

MID PENN BANCORP INC  
Form 10-Q  
August 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

OR

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

For the transition period from            to

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

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

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

Registrant's telephone number, including area code 1.866.642.7736

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

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

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

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

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

As of August 14, 2014, the registrant had 3,496,054 shares of common stock outstanding.

MID PENN BANCORP, INC.

FORM 10-Q

TABLE OF CONTENTS

PART 1 – FINANCIAL INFORMATION	2
Item 1 – Financial Statements	2
Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013 (Unaudited)	2
Consolidated Statements of Income for the Three and Six Months Ended June 30, 2014 and June 30, 2013 (Unaudited)	3
Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended June 30, 2014 and June 30, 2013 (Unaudited)	4
Consolidated Statements of Changes in Shareholders’ Equity for the Six Months Ended June 30, 2014 and June 30, 2013 (Unaudited)	5

Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and June 30, 2013 (Unaudited)	6
Notes to Consolidated Financial Statements (Unaudited)	7
Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 3 – Quantitative and Qualitative Disclosures about Market Risk	40
Item 4 – Controls and Procedures	40
 PART II – OTHER INFORMATION	 41
Item 1 – Legal Proceedings	41
Item 1A – Risk Factors	41
Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds	41
Item 3 – Defaults upon Senior Securities	41
Item 4 – Mine Safety Disclosures	41
Item 5 – Other Information	41
Item 6 – Exhibits	41
Signatures	42

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



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

## PART 1 – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
Cash and due from banks	\$ 11,220	\$ 7,407
Interest-bearing balances with other financial institutions	659	1,216
Total cash and cash equivalents	11,879	8,623
Interest-bearing time deposits with other financial institutions	5,872	7,513
Available for sale investment securities	142,836	122,803
Loans and leases, net of unearned interest	548,615	546,462
Less: Allowance for loan and lease losses	(6,130)	(6,317)
Net loans and leases	542,485	540,145
Bank premises and equipment, net	12,515	12,469
Restricted investment in bank stocks	2,729	2,969
Foreclosed assets held for sale	1,083	965
Accrued interest receivable	2,887	2,704
Deferred income taxes	2,004	3,235
Goodwill	1,016	1,016
Core deposit and other intangibles, net	230	249
Cash surrender value of life insurance	8,476	8,374
Other assets	2,468	2,060
<b>Total Assets</b>	<b>\$ 736,480</b>	<b>\$ 713,125</b>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest bearing demand	\$ 49,194	\$ 48,346
Interest bearing demand	215,294	201,090
Money Market	208,421	196,736
Savings	31,161	29,585
Time	127,935	132,373
<b>Total Deposits</b>	<b>632,005</b>	<b>608,130</b>
Short-term borrowings	7,620	23,833
Long-term debt	33,054	23,145
Accrued interest payable	600	393
Other liabilities	5,641	4,708
<b>Total Liabilities</b>	<b>678,920</b>	<b>660,209</b>
Shareholders' Equity:		
Series B Preferred stock, par value \$1.00; liquidation value \$1,000; authorized 5,000 shares; 7% non-cumulative dividend; 5,000 shares issued and outstanding at June 30, 2014 and December 31, 2013	5,000	5,000

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

Common stock, par value \$1.00; authorized 10,000,000 shares; 3,496,054 shares issued and outstanding at June 30, 2014 and 3,494,397 at December 31, 2013	3,496	3,494
Additional paid-in capital	29,876	29,853
Retained earnings	17,960	15,441
Accumulated other comprehensive income (loss)	1,228	(872)
Total Shareholders' Equity	57,560	52,916
Total Liabilities and Shareholders' Equity	\$ 736,480	\$ 713,125

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

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

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

(Dollars in thousands, except per share data)	Three Months		Six Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
<b>INTEREST INCOME</b>				
Interest & fees on loans and leases	\$ 6,925	\$ 6,494	\$ 13,465	\$ 12,755
Interest on interest-bearing balances	10	29	20	76
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	358	123	635	223
State and political subdivision obligations, tax-exempt	536	493	1,055	976
Other securities	41	8	75	14
Interest on federal funds sold and securities purchased under agreements to resell	-	6	-	11
Total Interest Income	7,870	7,153	15,250	14,055
<b>INTEREST EXPENSE</b>				
Interest on deposits	990	1,130	1,968	2,335
Interest on short-term borrowings	7	7	21	7
Interest on long-term debt	122	169	238	407
Total Interest Expense	1,119	1,306	2,227	2,749
Net Interest Income	6,751	5,847	13,023	11,306
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>				
Net Interest Income After Provision for Loan and Lease Losses	6,476	5,432	12,201	10,396
<b>NONINTEREST INCOME</b>				
Income from fiduciary activities	167	110	325	249
Service charges on deposits	136	146	263	280
Net gain on sales of investment securities	-	112	150	112
Earnings from cash surrender value of life insurance	51	58	102	116
Mortgage banking income	75	115	113	225
ATM debit card interchange income	139	127	265	246
Merchant services income	66	87	133	174
Net gain on sales of SBA loans	27	-	78	-
Other income	113	83	239	286
Total Noninterest Income	774	838	1,668	1,688
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	2,843	2,685	5,391	5,542
Occupancy expense, net	322	269	704	579
Equipment expense	310	345	611	661
Pennsylvania Bank Shares tax expense	109	133	208	261
FDIC Assessment	139	131	271	333
Legal and professional fees	168	166	265	320
Director fees and benefits expense	76	77	155	157
Marketing and advertising expense	84	62	132	105
Software licensing	212	246	449	427
Telephone expense	100	104	196	202



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

(Gain) loss on sale/write-down of foreclosed assets	(30)	(303)	57	(322)
Intangible amortization	7	7	14	14
Loan collection costs	82	76	153	146
Other expenses	646	614	1,200	1,224
Total Noninterest Expense	5,068	4,612	9,806	9,649
INCOME BEFORE PROVISION FOR INCOME TAXES	2,182	1,658	4,063	2,435
Provision for income taxes	475	292	845	384
NET INCOME	1,707	1,366	3,218	2,051
Series A preferred stock dividends and discount accretion	-	-	-	14
Series B preferred stock dividends	88	87	175	134
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$ 1,619	\$ 1,279	\$ 3,043	\$ 1,903
PER COMMON SHARE DATA:				
Basic Earnings Per Common Share	\$ 0.46	\$ 0.37	\$ 0.87	\$ 0.55
Cash Dividends	0.10	0.05	0.15	0.05

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

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

MID PENN BANCORP, INC.

