activities was \$1,155,000 for the year ended December 31, 2018, an increase of \$310,000 or 37 percent compared to fiduciary income of \$845,000 for the year ended December 31, 2017. These additional revenues were attributed to continued growth in trust assets under management, and increased sales of retail investment products, as a result of successful business development efforts by Mid Penn's trust and wealth management team.

Service charges on deposits were \$933,000 for the year ended December 31, 2018, an increase of \$212,000 or 29 percent, compared to service charges of \$721,000 for the year ended December 31, 2017. This increase was driven by an increase in collected charges on a higher volume of transactional deposit accounts, including deposit accounts assumed in both the Scottsdale and First Priority acquisitions.

Net gains on sales of securities were \$137,000 for the year ended December 31, 2018, an increase of \$95,000 compared to net gains on sales of securities of \$42,000 for the year ended December 31, 2017. Some investment securities acquired from Scottsdale and First Priority were sold to ensure that the overall portfolio, after the acquisitions, was in alignment with Mid Penn's investment management objectives.

ATM debit card interchange income was \$1,253,000 for the year ended December 31, 2018, an increase of \$316,000 or over 33 percent compared to interchange income of \$937,000 for the year ended December 31, 2017. The increase in Mid Penn Bank ATM and debit card activity resulted from both increasing card-based transaction volume, as well as new demand deposit accounts, including those acquired in the Scottsdale and First Priority transactions.

Other income was \$2,039,000 for the year ended December 31, 2018, an increase of \$1,146,000 compared to other income of \$893,000 for the year ended December 31, 2017. The increase in other income was primarily driven by \$737,000 of settlement gains recognized during 2018 as a result of certain lump sum payouts reducing pension liabilities to participants of the Scottsdale defined benefit retirement, with such pension liabilities being assumed as a result of the Scottsdale acquisition in 2018. Also, increases in letter of credit renewal fees and other service fees and commissions also contributed to the year-over-year growth in other income.

Mortgage banking income was \$751,000 for the year ended December 31, 2018, a decrease of \$121,000 or 14 percent compared to the year ended December 31, 2017. Higher longer-term mortgage interest rates for much of 2018 resulted in a lower volume of mortgage refinance activity during 2018 when compared to 2017.

Net gains on sales of SBA loans was \$561,000 for the year ended December 31, 2018, a decrease of \$239,000 when compared to the same period in 2017. Increased interest rates on SBA loans, and tighter market pricing on secondary market sales yields, resulted in lower levels of loan sales and related gains in 2018 versus the prior year.

2017 versus 2016

During the twelve months ended December 31, 2017, noninterest income (excluding net securities gains of \$42,000) increased \$765,000 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 \$25,000 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.

TABLE 5: NONINTEREST EXPENSE*(Dollars in thousands)*

| | Years ended December 31, | | |
|--|---------------------------------|------------------|------------------|
| | 2018 | 2017 | 2016 |
| Salaries and employee benefits | \$ 23,862 | \$ 16,929 | \$ 15,564 |
| Occupancy expense, net | 4,019 | 2,512 | 2,064 |
| Equipment expense | 2,186 | 1,536 | 1,689 |
| Pennsylvania Bank Shares tax expense | 225 | 451 | 648 |
| FDIC Assessment | 772 | 792 | 688 |
| Legal and professional fees | 1,117 | 802 | 711 |
| Marketing and advertising expense | 1,025 | 516 | 500 |
| Software licensing and utilization | 3,036 | 2,051 | 1,908 |
| Telephone expense | 621 | 497 | 548 |
| Loss on sale/write-down of foreclosed assets | 4 | 88 | 217 |
| Intangible amortization | 1,224 | 104 | 126 |
| Merger and acquisition expense | 4,790 | 619 | — |
| ATM debit card processing expense | 631 | 448 | 440 |
| Director fees and benefits expense | 792 | 465 | 340 |
| Loan collection costs | 271 | 148 | 178 |
| Meals, travel, and lodging expense | 945 | 544 | 428 |
| Data processing | 573 | 420 | 341 |
| Insurance | 278 | 216 | 178 |
| OREO expense | 275 | 79 | 248 |
| Investor services | 159 | 115 | 85 |
| Other expenses | 3,366 | 2,049 | 1,939 |
| Total Noninterest Expense | <u>\$ 50,171</u> | <u>\$ 31,381</u> | <u>\$ 28,840</u> |

Noninterest Expense*2018 versus 2017*

Noninterest expense for the year ended December 31, 2018 totaled \$50,171,000, an increase of \$18,790,000 or 60 percent compared to noninterest expenses of \$31,381,000 for the twelve months ended December 31, 2017. The primary source of the increase in noninterest expense were the merger expenses and other costs supporting Mid Penn's acquisition of both First Priority and Scottsdale, and from the opening of new retail branches and new corporate administrative offices in 2018.

For the year ended December 31, 2018, Mid Penn incurred merger and acquisition expenses totaling \$4,790,000 in connection with the First Priority and Scottsdale acquisitions, with such expenses including investment banking fees, merger-related legal expenses, professional fees related to the preparation and filing of merger documents, severance costs, and information technology conversion/termination costs. Merger and acquisition expenses of \$619,000 were recorded for the year ended December 31, 2017, and consisted primarily of investment banking fees, legal fees, and professional fees related to the preparation and filing of merger documents, related to the Scottsdale acquisition.

Salaries and employee benefits expense increased \$6,933,000 or 41 percent during the twelve months ended December 31, 2018 versus the same period in 2017, with the increase attributable to (i) the retail staff additions at the five retail locations added through the Scottsdale acquisition and the opening of the Halifax, PA branch, all effective January 8, 2018, (ii) the retail staff additions at the eight retail locations and loan production office added through the First Priority acquisition, effective July 31, 2018, (iii) the retail staff additions as a result of the opening of two additional retail offices in upper Dauphin County, Pennsylvania (Halifax and Pillow), and (iv) the addition of commercial lenders, credit administration personnel, and other staff additions in Mid Penn's legacy markets, in alignment with Mid Penn's core banking growth objectives.

Occupancy expenses increased \$1,507,000 or 60 percent during the year ended December 31, 2018 compared to the same period in 2017. Similarly, equipment expense increased \$650,000 or 42 percent during the year ended December 31, 2018 compared to the year ended December 31, 2017. These increases were driven by (i) the facility operating costs and increased depreciation expense for building, furniture, and equipment associated with the addition of the above-noted acquired and new branch offices, and (ii) depreciation and occupancy costs related to Mid Penn's addition of larger corporate administrative office facilities to increase the effectiveness and efficiency of administrative and operations support services for the growing franchise.

FDIC assessment expense was \$772,000 for the year ended December 31, 2018, a decrease of \$20,000 or 3 percent compared to \$792,000 for the year ended December 31, 2017. As a result of several factors, including the 2018 acquisitions, the favorable asset quality of both legacy portfolio loan assets and acquired portfolios, and successful workouts of non-performing assets, Mid Penn had more favorable capital and asset quality ratios, resulting in a lower overall FDIC assessment rate for 2018.

Legal and professional fees for the year ended December 31, 2018 increased by \$315,000 or 39 percent compared to the year ended December 31, 2017, due to increased third-party services for wealth management, audit, information technology consulting, and public relations activities given the expanded franchise operating profile.

Marketing and advertising expense increased 99 percent, from \$516,000 for the year ended December 31, 2017 to \$1,025,000 for the year ended December 31, 2018. The increased costs were a result of marketing and branding initiatives implemented at the recently acquired Scottsdale and First Priority locations, and market-specific business development promotions across Mid Penn's footprint.

Software licensing and utilization costs were \$3,036,000 during the year ended December 31, 2018, an increase of \$985,000 or 48 percent compared to \$2,051,000 for the year ended December 31, 2017. The increase is a result of additional costs to license (i) all of the Scottsdale and First Priority locations and the new retail branches, (ii) upgrades to internal systems to enhance data management and storage capabilities given the larger company profile, and (iii) increases in certain core processing fees as our customer base and account/transaction volumes continue to grow.

Intangible amortization increased from \$104,000 during the year ended December 31, 2017 to \$1,224,000 during the same period in 2018. In the first quarter of 2018, Mid Penn recorded a core deposit intangible (CDI) asset related to the Scottsdale acquisition of \$4,940,000. On July 31, 2018, Mid Penn recorded an additional CDI asset of \$2,832,000 as a result of the First Priority acquisition. These CDI assets will be amortized using the sum of the years' digit method over a ten-year period from the respective acquisition date. During the year ended December 31, 2018, the CDI amortization recorded related to the Scottsdale and First Priority acquisitions totaled \$1,113,000, of which \$898,000 was related to the amortization of the Scottsdale CDI and \$215,000 was related to the amortization of the First Priority CDI. The remaining intangible amortization expense in 2018, and the prior year's amortization expense, was attributable to CDI recorded as a result of Mid Penn's acquisition of Phoenix Bancorp in 2015.

Other expense was \$7,290,000 during the year ended December 31, 2018, an increase of \$2,806,000 or 63 percent compared to other expense of \$4,484,000 for the year ended December 31, 2017. As both organic growth and the Scottsdale and First Priority acquisitions have increased Mid Penn's geographic profile and employee base, several categories within other expenses experienced year-over-year increases, including insurance costs, stationary and supplies, printing, postage, employee travel costs, and directors fees.

2017 versus 2016

During the year ended December 31, 2017, noninterest expenses totaled \$31,381,000, an increase of \$2,541,000 or 9 percent compared to \$28,840,000 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.

Investments

Mid Penn's investment portfolio is utilized primarily to support overall liquidity management, to provide collateral supporting pledging requirements over public funds deposit, and to generate additional interest income within reasonable risk parameters. Mid Penn's investment portfolio includes both held-to-maturity securities and available-for-sale securities.

During the year ended December 31, 2018, the portfolio of held-to-maturity securities increased over 66 percent to \$168,370,000 as of December 31, 2018, as compared to \$101,356,000 as of December 31, 2017 (held-to-maturity investments are recorded at amortized cost). Mid Penn's total available-for-sale securities portfolio increased \$18,458,000 or 20 percent, from \$93,465,000 at December 31, 2017 to \$111,923,000 at December 31, 2018. The increase to the investment securities during 2018 was primarily due to investments acquired from Scottsdale and First Priority. Some acquired available-for-sale securities were sold after the mergers and the proceeds reinvested in held-to-maturity securities, both to support pledging requirements, and to ensure greater portfolio alignment with Mid Penn's investment management objectives.

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 and overall market yield curve changes, the fair value of securities changes accordingly. The fair values of securities can also be impacted by changing market supply and demand for certain types of securities.

At December 31, 2018, the unrealized loss on available-for-sale investment securities resulted in a decrease in shareholders' equity of \$3,242,000 (comprised of a gross unrealized loss on securities of \$4,103,000 net of a deferred income tax benefit of \$861,000). At December 31, 2017, the unrealized loss on available-for-sale investment securities resulted in a decrease in shareholders' equity of \$2,159,000 (gross unrealized loss on securities of \$2,733,000 net of a deferred income tax benefit of \$574,000). 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, and maturity and yield information relating to debt securities is shown in Table 7.

TABLE 6: FAIR VALUE OF INVESTMENT SECURITIES

(Dollars in thousands)

| | December 31, | | |
|--|-------------------|-------------------|-------------------|
| | 2018 | 2017 | 2016 |
| Available-for-sale securities: | | | |
| U.S. Treasury and U.S. government agencies | \$ 41,572 | \$ 38,730 | \$ 47,012 |
| Mortgage-backed U.S. government agencies | 38,849 | 25,831 | 25,619 |
| State and political subdivision obligations | 29,256 | 27,043 | 58,838 |
| Corporate debt securities | 2,246 | 1,355 | 1,099 |
| Total available-for-sale debt securities | <u>111,923</u> | <u>92,959</u> | <u>132,568</u> |
| Available-for-sale equity securities: | | | |
| Equity securities | \$ 492 | \$ 506 | \$ 1,057 |
| Total available-for-sale equity securities | <u>492</u> | <u>506</u> | <u>1,057</u> |
| Held-to-maturity securities: | | | |
| U.S. Treasury and U.S. government agencies | \$ 16,856 | \$ 10,894 | \$ — |
| Mortgage-backed U.S. government agencies | 64,548 | 52,949 | — |
| State and political subdivision obligations | 83,649 | 36,640 | — |
| Corporate debt securities | 1,539 | — | — |
| Total held-to-maturity securities | <u>166,592</u> | <u>100,483</u> | <u>—</u> |
| Total | <u>\$ 279,007</u> | <u>\$ 193,948</u> | <u>\$ 133,625</u> |

TABLE 7: INVESTMENT MATURITY AND YIELD

(Dollars in thousands)

| As of December 31, 2018 | One Year and Less | After One Year thru Five Years | After Five Years thru Ten Years | After Ten Years | Total |
|---|----------------------|--------------------------------------|---------------------------------------|--------------------|-------------------|
| Available for sale securities: | | | | | |
| U.S. Treasury and U.S. government agencies | \$ — | \$ 20,934 | \$ 20,638 | \$ — | \$ 41,572 |
| Mortgage-backed U.S. government agencies | 14 | 7,858 | 23,256 | 7,721 | 38,849 |
| State and political subdivision obligations | — | 3,548 | 19,389 | 6,319 | 29,256 |
| Corporate debt securities | — | 250 | 1,000 | 996 | 2,246 |
| | <u>\$ 14</u> | <u>\$ 32,590</u> | <u>\$ 64,283</u> | <u>\$ 15,036</u> | <u>\$ 111,923</u> |
| Held to maturity securities: | | | | | |
| U.S. Treasury and U.S. government agencies | \$ 991 | \$ 12,463 | \$ 3,531 | \$ — | \$ 16,985 |
| Mortgage-backed U.S. government agencies | — | — | 23,670 | 42,142 | 65,812 |
| State and political subdivision obligations | 95 | 6,282 | 77,657 | — | 84,034 |
| Corporate debt securities | — | — | 1,539 | — | 1,539 |
| | <u>\$ 1,086</u> | <u>\$ 18,745</u> | <u>\$ 106,397</u> | <u>\$ 42,142</u> | <u>\$ 168,370</u> |

| Weighted Average Yields | One Year and Less | After One Year thru Five Years | After Five Years thru Ten Years | After Ten Years | Total |
|---|------------------------------|---|--|----------------------------|--------------|
| Available for sale securities: | | | | | |
| U.S. Treasury and U.S. government agencies | — | 2.05% | 2.18% | — | 2.11% |
| Mortgage-backed U.S. government agencies | 4.08% | 3.15% | 2.71% | 2.72% | 2.80% |
| State and political subdivision obligations | — | 2.77% | 3.28% | 3.22% | 3.21% |
| Corporate debt securities | — | 1.50% | 4.75% | 6.50% | 5.16% |
| | <u>4.08%</u> | <u>2.38%</u> | <u>2.74%</u> | <u>2.75%</u> | <u>2.64%</u> |
| Held to maturity securities: | | | | | |
| U.S. Treasury and U.S. government agencies | 1.41% | 1.93% | 3.42% | — | 2.21% |
| Mortgage-backed U.S. government agencies | — | — | 2.91% | 2.72% | 2.79% |
| State and political subdivision obligations | 6.93% | 3.15% | 3.47% | — | 3.45% |
| Corporate debt securities | — | — | 5.36% | — | 5.36% |
| | <u>1.89%</u> | <u>2.34%</u> | <u>3.37%</u> | <u>2.72%</u> | <u>3.08%</u> |

Loans

Total loans at December 31, 2018 were \$1,624,067,000 compared to \$910,404,000 at December 31, 2017, an increase of \$713,663,000 or over 78 percent since year-end 2017. A large portion of the year-over-year increase was a result of the loans acquired from First Priority and Scottsdale totaling \$543,272,000 as of December 31, 2018. The majority of Mid Penn's \$170,391,000 of organic loan growth during 2018 was attributable to commercial loans, including both commercial and industrial financing, and commercial real estate credits.

At December 31, 2018, loans (net of unearned income) represented 85 percent of earning assets, compared to 83 percent at both December 31, 2017 and 2016.

The Bank's loan portfolio is diversified among individuals and businesses generally located within the Bank's primary market area of Berks, Bucks, Chester, Cumberland, Dauphin, Fayette, Lancaster, Luzerne, Montgomery, Northumberland, Schuylkill and Westmoreland counties in Pennsylvania. 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, and the maturity and rate sensitivity information related to the loan portfolio is reflected in Table 9.

TABLE 8: LOAN PORTFOLIO*(Dollars in thousands)*

| | December 31, | | | | | | | | | |
|---|---------------------|--------------|------------------|--------------|------------------|--------------|------------------|--------------|------------------|--------------|
| | 2018 | | 2017 | | 2016 | | 2015 | | 2014 | |
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Commercial real estate, construction and land development | \$1,003,542 | 61.8 | \$465,122 | 51.1 | \$397,547 | 48.8 | \$355,339 | 48.1 | \$289,378 | 50.6 |
| Commercial, industrial and agricultural | 286,583 | 17.6 | 188,262 | 20.7 | 171,985 | 21.1 | 160,988 | 21.8 | 120,326 | 21.0 |
| Real estate - residential | 323,639 | 19.9 | 253,152 | 27.8 | 240,418 | 29.5 | 216,269 | 29.6 | 159,004 | 27.8 |
| Consumer | 10,351 | 0.6 | 3,954 | 0.4 | 4,132 | 0.6 | 4,204 | 0.5 | 3,018 | 0.6 |
| Total Loans | <u>1,624,115</u> | <u>100.0</u> | <u>910,490</u> | <u>100.0</u> | <u>814,082</u> | <u>100.0</u> | <u>736,800</u> | <u>100.0</u> | <u>571,726</u> | <u>100.0</u> |
| Unearned income | (48) | | (86) | | (158) | | (287) | | (193) | |
| Loans net of unearned discount | 1,624,067 | | 910,404 | | 813,924 | | 736,513 | | 571,533 | |
| Allowance for loan and lease losses | (8,397) | | (7,606) | | (7,183) | | (6,168) | | (6,716) | |
| Net loans | <u>\$1,615,670</u> | | <u>\$902,798</u> | | <u>\$806,741</u> | | <u>\$730,345</u> | | <u>\$564,817</u> | |

TABLE 9: LOAN MATURITY AND INTEREST SENSITIVITY

(Dollars in thousands)

| As of December 31, 2018 | One Year and Less | After One Year thru Five Years | After Five Years | Total |
|---|------------------------------|---|-----------------------------|---------------------|
| Commercial real estate, construction and land development | \$ 79,430 | \$ 233,925 | \$ 690,187 | \$ 1,003,542 |
| Commercial, industrial and agricultural | 17,866 | 76,253 | 192,464 | 286,583 |
| Real estate - residential mortgages | 13,570 | 33,624 | 276,445 | 323,639 |
| Consumer | 279 | 2,429 | 7,595 | 10,303 |
| | <u>\$ 111,145</u> | <u>\$ 346,231</u> | <u>\$ 1,166,691</u> | <u>\$ 1,624,067</u> |
| Rate Sensitivity | | | | |
| Predetermined rate | \$ 53,061 | \$ 249,407 | \$ 287,796 | \$ 590,264 |
| Floating or adjustable rate | 58,084 | 96,824 | 878,895 | 1,033,803 |
| | <u>\$ 111,145</u> | <u>\$ 346,231</u> | <u>\$ 1,166,691</u> | <u>\$ 1,624,067</u> |

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

Other than as described herein, Mid Penn does not believe there are 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, | | | | |
|--|---------------------|------------------|-----------------|-----------------|------------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Nonperforming Assets: | | | | | |
| Nonaccrual loans | \$ 10,749 | \$ 10,575 | \$ 4,658 | \$ 4,418 | \$ 8,907 |
| Accruing troubled debt restructured loans | 517 | 544 | 877 | 459 | 2,035 |
| Total nonperforming loans | 11,266 | 11,119 | 5,535 | 4,877 | 10,942 |
| Foreclosed real estate | 1,017 | 189 | 224 | 1,185 | 565 |
| Total nonperforming assets | 12,283 | 11,308 | 5,759 | 6,062 | 11,507 |
| Accruing loans 90 days or more past due | — | — | 59 | 55 | — |
| Total risk elements | <u>\$ 12,283</u> | <u>\$ 11,308</u> | <u>\$ 5,818</u> | <u>\$ 6,117</u> | <u>\$ 11,507</u> |
| Nonperforming loans as a % of total loans outstanding | 0.69% | 1.22% | 0.68% | 0.66% | 1.91% |
| Nonperforming assets as a % of total loans outstanding and other real estate | 0.76% | 1.24% | 0.71% | 0.82% | 2.01% |
| Ratio of allowance for loan losses to nonperforming loans | 74.53% | 68.41% | 129.78% | 126.46% | 61.37% |

Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to partially or fully charging off the loan. If a partial charge off 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 2018, nonperforming loans increased \$147,000 from \$11,119,000 at December 31, 2017, to \$11,266,000 at December 31, 2018, and foreclosed real estate increased \$828,000 to \$1,017,000 at December 31, 2018. The increase in nonperforming loans is primarily due to the addition of approximately \$3,866,000 of nonaccrual loans

added during the twelve months ended December 31, 2018. This increase was partially offset by favorable reductions to the nonperforming loan portfolio due to (i) the successful workout of one nonaccrual loan relationship during the second quarter of 2018, which decreased the total nonaccrual loan pool by \$1,094,000 and (ii) the sale of some collateral in an existing nonaccrual loan relationship resulting in total principal pay-down of \$1,393,000. Additionally, certain loans totaling \$668,000 were transferred from nonaccrual loans to foreclosed real estate during 2018. Two loan relationships, which account for \$5,725,000 or the majority of the nonperforming loan balance, are discussed in more detail below.

Loan no. 1 – At December 31, 2018, the outstanding principal balance of this loan relationship was \$4,302,000. A \$275,000 specific allowance allocation was assigned to this relationship. As part of the workout process, this loan had 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 collect the remaining outstanding balance.

Loan no. 2 – At December 31, 2018, the contractual outstanding principal balance of this loan relationship was \$1,423,000 and was comprised of four loans collateralized primarily by commercial real estate, as well as certain machinery and equipment. As part of the workout process, the loans in this relationship were modified as a troubled debt restructured loans during 2017. During the second quarter of 2018, certain commercial real estate collateral was sold, resulting in the principal payoff of three previous loans associated with this loan relationship totaling \$1,393,000. Given that the fair value of the remaining collateral exceeds the outstanding principal balance, no specific allowance allocation has been assigned to this relationship. Management expects to recover the remaining outstanding balance through the sale of real estate and equipment collateral pledged in support of the loans.

Mid Penn's troubled debt restructured loans at December 31, 2017 totaled \$7,020,000, of which \$517,000 were accruing loans in compliance with the terms of the modification and \$6,503,000 are included in nonaccrual loans. As a result of the evaluation, a specific allocation, and subsequently, charge-offs have been taken as deemed appropriate.

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.

Further discussion of troubled debt restructured loans can be found in Note 9 to Mid Penn's Consolidated Financial Statements, which are included in Item 8. As of December 31, 2018, there were no defaulted troubled debt restructured loans, as all troubled debt restructured loans were current with respect to their associated forbearance agreements.

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

TABLE 11: PARTIALLY CHARGED OFF LOANS

| <i>(Dollars in thousands)</i> | December 31, 2018 | December 31, 2017 |
|---|------------------------------|------------------------------|
| Period ending total loans outstanding (net of unearned income) | \$ 1,624,067 | \$ 910,404 |
| Allowance for loan and lease losses | 8,397 | 7,606 |
| Total Nonperforming loans | 11,266 | 11,119 |
| Nonperforming and impaired loans with partial charge-offs | 333 | 1,701 |
| Ratio of nonperforming loans with partial charge-offs to total loans | 0.02% | 0.19% |
| Ratio of nonperforming loans with partial charge-offs to total nonperforming loans | 2.96% | 15.30% |
| Coverage ratio net of nonperforming loans with partial charge-offs | 76.80% | 80.76% |
| Ratio of total allowance to total loans less nonperforming loans with partial charge-offs | 0.52% | 0.84% |

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 loans with an aggregate balance of \$11,266,000 deemed impaired at December 31, 2018. Excluding \$2,803,000 in loans acquired with credit deterioration in connection with the closing of the Phoenix acquisition in 2015, and the Scottsdale and First Priority acquisitions in 2018, Mid Penn had several loan relationships deemed impaired with an aggregate carrying balance of \$8,463,000. This pool of impaired loans was further broken down into a group of loans with an aggregate carrying balance of \$5,615,000, for which specific allocations totaling \$742,000 were included within the loan loss reserve for these loans. The remaining \$2,848,000 of loans required no specific allocation within the loan loss reserve. Of the \$8,463,000 of impaired loan relationships, excluding the loans acquired with credit deterioration from the Phoenix, Scottsdale, and First Priority acquisitions, \$4,527,000 were commercial and industrial relationships, \$2,728,000 were commercial real estate relationships, \$811,000 were residential relationships, \$367,000 were commercial real estate – construction relationships, and \$30,000 were home equity relationships. There were specific loan loss reserve allocations of \$500,000 against the commercial and industrial relationships, \$204,000 against the commercial real estate relationships, and \$38,000 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 and consideration of the above-noted qualitative factors 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 \$8,397,000 as of December 31, 2018 is adequate to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

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

TABLE 12: ALLOCATION OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES*(Dollars in thousands)*

| | December 31, | | | | |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Commercial real estate, construction and land development | \$ 4,778 | \$ 4,613 | \$ 4,467 | \$ 3,705 | \$ 3,958 |
| Commercial, industrial and agricultural | 2,391 | 1,795 | 1,581 | 1,394 | 1,395 |
| Real estate - residential | 453 | 428 | 541 | 534 | 450 |
| Consumer | 535 | 426 | 382 | 329 | 688 |
| Unallocated | 240 | 344 | 212 | 206 | 225 |
| | <u>\$ 8,397</u> | <u>\$ 7,606</u> | <u>\$ 7,183</u> | <u>\$ 6,168</u> | <u>\$ 6,716</u> |

The organic growth in the loan portfolio during 2018, as well as an increase in specific allocations on impaired loans, resulted in a larger allowance in 2018. See also the discussion in the Provision for Loan and Lease Losses section.

The allowance for loan and lease losses at December 31, 2018 was \$8,397,000 or 0.52% of total loans (less unearned discount), as compared to \$7,606,000 or 0.84% at December 31, 2017, and \$7,183,000 or 0.88% at December 31, 2016.

Deposits and Other Funding Sources

Mid Penn's primary source of funds are retail deposits from business and consumers in its market area. Total deposits at December 31, 2018 increased by \$702,458,000 or 69 percent over December 31, 2017, which increased by \$88,195,000 or 9 percent over December 31, 2016. Deposits assumed from the First Priority and Scottsdale acquisitions accounted for \$596,780,000 of the increase in total deposits since year end 2017, while organic deposit growth totaled \$105,678,000. Many new customers have opened money market and time deposits to take advantage of higher deposit account yields in response to FOMC rate increases. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2018, 2017, and 2016 are presented in Table 13.

Short-term borrowings, consisting of FHLB borrowings having an initial term of less than one year, totaled \$43,100,000 as of December 31, 2018. Short-term borrowings totaled \$34,611,000 as of December 31, 2017 and consisted entirely of federal funds purchased.

At December 31, 2018, the Bank also had \$56,188,000 in brokered time deposits, an increase of \$53,096,000 or over 170 percent since December 31, 2017. The increase was primarily due to a portfolio of brokered certificates of deposit assumed in the First Priority acquisition. At December 31, 2017, the Bank had \$3,092,000 in brokered time deposits, a decrease of \$1,151,000 or 27 percent over December 31, 2016.

TABLE 13: DEPOSITS BY MAJOR CLASSIFICATION*(Dollars in thousands)*

| | Years Ended December 31, | | | | | |
|-------------------------------------|--------------------------|-----------------|--------------------|-----------------|--------------------|-----------------|
| | 2018 | | 2017 | | 2016 | |
| | Average Balance | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate |
| Noninterest-bearing demand deposits | \$ 232,562 | 0.00% | \$ 146,683 | 0.00% | \$ 120,244 | 0.00% |
| Interest-bearing demand deposits | 371,873 | 0.66 | 335,859 | 0.42 | 293,745 | 0.34 |
| Money market | 309,705 | 0.97 | 247,337 | 0.59 | 235,561 | 0.56 |
| Savings | 191,686 | 0.28 | 62,500 | 0.06 | 59,615 | 0.06 |
| Time | 324,853 | 1.51 | 197,154 | 1.30 | 172,657 | 1.25 |
| | <u>\$1,430,679</u> | <u>0.76%</u> | <u>\$ 989,533</u> | <u>0.55%</u> | <u>\$ 881,822</u> | <u>0.51%</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, | | |
|------------------------------------|---------------------|-------------------|------------------|
| | 2018 | 2017 | 2016 |
| Three months or less | \$ 29,957 | \$ 38,563 | \$ 16,083 |
| Over three months to twelve months | 201,827 | 27,295 | 28,254 |
| Over twelve months | 12,952 | 39,883 | 41,822 |
| | <u>\$ 244,736</u> | <u>\$ 105,741</u> | <u>\$ 86,159</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 19 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 a corporation's earnings have been invested in the continued growth of the business or paid to shareholders. Excess capital makes it difficult for a corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital management practices have been, and will continue to be, of paramount importance.

Shareholders' equity more than doubled, from \$75,703,000 at December 31, 2017 to \$223,209,000 at December 31, 2018, primarily due to (i) the issuance of 1,878,827 shares of Mid Penn common stock on January 8, 2018 in connection with the acquisition of Scottsdale; and (ii) the issuance of 2,320,800 shares of Mid Penn common stock on July 31, 2018, in connection with the acquisition of First Priority. Additionally, shareholders' equity reflects the growth in retained earnings through \$10,494,000 of net income available to common shareholders for 2018, less dividends declared during the year of \$3,453,000. These increases were partially offset by other comprehensive losses, primarily due to the after-tax impact of the unrealized reduction in market value within the available-for-sale investment portfolio since December 31, 2017.

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 dividends declared during 2017 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.

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". Dividends paid and declared on common shares totaled \$0.70 and \$0.45, respectively, for the year ended December 31, 2018. Dividends paid and declared totaled \$0.62 and \$0.77, respectively, for the year ended December 31, 2017, and \$0.58 and \$0.68, respectively, for the year ended December 31, 2016. The dividend payout ratio, which represents the percentage of annual net income returned to shareholders in the form of cash dividends, was 47.30% for 2018 and 37.18% for 2017.

Mid Penn maintained regulatory capital levels, leverage ratios, and risk-based capital ratios as of December 31, 2018 and 2017, 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 |
| Corporation | | | | | | |
| As of December 31, 2018 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 155,662 | 8.0% | \$ 77,499 | 4.000% | \$ N/A | N/A |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 155,662 | 10.0% | 98,977 | 6.375% | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 155,662 | 10.0% | 122,265 | 7.875% | N/A | N/A |
| Total Capital (to Risk Weighted Assets) | 191,300 | 12.3% | 153,317 | 9.875% | N/A | N/A |
| Bank | | | | | | |
| As of December 31, 2018 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 171,776 | 8.9% | \$ 77,230 | 4.000% | \$ 96,537 | 5.0% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 171,776 | 11.1% | 98,963 | 6.375% | 100,903 | 6.5% |
| Tier 1 Capital (to Risk Weighted Assets) | 171,776 | 11.1% | 122,248 | 7.875% | 124,189 | 8.0% |
| Total Capital (to Risk Weighted Assets) | 180,332 | 11.6% | 153,295 | 9.875% | 155,236 | 10.0% |
| Corporation | | | | | | |
| As of December 31, 2017 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 74,417 | 6.5% | \$ 45,857 | 4.000% | \$ N/A | N/A |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 74,417 | 8.4% | 50,661 | 5.750% | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 74,417 | 8.4% | 63,877 | 7.250% | N/A | N/A |
| Total Capital (to Risk Weighted Assets) | 99,466 | 11.3% | 81,498 | 9.250% | N/A | N/A |
| Bank | | | | | | |
| As of December 31, 2017 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 88,294 | 7.7% | \$ 45,846 | 4.000% | \$ 57,308 | 5.0% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 88,294 | 10.0% | 50,661 | 5.750% | 57,269 | 6.5% |
| Tier 1 Capital (to Risk Weighted Assets) | 88,294 | 10.0% | 63,877 | 7.250% | 70,485 | 8.0% |
| Total Capital (to Risk Weighted Assets) | 96,005 | 10.9% | 81,498 | 9.250% | 88,106 | 10.0% |

- (1) The minimum amounts and ratios as of December 31, 2018 include the third year phase in of the capital conservation buffer of 1.875% required by the Basel III framework. At December 31, 2017, the minimum amounts and ratios included the second year phase in of the capital conservation buffer of 1.25 percent required by the Basel III framework.

Effective in the third quarter of 2018, the Federal Reserve raised the consolidated asset limit to be considered a small bank holding company from \$1 billion to \$3 billion. A company that qualifies as a small bank holding company is not subject to the Federal Reserve's consolidated capital rules, although a company that so qualifies may continue to file reports that include such capital amounts and ratios. The Company has elected to continue to report those amounts and ratios.

Series D Preferred Stock

In accordance with the terms and conditions of the Agreement and Plan of Merger dated January 16, 2018 between Mid Penn and First Priority (the "Merger Agreement"), each share of First Priority Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "First Priority Preferred Stock") outstanding as of July 31, 2018 was converted into the right to receive one share of Mid Penn Fixed Rate Cumulative Perpetual Preferred Stock, Series D, having a \$1,000 liquidation preference per share (the "Mid Penn Preferred Stock"). In connection with the First Priority Merger, Mid Penn issued 3,404 shares of Mid Penn Preferred Stock. The terms of the Mid Penn Preferred Stock were no less favorable than those of the First Priority Preferred Stock as in effect immediately prior to the Merger. Dividends were payable quarterly on February 15, May 15, August 15 and November 15 of each year. The dividend rate on the Mid Penn Preferred Stock was fixed at 9%.

During the fourth quarter of 2018, the Federal Reserve Bank approved Mid Penn's request to redeem all 3,404 shares of Mid Penn Preferred Stock issued in connection with the First Priority Merger, and the redemption was completed and final dividend payment made on December 14, 2018.

Subordinated Debt*Subordinated Debt Assumed July 2018 with the First Priority Acquisition*

On July 31, 2018, Mid Penn completed its acquisition of First Priority and assumed \$9,500,000 of Subordinated Notes (the "First Priority Notes"). In accordance with purchase accounting principles, the First Priority Notes were assigned a fair value premium of \$247,000. The notes are intended to be treated as Tier 2 capital for regulatory reporting purposes.

The First Priority Notes agreements were entered into by First Priority on November 13, 2015 with five accredited investors, pursuant to which First Priority issued subordinated notes totaling \$9,500,000. The First Priority Notes have a maturity date of November 30, 2025, and bear interest at a fixed rate of 7.00% per annum. The Notes are non-callable for an initial period of five years and include provisions for redemption pricing between 101.5% and 100.5% of the liquidation value, if called after five years but prior to the stated maturity date.

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 2018 was \$2,129,000, compared to \$4,500,000 for 2017 and \$2,277,000 in 2016. Federal income tax expense in 2018 reflects the reduction in the maximum corporate income tax rate from 34 percent to 21 percent, legislated by the TCJA in December, 2017, with the rate change effective January 1, 2018. Also, as a result of the TCJA, federal income tax expense was negatively impacted by a one-time non-cash reduction in the value of Mid Penn's deferred tax asset, which resulted in a charge of \$1,169,000 during the year ended December 31, 2017. Mid Penn's deferred tax asset, which was previously valued based upon the projection of a 34 percent future tax benefit, was adjusted to reflect future deferred tax benefits at the new 21 percent corporate tax rate. The effective tax rate (excluding the one-time deferred tax adjustment) was 17% in 2018, 29% in 2017, and 23% in 2016.

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. In addition to its cash and equivalents, 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, prepayments on mortgage-backed securities, and from investments and interest-bearing balances with maturities of one year or less.

The Bank can obtain funds from overnight borrowings, short-term borrowings, and long-term borrowings from the FHLB, up to the Bank's maximum borrowing capacity with the FHLB, which was \$507,462,000 at December 31, 2018. FHLB borrowings require the Bank to make certain restricted stock purchases in accordance with FHLB requirements. Borrowings with the FHLB are collateralized by certain qualifying loans and investment securities of the Bank. The Bank also has unused lines of credit with other correspondent banks amounting to \$15,000,000 at December 31, 2018.

Major sources of cash in 2018 came from the \$158,271,000 in proceeds from the sales of available-for-sale investments securities and the \$72,616,000 in net cash received from the acquisitions of Scottsdale and First Priority.

Major uses of cash in 2018 were \$132,097,000 to fund loan growth and \$100,205,000 for investment purchases.

Major sources of cash in 2017 came from the increase in deposits of \$88,195,000, as well as \$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.

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, 2018.

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 | 10 | \$ 15,144 | \$ 2,171 | \$ 3,573 | \$ 2,709 | \$ 6,691 |
| Certificates of deposit | 11 | 497,225 | 276,169 | 186,364 | 33,848 | 844 |
| Long-term debt | 13 | 50,363 | 13,221 | 34,536 | 206 | 2,400 |
| Subordinated debt | 14 | 39,005 | 1,576 | 3,152 | 3,152 | 31,125 |
| Payments under benefit plans | 16 | 3,649 | 247 | 548 | 604 | 2,250 |
| Executive compensation payments | 17 | 6,114 | 50 | 96 | 96 | 5,872 |
| | | <u>\$ 596,356</u> | <u>\$ 291,263</u> | <u>\$ 224,696</u> | <u>\$ 37,906</u> | <u>\$ 42,491</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 measure its sensitivity to changes in interest rates and to take appropriate actions, as needed or controllable by the Bank, to mitigate the impacts of inflation 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 previously discussed risk factors, the composition of and yields on loans and investments, and the composition and costs of deposits and other interest-bearing liabilities, 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, 2018, commitments to extend credit amounted to \$346,238,000 compared to \$199,240,000 as of December 31, 2017.

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 \$20,839,000 at December 31, 2018, from \$20,496,000 at December 31, 2017.

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, 2018, all interest rate risk levels according to the model were within the tolerance limits of the Board-approved policy.

TABLE 16: EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES

| December 31, 2018 | | | December 31, 2017 | | |
|-------------------------------|--|--------------------------|-------------------------------|--|--------------------------|
| Change in Basis Points | % Change in Net Interest Income | Policy Risk Limit | Change in Basis Points | % Change in Net Interest Income | Policy Risk Limit |
| 300 | 8.09% | ≥ -20% | 300 | 7.83% | ≥ -20% |
| 200 | 5.38% | ≥ -15% | 200 | 5.12% | ≥ -15% |
| 100 | 2.66% | ≥ -10% | 100 | 2.41% | ≥ -10% |
| 0 | | | 0 | | |
| (100) | -2.01% | ≥ -10% | (100) | -1.49% | ≥ -10% |
| (200) | -3.49% | ≥ -15% | (200) | -6.19% | ≥ -15% |
| (300) | -6.43% | ≥ -20% | (300) | -11.37% | ≥ -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, 2018, 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, 2018, 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, 2018, 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 18, 2019

/s/ Michael D. Peduzzi, CPA
Michael D. Peduzzi, CPA
Sr. Executive Vice President and
Chief Financial Officer
March 18, 2019

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, 2018 and 2017, 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, 2018, 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, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, 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, 2018, 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 18, 2019 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 18, 2019

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, 2018, 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, 2018, 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, 2018 and 2017, 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, 2018 and the related notes and our report dated March 18, 2019 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 18, 2019

MID PENN BANCORP, INC.*(Dollars in thousands)***Consolidated Balance Sheets**

| | <u>December 31, 2018</u> | <u>December 31, 2017</u> |
|--|--------------------------|--------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 24,600 | \$ 19,795 |
| Interest-bearing balances with other financial institutions | 4,572 | 3,028 |
| Federal funds sold | 10,893 | 691 |
| Total cash and cash equivalents | <u>40,065</u> | <u>23,514</u> |
| Investment securities available for sale | 111,923 | 93,465 |
| Investment securities held to maturity, at amortized cost (fair value \$166,582 and \$100,483) | 168,370 | 101,356 |
| Loans held for sale | 1,702 | 1,040 |
| Loans and leases, net of unearned interest | 1,624,067 | 910,404 |
| Less: Allowance for loan and lease losses | <u>(8,397)</u> | <u>(7,606)</u> |
| Net loans and leases | <u>1,615,670</u> | <u>902,798</u> |
| Bank premises and equipment, net | 25,303 | 16,168 |
| Cash surrender value of life insurance | 16,691 | 13,042 |
| Restricted investment in bank stocks | 6,646 | 4,384 |
| Foreclosed assets held for sale | 1,017 | 189 |
| Accrued interest receivable | 8,244 | 4,564 |
| Deferred income taxes | 4,696 | 1,888 |
| Goodwill | 62,840 | 3,918 |
| Core deposit and other intangibles, net | 7,221 | 434 |
| Other assets | 7,593 | 3,594 |
| Total Assets | <u>\$ 2,077,981</u> | <u>\$ 1,170,354</u> |
| LIABILITIES & SHAREHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing demand | \$ 269,870 | \$ 163,714 |
| Interest-bearing demand | 384,834 | 349,241 |
| Money Market | 375,648 | 246,220 |
| Savings | 209,345 | 62,770 |
| Time | 486,329 | 201,623 |
| Total Deposits | <u>1,726,026</u> | <u>1,023,568</u> |
| Short-term borrowings | 43,100 | 34,611 |
| Long-term debt | 48,024 | 12,352 |
| Subordinated debt | 27,082 | 17,338 |
| Accrued interest payable | 2,262 | 645 |
| Other liabilities | <u>8,278</u> | <u>6,137</u> |
| Total Liabilities | <u>1,854,772</u> | <u>1,094,651</u> |
| Shareholders' Equity: | | |
| Common stock, par value \$1.00; authorized 10,000,000 shares; 8,459,918 and 4,242,216 shares issued and outstanding at December 31, 2018 and December 31, 2017, respectively | 8,460 | 4,242 |
| Additional paid-in capital | 177,565 | 40,970 |
| Retained earnings | 39,562 | 32,565 |
| Accumulated other comprehensive loss | <u>(2,378)</u> | <u>(2,074)</u> |
| Total Shareholders' Equity | <u>223,209</u> | <u>75,703</u> |
| Total Liabilities and Shareholders' Equity | <u>\$ 2,077,981</u> | <u>\$ 1,170,354</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, | | |
|---|--------------------------|-----------|-----------|
| | 2018 | 2017 | 2016 |
| INTEREST INCOME | | | |
| Interest and fees on loans and leases | \$ 61,692 | \$ 40,156 | \$ 36,402 |
| Interest on interest-bearing balances | 75 | 18 | 12 |
| Interest on federal funds sold | 451 | 115 | 82 |
| Interest and dividends on investment securities: | | | |
| U.S. Treasury and government agencies | 3,518 | 2,273 | 1,346 |
| State and political subdivision obligations, tax-exempt | 2,323 | 1,113 | 2,066 |
| Other securities | 595 | 217 | 304 |
| Total Interest Income | 68,654 | 43,892 | 40,212 |
| INTEREST EXPENSE | | | |
| Interest on deposits | 10,884 | 5,463 | 4,514 |
| Interest on short-term borrowings | 207 | 111 | 15 |
| Interest on long-term and subordinated debt | 1,629 | 730 | 838 |
| Total Interest Expense | 12,720 | 6,304 | 5,367 |
| Net Interest Income | 55,934 | 37,588 | 34,845 |
| PROVISION FOR LOAN AND LEASE LOSSES | | | |
| Net Interest Income After Provision for Loan and Lease Losses | 55,434 | 37,263 | 32,975 |
| NONINTEREST INCOME | | | |
| Income from fiduciary activities | 1,155 | 845 | 481 |
| Service charges on deposits | 933 | 721 | 684 |
| Net gain on sales of investment securities | 137 | 42 | 1,046 |
| Earnings from cash surrender value of life insurance | 286 | 262 | 264 |
| Mortgage banking income | 751 | 872 | 922 |
| ATM debit card interchange income | 1,253 | 937 | 844 |
| Merchant services income | 347 | 335 | 317 |
| Net gain on sales of SBA loans | 561 | 800 | 470 |
| Other income | 2,039 | 893 | 918 |
| Total Noninterest Income | 7,462 | 5,707 | 5,946 |
| NONINTEREST EXPENSE | | | |
| Salaries and employee benefits | 23,862 | 16,929 | 15,564 |
| Occupancy expense, net | 4,019 | 2,512 | 2,064 |
| Equipment expense | 2,186 | 1,536 | 1,689 |
| Pennsylvania Bank Shares Tax expense | 225 | 451 | 648 |
| FDIC Assessment | 772 | 792 | 688 |
| Legal and professional fees | 1,117 | 802 | 711 |
| Marketing and advertising expense | 1,025 | 516 | 500 |
| Software licensing and utilization | 3,036 | 2,051 | 1,908 |
| Telephone expense | 621 | 497 | 548 |
| Loss on sale or write-down of foreclosed assets | 4 | 88 | 217 |
| Intangible amortization | 1,224 | 104 | 126 |
| Merger and acquisition expense | 4,790 | 619 | — |
| Other expenses | 7,290 | 4,484 | 4,177 |
| Total Noninterest Expense | 50,171 | 31,381 | 28,840 |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 12,725 | 11,589 | 10,081 |
| Provision for income taxes | 2,129 | 4,500 | 2,277 |
| NET INCOME | 10,596 | 7,089 | 7,804 |
| Series D preferred stock dividends | 102 | — | — |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | \$ 10,494 | \$ 7,089 | \$ 7,804 |
| PER COMMON SHARE DATA: | | | |
| Basic and Diluted Earnings Per Common Share | \$ 1.48 | \$ 1.67 | \$ 1.85 |
| Cash Dividends Declared | \$ 0.45 | \$ 0.77 | \$ 0.68 |

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

MID PENN BANCORP, INC.
Consolidated Statements of Comprehensive Income
(Dollars in thousands)

| | Years Ended December 31, | | |
|---|---------------------------------|-----------------|-----------------|
| | 2018 | 2017 | 2016 |
| Net income | \$ 10,596 | \$ 7,089 | \$ 7,804 |
| Other comprehensive income (loss) (a): | | | |
| Unrealized gains (losses) arising during the period on available for sale securities, net of income taxes of (\$259), \$589, and (\$1,954), respectively | (1,010) | 1,143 | (3,794) |
| Reclassification adjustment for net gain on sales of available for sale securities included in net income, net of income taxes of (\$29), (\$14), and (\$356), respectively (b) | (108) | (28) | (690) |
| Change in defined benefit plans, net of income taxes of \$361, \$3, and (\$93), respectively (c) | 1,361 | 5 | (181) |
| Reclassification adjustment for settlement gains on benefit plans, net of income taxes of (\$155) and \$0, respectively (d) | (582) | — | — |
| Total other comprehensive income (loss) | (339) | 1,120 | (4,665) |
| Total comprehensive income | \$ 10,257 | \$ 8,209 | \$ 3,139 |

- (a) The income tax impacts of the components of other comprehensive income are calculated using a 21 percent tax rate for 2018 and a 34 percent tax rate for 2017 and 2016.
- (b) 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
- (c) The change in defined benefit plans includes several components of net periodic benefit costs, including service costs, interest costs, expected return on plan assets, and amortization of prior service costs. Please reference Note 16 – Defined Benefit Plans, for the classification of these components on Consolidated Statements of Income.
- (d) Amounts are included in other income on the Consolidated Statements of Income within total noninterest income.

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

MID PENN BANCORP, INC.

Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands, except share data)

| | Preferred Stock | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|-----------------|-----------------|----------------------------|-------------------|---|----------------------------|
| Balance, January 1, 2016 | \$ — | \$ 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 declared | — | — | — | (2,875) | — | (2,875) |
| Employee Stock Purchase Plan (4,465 shares) | — | 4 | 78 | — | — | 82 |
| Restricted stock activity (2,115 shares) | — | 2 | 51 | — | — | 53 |
| Balance, December 31, 2016 | <u>\$ 0</u> | <u>\$ 4,233</u> | <u>\$ 40,688</u> | <u>\$ 28,399</u> | <u>\$ (2,853)</u> | <u>\$ 70,467</u> |
| Net income | — | — | — | 7,089 | — | 7,089 |
| Total other comprehensive income, net of taxes | — | — | — | — | 1,120 | 1,120 |
| Common stock dividends declared | — | — | — | (3,264) | — | (3,264) |
| Employee Stock Purchase Plan (3,578 shares) | — | 4 | 100 | — | — | 104 |
| Director Stock Purchase Plan (1,345 shares) | — | 1 | 41 | — | — | 42 |
| Restricted stock activity (3,996 shares) | — | 4 | 141 | — | — | 145 |
| Tax rate adjustment impact | — | — | — | 341 | (341) | — |
| Balance, December 31, 2017 | <u>\$ 0</u> | <u>\$ 4,242</u> | <u>\$ 40,970</u> | <u>\$ 32,565</u> | <u>\$ (2,074)</u> | <u>\$ 75,703</u> |
| Impact of adoption of new accounting standard (a) | — | — | — | (44) | 35 | (9) |
| Balance at January 1, 2018, adjusted | — | 4,242 | 40,970 | 32,521 | (2,039) | 75,694 |
| Net income | — | — | — | 10,596 | — | 10,596 |
| Total other comprehensive loss, net of taxes | — | — | — | — | (339) | (339) |
| Series D preferred stock issued in connection with the First Priority acquisition | 3,404 | — | — | — | — | 3,404 |
| Series D preferred stock dividends | — | — | — | (102) | — | (102) |
| Series D preferred stock redemption | (3,404) | — | — | — | — | (3,404) |
| Common stock dividends declared | — | — | — | (3,453) | — | (3,453) |
| Common stock issued to Scottsdale shareholders (1,878,827 shares) (b) | — | 1,879 | 62,302 | — | — | 64,181 |
| Common stock issued to First Priority shareholders (2,320,800 shares) (c) | — | 2,321 | 73,801 | — | — | 76,122 |
| Employee Stock Purchase Plan (4,132 shares) | — | 4 | 115 | — | — | 119 |
| Director Stock Purchase Plan (4,296 shares) | — | 4 | 120 | — | — | 124 |
| Restricted stock activity (9,647 shares) | — | 10 | 257 | — | — | 267 |
| Balance, December 31, 2018 | <u>\$ 0</u> | <u>\$ 8,460</u> | <u>\$ 177,565</u> | <u>\$ 39,562</u> | <u>\$ (2,378)</u> | <u>\$ 223,209</u> |

- (a) Represents the impact of adopting Accounting Standard Update ASU 2016-01. See Note 26 to the consolidated financial statements for more information.
- (b) Shares issued on January 8, 2018 as a result of the acquisition of The Scottsdale Bank & Trust Company ("Scottsdale"). See Note 4 to the consolidated financial statements for more information.
- (c) Shares issued on July 31, 2018 as a result of the acquisition of First Priority Financial Corp. ("First Priority"). See Note 5 to the consolidated financial statements for more information.

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, | | |
|---|--------------------------|------------------|------------------|
| | 2018 | 2017 | 2016 |
| Operating Activities: | | | |
| Net Income | \$ 10,596 | \$ 7,089 | \$ 7,804 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan and lease losses | 500 | 325 | 1,870 |
| Depreciation | 2,395 | 1,464 | 1,658 |
| Amortization of intangibles | 1,224 | 105 | 126 |
| Net amortization of security premiums | 517 | 1,280 | 11,709 |
| Gain on sales of investment securities | (137) | (42) | (1,046) |
| Earnings on cash surrender value of life insurance | (286) | (262) | (264) |
| Mortgage loans originated for sale | (46,264) | (44,010) | (42,888) |
| Proceeds from sales of mortgage loans originated for sale | 46,353 | 45,801 | 43,810 |
| Gain on sale of mortgage loans | (751) | (872) | (922) |
| SBA loans originated for sale | (7,734) | (10,282) | (5,872) |
| Proceeds from sales of SBA loans originated for sale | 8,296 | 11,082 | 6,342 |
| Gain on sale of SBA loans | (561) | (800) | (470) |
| Loss on write-down/disposal of property, plant, and equipment | 71 | 14 | 142 |
| Loss on sale / write-down of foreclosed assets | 4 | 88 | 217 |
| Restricted stock compensation expense | 267 | 145 | 53 |
| Deferred income tax expense (benefit) | 1,317 | 1,828 | (336) |
| Increase in accrued interest receivable | (398) | (636) | (115) |
| Increase in other assets | (1,779) | (380) | (99) |
| Increase in accrued interest payable | 528 | 130 | 125 |
| (Decrease) increase in other liabilities | (3,175) | (172) | 4 |
| Net Cash Provided By Operating Activities | 10,983 | 11,895 | 21,848 |
| Investing Activities: | | | |
| Net decrease in interest-bearing time deposits with other financial institutions | — | — | 4,317 |
| Proceeds from the maturity of investment securities | 31,728 | 11,062 | 16,110 |
| Proceeds from the sale of investment securities | 158,271 | 52,932 | 111,390 |
| Purchases of investment securities | (100,205) | (124,738) | (142,861) |
| Net cash received from acquisitions | 72,616 | — | — |
| Redemptions (purchases) of restricted investment in bank stocks | 72 | (1,941) | 1,823 |
| Net increase in loans and leases | (132,097) | (96,570) | (77,795) |
| Purchases of bank premises and equipment | (8,958) | (6,879) | (775) |
| Proceeds from sale of bank premises and equipment | — | 2,201 | — |
| Proceeds from sale of foreclosed assets | 420 | 136 | 992 |
| Net Cash Provided By (Used In) Investing Activities | 21,847 | (163,797) | (86,799) |
| Financing Activities: | | | |
| Net (decrease) increase in deposits | (12,469) | 88,195 | 158,330 |
| Net (decrease) increase in short-term borrowings | (25,836) | 34,611 | (31,596) |
| Proceeds from long-term debt issuance | 30,000 | — | — |
| Series D preferred stock dividends paid | (102) | — | — |
| Series D preferred stock redemption | (3,404) | — | — |
| Common stock dividends paid | (4,513) | (2,204) | (2,452) |
| Employee Stock Purchase Plan share issuance | 119 | 104 | 82 |
| Director Stock Purchase Plan share issuance | 124 | 42 | — |
| Long-term debt repayment | (198) | (1,220) | (26,724) |
| Deferred financing fees paid for subordinated debt issuance | — | (85) | — |
| Subordinated debt issuance | — | 10,000 | — |
| Net Cash (Used In) Provided By Financing Activities | (16,279) | 129,443 | 97,640 |
| Net increase (decrease) in cash and cash equivalents | 16,551 | (22,459) | 32,689 |
| Cash and cash equivalents, beginning of year | 23,514 | 45,973 | 13,284 |
| Cash and cash equivalents, end of year | <u>\$ 40,065</u> | <u>\$ 23,514</u> | <u>\$ 45,973</u> |

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

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2018 | 2017 | 2016 |
| Supplemental Disclosures of Cash Flow Information: | | | |
| Interest paid | \$ 11,103 | \$ 6,174 | \$ 5,242 |
| Income taxes paid | \$ 1,425 | \$ 3,890 | \$ 1,700 |
| Supplemental Noncash Disclosures: | | | |
| Loan transfers to foreclosed assets held for sale | \$ 1,116 | \$ 189 | \$ 248 |
| Dividends declared and not paid | \$ — | \$ 1,060 | \$ 423 |
| Asset transfers to bank premises and equipment held for sale | \$ — | \$ — | \$ 1,894 |
| Common stock issued to First Priority and Scottsdale shareholders | \$ 4,200 | \$ — | \$ — |

Assets, Liabilities, and Equity in Connection with Mergers (a):
(Dollars in thousands)

| | | | |
|--|-------------------|-------------|-------------|
| Assets Acquired: | | | |
| Securities | \$ 177,016 | \$ — | \$ — |
| Loans | 582,392 | — | — |
| Restricted stock | 2,334 | — | — |
| Property and equipment | 2,643 | — | — |
| Foreclosed assets | 136 | — | — |
| Deferred income taxes | 4,190 | — | — |
| Accrued interest receivable | 3,282 | — | — |
| Core deposit and other intangible assets | 7,976 | — | — |
| Cash surrender value of life insurance | 3,363 | — | — |
| Other assets | 1,100 | — | — |
| | <u>\$ 784,432</u> | <u>\$ —</u> | <u>\$ —</u> |
| Liabilities Assumed: | | | |
| Deposits | \$ 714,927 | \$ — | \$ — |
| Borrowings | \$ 49,939 | — | — |
| Accrued interest payable | 1,089 | — | — |
| Other liabilities | 6,309 | — | — |
| | <u>\$ 772,264</u> | <u>\$ —</u> | <u>\$ —</u> |
| Equity Acquired: | | | |
| Preferred stock | <u>\$ 3,404</u> | <u>\$ —</u> | <u>\$ —</u> |

- (a) This disclosure includes the impact of both the acquisition of The Scottsdale Bank and Trust Company, effective January 8, 2018, and the acquisition of First Priority Financial Corp., effective July 31, 2018. Please reference Notes 4 and 5 for more information.

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

(1) Basis of Presentation

For all periods presented, the accompanying consolidated financial statements include the accounts of Mid Penn Bancorp, Inc. and its wholly-owned subsidiary Mid Penn Bank (the “Bank”), and for the year ended December 31, 2016, include the accounts of the Bank’s former wholly-owned subsidiary, Mid Penn Insurance Services, LLC, were included in the accompanying consolidated financial statements which was closed effective March 1, 2016. Mid Penn Bancorp, Inc. and its wholly owned subsidiaries are collectively referred to herein as “Mid Penn” or the “Corporation.” 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.

On January 8, 2018, Mid Penn completed its acquisition of The Scottdale Bank & Trust Company (“Scottdale”), a Pennsylvania bank and trust company, through the merger of Scottdale with and into Mid Penn Bank pursuant to the previously announced Agreement and Plan of Merger, dated as of March 29, 2017, among Mid Penn, Mid Penn Bank and Scottdale. Refer to Note 4, *Acquisition of The Scottdale Bank & Trust Company*, as well as the Company’s Current Report on Form 8-K filed on January 8, 2018, for more information.

On July 31, 2018, Mid Penn completed its acquisition of First Priority Financial Corp. (“First Priority”), pursuant to the previously announced Agreement and Plan of Merger dated as of January 16, 2018. On July 31, 2018, First Priority was merged with and into Mid Penn, with Mid Penn being the surviving corporation. Refer to Note 5, *Acquisition of First Priority Financial Corp.*, as well as the Company’s Current Report on Form 8-K filed on August 1, 2018, for more information.

The comparability of Mid Penn’s results of operations for the year ended December 31, 2018, compared to the years ended December 31, 2017 and 2016, in general, have been materially impacted by these two acquisitions, as further described in Note 4 and Note 5. For comparative purposes, the 2017 and 2016 balances have been reclassified to conform to the 2018 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 and wealth management 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 38 retail banking offices located in Berks, Bucks, Chester, Cumberland, Dauphin, Fayette, Lancaster, Luzerne, Montgomery, Northumberland, Schuylkill and Westmoreland counties in Pennsylvania.

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.

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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 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. Beginning January 1, 2018, upon adoption of ASU 2016-01, equity securities with readily determinable fair values are stated at fair value within other assets on the balance sheet, with realized and unrealized gains and losses reported in other expense on the income statement. For periods prior to January 1, 2018, equity securities were classified as available-for-sale and stated at fair value within investment securities available-for-sale on the balance sheet, with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax.

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.

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.

(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.

(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 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.

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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.

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.

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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 non-qualifying condition(s) 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.

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. 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. 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 \$159,000 at December 31, 2018 and \$105,000 at December 31, 2017.

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.

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

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

Mid Penn 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.

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. 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. 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. 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, and will update the allowance impact calculation upon receipt of the updated real estate valuation. The Asset Recovery department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no material time lapses noted with the above processes.

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In some instances, Mid Penn is not holding real estate as collateral and is relying on business assets (personal property) for repayment. In these circumstances a collateral inspection is performed by Mid Penn personnel to determine an estimated value. The value is based on net book value, as provided by the financial statements, and discounted accordingly based on determinations made by management. Occasionally, Mid Penn will employ an outside service to provide an estimate of fair 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's practice of obtaining independent third party market valuations on the subject property as soon as practically possible of the credit being identified as impaired sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation. 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 twelve months for revaluation by an independent third party.

The unallocated component of the allowance for loan and lease losses 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 do not necessarily correlate to unexpected changes to specific-credit or general portfolio cash flows and collateral values which could negatively impact unimpaired portfolio loss factors. Also, the unallocated component 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.

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.

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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.

On loans determined to purchase credit impaired, 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.

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 fifteen 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 level of stock ownership in the FHLB is adjusted by the FHLB throughout the year based upon the level of outstanding borrowings of the Bank (in general, the higher the amount of borrowings, the higher the amount of FHLB stock ownership requirement). Total dividends received from the FHLB in 2018 and 2017 totaled \$275,000 and \$114,000, respectively.

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(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, 2018, Mid Penn had \$844,000 of residential real estate held in other real estate owned. There was also \$211,000 in loans for which formal foreclosure proceedings were in process at December 31, 2018. As of December 31, 2017, Mid Penn had \$42,000 of residential real estate held in other real estate owned and \$308,000 in loans for which formal foreclosure proceedings were in process.

(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 \$106,000 and \$126,000 at December 31, 2018 and 2017, respectively. Amortization expense is reflected in the Consolidated Statements of Income in intangible amortization and was \$20,000, \$18,000, and \$30,000 for the years 2018, 2017, and 2016, respectively. Servicing rights are evaluated for impairment based upon estimated fair value as compared to unamortized carrying value. No servicing right impairments were identified or recorded for the three year period ended December 31, 2018. The principal balance of loans serviced for others was \$15,601,000 and \$17,963,000 for December 31 2018 and 2017, respectively.

(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 \$233,000 at December 31, 2018 and \$277,000 at December 31, 2017, 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. Mid Penn received \$76,000 in low-income housing tax credits for each of the tax years ended December 31, 2017 and 2016.

During the second quarter of 2018, Mid Penn entered into a commitment to purchase a limited partnership interest in a low-income housing project to construct thirty-seven apartments and common amenities in Dauphin County, Pennsylvania. All of the units are intended to qualify for Federal Low-Income Housing Tax Credits ("LIHTCs") as provided for in Section 42 of the Internal Revenue Code of 1986, as amended. Mid Penn's limited partner capital contribution commitment is \$7,579,000, which will be paid in installments over the course of construction of the low-income housing facilities. Each installment payment is conditional upon both Mid Penn's review and approval of the installment payment certificate and continued compliance with the terms of the original partnership agreement. The investment in the limited partnership will be reported in other assets on the Consolidated Balance Sheet and amortized over a ten year period. The project has been conditionally awarded \$861,000 in annual LIHTCs by the Pennsylvania Housing Finance Agency, with a total anticipated LIHTC amount of \$8,613,000 to be awarded to Mid Penn over the ten year amortization period. Mid Penn's commitment to initiate investments in the limited partnership interest was conditional upon (i) the review and approval of all closing documents, (ii) an opinion letter for tax counsel to the Partnership that the project qualifies for the LIHTCs, and (iii) review and approval by Mid Penn of other documents it deemed necessary. All such initial conditions were satisfied and Mid Penn began funding the investment during 2018. As of December 31, 2018, the total investment in the limited partnership was \$1,710,000 and was reported in other assets on the Consolidated Balance Sheet.

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(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.

In December, 2017, the Tax Cuts and Jobs Act (the "TCJA") was enacted 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 a one-time \$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 18 (Federal Income Taxes) to the consolidated financial statements.

(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 carrying amount of core deposit intangibles was \$6,893,000 and \$308,000 at December 31, 2018 and 2017, respectively. Amortization expense is reflected in the Consolidated Statements of Income in intangible amortization and was \$1,188,000, \$86,000, and \$96,000 for the years 2018, 2017, and 2016, respectively. The core deposit intangible for each respective acquisition (Phoenix in 2015, and Scottsdale and First Priority in 2018) is being amortized over a ten-year period starting at the respective acquisition date and using a sum-of-the-year's digits basis. Core deposit intangibles are subject to impairment testing whenever events or changes in circumstances indicate the need for such evaluation.

(n) Goodwill

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with past business acquisitions. The goodwill balance at December 31, 2018 was comprised of, (i) \$39,744,000 related to the July 31, 2018 First Priority acquisition, (ii) \$19,178,000 related to the January 8, 2018 Scottsdale acquisition and (iii) \$3,918,000 recorded as a result of the Phoenix acquisition in 2015. 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 evaluation, which was performed as of October 31, 2018 using a qualitative analysis. In addition, Mid Penn did not identify any impairment in 2017 or 2016 using a similar qualitative analyses.

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(o) **Bank Owned Life Insurance**

Mid Penn is the owner and beneficiary of bank-owned life insurance (“BOLI”) policies on current and former Mid Penn directors, as well as BOLI policies acquired through the Phoenix and First Priority acquisitions covering select Miners Bank and First Priority employees. 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.

As a result of the acquisition of Scottdale on January 8, 2018, Mid Penn assumed a noncontributory defined benefit pension plan covering certain former employees of Scottdale. A liability of \$345,000 representing the funded status of the plan was included in other liabilities as of December 31, 2018. Additionally, for the year ended December 31, 2018, Mid Penn recognized \$737,000 of settlement gains as a result of certain lump sum payouts to participants of the defined benefit pension plan. The settlement gains were recorded in noninterest income as a component of other income for the year ended December 31, 2018.

(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.

During 2018, Mid Penn assumed the 401(k) plans of Scottdale and First Priority and, as of December 31, 2018, these 401(k) plans were managed by Mid Penn’s Human Resources and Trust areas. These 401(k) plans were frozen and no contributions were made to the plans in 2018. The plans are being evaluated for either termination or merger into Mid Penn’s primary 401(k) plan.

(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 assets under management totaled \$125,567,000 and \$124,354,000 at December 31, 2018 and 2017, respectively. Most trust income is recognized on the cash basis, which is not materially different than if it were reported on the accrual basis.

(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.

MID PENN BANCORP, INC.**(u) Restricted Stock**

On May 6, 2014, Mid Penn shareholders approved the 2014 Restricted Stock Plan (the “Plan”), which authorizes the issuance of awards that shall not exceed, in the aggregate, 100,000 shares of common stock. Awards under the Plan are limited to employees and directors of the Company and the Bank selected by the Compensation Committee of the Board of Directors, to advance the best interest of Mid Penn and its shareholders.

Share-based compensation expense relating to restricted stock is recognized on a straight-line basis over the vesting periods of the awards and is a component of salaries and benefits expense. The restricted stock is non-voting and non-participating until the granted shares vest. Once the shares vest, the recipient has full voting rights and is entitled to 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)

| | 2018 | 2017 | 2016 |
|---|-------------|-------------|-------------|
| Net Income | \$ 10,596 | \$ 7,089 | \$ 7,804 |
| Less: | | | |
| Dividends on Series D preferred stock | 102 | — | — |
| Net income available to common shareholders | \$ 10,494 | \$ 7,089 | \$ 7,804 |
| Weighted average common shares outstanding | 7,071,091 | 4,236,616 | 4,229,284 |
| Basic earnings per common share | \$ 1.48 | \$ 1.67 | \$ 1.85 |

There were no antidilutive shares used in the calculation at December 31, 2018, 2017, and 2016.

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(4) Acquisition of The Scottdale Bank and Trust Company

On January 8, 2018, Scottdale merged with and into Mid Penn Bank, with Mid Penn Bank continuing as the surviving entity.

Pursuant to the merger agreement, each share of Scottdale common stock issued and outstanding immediately prior to January 8, 2018 converted into the right to receive (i) \$1,166 in cash without interest or (ii) 38.88 shares of Mid Penn common stock. As a result, Mid Penn issued 1,878,827 shares of Mid Penn common stock with an acquisition date fair value of approximately \$64,181,000, based on the closing stock price of Mid Penn's common stock on January 8, 2018 of \$34.16, and cash of \$2,792,000. Including an insignificant amount of cash paid in lieu of fractional shares, the fair value of total consideration paid was \$66,973,000.

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

Included in the purchase price was goodwill of \$19,178,000 and a core deposit intangible of \$4,940,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense related to the Scottdale acquisition in 2018 totaled \$898,000. Core deposit intangible amortization related to the Scottdale acquisition for the five years beginning 2019 through 2023 is estimated to be \$808,000, \$719,000, \$629,000, \$539,000, and \$449,000 per year, respectively, and \$898,000 in total for the four years after 2023.

The allocation of the purchase price is as follows:

(Dollars in thousands)

| | |
|-----------------------------------|-----------|
| Assets acquired: | |
| Cash and cash equivalents | \$ 67,817 |
| Investment securities | 114,039 |
| Restricted stock | 97 |
| Loans | 70,769 |
| Goodwill | 19,178 |
| Core deposit intangible | 4,940 |
| Premises and equipment | 1,496 |
| Foreclosed assets | 11 |
| Deferred income taxes | 1,050 |
| Accrued interest receivable | 989 |
| Other assets | 266 |
| Total assets acquired | 280,652 |
| Liabilities assumed: | |
| Deposits | 209,981 |
| Accrued interest payable | 16 |
| Other liabilities | 3,682 |
| Total liabilities assumed | 213,679 |
| Consideration paid | \$ 66,973 |
| Cash paid | \$ 2,792 |
| Fair value of common stock issued | 64,181 |

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The following table summarizes the final estimated fair value of the assets acquired and liabilities and equity assumed in the Scottsdale transaction.

(Dollars in thousands)

| | |
|---|------------------|
| Total purchase price (consideration paid) | \$ 66,973 |
| Net assets acquired: | |
| Cash and cash equivalents | 67,817 |
| Investment securities | 114,039 |
| Restricted stock | 97 |
| Loans | 70,769 |
| Core deposit intangible | 4,940 |
| Premises and equipment | 1,496 |
| Foreclosed assets | 11 |
| Deferred income taxes | 1,050 |
| Accrued interest receivable | 989 |
| Other assets | 266 |
| Deposits | (209,981) |
| Accrued interest payable | (16) |
| Other liabilities | (3,682) |
| | <u>47,795</u> |
| Goodwill | <u>\$ 19,178</u> |

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

The fair value of the financial assets acquired included loans receivable with a net amortized cost basis of \$70,769,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired.

(Dollars in thousands)

| | |
|--|------------------|
| Gross amortized cost basis at January 8, 2018 | \$ 71,809 |
| Market rate adjustment | 601 |
| Credit fair value adjustment on pools of homogeneous loans | (995) |
| Credit fair value adjustment on impaired loans | (646) |
| Fair value of purchased loans at January 8, 2018 | <u>\$ 70,769</u> |

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

The information about the acquired Scottsdale impaired loan portfolio as of January 8, 2018 is as follows:

(Dollars in thousands)

| | |
|--|-----------------|
| Contractually required principal and interest at acquisition | \$ 2,586 |
| Contractual cash flows not expected to be collected (nonaccretable discount) | (1,010) |
| Expected cash flows at acquisition | 1,576 |
| Interest component of expected cash flows (accretable discount) | (305) |
| Fair value of acquired loans | <u>\$ 1,271</u> |

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The following table presents pro forma information as if the merger between Mid Penn Bank and Scottsdale had been completed on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn Bank merged with Scottsdale at the beginning of 2017. The supplemental pro forma earnings for the year ended December 31, 2018 exclude both (i) adjustments to estimate the eight day impact of Scottsdale due to immateriality and impracticality and (ii) \$1,304,000 of merger related costs incurred in 2018 related to the Scottsdale acquisition, of which \$205,000 was not deductible for federal income tax purposes. Scottsdale merger related costs also included approximately \$518,000 of severance and retention bonus expenses. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, expense efficiencies, or other factors.

(Dollars in thousands, except per share data)

| | For the Year Ended December 31, 2018 | |
|---|---|-----------|
| | 2018 | 2017 |
| Net interest income after loan loss provision | \$ 55,434 | \$ 43,371 |
| Noninterest income | 7,462 | 6,094 |
| Noninterest expense | 48,867 | 38,403 |
| Net income | 11,736 | 8,075 |
| Net income per common share | 1.64 | 1.32 |

(5) Acquisition of First Priority Financial Corp.

On July 31, 2018, Mid Penn completed its acquisition of First Priority, through the merger of First Priority with and into Mid Penn. In connection with this acquisition, First Priority Bank, First Priority's wholly-owned bank subsidiary, was merged with and into Mid Penn Bank.

Pursuant to the merger agreement between Mid Penn and First Priority, the common shareholders of First Priority received 0.3481 shares of Mid Penn common stock for each share of First Priority common stock owned. Additionally, outstanding options to purchase First Priority common stock at the time of the merger were converted into the right to receive cash at a per-option value of \$11.07 less the applicable exercise price, without interest. As a result of the acquisition, Mid Penn's fulfillment of the merger consideration requirements resulted in (i) the issuance of 2,320,800 shares of Mid Penn common stock with an acquisition date fair value of approximately \$76,122,000 based on the closing stock price of Mid Penn's common stock of \$32.80 on July 31, 2018, (ii) the payment \$3,801,000 related to cashing out the stock options, (iii) cash paid of \$6,000 in lieu of fractional shares, and (iv) the issuance of 3,404 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series D totaling \$3,404,000 in replacement of similarly valued preferred shares previously issued by First Priority. Aggregately, this resulted in a combined fair value of total consideration paid of \$79,929,000.

The assets and liabilities of First Priority were recorded on the consolidated balance sheet of the Company at their estimated fair value as of July 31, 2018, and their results of operations have been included in the consolidated income statement of the Company since such date. First Priority has been fully integrated into Mid Penn; therefore, the amount of revenue and earnings of First Priority included in the consolidated income statement since the acquisition date is impracticable to provide. Included in the purchase price was \$39,744,000 of goodwill, a core deposit intangible of \$2,832,000, and a trade name intangible of \$205,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense recognized in 2018 related to the First Priority acquisition totaled \$215,000. Core deposit intangible amortization expense related to the First Priority acquisition for the five years beginning 2019 through 2023 is estimated to be \$493,000, \$442,000, \$390,000, \$339,000 and \$288,000 per year, respectively, and \$665,000 in total for the four years after 2023.

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The allocation of the purchase price is as follows:

(Dollars in thousands)

| | |
|---|-----------|
| Assets acquired: | |
| Cash and cash equivalents | \$ 11,398 |
| Investment securities | 62,977 |
| Restricted stock | 2,237 |
| Loans | 511,623 |
| Goodwill | 39,744 |
| Core deposit intangible | 2,832 |
| Trade name intangible | 205 |
| Premises and equipment | 1,147 |
| Foreclosed assets | 125 |
| Deferred income taxes | 3,140 |
| Accrued interest receivable | 2,293 |
| Other assets | 4,197 |
| Total assets acquired | 641,918 |
| Liabilities assumed: | |
| Deposits | 504,946 |
| Borrowings | 49,939 |
| Accrued interest payable | 1,073 |
| Other liabilities | 2,627 |
| Total liabilities assumed | 558,585 |
| Equity acquired: | |
| Preferred stock | 3,404 |
| Total equity acquired and liabilities assumed | 561,989 |
| Consideration paid | \$ 79,929 |
| Cash paid | \$ 3,807 |
| Fair value of common stock issued | 76,122 |

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Accounting Standards Codification (“ASC”) Topic 805, *Business Combinations*, allows for adjustments to goodwill for a period of up to one year after the merger date for information that becomes available that reflects circumstances at the merger date. The following table summarizes the estimated fair value of the assets acquired and liabilities and equity assumed in the First Priority transaction that management believes are final, however, ASC 805 does allow for adjustments for a period up to one year from the merger date.

(Dollars in thousands)

| | |
|---|------------------|
| Total purchase price (consideration paid) | \$ 79,929 |
| Net assets acquired: | |
| Cash and cash equivalents | 11,398 |
| Investment securities | 62,977 |
| Restricted stock | 2,237 |
| Loans | 511,623 |
| Core deposit intangible | 2,832 |
| Trade name intangible | 205 |
| Premises and equipment | 1,147 |
| Foreclosed assets | 125 |
| Deferred income taxes | 3,140 |
| Accrued interest receivable | 2,293 |
| Other assets | 4,197 |
| Deposits | (504,946) |
| Borrowings | (49,939) |
| Accrued interest payable | (1,073) |
| Other liabilities | (2,627) |
| Preferred stock | (3,404) |
| | <u>40,185</u> |
| Goodwill | <u>\$ 39,744</u> |

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

The fair value of the financial assets acquired included loans receivable with a net amortized cost basis of \$511,623,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired.

(Dollars in thousands)

| | |
|--|-------------------|
| Gross amortized cost basis at January 8, 2018 | \$ 521,644 |
| Market rate adjustment | (3,023) |
| Credit fair value adjustment on pools of homogeneous loans | (6,742) |
| Credit fair value adjustment on impaired loans | (256) |
| Fair value of purchased loans at January 8, 2018 | <u>\$ 511,623</u> |

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

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The information about the acquired First Priority impaired loan portfolio as of July 31, 2018 is as follows:

(Dollars in thousands)

| | |
|--|---------------|
| Contractually required principal and interest at acquisition | \$ 1,855 |
| Contractual cash flows not expected to be collected (nonaccretable discount) | (858) |
| Expected cash flows at acquisition | 997 |
| Interest component of expected cash flows (accretable discount) | (125) |
| Fair value of acquired loans | <u>\$ 872</u> |

The following table presents pro forma information as if the merger between Mid Penn and First Priority had been completed on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn merged with First Priority at the beginning of 2017. The supplemental pro forma earnings for the year ended December 31, 2018 excludes \$3,486,000 of merger related costs related to the First Priority acquisition, of which \$714,000 was not deductible for federal income tax purposes. First Priority merger related costs also included approximately \$1,475,000 of severance and retention bonus expenses. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, expense efficiencies, or other factors.

(Dollars in thousands, except per share data)

| | For the Year Ended | |
|---|--------------------|-----------|
| | December 31, | |
| | 2018 | 2017 |
| Net interest income after loan loss provision | \$ 66,370 | \$ 55,082 |
| Noninterest income | 7,845 | 6,748 |
| Noninterest expense | 55,689 | 49,268 |
| Net income | 15,469 | 9,170 |
| Net income per common share | 1.84 | 1.40 |

(6) Accumulated Other Comprehensive (Loss) Income

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

(Dollars in thousands)

| | Unrealized (Loss) Gain on Securities | Defined Benefit Plan Liability | Accumulated Other Comprehensive (Loss) Income |
|-----------------------------|--|-----------------------------------|---|
| Balance - December 31, 2018 | \$ (3,242) | \$ 864 | \$ (2,378) |
| Balance - December 31, 2017 | \$ (2,159) | \$ 85 | \$ (2,074) |

(7) 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, 2018 and December 31, 2017 because the Bank had sufficient vault cash available.

(8) 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.

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

In instances when a determination is made that other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, this guidance changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income (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 2018, 2017, and 2016.

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

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

(Dollars in thousands)

| December 31, 2018 | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---------------------------|-----------------------------|------------------------------|-----------------------|
| Available for sale securities: | | | | |
| U.S. Treasury and U.S. government agencies | \$ 43,270 | \$ 10 | \$ 1,708 | \$ 41,572 |
| Mortgage-backed U.S. government agencies | 39,865 | — | 1,016 | 38,849 |
| State and political subdivision obligations | 30,642 | 11 | 1,397 | 29,256 |
| Corporate debt securities | 2,250 | — | 4 | 2,246 |
| Total available for sale securities | <u>116,027</u> | <u>21</u> | <u>4,125</u> | <u>111,923</u> |
| Held to maturity securities: | | | | |
| U.S. Treasury and U.S. government agencies | \$ 16,985 | \$ 14 | \$ 143 | \$ 16,856 |
| Mortgage-backed U.S. government agencies | 65,812 | 46 | 1,310 | 64,548 |
| State and political subdivision obligations | 84,034 | 457 | 842 | 83,649 |
| Corporate debt securities | 1,539 | — | 10 | 1,529 |
| Total held to maturity securities | <u>168,370</u> | <u>517</u> | <u>2,305</u> | <u>166,582</u> |
| Total | <u>\$ 284,397</u> | <u>\$ 538</u> | <u>\$ 6,430</u> | <u>\$ 278,505</u> |

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(Dollars in thousands)

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

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.

Equity securities consist of Community Reinvestment Act funds and, as of December 31, 2018 and December 31, 2017, Mid Penn had \$492,000 and \$506,000, respectively, in equity securities recorded at fair value. Prior to January 1, 2018, equity securities were stated at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax. At December 31, 2017, net unrealized gains of \$44,000 had been recognized in accumulated other comprehensive loss. On January 1, 2018, with the adoption of ASU 2016-01, these unrealized gains and losses were reclassified out of accumulated other comprehensive loss and into retained earnings and subsequent changes in fair value are now recognized in net income and the fair value of securities is presented in other assets. During the year ended December 31, 2018, no equity securities were sold and \$15,000 of loss related to the change in fair value of the equity securities was recorded in other expense.

Investment securities having a fair value of \$214,239,000 at December 31, 2018, and \$141,465,000 at December 31, 2017, 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, 2018 and 2017.

(Dollars in thousands)

| | Less Than 12 Months | | | 12 Months or More | | | Total | | |
|--|----------------------|-----------------|-------------------|----------------------|------------------|-------------------|----------------------|------------------|-------------------|
| | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses |
| December 31, 2018 | | | | | | | | | |
| Available for sale securities: | | | | | | | | | |
| U.S. Treasury and U.S. government agencies | 0 | \$ — | \$ — | 21 | \$ 38,386 | \$ 1,708 | 21 | \$ 38,386 | \$ 1,708 |
| Mortgage-backed U.S. government agencies | 11 | 16,740 | 163 | 19 | 22,093 | 853 | 30 | 38,833 | 1,016 |
| State and political subdivision obligations | 3 | 1,751 | 23 | 51 | 24,520 | 1,374 | 54 | 26,271 | 1,397 |
| Corporate debt securities | 2 | 1,996 | 4 | 0 | — | — | 2 | 1,996 | 4 |
| Total temporarily impaired available for sale securities | 16 | 20,487 | 190 | 91 | 84,999 | 3,935 | 107 | 105,486 | 4,125 |
| Held to maturity securities: | | | | | | | | | |
| U.S. Treasury and U.S. government agencies | 1 | \$ 1,985 | \$ 10 | 3 | \$ 8,852 | \$ 133 | 4 | \$ 10,837 | \$ 143 |
| Mortgage-backed U.S. government agencies | 10 | 16,165 | 79 | 35 | 42,431 | 1,231 | 45 | 58,596 | 1,310 |
| State and political subdivision obligations | 26 | 11,321 | 111 | 77 | 29,460 | 731 | 103 | 40,781 | 842 |
| Corporate debt securities | 1 | 1,529 | 10 | 0 | — | — | 1 | 1,529 | 10 |
| Total temporarily impaired held to maturity securities | 38 | 31,000 | 210 | 115 | 80,743 | 2,095 | 153 | 111,743 | 2,305 |
| Total | 54 | \$51,487 | \$ 400 | 206 | \$165,742 | \$ 6,030 | 260 | \$217,229 | \$ 6,430 |

(Dollars in thousands)

| | Less Than 12 Months | | | 12 Months or More | | | Total | | |
|--|----------------------|-----------------|-------------------|----------------------|------------------|-------------------|----------------------|------------------|-------------------|
| | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses |
| December 31, 2017 | | | | | | | | | |
| Available for sale securities: | | | | | | | | | |
| U.S. Treasury and U.S. government agencies | 3 | \$ 5,008 | \$ 184 | 18 | \$ 33,722 | \$ 1,211 | 21 | \$ 38,730 | \$ 1,395 |
| Mortgage-backed U.S. government agencies | 4 | 5,267 | 75 | 15 | 20,497 | 494 | 19 | 25,764 | 569 |
| State and political subdivision obligations | 11 | 6,144 | 102 | 40 | 19,091 | 637 | 51 | 25,235 | 739 |
| Corporate debt securities | 0 | — | — | 0 | — | — | 0 | — | — |
| Equity securities | 0 | — | — | 1 | 506 | 44 | 1 | 506 | 44 |
| Total temporarily impaired available for sale securities | 18 | 16,419 | 361 | 74 | 73,816 | 2,386 | 92 | 90,235 | 2,747 |
| Held to maturity securities: | | | | | | | | | |
| U.S. Treasury and U.S. government agencies | 0 | \$ — | \$ — | 4 | \$ 10,894 | \$ 90 | 4 | \$ 10,894 | \$ 90 |
| Mortgage-backed U.S. government agencies | 0 | — | — | 35 | 52,949 | 523 | 35 | 52,949 | 523 |
| State and political subdivision obligations | 0 | — | — | 77 | 29,976 | 301 | 77 | 29,976 | 301 |
| Total temporarily impaired held to maturity securities | 0 | — | — | 116 | 93,819 | 914 | 116 | 93,819 | 914 |
| Total | 18 | \$16,419 | \$ 361 | 190 | \$167,635 | \$ 3,300 | 208 | \$184,054 | \$ 3,661 |

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

The majority of the investment portfolio is comprised of 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, 2018, the majority of the unrealized losses on securities in an unrealized loss position were attributed to state and political subdivision obligations, mortgage-back U.S. government agencies and U.S. Treasury and government agencies. 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. 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 primarily to changes in interest rates (based upon the respective securities maturity date relative to the yield curve) and not due to any notable erosion of credit quality.

Gross realized gains and losses on sales of available-for-sale securities for the years ended December 31, 2018, 2017, and 2016 are shown in the table below.

| <i>(Dollars in thousands)</i> | For the year ended December 31, | | |
|-------------------------------|---------------------------------|--------------|-----------------|
| | 2018 | 2017 | 2016 |
| Realized gains | \$ 150 | \$ 246 | \$ 1,927 |
| Realized losses | (13) | (204) | (881) |
| Net gains | <u>\$ 137</u> | <u>\$ 42</u> | <u>\$ 1,046</u> |

The table below is the maturity distribution of investment securities at amortized cost and fair value at December 31, 2018.

| <i>(Dollars in thousands)</i> | Available for Sale | | Held to Maturity | |
|---------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| December 31, 2018 | | | | |
| Due in 1 year or less | \$ — | \$ — | \$ 1,086 | \$ 1,087 |
| Due after 1 year but within 5 years | 25,285 | 24,732 | 18,745 | 18,597 |
| Due after 5 years but within 10 years | 43,070 | 41,027 | 82,727 | 82,350 |
| Due after 10 years | 7,807 | 7,315 | — | — |
| | <u>76,162</u> | <u>73,074</u> | <u>102,558</u> | <u>102,034</u> |
| Mortgage-backed securities | 39,865 | 38,849 | 65,812 | 64,548 |
| | <u>\$ 116,027</u> | <u>\$ 111,923</u> | <u>\$ 168,370</u> | <u>\$ 166,582</u> |

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(9) 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 \$475,000 and \$464,000 as of December 31, 2018 and 2017, respectively, and the classified ratings of special mention, substandard, and doubtful within Mid Penn's internal risk rating system as of December 31, 2018 and 2017, are noted below:

(Dollars in thousands)

| December 31, 2018 | Pass | Special Mention | Substandard | Doubtful | Total |
|---------------------------------------|--------------------|------------------------|--------------------|-----------------|--------------------|
| Commercial and industrial | \$ 276,690 | \$ 2,769 | \$ 7,059 | \$ — | \$ 286,518 |
| Commercial real estate | 850,150 | 2,432 | 8,787 | — | 861,369 |
| Commercial real estate - construction | 141,806 | — | 367 | — | 142,173 |
| Lease financing | 53 | — | — | — | 53 |
| Residential mortgage | 251,151 | 147 | 2,245 | — | 253,543 |
| Home equity | 70,004 | — | 92 | — | 70,096 |
| Consumer | 10,315 | — | — | — | 10,315 |
| | <u>\$1,600,169</u> | <u>\$ 5,348</u> | <u>\$ 18,550</u> | <u>\$ —</u> | <u>\$1,624,067</u> |

(Dollars in thousands)

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

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

(Dollars in thousands)

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---------------------|--------------------------|-------------------|---------------------|--------------------------|-------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| <u>With no related allowance recorded:</u> | | | | | | |
| Commercial and industrial | \$ — | \$ — | \$ — | \$ — | \$ 13 | \$ — |
| Commercial real estate | 2,007 | 2,276 | — | 3,424 | 4,056 | — |
| Commercial real estate - construction | — | — | — | — | — | — |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | 657 | 811 | — | 760 | 877 | — |
| Home equity | 30 | 106 | — | 260 | 295 | — |
| Consumer | — | — | — | — | — | — |
| <u>With no related allowance recorded and acquired with credit deterioration: *</u> | | | | | | |
| Commercial and industrial | \$ 28 | \$ 28 | \$ — | \$ — | \$ — | \$ — |
| Commercial real estate | 1,563 | 1,563 | — | 555 | 555 | — |
| Commercial real estate - construction | — | — | — | — | — | — |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | 1,208 | 1,208 | — | 306 | 306 | — |
| Home equity | 4 | 4 | — | — | — | — |
| Consumer | — | — | — | — | — | — |
| <u>With an allowance recorded:</u> | | | | | | |
| Commercial and industrial | \$ 4,527 | \$ 4,635 | \$ 500 | \$ 4,434 | \$ 4,460 | \$ 136 |
| Commercial real estate | 721 | 721 | 204 | 1,423 | 1,589 | 293 |
| Commercial real estate - construction | 367 | 370 | 38 | 487 | 492 | 100 |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | — | — | — | — | — | — |
| Home equity | — | — | — | — | — | — |
| Consumer | — | — | — | — | — | — |
| <u>Total:</u> | | | | | | |
| Commercial and industrial | \$ 4,555 | \$ 4,663 | \$ 500 | \$ 4,434 | \$ 4,473 | \$ 136 |
| Commercial real estate | 4,291 | 4,560 | 204 | 5,402 | 6,200 | 293 |
| Commercial real estate - construction | 367 | 370 | 38 | 487 | 492 | 100 |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | 2,019 | 1,865 | — | 1,066 | 1,183 | — |
| Home equity | 34 | 110 | — | 260 | 295 | — |

* 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, 2018, 2017, and 2016 are summarized as follows:

(Dollars in thousands)

| | <u>December 31, 2018</u> | | <u>December 31, 2017</u> | | <u>December 31, 2016</u> | |
|---|------------------------------------|-----------------------------------|------------------------------------|-----------------------------------|------------------------------------|-----------------------------------|
| | <u>Average Recorded Investment</u> | <u>Interest Income Recognized</u> | <u>Average Recorded Investment</u> | <u>Interest Income Recognized</u> | <u>Average Recorded Investment</u> | <u>Interest Income Recognized</u> |
| <u>With no related allowance recorded:</u> | | | | | | |
| Commercial and industrial | \$ — | \$ — | \$ 15 | \$ — | \$ 9 | \$ — |
| Commercial real estate | 3,048 | 3 | 1,915 | 279 | 820 | — |
| Commercial real estate - construction | — | — | 164 | — | 124 | — |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | 754 | 29 | 890 | 18 | 821 | 21 |
| Home equity | 101 | — | 218 | 6 | 75 | — |
| Consumer | — | — | — | — | — | — |
| <u>With no related allowance recorded and acquired with credit deterioration:</u> | | | | | | |
| Commercial and industrial | \$ 23 | \$ — | \$ — | \$ — | \$ — | \$ — |
| Commercial real estate | 1,414 | 23 | 651 | 110 | 810 | 164 |
| Commercial real estate - construction | — | — | — | — | — | — |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | 832 | — | 332 | — | 378 | 4 |
| Home equity | 1 | — | — | — | — | — |
| Consumer | — | — | — | — | — | — |
| <u>With an allowance recorded:</u> | | | | | | |
| Commercial and industrial | \$ 4,437 | \$ — | \$ 1,779 | \$ — | \$ 59 | \$ — |
| Commercial real estate | 541 | — | 1,446 | — | 2,177 | — |
| Commercial real estate - construction | 367 | — | 488 | — | 48 | — |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | — | — | — | — | 14 | — |
| Home equity | — | — | — | — | 32 | — |
| Consumer | — | — | — | — | — | — |
| <u>Total:</u> | | | | | | |
| Commercial and industrial | \$ 4,460 | \$ — | \$ 1,794 | \$ — | \$ 68 | \$ — |
| Commercial real estate | 5,003 | 26 | 4,012 | 389 | 3,807 | 164 |
| Commercial real estate - construction | 367 | — | 652 | — | 172 | — |
| Lease financing | — | — | — | — | — | — |
| Residential mortgage | 1,586 | 29 | 1,222 | 18 | 1,213 | 25 |
| Home equity | 102 | — | 218 | 6 | 107 | — |

Nonaccrual loans by loan portfolio class, including loans acquired with credit deterioration, as of December 31, 2018 and 2017 are summarized as follows:

(Dollars in thousands)

| | <u>2018</u> | <u>2017</u> |
|---------------------------------------|------------------|------------------|
| Commercial and industrial | \$ 4,555 | \$ 4,434 |
| Commercial real estate | 4,291 | 4,902 |
| Commercial real estate - construction | 367 | 487 |
| Residential mortgage | 1,502 | 492 |
| Home equity | 34 | 260 |
| | <u>\$ 10,749</u> | <u>\$ 10,575</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 \$536,000, \$780,000, and \$778,000, in the years ended December 31, 2018, 2017, and 2016, 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, 2018 and 2017 are summarized as follows:

(Dollars in thousands)

| December 31, 2018 | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days | Total Past Due | Current | Total Loans | Loans Receivable > 90 Days and Accruing |
|---|------------------------------------|------------------------------------|-------------------------------------|---------------------------|--------------------|------------------------|---|
| Commercial and industrial: | | | | | | | |
| Commercial and industrial | \$ 17 | \$ — | \$ 4,527 | \$ 4,544 | \$ 281,946 | \$ 286,490 | \$ — |
| Acquired with credit deterioration | 23 | 5 | — | 28 | — | 28 | — |
| Commercial real estate: | | | | | | | |
| Commercial real estate | 685 | — | 458 | 1,143 | 858,663 | 859,806 | — |
| Acquired with credit deterioration | 29 | — | 1,534 | 1,563 | — | 1,563 | — |
| Commercial real estate - construction: | | | | | | | |
| Commercial real estate - construction | — | — | 367 | 367 | 141,806 | 142,173 | — |
| Lease financing: | | | | | | | |
| Lease financing | — | — | — | — | 53 | 53 | — |
| Residential mortgage: | | | | | | | |
| Residential mortgage | 461 | — | 277 | 738 | 251,597 | 252,335 | — |
| Acquired with credit deterioration | 19 | 57 | 913 | 989 | 219 | 1,208 | — |
| Home equity: | | | | | | | |
| Home equity | 166 | 22 | 25 | 213 | 69,879 | 70,092 | — |
| Acquired with credit deterioration | — | — | 4 | 4 | — | 4 | — |
| Consumer: | | | | | | | |
| Consumer | 57 | 5 | — | 62 | 10,253 | 10,315 | — |
| Total | <u>\$ 1,457</u> | <u>\$ 89</u> | <u>\$ 8,105</u> | <u>\$ 9,651</u> | <u>\$1,614,416</u> | <u>\$1,624,067</u> | <u>\$ —</u> |

MID PENN BANCORP, INC.

(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 > 90 Days and Accruing</u> |
|---|------------------------------------|------------------------------------|-------------------------------------|---------------------------|-------------------|------------------------|---|
| Commercial and industrial: | | | | | | | |
| Commercial and industrial | \$ 4,439 | \$ 16 | \$ — | \$ 4,455 | \$ 183,578 | \$ 188,033 | \$ — |
| Commercial real estate: | | | | | | | |
| Commercial real estate | — | — | 3,669 | 3,669 | 510,788 | 514,457 | — |
| Acquired with credit deterioration | 500 | — | 55 | 555 | — | 555 | — |
| Commercial real estate - construction: | | | | | | | |
| Commercial real estate - construction | — | — | 487 | 487 | 61,849 | 62,336 | — |
| Lease financing: | | | | | | | |
| Lease financing | — | — | — | — | 229 | 229 | — |
| Residential mortgage: | | | | | | | |
| Residential mortgage | 310 | 467 | 177 | 954 | 97,773 | 98,727 | — |
| Acquired with credit deterioration | — | 31 | 193 | 224 | 82 | 306 | — |
| Home equity: | | | | | | | |
| Home equity | 54 | 98 | 250 | 402 | 41,491 | 41,893 | — |
| Consumer: | | | | | | | |
| Consumer | 3 | — | — | 3 | 3,865 | 3,868 | — |
| Total | <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> |

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Activity in the allowance for loan and lease losses for the years ended December 31, 2018, 2017, and 2016, and the recorded investment in loans receivable as of December 31, 2018, 2017, and 2016 are as follows:

(Dollars in thousands)

| December 31, 2018 | <u>Commercial and industrial</u> | <u>Commercial real estate</u> | <u>Commercial real estate - construction</u> | <u>Lease financing</u> | <u>Residential mortgage</u> | <u>Home equity</u> | <u>Consumer</u> | <u>Unallocated</u> | <u>Total</u> |
|--|--|---------------------------------------|--|----------------------------|---------------------------------|------------------------|-----------------|--------------------|--------------|
| Allowance for loan and lease losses: | | | | | | | | | |
| Beginning balance | \$ 1,795 | \$ 4,435 | \$ 178 | \$ — | \$ 428 | \$ 423 | \$ 3 | \$ 344 | \$ 7,606 |
| Charge-offs | (142) | (64) | (40) | — | (60) | (185) | (37) | — | (528) |
| Recoveries | 1 | 808 | — | — | — | 1 | 9 | — | 819 |
| Provisions | 737 | (476) | (63) | — | 85 | 289 | 32 | (104) | 500 |
| Ending balance | 2,391 | 4,703 | 75 | — | 453 | 528 | 7 | 240 | 8,397 |
| Ending balance: individually evaluated for impairment | 500 | 204 | 38 | — | — | — | — | — | 742 |
| Ending balance: collectively evaluated for impairment | \$ 1,891 | \$ 4,499 | \$ 37 | \$ — | \$ 453 | \$ 528 | \$ 7 | \$ 240 | \$ 7,655 |
| Loans receivable: | | | | | | | | | |
| Ending balance | \$ 286,518 | \$ 861,369 | \$ 142,173 | \$ 53 | \$ 253,543 | \$ 70,096 | \$ 10,315 | \$ — | \$ 1,624,067 |
| Ending balance: individually evaluated for impairment | 4,527 | 2,728 | 367 | — | 811 | 30 | — | — | 8,463 |
| Ending balance: acquired with credit deterioration | 28 | 1,563 | — | — | 1,208 | 4 | — | — | 2,803 |
| Ending balance: collectively evaluated for impairment | \$ 281,963 | \$ 857,078 | \$ 141,806 | \$ 53 | \$ 251,524 | \$ 70,062 | \$ 10,315 | \$ — | \$ 1,612,801 |

MID PENN BANCORP, INC.

(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 |
|--|--|-----------------------------------|--|----------------------------|---------------------------------|------------------------|-----------------|--------------------|--------------|
| Allowance for loan and lease losses: | | | | | | | | | |
| 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 |
| Loans receivable: | | | | | | | | | |
| 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 | Commercial and industrial | Commercial real estate | Commercial real estate - construction | Lease financing | Residential mortgage | Home equity | Consumer | Unallocated | Total |
|--|--|---------------------------------------|--|----------------------------|---------------------------------|------------------------|-----------------|--------------------|--------------|
| Allowance for loan and lease losses: | | | | | | | | | |
| Beginning Balance | \$ 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 |
| Loans receivable: | | | | | | | | | |
| Ending balance | \$ 172,518 | \$ 446,524 | \$ 54,376 | \$ 425 | \$ 99,457 | \$ 37,608 | \$ 3,016 | \$ — | \$ 813,924 |
| Ending balance: individually evaluated for impairment | 60 | 3,246 | 860 | — | 916 | 140 | — | — | 5,222 |
| Ending balance: acquired with credit deterioration | — | 842 | — | — | 389 | — | — | — | 1,231 |
| Ending balance: collectively evaluated for impairment | \$ 172,458 | \$ 442,436 | \$ 53,516 | \$ 425 | \$ 98,152 | \$ 37,468 | \$ 3,016 | \$ — | \$ 807,471 |

MID PENN BANCORP, INC.

The recorded investments in troubled debt restructured loans at December 31, 2018 and 2017 are as follows:

(Dollars in thousands)

| December 31, 2018 | Pre-Modification | | Post-Modification | |
|---------------------------|-------------------------|-------------------|--------------------------|----------------------------|
| | Outstanding | Recorded | Outstanding | Recorded |
| | Investment | Investment | Investment | Recorded Investment |
| Commercial and industrial | \$ 4,110 | \$ 4,110 | \$ 4,460 | \$ 4,302 |
| Commercial real estate | 2,940 | 2,940 | 2,841 | 2,201 |
| Residential mortgage | 677 | 677 | 675 | 516 |
| Home equity | 14 | 14 | 14 | 1 |
| | <u>\$ 7,741</u> | <u>\$ 7,741</u> | <u>\$ 7,990</u> | <u>\$ 7,020</u> |

(Dollars in thousands)

| December 31, 2017 | Pre-Modification | | Post-Modification | |
|---------------------------|-------------------------|-------------------|--------------------------|----------------------------|
| | Outstanding | Recorded | Outstanding | Recorded |
| | Investment | Investment | Investment | Recorded Investment |
| Commercial and industrial | \$ 4,110 | \$ 4,110 | \$ 4,460 | \$ 4,434 |
| Commercial real estate | 5,735 | 5,735 | 5,581 | 4,593 |
| Residential mortgage | 677 | 677 | 675 | 540 |
| Home equity | 14 | 14 | 14 | 4 |
| | <u>\$ 10,536</u> | <u>\$ 10,536</u> | <u>\$ 10,730</u> | <u>\$ 9,571</u> |

Mid Penn's troubled debt restructured loans at December 31, 2018 totaled \$7,020,000, and included four loans totaling \$517,000 representing accruing impaired loans to unrelated borrowers in compliance with the terms of the modification, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling \$516,000 and one loan being an accruing impaired home equity loan of \$1,000. The remaining \$6,503,000 of troubled debt restructurings was attributable to ten loans among five relationships which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$5,463,000 of the total \$6,503,000 in nonaccrual impaired troubled debt restructured loans. As of December 31, 2018, 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 2018.

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, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling \$540,000, and one loan being an accruing impaired home equity loan of \$4,000. The remaining \$9,027,000 of troubled debt restructured loans is attributable to fifteen loans among seven relationships, which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for \$7,284,000 of the \$9,027,000 in nonaccrual impaired troubled debt restructured loans. 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.

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 was one loan modified in 2018, ten loans modified in 2017, and three loans modified in 2016 that resulted in troubled debt restructurings. The following table summarizes the loans whose terms have been modified resulting in troubled debt restructurings during the years ended December 31, 2018, 2017, and 2016.

(Dollars in thousands)

| December 31, 2018 | Number of Contracts | Pre-Modification | | Post-Modification | |
|--------------------------|----------------------------|-------------------------|-------------------|--------------------------|----------------------------|
| | | Outstanding | Recorded | Outstanding | Recorded |
| | | Investment | Investment | Investment | Recorded Investment |
| Commercial real estate | 1 | \$ 270 | \$ 270 | \$ 270 | \$ 266 |
| | 1 | \$ 270 | \$ 270 | \$ 270 | \$ 266 |

MID PENN BANCORP, INC.

(Dollars in thousands)

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

(Dollars in thousands)

| | Number of Contracts | Pre- Modification Outstanding Recorded Investment | Post- Modification Outstanding Recorded Investment | Recorded Investment |
|---------------------------|------------------------------------|--|---|--------------------------------|
| December 31, 2016 | | | | |
| Commercial and industrial | 2 | \$ 934 | \$ 914 | \$ 914 |
| Residential mortgage | 1 | 68 | 68 | 68 |
| | <u>3</u> | <u>\$ 1,002</u> | <u>\$ 982</u> | <u>\$ 982</u> |

The following table provides activity for the accretable yield of purchased impaired loans for the year ended December 31, 2018.

(Dollars in thousands)

| | |
|---|---------------|
| Accretable yield, January 1, 2018 | \$ 67 |
| Acquisition of impaired loans | \$ 430 |
| Accretable yield amortized to interest income | (188) |
| Accretable yield, December 31, 2018 | <u>\$ 309</u> |

The Bank has granted loans to certain of its executive officers, directors, and their related interests. The aggregate amount of these loans was \$17,843,000 and \$15,163,000 at December 31, 2018 and 2017, respectively. During 2018, \$6,458,000 of new loans and advances were extended, \$582,000 of loans were assumed from First Priority as a result of the addition of new directors, and repayments totaled \$4,360,000. None of these loans were past due, in nonaccrual status, or restructured at December 31, 2018.

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(10) Bank Premises and Equipment

At December 31, 2018 and 2017, bank premises and equipment are as follows:

(Dollars in thousands)

| | <u>2018</u> | <u>2017</u> |
|------------------------------------|------------------|------------------|
| Land | \$ 4,305 | \$ 3,564 |
| Buildings | 19,490 | 8,632 |
| Furniture, fixtures, and equipment | 11,837 | 8,262 |
| Leasehold improvements | 1,363 | 1,126 |
| Construction in progress | 83 | 4,467 |
| Total cost | 37,078 | 26,051 |
| Less accumulated depreciation | (11,775) | (9,883) |
| Total bank premises and equipment | <u>\$ 25,303</u> | <u>\$ 16,168</u> |

There were no premises and equipment classified as held for sale as of December 31, 2018 or 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 Mid Penn, 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 \$2,395,000 in 2018, \$1,464,000 in 2017, and \$1,658,000 in 2016.

On January 1, 2019, as a result of the adoption of ASU 2016-02, *Leases*, the remaining balance of the deferred sale/leaseback gain was eliminated through an opening adjustment to retained earnings. The adoption of this standard also resulted in an increase to both other assets and other liabilities to record right-of-use lease assets and corresponding lease liabilities for all of Mid Penn's leased facilities. Please reference Note 26, *Recent Accounting Pronouncements*, for more information.

Operating Leases:

As of December 31, 2018, 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. Three of Mid Penn's operating leases are with related parties. The rental expense paid to related parties was \$320,000 in 2018, \$352,000 in 2017, and \$348,000 in 2016. The future minimum payments to related parties are \$208,000 (2019), \$214,000 (2020), \$186,000 (2021), \$175,000 (2022), \$175,000 in 2023, and \$1,700,000 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.

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The following summary reflects the future minimum rental payments by year under Mid Penn's operating leases as of December 31, 2018, including a breakdown of the sublease rental income and future minimum payments owed to related parties.

(Dollars in thousands)

| | Lease Obligation | Sublease Rental Income | Net Rental Expense |
|------------|-----------------------------|---------------------------------------|-----------------------------------|
| 2019 | 2,171 | 81 | 2,090 |
| 2020 | 1,970 | 81 | 1,889 |
| 2021 | 1,603 | 20 | 1,583 |
| 2022 | 1,464 | — | 1,464 |
| 2023 | 1,245 | — | 1,245 |
| thereafter | 6,691 | — | 6,691 |
| | <u>\$ 15,144</u> | <u>\$ 182</u> | <u>\$ 14,962</u> |

Rental expense in connection with leases was \$1,433,000 in 2018, \$1,087,000 in 2017, \$716,000 in 2016.

(11) Deposits

At December 31, 2018 and 2017, time deposits amounted to \$486,329,000 and \$201,623,000, respectively. Interest expense on certificates of deposit amounted to \$4,906,000, \$2,570,000, and \$2,156,000 for the years ended December 31, 2018, 2017, and 2016, respectively. The aggregate amount of demand deposit overdrafts that were reclassified as loans were \$356,000 at December 31, 2018, compared to \$136,000 as of December 31, 2017.

Time deposits at December 31, 2018, mature as follows:

(Dollars in thousands)

| | Time Deposits | |
|---------------------|----------------------------|--------------------------|
| | Less than \$250,000 | \$250,000 or more |
| Maturing in 2019 | \$ 199,257 | \$ 70,445 |
| Maturing in 2020 | 129,223 | 8,618 |
| Maturing in 2021 | 42,965 | 1,796 |
| Maturing in 2022 | 19,370 | 2,499 |
| Maturing in 2023 | 10,566 | 770 |
| Maturing thereafter | 820 | — |
| | <u>\$ 402,201</u> | <u>\$ 84,128</u> |

Brokered deposits included in the time deposit totals equaled \$110,218,000 at December 31, 2018 and \$19,447,000 at December 31, 2017. Deposits and other funds from related parties held by Mid Penn at December 31, 2018 and 2017 amounted to \$27,399,000 and \$20,262,000, respectively.

(12) Short-term Borrowings

At December 31, 2018 and 2017, Mid Penn had short-term borrowings totaling \$43,100,000 and \$34,611,000, respectively, consisting of federal funds purchased and advances from the FHLB with an original maturity of less than a year. Federal funds purchased from correspondent banks mature in one business day and reprice daily based on the Federal Funds rate. Advances from the FHLB are collateralized by our investment in the common stock of the FHLB and by a blanket lien on selected loan receivables comprised principally real estate secured loans totaling \$507,462,000 within the Bank's portfolio. As of December 31, 2018, the Bank had short-term borrowing capacity from the FHLB up to the Bank's unused borrowing capacity of \$464,362,000 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, 2018. No draws have been made on these lines of credit and on December 31, 2018 and 2017, the balance was zero.

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The following table outlines Mid Penn’s various sources of short-term borrowed funds at or for the years ended December 31, 2018 and 2017. The maximum balance represents the highest indebtedness for each category of short-term borrowed funds at any month-end during each of the years shown.

(Dollars in thousands)

| | December 31, | |
|---------------------------------------|---------------------|-------------|
| | 2018 | 2017 |
| Federal funds purchased: | | |
| Balance at year end | \$ — | \$ 34,511 |
| Weighted average rate at year end | 0% | 1.54% |
| Maximum month-end balance | \$ 35,050 | \$ 41,610 |
| Average daily balance during the year | \$ 7,049 | \$ 7,961 |
| Weighted average rate during the year | 2.24% | 1.39% |
| FHLB short-term borrowings: | | |
| Balance at year end | \$ 43,100 | \$ — |
| Weighted average rate at year end | 2.74% | 0.00% |
| Maximum month-end balance | \$ 43,100 | \$ — |
| Average daily balance during the year | \$ 1,784 | \$ — |
| Weighted average rate during the year | 2.74% | 0.00% |

(13) 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, 2018 and 2017, the Bank had long-term debt outstanding in the amount of \$48,024,000 and \$12,352,000, respectively, consisting of FHLB fixed rate instruments. The obligations are secured under the terms of a blanket collateral agreement with the FHLB consisting of FHLB stock and qualifying Mid Penn loan receivables, principally real estate secured loans totaling \$507,462,000. The following table presents a summary of long-term debt as of December 31, 2018 and December 31, 2017.

(Dollars in thousands)

| | At December 31, | |
|---|------------------------|------------------|
| | 2018 | 2017 |
| Due July 2019, 1.64% | \$ 2,000 | \$ — |
| Due December 2019, 1.87% | 10,000 | 10,000 |
| Due January 2020, 3.00% | 5,000 | — |
| Due February 2020, 3.01% | 5,000 | — |
| Due March 2020, 3.02% | 5,000 | — |
| Due April 2020, 3.03% | 5,000 | — |
| Due June 2020, 1.72% | 2,000 | — |
| Due August 2020, 3.05% | 5,000 | — |
| Due October 2020, 3.06% | 5,000 | — |
| Due December 2020, 1.78% | 2,000 | — |
| Due August 2026, 4.80% | 2,076 | 2,295 |
| Due February 2027, 6.71% | 52 | 57 |
| | <u>48,128</u> | <u>12,352</u> |
| Less: fair value adjustment on debt assumed from acquisitions | 104 | — |
| | <u>\$ 48,024</u> | <u>\$ 12,352</u> |

The aggregate principal amounts due on long-term debt subsequent to December 31, 2018 are \$12,234,000 (2019), \$34,246,000 (2020), \$258,000 (2021), \$271,000 (2022), \$284,000 (2023) and \$835,000 thereafter.

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(14) Subordinated Debt

Subordinated Debt Assumed July 2018 with the First Priority Acquisition

On July 31, 2018, Mid Penn completed its acquisition of First Priority and assumed \$9,500,000 of Subordinated Notes (the "First Priority Notes"). In accordance with purchase accounting principles, the First Priority Notes were assigned a fair value premium of \$247,000. The notes are intended to be treated as Tier 2 capital for regulatory reporting purposes.

The First Priority Notes agreements were entered into by First Priority on November 13, 2015 with five accredited investors pursuant to which First Priority issued subordinated notes totaling \$9,500,000. The First Priority Notes have a maturity date of November 30, 2025, and bear interest at a fixed rate of 7.00% per annum. The Notes are non-callable for an initial period of five years and include provisions for redemption pricing between 101.5% and 100.5% of the liquidation value if called after five years but prior to the stated maturity date.

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, 2018, 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.

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, 2018, related parties held \$1,930,000 of the 2015 Notes.

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(15) 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.

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There were no transfers of assets between fair value Level 1 and Level 2 for the years ended December 31, 2018 or 2017. 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, 2018 | Fair value measurements at December 31, 2018 using: | | |
|---|---|---|---|---|
| | | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets: | | | | |
| Available-for-sale debt securities: | | | | |
| U.S. Treasury and U.S. government agencies | \$ 41,572 | \$ — | \$ 41,572 | \$ — |
| Mortgage-backed U.S. government agencies | 38,849 | — | 38,849 | — |
| State and political subdivision obligations | 29,256 | — | 29,256 | — |
| Corporate debt securities | 2,246 | — | 2,246 | — |
| Other assets: | | | | |
| Equity securities | 492 | 492 | — | — |
| | <u>\$ 112,415</u> | <u>\$ 492</u> | <u>\$ 111,923</u> | <u>\$ —</u> |

(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) |
| Assets: | | | | |
| Available-for-sale debt securities: | | | | |
| 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 | 1,355 | — | 1,355 | — |
| Other assets: | | | | |
| Equity securities | 506 | 506 | — | — |
| | <u>\$ 93,465</u> | <u>\$ 506</u> | <u>\$ 92,959</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, 2018 | Fair value measurements at December 31, 2018 using: | | |
|---------------------------------|---|---|---|---|
| | | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets: | | | | |
| Impaired Loans | \$ 4,935 | \$ — | \$ — | \$ 4,935 |
| Foreclosed Assets Held for Sale | 581 | — | — | 581 |

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Fair value measurements at December 31, 2017

using:

(Dollars in thousands)

| | Total carrying value at December 31, 2017 | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---------------------------------|--|--|--|--|
| Assets: | | | | |
| Impaired Loans | \$ 6,090 | \$ — | \$ — | \$ 6,090 |
| Foreclosed Assets Held for Sale | — | — | — | — |

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

(Dollars in thousands)

Quantitative Information about Level 3 Fair Value Measurements

| December 31, 2018 | Fair Value Estimate | Valuation Technique | Unobservable Input | Range | Weighted Average |
|---------------------------------|----------------------------|----------------------------------|---------------------------|--------------|-------------------------|
| Impaired Loans | \$ 4,935 | Appraisal of collateral (a), (c) | Appraisal adjustments (b) | 26% - 100% | 40% |
| Foreclosed Assets Held for Sale | 581 | Appraisal of collateral (a), (c) | Appraisal adjustments (b) | 17% - 17% | 17% |

(Dollars in thousands)

Quantitative Information about Level 3 Fair Value Measurements

| December 31, 2017 | Fair Value Estimate | Valuation Technique | Unobservable Input | Range | Weighted Average |
|---------------------------------|----------------------------|----------------------------------|---------------------------|--------------|-------------------------|
| Impaired Loans | \$ 6,090 | Appraisal of collateral (a), (c) | Appraisal adjustments (b) | 6% - 51% | 28% |
| Foreclosed Assets Held for Sale | — | Appraisal of collateral (a), (c) | Appraisal adjustments (b) | 0% - 0% | 0% |

- (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:

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:

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.

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It is Mid Penn's policy to obtain updated third party valuations on all substandard nonaccrual loans collateralized by real estate within 30 days of the credit being classified as impaired. Prior to receipt of the updated real estate valuation Mid Penn will use any existing real estate valuation to determine any potential allowance for loan loss issues and will update the allowance impact calculation upon receipt of the updated real estate 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.

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.

The following table summarizes the carrying value and fair value of financial instruments at December 31, 2018 and 2017.

(Dollars in thousands)

| | December 31, 2018 | | December 31, 2017 | |
|--|--------------------------|-------------------|--------------------------|-------------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | \$ 40,065 | \$ 40,065 | \$ 23,514 | \$ 23,514 |
| Available for sale investment securities | 111,923 | 111,923 | 93,465 | 93,465 |
| Held to maturity investment securities | 168,370 | 166,582 | 101,356 | 100,483 |
| Loans held for sale | 1,702 | 1,702 | 1,040 | 1,040 |
| Equity securities | 492 | 492 | 506 | 506 |
| Net loans and leases | 1,615,670 | 1,622,287 | 902,798 | 917,081 |
| Restricted investment in bank stocks | 6,646 | 6,646 | 4,384 | 4,384 |
| Accrued interest receivable | 8,244 | 8,244 | 4,564 | 4,564 |
| Mortgage servicing rights | 101 | 101 | 126 | 126 |
| Financial liabilities: | | | | |
| Deposits | \$ 1,726,026 | \$ 1,725,674 | \$ 1,023,568 | \$ 1,026,830 |
| Short-term borrowings | 43,100 | 43,100 | 34,611 | 34,611 |
| Long-term debt | 48,024 | 44,585 | 12,352 | 11,692 |
| Subordinated debt | 27,082 | 24,881 | 17,338 | 17,358 |
| Accrued interest payable | 2,262 | 2,262 | 645 | 645 |

The Bank's outstanding and unfunded credit commitments and financial standby letters of credit were deemed to have no significant fair value as of December 31, 2018 and 2017.

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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, 2018 and 2017. 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.

(Dollars in thousands)

| | Carrying Amount | Fair Value | Fair Value Measurements | | |
|--|-----------------|--------------|---|---|---|
| | | | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| December 31, 2018 | | | | | |
| Financial instruments - assets | | | | | |
| Held-to-maturity investment securities | \$ 168,370 | \$ 166,582 | \$ — | \$ 166,582 | \$ — |
| Net loans and leases | 1,615,670 | 1,622,287 | — | — | 1,622,287 |
| Financial instruments - liabilities | | | | | |
| Deposits | \$ 1,726,026 | \$ 1,725,674 | \$ — | \$ 1,725,674 | \$ — |
| Long-term debt | 48,024 | 44,585 | — | 44,585 | — |
| Subordinated debt | 27,082 | 24,881 | — | 24,881 | — |

(Dollars in thousands)

| | Carrying Amount | Fair Value | Fair Value Measurements | | |
|--|-----------------|--------------|---|---|---|
| | | | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| December 31, 2017 | | | | | |
| Financial instruments - assets | | | | | |
| Held-to-maturity investment securities | \$ 101,356 | \$ 100,483 | \$ — | \$ 100,483 | \$ — |
| 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 | — |

(16) 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, as well as a postretirement healthcare and life insurance benefit plan, which is noncontributory, covering certain full-time employees. Mid Penn also assumed a noncontributory defined benefit pension plan as a result of the acquisition of Scottsdale on January 8, 2018.

Service costs related to plans benefiting Mid Penn employees are reported as a component of salaries and employee benefits on the Consolidated Statements of Income, while interest costs, expected return on plan assets, amortization (accretion) of prior service cost, and settlement gain are reported as a component of other income. Service costs, interest costs, and amortization of prior service costs related to plans benefiting Mid Penn's nonemployee directors are reported as a component of director fees and benefits expense within the other expense line item on the Consolidated Statement of Income.

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The accrued benefit liability, related income statement impacts, and other significant aspects of the plans are detailed below.

(a) 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.

(b) Health and Life Benefit Plan

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. Medical benefits are provided for up to five years after retirement. 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 (grossed up by 36.79 percent as of December 31, 2018) 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.

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, 2018 and 2017, and a statement of the funded status at December 31, 2018 and 2017.

(Dollars in thousands)

| | December 31, | |
|--|-----------------|-----------------|
| | 2018 | 2017 |
| Change in benefit obligations: | | |
| Benefit obligations, January 1 | \$ 508 | \$ 540 |
| Service cost | 4 | 4 |
| Interest cost | 17 | 20 |
| Change in experience | (38) | (11) |
| Change in assumptions | (17) | 20 |
| Change due to plan amendment | \$ 60 | — |
| Benefit payments | (59) | (65) |
| Benefit obligations, December 31 | <u>\$ 475</u> | <u>\$ 508</u> |
| Change in fair value of plan assets: | | |
| Fair value of plan assets, January 1 | \$ — | \$ — |
| Employer contributions | 59 | 65 |
| Benefit payments | (59) | (65) |
| Fair value of plan assets, December 31 | \$ — | \$ — |
| Funded status at year end | <u>\$ (475)</u> | <u>\$ (508)</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.

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The amount recognized in other liabilities on the consolidated balance sheets at December 31, 2018 and 2017, is as follows:

(Dollars in thousands)

| | <u>2018</u> | <u>2017</u> |
|---------------------------|-------------|-------------|
| Accrued benefit liability | \$ 475 | \$ 508 |

The amounts recognized in accumulated other comprehensive loss consist of:

(Dollars in thousands)

| | <u>December 31,</u> | |
|--------------------------------|---------------------|-------------|
| | <u>2018</u> | <u>2017</u> |
| Net gain, pretax | \$ (76) | \$ (22) |
| Net prior service cost, pretax | (89) | (174) |

The accumulated benefit obligation for health and life insurance plans was \$475,000 and \$508,000 at December 31, 2018 and 2017, respectively.

There will be \$25,000 in estimated prior service costs amortized from accumulated other comprehensive income into net periodic benefit cost during 2019.

The components of net periodic postretirement benefit (income) cost for 2018, 2017 and 2016 are as follows:

(Dollars in thousands)

| | <u>2018</u> | <u>2017</u> | <u>2016</u> |
|---|---------------|----------------|---------------|
| Service cost | \$ 4 | \$ 4 | \$ 4 |
| Interest cost | 17 | 20 | 23 |
| Amortization of prior service cost | (25) | (35) | (35) |
| Amortization of net (gain) or loss | (1) | — | — |
| Net periodic postretirement benefit (income) cost | <u>\$ (5)</u> | <u>\$ (11)</u> | <u>\$ (8)</u> |

Assumptions used in the measurement of Mid Penn's benefit obligations at December 31, 2018 and 2017 are as follows:

| Weighted-average assumptions: | <u>2018</u> | <u>2017</u> |
|-------------------------------|-------------|-------------|
| Discount rate | 4.00% | 3.50% |
| Rate of compensation increase | 3.00% | 2.50% |

Assumptions used in the measurement of Mid Penn's net periodic benefit cost for the years ended December 31, 2018, 2017 and 2016 are as follows:

| Weighted-average assumptions: | <u>2018</u> | <u>2017</u> | <u>2016</u> |
|-------------------------------|-------------|-------------|-------------|
| Discount rate | 3.50% | 4.00% | 4.25% |
| Rate of compensation increase | 2.50% | 3.00% | 3.25% |

Assumed health care cost trend rates at December 31, 2018, 2017 and 2016 are as follows:

| | <u>2018</u> | <u>2017</u> | <u>2016</u> |
|---|-------------|-------------|-------------|
| Health care cost trend rate assumed for next year | 5.50% | 6.00% | 6.00% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5.40% | 5.40% | 5.50% |
| Year that the rate reaches the ultimate trend rate | 2022 | 2024 | 2018 |

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. At December 31, 2018, a one-percentage-point change in assumed health care cost trend rates would have the following effects:

(Dollars in thousands)

| | <u>One-Percentage Point</u> | |
|---|-----------------------------|-----------------|
| | <u>Increase</u> | <u>Decrease</u> |
| Effect on total of service and interest cost | \$ — | \$ — |
| Effect on accumulated postretirement benefit obligation | 6 | (9) |

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Mid Penn expects to contribute \$60,000 to its life and health benefit plans in 2019. The following table shows the estimated benefit payments for future periods.

(Dollars in thousands)

| | | |
|------------------------|----|-----|
| 1/1/2019 to 12/31/2019 | \$ | 60 |
| 1/1/2020 to 12/31/2020 | | 50 |
| 1/1/2021 to 12/31/2021 | | 34 |
| 1/1/2022 to 12/31/2022 | | 38 |
| 1/1/2023 to 12/31/2023 | | 31 |
| 1/1/2024 to 12/31/2028 | | 160 |

(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 had been amortized over the expected future years of service of active directors, of which \$22,000 was recognized in 2018 and was fully amortized as of December 31, 2018.

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, 2018 and 2017, and a statement of the status at December 31, 2018 and 2017. This Plan is unfunded.

(Dollars in thousands)

| | December 31, | |
|--|---------------------|-------------------|
| | 2018 | 2017 |
| Change in benefit obligations: | | |
| Benefit obligations, January 1 | \$ 1,116 | \$ 1,122 |
| Service cost | 36 | 35 |
| Interest cost | 38 | 43 |
| Actuarial gain (loss) | 5 | 6 |
| Change in assumptions | (5) | 2 |
| Benefit payments | (90) | (92) |
| Benefit obligations, December 31 | <u>\$ 1,100</u> | <u>\$ 1,116</u> |
| Change in fair value of plan assets: | | |
| Fair value of plan assets, January 1 | \$ — | \$ — |
| Employer contributions | 90 | 92 |
| Benefit payments | (90) | (92) |
| Fair value of plan assets, December 31 | \$ — | \$ — |
| Funded status at year end | <u>\$ (1,100)</u> | <u>\$ (1,116)</u> |

Amounts recognized in other liabilities on the consolidated balance sheet at December 31, 2018 and 2017 are as follows:

(Dollars in thousands)

| | 2018 | 2017 |
|---------------------------|-------------|-------------|
| Accrued benefit liability | \$ 1,100 | \$ 1,116 |

Amounts recognized in accumulated other comprehensive loss consist of:

(Dollars in thousands)

| | December 31, | |
|--------------------------------|---------------------|-------------|
| | 2018 | 2017 |
| Net prior service cost, pretax | \$ — | \$ 22 |
| Net loss, pretax | 67 | 67 |

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The accumulated benefit obligation for the retirement plan was \$1,100,000 at December 31, 2018 and \$1,116,000 at December 31, 2017.

No estimated prior service costs will be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2019 as the amount is fully amortized.

The components of net periodic retirement cost for 2018, 2017 and 2016 are as follows:

(Dollars in thousands)

| | 2018 | 2017 | 2016 |
|------------------------------------|--------------|---------------|---------------|
| Service cost | \$ 36 | \$ 35 | \$ 34 |
| Interest cost | 38 | 43 | 46 |
| Amortization of prior-service cost | 22 | 22 | 22 |
| Net periodic retirement cost | <u>\$ 96</u> | <u>\$ 100</u> | <u>\$ 102</u> |

Assumptions used in the measurement of Mid Penn’s benefit obligations at December 31, 2018 and 2017 are as follows:

| Weighted-average assumptions: | 2018 | 2017 |
|--------------------------------|-------------|-------------|
| Discount rate | 4.00% | 3.50% |
| Change in consumer price index | 2.00% | 1.50% |

Assumptions used in the measurement of Mid Penn’s net periodic benefit cost for the years ended December 31, 2018, 2017 and 2016 are as follows:

| Weighted-average assumptions: | 2018 | 2017 | 2016 |
|--------------------------------|-------------|-------------|-------------|
| Discount rate | 4.00% | 4.00% | 4.25% |
| Change in consumer price index | 2.00% | 1.50% | 2.25% |

Mid Penn expects to contribute \$95,000 to its retirement plan in 2019. The following table shows the estimated benefit payments for future periods.

(Dollars in thousands)

| | |
|------------------------|-------|
| 1/1/2019 to 12/31/2019 | \$ 95 |
| 1/1/2020 to 12/31/2020 | 97 |
| 1/1/2021 to 12/31/2021 | 108 |
| 1/1/2022 to 12/31/2022 | 107 |
| 1/1/2023 to 12/31/2024 | 106 |
| 1/1/2024 to 12/31/2028 | 376 |

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 \$3,976,000 and \$3,905,000 at December 31, 2018 and 2017, respectively.

(d) Defined Benefit Pension Plan

As a result of the acquisition of Scottsdale on January 8, 2018, Mid Penn has assumed a noncontributory defined benefit pension plan covering certain former employees of Scottsdale. Mid Penn’s policy is to fund pension benefits as accrued. The Plan’s assets are managed by the Trust Department of the Bank and were primarily invested in corporate equity securities at the time of acquisition, but have since been diversified into a more conservative investment profile, including fixed income debt securities. The investment objective of the plan is “Balanced” to provide relatively stable growth from assets offset by a moderate level of income with target portfolio allocations of up to 20% cash, 30-50% fixed income securities, and 40-60% equity securities. The valuation of the plan’s assets are subject to market fluctuations.

For the year ended December 31, 2018, Mid Penn recognized \$737,000 of settlement gains as a result of certain lump sum payouts to participants of the defined benefit pension plan. The settlement gains were recorded in noninterest income as a component of other income for the year ended December 31, 2018.

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The following tables provide a reconciliation of the changes in the defined benefit pension plan's benefit obligations and fair value of plan assets for the year ended December 31, 2018, and a statement of the status at December 31, 2018.

(Dollars in thousands)

| | December 31, |
|--|---------------------|
| | 2018 |
| Change in benefit obligations: | |
| Benefit obligations, January 1 | \$ 10,542 |
| Service cost | 287 |
| Interest cost | 392 |
| Settlement loss | 118 |
| Actuarial gain | (2,271) |
| Settlement payments | (3,828) |
| Benefit payments | (77) |
| Benefit obligations, December 31 | <u>\$ 5,163</u> |
| Change in fair value of plan assets: | |
| Fair value of plan assets, January 1 | \$ 8,121 |
| Return on plan assets | \$ 57 |
| Employer contributions | 600 |
| Benefit payments | (77) |
| Administrative expenses | (55) |
| Settlement payments | (3,828) |
| Fair value of plan assets, December 31 | <u>\$ 4,818</u> |
| Funded status at year end | <u>\$ (345)</u> |

Amounts recognized in other liabilities on the consolidated balance sheet at December 31, 2018 and 2017 are as follows:

(Dollars in thousands)

| | 2018 |
|---------------------------|-------------|
| Accrued benefit liability | \$ 345 |

Amounts recognized in accumulated other comprehensive loss consist of:

(Dollars in thousands)

| | December 31, |
|-----------------------------|---------------------|
| | 2018 |
| Unrecognized actuarial gain | \$ 994 |

The accumulated benefit obligation for the retirement plan was \$5,163,000 at December 31, 2018.

The components of net periodic retirement cost for 2018 are as follows:

(Dollars in thousands)

| | 2018 |
|--------------------------------|---------------|
| Service cost | \$ 287 |
| Interest cost | 392 |
| Expected return on plan assets | (423) |
| Net periodic retirement cost | <u>\$ 256</u> |

Assumptions used in the measurement of Mid Penn's benefit obligations at December 31, 2018 are as follows:

| Weighted-average assumptions: | 2018 |
|--|-------------|
| Discount rate | 4.25% |
| Expected long-term return on plan assets | 5.00% |
| Rate of compensation increases | 3.00% |

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Assumptions used in the measurement of Mid Penn's net periodic benefit cost for the years ended December 31, 2018 are as follows:

| Weighted-average assumptions: | <u>2018</u> |
|--|-------------|
| Discount rate | 4.25% |
| Expected long-term return on plan assets | 5.00% |
| Rate of compensation increases | 3.00% |

The plan's weighted-average asset allocations by investment category as of December 31, 2018 are as follows:

| Weighted-average asset allocations: | <u>2018</u> |
|-------------------------------------|----------------|
| Cash and cash equivalents | 50.44% |
| Common stock | 38.14% |
| Corporate bonds | 11.42% |
| | <u>100.00%</u> |

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of December 31, 2018.

| | <u>Fair Value Measurements</u> | | |
|---|--|---|--|
| | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| <i>(Dollars in thousands)</i> | | | |
| December 31, 2018 | | | |
| Cash and cash equivalents | \$ 2,430 | \$ — | \$ — |
| Common stock: | | | |
| Mining | 36 | — | — |
| Manufacturing | 888 | — | — |
| Transportation, Communications, Electric, Gas, and Sanitary Services | 468 | — | — |
| Finance, Insurance, and Real Estate Services | 189 | — | — |
| Other | 9 | — | — |
| Corporate bonds | — | 550 | — |
| | <u>\$ 4,268</u> | <u>\$ 550</u> | <u>\$ —</u> |

A description of the valuation methodologies used for assets measured at fair value is disclosed below.

Common Stocks

Valued at the closing price reported on the active market on which the individual securities are traded.

Corporate Bonds

Valued using matrix pricing, 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.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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Mid Penn expects to contribute \$600,000 to the defined benefit pension plan in 2019. The following table shows the estimated benefit payments for future periods.

(Dollars in thousands)

| | | |
|------------------------|----|-------|
| 1/1/2019 to 12/31/2019 | \$ | 92 |
| 1/1/2020 to 12/31/2020 | | 115 |
| 1/1/2021 to 12/31/2021 | | 144 |
| 1/1/2022 to 12/31/2022 | | 160 |
| 1/1/2023 to 12/31/2024 | | 162 |
| 1/1/2024 to 12/31/2028 | | 1,714 |

(17) **Other Benefit Plans**

Mid Penn maintains several benefit plans for both current and former employees of the Bank. Liabilities related to the plans are recorded in other liabilities on the balance sheet, and aggregate cash surrender values assets related to the life insurance plans are recorded in the cash surrender value of life insurance line item on the balance sheet. Significant aspects of the plans are detailed below.

(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 \$514,000, \$383,000, and \$362,000 for the years ending December 31, 2018, 2017, and 2016, respectively.

During 2018, Mid Penn assumed the 401(k) plans of Scottdale and First Priority and, as of December 31, 2018, these 401(k) plans were managed by Mid Penn's Human Resources and Trust areas. These 401(k) plans were frozen and no contributions were made to the plans in 2018. The plans are being evaluated for either termination or merger into Mid Penn's primary 401(k) plan.

(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 2018, 2017, or 2016.

(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 \$106,000 at December 31, 2018 and \$125,000 at December 31, 2017. The expense related to the plan was \$78,000 in 2018, \$5,000 in 2017, and \$6,000 in 2016.

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, 2018 and 2017, the Bank accrued a liability of \$838,000 and \$683,000, respectively, for this plan. The expense related to the plan was \$31,000 in 2018, \$25,000 in 2017, and \$21,000 in 2016.

(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, 2018 and 2017, the Bank accrued a liability of approximately \$236,000 and \$246,000, respectively, for the Agreement. The expense related to the Agreement was \$17,000 for 2018, \$17,000 for 2017, and \$17,000 for 2016.

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 \$1,352,000 and \$1,317,000 at December 31, 2018 and 2017, respectively.

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(e) Split Dollar Life Insurance Arrangements

At December 31, 2018 and 2017, the Bank had Split Dollar Life Insurance arrangements with two former executives for which the aggregate collateral assignment and cash surrender values are approximately \$1,387,000 and \$1,375,000, respectively. Mid Penn acquired Phoenix's Split Dollar Life Insurance arrangements in 2015 on select employees, which had aggregate cash surrender values of \$4,010,000 at December 31, 2018 and \$3,924,000 at December 31, 2017.

(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 shares of Mid Penn common stock at the market value of shares at the end of each calendar quarter.

| | <u>2018</u> | <u>2017</u> | <u>2016</u> |
|----------------------------------|-------------|-------------|-------------|
| ESPP shares purchased | 4,132 | 3,578 | 4,465 |
| Average purchase price per share | \$28.716 | \$29.027 | \$18.520 |

(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 DSPP 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 4,296 shares at an average purchase price per share of \$28.94 during the year ended December 31, 2018. Participants purchased 1,345 shares at an average purchase price per share of \$31.136 during the year ended December 31, 2017.

(h) Supplemental Executive Retirement Plan

On August 31, 2018, Mid Penn entered into supplemental executive retirement plan agreements ("SERPs") with four named executive officers. Each SERP provides for the monthly payment of a fixed cash benefit over a period of fifteen (15) years, commencing on the first day of the month following the Executive's separation from service: (i) occurring on or after reaching normal retirement age (age 70); (ii) due to disability; (iii) due to death; or (iv) within two (2) years following a change in control of the Bank. One-half of the benefit vests on January 1, 2022, with an additional 10% vesting each January 1 thereafter until fully vested on January 1, 2027. Any unvested portion of the benefit fully vests upon a change in control of the Bank. The accrued liability for the supplemental retirement plans was \$73,000 as of December 31, 2018.

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(18) Federal Income Taxes

The following temporary differences gave rise to the net deferred tax asset at December 31, 2018 and 2017.

| <i>(Dollars in thousands)</i> | <u>2018</u> | <u>2017</u> |
|--|-----------------|-----------------|
| Deferred tax assets: | | |
| Allowance for loan and lease losses | \$ 1,763 | \$ 1,597 |
| Loan fees | 136 | 105 |
| Deferred compensation | 508 | 221 |
| Benefit plans | 134 | 320 |
| Unrealized loss on securities | 862 | 574 |
| Sale/leaseback adjustment | 66 | 72 |
| Business combination adjustments | 1,692 | 358 |
| Acquired NOL and charitable contribution carryforwards | 1,391 | — |
| Acquired AMT carryforward | 1,433 | — |
| Other | 128 | 108 |
| | <u>8,113</u> | <u>3,355</u> |
| Deferred tax liabilities: | | |
| Depreciation | (1,073) | (619) |
| Bond accretion | (29) | (9) |
| Goodwill and intangibles | (348) | (329) |
| Prepaid expenses | (515) | (333) |
| Business combination adjustments | (948) | (176) |
| Benefit plans | (459) | — |
| Other | (45) | (1) |
| | <u>(3,417)</u> | <u>(1,467)</u> |
| Deferred tax asset, net | <u>\$ 4,696</u> | <u>\$ 1,888</u> |

As reflected Notes 4 and 5, a substantial portion of the net deferred tax asset increase year-over-year relates to the deferred tax assets generated by or acquired from the mergers of Scottdale and First Priority.

At December 31, 2018, the Company had no valuation allowance established against its NOL and charitable contribution carryforwards, as management believes the Corporation will generate sufficient future taxable income to fully utilize these deferred tax assets. The charitable contribution carryforwards will expire between 2019 and 2021. The Tax Cuts and Jobs Act enacted on December 22, 2017 repealed Corporate Alternative Minimum Tax (AMT). As a result, AMT carryforwards as of December 31, 2018 will be systematically refunded with each return until fully refunded no later than the filing of the Corporation's December 31, 2021 tax return. At December 31, 2018, Mid Penn had net operating loss carryforwards of \$5,465,000 which are all due to acquisitions that occurred in 2018 and are available to offset future taxable income. The NOL carryforwards do not expire, however, Mid Penn is limited to a deduction of the lesser of the available NOL carryforward or 80 percent of pre-NOL deductible taxable income in a single tax year as set forth in the Tax Cuts and Jobs Act. Due to the fact that these NOLs were acquired, there are Section 382 limitations that establish the amount allowable to be used to offset taxable income in the amount of \$1,854,000 per year.

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 TCJA 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.

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The provision for income taxes consists of the following:

| <i>(Dollars in thousands)</i> | 2018 | 2017 | 2016 |
|----------------------------------|-----------------|-----------------|-----------------|
| Current expense | \$ 812 | \$ 2,672 | \$ 2,613 |
| Deferred expense (benefit) | 1,317 | 1,828 | (336) |
| Total provision for income taxes | <u>\$ 2,129</u> | <u>\$ 4,500</u> | <u>\$ 2,277</u> |

A reconciliation of income tax at the statutory rate of 21% for 2018 and 34% for 2017 and 2016 to Mid Penn's effective rate is as follows:

| <i>(Dollars in thousands)</i> | 2018 | 2017 | 2016 |
|--|-----------------|-----------------|-----------------|
| Provision at the expected statutory rate | \$ 2,672 | \$ 3,940 | \$ 3,428 |
| Effect of tax-exempt income | (704) | (668) | (1,089) |
| Effect of investment in life insurance | (60) | (89) | (90) |
| Nondeductible interest | 40 | 30 | 41 |
| Nondeductible merger and acquisition expense | 193 | 191 | — |
| Rate change adjustment | — | 1,169 | — |
| Other items | (12) | (73) | (13) |
| Provision for income taxes | <u>\$ 2,129</u> | <u>\$ 4,500</u> | <u>\$ 2,277</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, 2018, 2017, or 2016. There were no amounts accrued for interest and penalties at December 31, 2018 or 2017.

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 2015.

(19) 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, 2018 and December 31, 2017, 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, which 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 increased 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.

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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, 2018, \$4,207,000 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, 2018, and December 31, 2017:

(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 |
| Corporation | | | | | | |
| As of December 31, 2018 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 155,662 | 8.0% | \$ 77,499 | 4.000% | N/A | N/A |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 155,662 | 10.0% | 98,977 | 6.375% | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 155,662 | 10.0% | 122,265 | 7.875% | N/A | N/A |
| Total Capital (to Risk Weighted Assets) | 191,300 | 12.3% | 153,317 | 9.875% | N/A | N/A |
| Bank | | | | | | |
| As of December 31, 2018 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 171,776 | 8.9% | \$ 77,230 | 4.000% | \$ 96,537 | 5.0% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 171,776 | 11.1% | 98,963 | 6.375% | 100,903 | 6.5% |
| Tier 1 Capital (to Risk Weighted Assets) | 171,776 | 11.1% | 122,248 | 7.875% | 124,189 | 8.0% |
| Total Capital (to Risk Weighted Assets) | 180,332 | 11.6% | 153,295 | 9.875% | 155,236 | 10.0% |
| Corporation | | | | | | |
| As of December 31, 2017 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 74,417 | 6.5% | \$ 45,857 | 4.000% | N/A | N/A |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 74,417 | 8.4% | 50,661 | 5.750% | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 74,417 | 8.4% | 63,877 | 7.250% | N/A | N/A |
| Total Capital (to Risk Weighted Assets) | 99,466 | 11.3% | 81,498 | 9.250% | N/A | N/A |
| Bank | | | | | | |
| As of December 31, 2017 | | | | | | |
| Tier 1 Capital (to Average Assets) | \$ 88,294 | 7.7% | \$ 45,846 | 4.000% | \$ 57,308 | 5.0% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 88,294 | 10.0% | 50,661 | 5.750% | 57,269 | 6.5% |
| Tier 1 Capital (to Risk Weighted Assets) | 88,294 | 10.0% | 63,877 | 7.250% | 70,485 | 8.0% |
| Total Capital (to Risk Weighted Assets) | 96,005 | 10.9% | 81,498 | 9.250% | 88,106 | 10.0% |

(1) The minimum amounts and ratios as of December 31, 2018 include the third year phase in of the capital conservation buffer of 1.875% required by the Basel III framework. As of December 31, 2017, minimum amounts and ratios include the second year phase in of the capital conservation buffer of 1.25% required by the Basel III framework.

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(20) 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, 2018 and 2017 for guarantees under letters of credit issued is not considered material.

As of December 31, 2018, commitments to extend credit amounted to \$346,238,000 and standby letters of credit amounted to \$20,839,000. As of December 31, 2017, commitments to extend credit amounted to \$199,240,000 and standby letters of credit amounted to \$20,496,000.

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 \$5,836,000 and \$7,314,000 for the years ended December 31, 2018 and 2017.

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, 2018, 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 twelve counties in Pennsylvania.

The Bank's highest industry concentration within the loan portfolio is in commercial real estate financing, which was 61.8 % and 51.1%, as of December 31, 2018 and 2017, respectively.

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(21) Commitments and Contingencies

Commitments

During the second quarter of 2018, Mid Penn entered into a commitment to purchase a limited partnership interest in a low-income housing project to construct thirty-seven apartments and common amenities in Dauphin County, Pennsylvania. All of the units are intended to qualify for Federal Low-Income Housing Tax Credits (“LIHTCs”) as provided for in Section 42 of the Internal Revenue Code of 1986, as amended. Mid Penn’s limited partner capital contribution commitment is \$7,579,000, which will be paid in installments over the course of construction of the low-income housing facilities. Each installment payment is conditional upon both Mid Penn’s review and approval of the installment payment certificate and continued compliance with the terms of the original partnership agreement. The investment in the limited partnership will be reported in other assets on the Consolidated Balance Sheet and amortized using the straight-line method over a ten year period. The project has been conditionally awarded \$861,000 in annual LIHTCs by the Pennsylvania Housing Finance Agency, with a total anticipated LIHTC amount of \$8,613,000 to be awarded to Mid Penn over the ten year amortization period. Mid Penn’s commitment to initiate investments in the limited partnership interest was conditional upon (i) the review and approval of all closing documents, (ii) an opinion letter for tax counsel to the Partnership that the project qualifies for the LIHTCs, and (iii) review and approval by Mid Penn of other documents it deemed necessary. All such initial conditions were satisfied and Mid Penn began funding the investment during 2018. As of December 31, 2018, the total investment in the limited partnership was \$1,710,000 and was reported in other assets on the Consolidated Balance Sheet.

Contingencies

In a letter dated January 24, 2019, notification was received from the FDIC indicating that Mid Penn was eligible for small bank assessment credits. In general, banks that did not pay surcharges during the credit calculation period, defined as the third quarter of 2016 through the third quarter of 2018, are eligible for small bank assessment credits. Small banks with total consolidated assets of less than \$10 billion were awarded assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from 1.15 percent to 1.35 percent. Each individual bank’s credit share is calculated as the product of the apportioned share of credits to an individual eligible institution multiplied by the total aggregate credits, and the FDIC’s preliminary estimate of Mid Penn’s total assessment credit is \$492,000. The small bank assessment credits are contingent on the reserve ratio reaching at least 1.38 percent, which had not occurred as of December 31, 2018. The credit can only be applied against future assessments, is not refundable in cash, and cannot be sold.

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.

(22) 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, 2018, 36,859 shares have been granted under the Plan. During 2018, Mid Penn granted 12,250 restricted shares, 7,450 of which were granted to employees, while 4,800 were granted to directors. Mid Penn granted 10,440 restricted shares in 2017, 6,040 of which were granted to employees, while 4,400 were granted to directors. Throughout 2016, Mid Penn granted 7,450 restricted shares to employees. In 2018, 1,876 granted shares were forfeited to Mid Penn due to the termination of employment of three plan participants, while no shares were forfeited in 2017, and 470 shares were forfeited in 2016.

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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 statements of income.

| <i>(Dollars in thousands)</i> | 2018 | 2017 | 2016 |
|-------------------------------|---------------|--------------|--------------|
| Compensation expense | \$ 267 | \$ 145 | \$ 53 |
| Tax benefit | (56) | (49) | (18) |
| Net income effect | <u>\$ 211</u> | <u>\$ 96</u> | <u>\$ 35</u> |

At December 31, 2017, there was \$582,000 of unrecognized compensation cost related to all non-vested share-based compensation awards. This cost is expected to be recognized through July 2022 with a weighted average recognition period of 2.3 years. 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, 2018.

| | Shares | Weighted-Average Grant Date Fair Value |
|---------------------------------|---------------|---|
| Non-vested at January 1, 2018 | 19,499 | \$ 22.54 |
| Vested | (9,647) | 22.85 |
| Forfeited | (1,876) | 24.20 |
| Granted | 12,250 | 33.50 |
| Non-vested at December 31, 2018 | <u>20,226</u> | <u>28.76</u> |

(23) Preferred Stock

In accordance with the terms and conditions of the Agreement and Plan of Merger dated January 16, 2018 between Mid Penn and First Priority (the "Merger Agreement"), each share of First Priority Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "First Priority Preferred Stock") outstanding as of July 31, 2018 was converted into the right to receive one share of Mid Penn Fixed Rate Cumulative Perpetual Preferred Stock, Series D, having a \$1,000 liquidation preference per share (the "Mid Penn Preferred Stock"). In connection with the Merger, Mid Penn issued 3,404 shares of Mid Penn Preferred Stock totaling \$3,404,000.

The terms of the Mid Penn Preferred Stock were no less favorable than those of the First Priority Preferred Stock as in effect immediately prior to the Merger. Under the terms of the Mid Penn Preferred Stock, no repurchases may be effected, and no dividends may be declared or paid on preferred shares ranking pari passu with the Mid Penn Preferred Stock, junior preferred shares, or other junior securities (including the common stock) unless all accrued and unpaid dividends on the Mid Penn Preferred Stock for all past dividend periods are paid in full. The Mid Penn Preferred Stock was redeemable at the option of Mid Penn, subject to the prior receipt of any requisite regulatory approval.

Dividends were payable quarterly on February 15, May 15, August 15 and November 15 of each year. The dividend rate on the Mid Penn Preferred Stock was fixed at 9%.

During the fourth quarter of 2018, the Federal Reserve Bank approved Mid Penn's request to redeem all 3,404 shares of the Mid Penn Preferred Stock at the \$1,000 liquidation value. The redemption of the \$3,404,000 of the Mid Penn Preferred Stock was completed and final dividend payment made on December 14, 2018.

(24) Revenue Recognition

Mid Penn recognizes revenues when earned based upon (i) contractual terms as transactions occur, or (ii) as related services are provided and collectability is reasonably assured. The largest source of revenue for Mid Penn is interest income, which is primarily recognized on an accrual basis according to a written contract, such as loan and lease agreements or investment securities contracts. Mid Penn earns noninterest income through a variety of financial and transactional services such as trust and wealth management services, deposit account transaction fees, ATM debit card fees, and mortgage banking fees. Revenue is recorded for noninterest income based on the contractual terms for the service or transaction performed. In certain circumstances, noninterest income is reported net of associated expenses.

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On January 1, 2018, Mid Penn adopted FASB ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606). Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the previous accounting guidance under ASC 605. This ASU establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods and services to customers. ASU 2014-09 applies primarily to transactional-based non-interest income revenue streams and excludes mortgage banking income, earnings from cash surrender value of life insurance, and gains on SBA loans.

Mid Penn's non-interest income revenue streams of income from fiduciary activities, service charges on deposits, ATM debit card interchange income, merchant service fees and certain components of other income are within the scope of Topic 606 and are discussed in greater detail below.

Income from Fiduciary Activities

Income from fiduciary activities consist of investment management fee income, brokerage transaction fee income, and estate fee income. Investment management fee income consists of advisory fees that are based on market values of clients' managed portfolios and transaction fees for fiduciary services performed, both of which are recognized as earned. Brokerage transaction fee income includes advisory fees which are recognized as earned on a monthly basis and transaction fees that are recognized when transactions occur. Payment is typically received in the following month. Estate fee income is recognized as services are performed over the service period, generally eighteen months.

Service Charges on Deposits

Service charges on deposits consist of cash management, overdraft, non-sufficient fund fees and other service charges on deposit accounts. Revenue is primarily transactional and recognized when earned, which is at the time the respective initiating transaction occurs and the related service charge is subsequently processed. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to the customers' accounts.

ATM Debit Card Interchange Income

ATM debit card interchange income consists interchange fees earned when Mid Penn's debit cards are processed through card payments networks. The interchange fee is calculated as a percentage of the total electronic funds transfer (EFT) transaction plus a per-transaction fee, which varies based on the type of card used, the method used to process the EFT transaction, and the type of business at which the transaction was processed. Revenue is recognized daily as transactions occur and interchange fees are subsequently processed. Payment for interchange activity is received primarily daily, while some fees are aggregated and payment is received in the following month.

Merchant Services Income

Merchant services income is processed through a third party provider with whom Mid Penn has partnered to provide merchant services to its business customers. Fees are charged to merchants to process their debit card transactions, cash advance services, and other related products. Mid Penn receives a percentage of the revenue generated from each joint customer relationship after the third party has collected the fee income from the merchant. Payment is primarily received in the following month.

Other Income

Certain aspects of other income, such as credit card royalties, check orders, and letter of credit fees, are within the scope of Topic 606. These fees are primarily transactional, and revenue is recognized when transactions occur and the related services are subsequently processed. Payment is primarily received immediately or in the following month.

Mid Penn does not exercise significant judgements in the recognition of income, as typically income is not recognized until the performance obligation has been satisfied. Mid Penn has not recognized any assets from the costs to obtain or fulfill a contract with customers for revenue streams that fall within the guidance of Topic 606.

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(25) Parent Company Statements

CONDENSED BALANCE SHEETS

(Dollars in thousands)

| | December 31, | |
|---|---------------------|------------------|
| | 2018 | 2017 |
| ASSETS | | |
| Cash and cash equivalents | \$ 1,572 | \$ 4,686 |
| Investment in subsidiaries | 239,323 | 89,581 |
| Other assets | 296 | — |
| Total assets | <u>\$ 241,191</u> | <u>\$ 94,267</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Subordinated debt | \$ 17,694 | \$ 17,338 |
| Other liabilities | 288 | 1,226 |
| Shareholders' equity | 223,209 | 75,703 |
| Total liabilities and shareholders' equity | <u>\$ 241,191</u> | <u>\$ 94,267</u> |

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Dollars in thousands)

| | For Years Ended December 31, | | |
|--|-------------------------------------|-----------------|-----------------|
| | 2018 | 2017 | 2016 |
| Income | | | |
| Dividends from subsidiaries | \$ 10,837 | \$ 9,657 | \$ 2,871 |
| Other income | — | 19 | 33 |
| Total Income | 10,837 | 9,676 | 2,904 |
| Expense | | | |
| Other expenses | (5,668) | (1,899) | (606) |
| Total Expense | (5,668) | (1,899) | (606) |
| Income before income tax and equity in undistributed earnings (loss) of subsidiary | 5,169 | 7,777 | 2,298 |
| Equity in undistributed earnings (loss) of subsidiary | 4,207 | (1,136) | 5,311 |
| Income before income tax | 9,376 | 6,641 | 7,609 |
| Income tax benefit | 1,220 | 448 | 195 |
| Net income | 10,596 | 7,089 | 7,804 |
| Series D preferred stock dividends | 102 | — | — |
| Net income available to common shareholders | <u>\$ 10,494</u> | <u>\$ 7,089</u> | <u>\$ 7,804</u> |
| Comprehensive income | <u>\$ 10,257</u> | <u>\$ 8,209</u> | <u>\$ 3,139</u> |

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CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

| | For Years Ended December 31, | | |
|---|-------------------------------------|-----------------|----------------|
| | 2018 | 2017 | 2016 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | \$ 10,596 | \$ 7,089 | \$ 7,804 |
| Equity in undistributed loss (earnings) of subsidiaries | (4,207) | 1,136 | (5,311) |
| Decrease (increase) in other assets | (49) | 240 | 59 |
| Increase (decrease) in other liabilities | 1,120 | 626 | 457 |
| Net cash provided by operating activities | <u>7,460</u> | <u>9,091</u> | <u>3,009</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Net cash paid for acquisitions | (2,798) | — | — |
| Proceeds from the sale of investment securities | — | 618 | — |
| Repayment from (investment in) subsidiary | — | (12,600) | — |
| Net cash used in investing activities | <u>(2,798)</u> | <u>(11,982)</u> | <u>—</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Dividends paid | (4,513) | (3,264) | (2,875) |
| Series D preferred stock dividends | (102) | — | — |
| Series D preferred stock redemption | (3,404) | — | — |
| Employee Stock Purchase Plan | 119 | 104 | 82 |
| Director Stock Purchase Plan | 124 | 42 | — |
| Deferred financing fees paid for subordinated debt issuance | — | (85) | — |
| Subordinated debt issuance | — | 10,000 | — |
| Net cash provided by (used in) financing activities | <u>(7,776)</u> | <u>6,797</u> | <u>(2,793)</u> |
| Net increase in cash and cash equivalents | (3,114) | 3,906 | 216 |
| Cash and cash equivalents, beginning of year | 4,686 | 780 | 564 |
| Cash and cash equivalents, end of year | <u>\$ 1,572</u> | <u>\$ 4,686</u> | <u>\$ 780</u> |

(26) Recent Accounting Pronouncements

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.

Mid Penn adopted this ASU in the first quarter of 2018. For the year ended December 31, 2018, service costs totaling \$287,000 related to plans benefiting Mid Penn employees are reported as a component of salaries and employee benefits on the Consolidated Statements of Income, while interest costs, expected return on plan assets, amortization (accretion) of prior service cost, and settlement gain were reported as a component of other income and collectively totaled \$768,000. Service costs, interest costs, and amortization of prior service costs related to plans benefiting Mid Penn's nonemployee directors totaling \$93,000 are reported as a component of director fees and benefits expense within the other expense line item on the Consolidated Statement of Income. The components of net benefit cost were impacted by the acquisition of a defined benefit plan from Scottsdale in 2018. Net benefit costs in 2017 and 2016 were immaterial. The adoption of this standard did not impact Mid Penn's results of operations.

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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 did not have a material impact on its consolidated financial statements as Mid Penn typically does not engage in partial sale transactions.

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.

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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 adopted the amendments in the first quarter of 2018. As a result of the adoption of this standard, there were no changes required to cash flow presentation and no impact on Mid Penn's operating results. Mid Penn will continue to monitor for transactions that may be impacted by this standard, 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.

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.

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. Mid Penn has selected a software vendor to support both the implementation of ASU 2016-13 and the ongoing compliance requirements. We have provided our core data to the vendor and completed an assessment of the information to see what, if any, additional data elements may be need to be collected to perform the calculation. After all required data elements are collected and loaded into the software, Mid Penn plans to run one quarter of reports based on our current methodology to validate the data flow, and intends to run two quarters under the CECL methodology prior to the implementation of the standard on January 1, 2020.

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.

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On July 30, 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides an option to apply the transition provisions of the new standard at the adoption date instead of the earliest comparative period presented. Additionally, the ASU provides a practical expedient permitting lessors to not separate non-lease components from the associated lease component if certain conditions are met.

The amendments for both ASUs 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.

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 adopted this standard in the first quarter of 2019 using the option to apply the transition provisions of the new standard at the adoption date instead of the earliest period presented as provided in ASU 2018-11. Additionally, Mid Penn elected to apply all practical expedients as provided in ASU 2016-02, with the exception of the hindsight practical expedient which was not elected. As a result of the adoption of this standard, effective January 1, 2019, Mid Penn recognized (i) a ROU asset of \$11,661,000 to be recorded in other assets on the balance sheet, (ii) a lease liability of \$12,866,000 to be recorded in other liabilities on the balance sheet, and (iii) an opening adjustment to retaining earnings of \$316,000 to eliminate the remaining balance of the deferred sale/leaseback gain on two retail branch locations which had originally been recorded in 2016. The lease liability represents the present value of future payments on twenty-four leased properties within the Mid Penn footprint as of the January 1, 2019 adoption date, while the ROU asset reflects the lease liability, adjusted for deferred/accrued rent balances and the balance of acquisition accounting fair value adjustments of the respective properties as of the adoption date of January 1, 2019. The adoption of this standard is not expected to have a material impact on Mid Penn's capital ratios or cause Mid Penn to no longer be well capitalized.

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, and was adopted by Mid Penn effective January 1, 2018. The adoption of this ASU resulted in the reclassification of equity securities to other assets (equity securities had previously been classified as available-for-sale investment securities). Also, related to this reclassification, a one-time cumulative-effect adjustment was recorded on January 1, 2018 that decreased retained earnings by \$44,000, increased accumulated other comprehensive loss by \$35,000, and decreased the deferred tax asset by \$9,000. The impact on net income as a result of the adoption of this standard was immaterial for the year ended December 31, 2018.

Additionally, the adoption of this ASU resulted in the refinement of our loan fair value calculation to comply with the exit price measurement requirement. The adoption of the exit price measurement requirement portion of this ASU did not have a material impact on Mid Penn's fair value disclosures.

In February 2018, the FASB issued ASU 2018-03, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which clarifies certain amendments included in ASU 2016-01 primarily related to measurement of equity securities without a readily determinable fair value and financial liabilities for which the fair value option was elected. This ASU was effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, and was adopted by Mid Penn effective January 1, 2018. Mid Penn's equity securities have a determinable fair value and, as of December 31, 2018, we do not have any financial liabilities for which the fair value option was elected; therefore, the adoption of this ASU did not have a material impact on the results of operations.

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.

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

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

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

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 adopted the standard effective January 1, 2018. Through our assessment, we identified certain non-interest income financial statement revenue streams that met the criteria of this Standard and worked through the five step assessment process for each revenue stream within the scope of the Standard. Mid Penn has concluded that the adoption of the Standard using the modified retrospective approach did not have a financial statement impact as the current financial statement line items within the scope of this Standard were in compliance with the new guidance. As a result of the adoption of this standard, additional qualitative disclosures related to revenue recognition can be found in Note 11, *Revenue Recognition*. We will update our internal assessment at least annually, or more frequently if necessary.

ASU 2018-07: The FASB issued ASU 2018-07, *Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

The ASU makes certain changes to the accounting for nonemployee awards to align the accounting for share-based payment awards issued to employees and nonemployees. The changes require that the compensation expense associated with nonemployee equity awards with performance conditions be recognized when the achievement of the performance condition is probable, rather than upon achievement of the performance condition. Additionally, the new ASU requires that equity-classified share-based payment awards issued to nonemployees be measured on the grant date, versus the previous GAAP requirement to re-measure the awards through the performance completion date. The current requirement to reassess the classification (equity or liability) for the nonemployee awards upon vesting will be eliminated.

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, including interim periods.

Mid Penn currently issues restricted stock awards to nonemployee directors through the 2014 Restricted Stock Plan (the “Plan”). The single performance condition of the award is that the individual remain a director of Mid Penn through the duration of the vesting period. Mid Penn is currently evaluating the details of this ASU and expects that the adoption of this ASU will not have a material impact on our consolidated financial statements as the compensation expense related to nonemployee equity awards is immaterial to Mid Penn’s overall financial condition.

ASU 2018-13: The FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*

This ASU, issued as part of the FASB’s disclosure framework project to improve the effectiveness of disclosures in financial statements, amends the disclosure requirements related to recurring and nonrecurring fair value measurements by removing, modifying, and adding certain disclosures.

The ASU is effective for all entities for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted.

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As a result of this ASU, several disclosures were removed from Topic 820, including: (i) disclosure of the valuation process for Level 3 fair value measurements, and (ii) amounts of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy. However, some additional disclosures will be required as a result of this ASU, including the requirement to disclose the changes in unrealized gains and losses included in other comprehensive income for the period related to Level 3 recurring fair value measurements, as well as the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements.. Mid Penn is currently evaluating the impact of this ASU on our current disclosures. The adoption of this standard will result in disclosure changes only and will not impact Mid Penn's overall financial condition.

ASU 2018-14: The FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*

This ASU, issued as part of the FASB's disclosure framework project to improve the effectiveness of disclosures in financial statements, amends the disclosure requirements related to defined benefit pension and other postretirement plans by removing and adding certain disclosures.

The ASU is effective for public business entities for fiscal years ending after December 15, 2020. Early adoption is permitted.

As a result of this ASU, several disclosures were removed from Topic 715, including: (i) disclosures of the amounts in accumulated comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year, and (ii) the effects of a one-percentage point change in the assumed health care cost trend rates on the aggregate of service and interest cost components of net periodic postretirement health care benefit costs. However, some additional disclosures will be required as a result of this ASU, including the requirement to disclose an explanation for significant gains and losses related to changes in the benefit obligation for the period. Mid Penn is currently evaluating the impact of this ASU on our current disclosures. The adoption of this standard will result in disclosure changes only and will not impact Mid Penn's overall financial condition.

(27) Summary of Quarterly Consolidated Financial Data (Unaudited)

The following table presents summarized quarterly financial data for 2018 and 2017. Due to the methodology and rounding of quarterly earnings per share versus full-year earnings per share calculations, the quarterly measures may not equal to the full-year measurement disclosed on the respective year's income statement.

(Dollars in thousands, except per share data)

| | 2018 Quarter Ended | | | |
|---|---------------------------|----------------|---------------------|--------------------|
| | March 31 | June 30 | September 30 | December 31 |
| Interest Income | \$ 12,980 | \$ 13,720 | \$ 19,583 | \$ 22,371 |
| Interest Expense | 2,102 | 2,306 | 3,672 | 4,640 |
| Net Interest Income | 10,878 | 11,414 | 15,911 | 17,731 |
| Provision for Loan and Lease Losses | 125 | — | 100 | 275 |
| Net Interest Income After Provision for Loan Losses | 10,753 | 11,414 | 15,811 | 17,456 |
| Noninterest Income | 1,647 | 1,559 | 2,165 | 2,091 |
| Noninterest Expense | 11,183 | 9,742 | 15,264 | 13,982 |
| Income Before Provision for Income Taxes | 1,217 | 3,231 | 2,712 | 5,565 |
| Provision for Income Taxes | 213 | 452 | 548 | 916 |
| Net Income | 1,004 | 2,779 | 2,164 | 4,649 |
| Series D Preferred Stock Dividends | — | — | 38 | 64 |
| Net Income Available to Common Shareholders | \$ 1,004 | \$ 2,779 | \$ 2,126 | \$ 4,585 |
| Per Share Data: | | | | |
| Basic Earnings Per Common Share | \$ 0.17 | \$ 0.45 | \$ 0.28 | \$ 0.54 |
| Cash Dividends Declared | 0.00 | 0.15 | 0.15 | 0.15 |

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| | 2017 Quarter Ended | | | |
|--|---------------------------|-----------------|---------------------|--------------------|
| | March 31 | June 30 | September 30 | December 31 |
| <i>(Dollars in thousands, except per share data)</i> | | | | |
| 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> |
| Per Share Data: | | | | |
| Basic Earnings Per Common Share | \$ 0.47 | \$ 0.55 | \$ 0.53 | \$ 0.12 |
| Cash Dividends Declared | 0.13 | 0.13 | 0.13 | 0.38 |

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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, 2018. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded, as of December 31, 2018, 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, 2018. 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 2018 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 2019 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 28, 2018. A copy is posted under Governance Documents in the Corporate Information section under the Investors link on the Corporation's website, www.midpennbank.com. The Corporation's Code of Ethics may be viewed on the Mid Penn website at 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 2019 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

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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 2019 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, 2018:

| <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 | 20,226 | — (1) | 63,141 |
| Equity compensation plans not approved by security holders | — | — | — |
| Total | 20,226 | — | 63,141 |

- (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 2019 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 2019" of Mid Penn's definitive proxy statement to be used in connection with the 2019 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.

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

- 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 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.)
- 10.2 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.)
- 10.3 Form of Mid Penn Bancorp, Inc. Restricted Stock Agreement. (Incorporated by reference to Exhibit 10.4 of the Registrant's Annual Report on Form 10-K filed with the SEC on March 12, 2018.)
- 10.4 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.)
- 10.5 Mid Penn Bancorp, Inc. 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.)
- 10.6 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.)
- 10.7 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.)
- 10.8 Form of Supplemental Executive Retirement Plan Agreement dated August 31, 2018 by and among Mid Penn Bank and each of Rory G. Ritrievi, Michael D. Peduzzi, Scott W. Micklewright, and Justin T. Webb (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 5, 2018.)
- 10.9 Amendment No. 1 to Employment Agreement, dated August 13, 2018, among Mid Penn Bancorp, Inc., Mid Penn Bank, and Rory G. Ritrievi (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 5, 2018.)
- 10.10 Form of Amendment No. 1 to Change in Control Severance Agreement of Messrs. Micklewright, Peduzzi, and Webb (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 5, 2018.)
- 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.

ITEM 16. FORM 10-K SUMMARY

None.

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 18, 2019

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: <u>/s/ Rory G. Ritrievi</u> Rory G. Ritrievi President, Chief Executive Officer and Director (Principal Executive Officer) | March 18, 2019 |
| By: <u>/s/ Michael D. Peduzzi, CPA</u> Michael D. Peduzzi, CPA Sr. Executive Vice President and Chief Financial Officer | March 18, 2019 |
| By: <u>/s/ Robert A. Abel</u> Robert A. Abel, Director | March 18, 2019 |
| By: <u>/s/ Steven T. Boyer</u> Steven T. Boyer, Director | March 18, 2019 |
| By: <u>/s/ Kimberly J. Brumbaugh</u> Kimberly J. Brumbaugh, Director | March 18, 2019 |
| By: <u>/s/ Matthew G. DeSoto</u> Matthew G. DeSoto, Director | March 18, 2019 |
| By: <u>/s/ Joel L. Frank</u> Joel L. Frank, Director | March 18, 2019 |
| By: <u>/s/ Robert C. Grubic</u> Robert C. Grubic, Director | March 18, 2019 |
| By: <u>/s/ Gregory M. Kerwin</u> Gregory M. Kerwin, Director | March 18, 2019 |
| By: <u>/s/ Donald F. Kiefer</u> Donald F. Kiefer, Director | March 18, 2019 |
| By: <u>/s/ Robert E. Klinger</u> Robert E. Klinger, Director | March 18, 2019 |
| By: <u>/s/ Robert J. Moisey</u> Robert J. Moisey, Director | March 18, 2019 |
| By: <u>/s/ Theodore W. Mowery</u> Theodore W. Mowery, Director | March 18, 2019 |

MID PENN BANCORP, INC.

By: /s/ John E. Noone March 18, 2019
John E. Noone, Director

By: /s/ Alan P. Novak, Esq. March 18, 2019
Alan P. Novak, Esq., Director

By: /s/ Noble C. Quandel, Jr. March 18, 2019
Noble C. Quandel, Jr., Director

By: /s/ Patrick M. Smith March 18, 2019
Patrick M. Smith, Director

By: /s/ David E. Sparks March 18, 2019
David E. Sparks, Director

By: /s/ William A. Specht, III March 18, 2019
William A. Specht, Director

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. 333-218592, 333-197024, and 333-170833) and Form S-3 (No. 333-128958) of Mid Penn Bancorp, Inc. of our reports dated March 18, 2019, 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 18, 2019

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 18, 2019

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 18, 2019

**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, 2018, 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 18, 2019

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

Date: March 18, 2019

Mid-Atlantic Custom Peer Group

| Company | City | State |
|---|------------------|-------|
| 1st Constitution Bancorp | Cranbury | NJ |
| 1st Summit Bancorp of Johnstown, Inc. | Johnstown | PA |
| ACNB Corporation | Gettysburg | PA |
| Adirondack Trust Company | Saratoga Springs | NY |
| AmeriServ Financial, Inc. | Johnstown | PA |
| Bank of Princeton | Princeton | NJ |
| Bank of Utica | Utica | NY |
| Capital Bancorp, Inc. | Rockville | MD |
| CB Financial Services, Inc. | Carmichaels | PA |
| Chemung Financial Corporation | Elmira | NY |
| Citizens & Northern Corporation | Wellsboro | PA |
| Citizens Financial Services, Inc. | Mansfield | PA |
| Codorus Valley Bancorp, Inc. | York | PA |
| Community Financial Corporation | Waldorf | MD |
| DNB Financial Corporation | Downingtown | PA |
| Embassy Bancorp, Inc. | Bethlehem | PA |
| ENB Financial Corp | Ephrata | PA |
| ESSA Bancorp, Inc. | Stroudsburg | PA |
| Evans Bancorp, Inc. | Hamburg | NY |
| First Bank | Hamilton | NJ |
| First Keystone Corporation | Berwick | PA |
| First United Corporation | Oakland | MD |
| FNCB Bancorp, Inc. | Dunmore | PA |
| Franklin Financial Services Corporation | Chambersburg | PA |
| Greene County Bancorp, Inc. (MHC) | Catskill | NY |
| Malvern Bancorp, Inc. | Paoli | PA |
| Marlin Business Services Corp. | Mount Laurel | NJ |
| Metropolitan Bank Holding Corp. | New York | NY |
| Norwood Financial Corp. | Honesdale | PA |
| Orange County Bancorp, Inc. | Middletown | NY |
| Orrstown Financial Services, Inc. | Shippensburg | PA |
| Parke Bancorp, Inc. | Sewell | NJ |
| PCSB Financial Corporation | Yorktown Heights | NY |
| Penns Woods Bancorp, Inc. | Williamsport | PA |
| Prudential Bancorp, Inc. | Philadelphia | PA |
| QNB Corp. | Quakertown | PA |
| Riverview Financial Corporation | Harrisburg | PA |
| SB One Bancorp | Rockaway | NJ |
| Shore Bancshares, Inc. | Easton | MD |
| Somerset Trust Holding Company | Somerset | PA |



COMMUNITY GIVING

Our core values guide our direction and growth as a community bank. We are committed to serving our local communities through giving campaigns, community events, employee volunteerism and giving, educational outreach and corporate donations.

2018 GIVING HIGHLIGHTS



\$711,000

EITC & COMMUNITY CONTRIBUTIONS



3,000+

HOURS OF EMPLOYEE VOLUNTEER TIME



\$57,000

RAISED BY EMPLOYEES FOR CHARITABLE CAUSES



133

COMMUNITY EVENTS PARTICIPATED IN

We are a proud recipient of the Pennsylvania Association of Community Bankers "Grow Your Community" award for five years running. Our No Shave November campaign, a partnership with Penn State Health's Urology division was the winning project for the award in 2018. We raised \$40,000 for prostate cancer research in 2018, a 333% increase over the previous year.

Mid Penn Bank continues to champion the cause of finding a cure for breast cancer through the Mid Penn Bank Celebrity Golf Tournament for Charity. This event, spanning two days and engaging more than 30 celebrities and athletes from the world of college and professional football and basketball, raised \$100,000 in 2018. The dollars raised were donated to the Pennsylvania Breast Cancer Coalition (PBCC) and the American Cancer Society for breast cancer research. As a result of our three year-long partnership with PBCC, Mid Penn President and CEO, Rory Ritrievi, was honored with PBCC's Pink Ribbon Award in October 2018 for his leadership and dedication to the cause of finding a cure for breast cancer. He has committed the bank to raising \$1 million for breast cancer research through the golf tournament and additional fundraising efforts.



THE COMMUNITY BANK DIFFERENCE

Mid Penn has established a regional management presence in each distinct community we serve. Our team is committed to providing local, prompt service and personalized banking solutions.



Pictured (left to right): Charlie E. Bernier, President of Cyber Division & Corporate Counsel, ECBM; Daniel Krewson, Regional President, First Priority Bank; Charlie H. Bernier, President & CEO, ECBM; Rick Eckert, CFO, ECBM; Gloria Forbes, Executive Vice President, ECBM

ECBM Insurance Brokers and Consultants

ECBM is based in Media, PA and serves the Greater Philadelphia area as a commercial insurance brokerage offering corporate and personal insurance and risk management solutions. ECBM continues to expand their business, and our team in the Delaware Valley works closely with the firm's executives to facilitate a strong loan and deposit relationship.

The Zieglers

The Zieglers of Mount Joy, PA have a three-decade long and multi-faceted relationship with Mid Penn Bank, originally receiving financing from our Millersburg branch for a real estate venture. Their relationship has grown over the years to include financing for their agricultural businesses, along with local support from our Lancaster County team.



Pictured (left to right): Stan Michonski, Senior Agricultural Lender, Mid Penn Bank; Gordie and Bertie Ziegler



Pictured (left to right): DJ Risk, President, Paul Risk Construction; Joan Dickinson, Chief of Staff, Mid Penn Bank; Steve Risk, Chairman of the Board, Paul Risk Construction

Paul Risk Construction

A fourth-generation, family-owned construction company based in Quarryville, PA, Paul Risk Construction offers values-based construction services. A customer since 2014, Paul Risk appreciates the principles of community banking and the personalized service that the Mid Penn team provides. Our relationship includes commercial lending and cash management services, along with a line of credit for working capital and commercial mortgages.

McClure Company

Based in Harrisburg, PA, McClure Company is a mechanical engineering firm that offers a full spectrum of design, implementation and maintenance services for its clients. Market President Heather Hall has developed a commercial and industrial banking relationship with the firm that has supported both short- and long-term financing needs, as well as day-to-day banking services.



Pictured: Chip Brown, President, McClure Company; Heather Hall, Market President, Mid Penn Bank



Pictured: Alex Kauffman, Regional President, Mid Penn Bank; Judy Craig, Franchise Developer, Lynn Dairy Queens, Inc.

Lynn Dairy Queens, Inc.

Lynn Dairy Queens, Inc. owns several Dairy Queen stores throughout the Scottsdale Bank & Trust region. In 2018, Regional President Alex Kauffman worked with franchise developer Judy Craig to finance the seventh location that the company now owns and operates in California, PA. Judy's connection to the bank spans multiple generations as her father previously served on the Scottsdale Bank & Trust Board of Directors.

Miller Distributing

Miller Distributing, based in St. Clair, PA, is a wholesale meat distributor. Our team in Schuylkill County works closely with owner Fred Miller to ensure his everyday banking needs are being met through lending services, cash management solutions and deposit products.



Pictured (L to R): Mark Ketch, Regional President, Mid Penn Bank; Sandra Bigg, Branch Manager, Mid Penn Bank; W. Fred Miller, Owner, Miller Distributing; James Brennan, Commercial Loan Officer, Mid Penn Bank; Keith Kirby, Cash Management Officer, Mid Penn Bank



MID PENN BANCORP^{INC.}

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MISSION

To be the best financial institution for our shareholders, customers, employees and the communities we serve while upholding the core values of Mid Penn Bank and the virtues of community banking.



For the fifth year in a row, Mid Penn was recognized as being one of the **“Top 200 Community Banks”** in the country by American Banker magazine for our performance in return on equity.

For the fifth year in a row, Mid Penn won the **“Grow Your Community Award”** from the Pennsylvania Association of Community Bankers.

As a leader in breast cancer research funding, Mid Penn received the prestigious **“Pink Ribbon Award”** from the Pennsylvania Breast Cancer Coalition.

“IF THE BEST WAY TO PREDICT OUR FUTURE IS TO CREATE IT, THEN WE ARE CONFIDENT THAT WE ARE CREATING **THE** BEST BANK IN THE STATE OF PENNSYLVANIA.”

—Rory G. Ritrievi
President and CEO


MID PENN BANCORP^{INC.}

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