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(Dollars in thousands)	Three Months Ended June 30,	
	2014	2013
Net income	\$ 1,707	\$ 1,366
Other comprehensive income (loss):		
Unrealized gains (losses) arising during the period on available for sale securities, net of income taxes of \$532 and (\$1,273), respectively	1,031	(2,473)
Reclassification adjustment for net gain on sales of available for sale securities included in net income, net of income taxes of \$0 and (\$38), respectively (1) (3)	-	(74)
Change in defined benefit plans, net of income taxes of \$2 and \$2, respectively (2) (3)	4	4
Total other comprehensive income (loss)	1,035	(2,543)
Total comprehensive income (loss)	\$ 2,742	\$ (1,177)

(Dollars in thousands)	Six Months Ended June 30,	
	2014	2013
Net income	\$ 3,218	\$ 2,051
Other comprehensive income (loss):		
Unrealized gains (losses) arising during the period on available for sale securities, net of income taxes of \$1,131 and (\$1,482), respectively	2,193	(2,878)
Reclassification adjustment for net gain on sales of available for sale securities included in net income, net of income taxes of (\$51) and (\$38), respectively (1) (3)	(99)	(74)
Change in defined benefit plans, net of income taxes of \$3 and \$4, respectively (2) (3)	6	7
Total other comprehensive income (loss)	2,100	(2,945)

Total comprehensive income (loss)	\$ 5,318	\$ (894)
-----------------------------------	----------	----------

- (1) Amounts are included in net gain on sales of investment securities on the Consolidated Statements of Income as a separate element within total noninterest income
- (2) Amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income as a separate element within total noninterest expense
- (3) Income tax amounts are included in the provision for income taxes in the Consolidated Statements of Income

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

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

MID PENN BANCORP, INC. Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(Dollars in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2014	\$ 5,000	\$ 3,494	\$ 29,853	\$ 15,441	\$ (872)	\$ 52,916
Net income	-	-	-	3,218	-	3,218
Total other comprehensive income, net of taxes	-	-	-	-	2,100	2,100
Employee Stock Purchase Plan (1,657 shares)	-	2	23	-	-	25
Common stock dividends	-	-	-	(524)	-	(524)
Series B Preferred stock dividends	-	-	-	(175)	-	(175)
Balance, June 30, 2014	\$ 5,000	\$ 3,496	\$ 29,876	\$ 17,960	\$ 1,228	\$ 57,560
Balance, January 1, 2013	\$ 4,880	\$ 3,490	\$ 29,816	\$ 11,741	\$ 2,293	\$ 52,220
Net income	-	-	-	2,051	-	2,051
Total other comprehensive loss, net of taxes	-	-	-	-	(2,945)	(2,945)
Common stock dividends	-	-	-	(174)	-	(174)
Employee Stock Purchase Plan (2,530 shares)	-	2	26	-	-	28
Series B Preferred stock issuance	120	-	-	-	-	120
Series B Preferred stock dividends	-	-	-	(134)	-	(134)
Amortization of warrant cost	-	-	(14)	-	-	(14)
Warrant repurchase	-	-	-	(58)	-	(58)
Balance, June 30, 2013	\$ 5,000	\$ 3,492	\$ 29,828	\$ 13,426	\$ (652)	\$ 51,094

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

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

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

(Dollars in thousands)	Six Months Ended	
	June 30, 2014	2013
Operating Activities:		
Net Income	\$ 3,218	\$ 2,051
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	822	910
Depreciation	624	618
Amortization of intangibles	19	36
Net (accretion) amortization of security premiums	(441)	1,718
Gain on sales of investment securities	(150)	(112)
Earnings on cash surrender value of life insurance	(102)	(116)
SBA loans originated for sale	(733)	-
Proceeds from sales of SBA loans originated for sale	811	-
Gain on sale of SBA loans	(78)	-
Loss (gain) on disposal of property, plant, and equipment	3	(8)
Loss (gain) on sale / write-down of foreclosed assets	57	(322)
Deferred income tax expense (benefit)	158	(967)
(Increase) decrease in accrued interest receivable	(183)	50
(Increase) decrease in other assets	(409)	1,032
Increase in accrued interest payable	207	157
Increase in other liabilities	933	170
Net Cash Provided By Operating Activities	4,756	5,217
Investing Activities:		
Net decrease in interest-bearing time deposits with other financial institutions	1,641	10,130
Proceeds from the maturity of investment securities	6,644	24,690
Proceeds from the sale of investment securities	7,199	3,286
Purchases of investment securities	(30,111)	(13,715)
Redemptions (purchases) of restricted investment in bank stock	240	(750)
Net increase in loans and leases	(3,840)	(35,852)
Purchases of bank premises and equipment	(673)	(511)
Proceeds from sale of foreclosed assets	503	1,397
Net Cash Used In Investing Activities	(18,397)	(11,325)
Financing Activities:		
Net increase (decrease) in demand deposits and savings accounts	28,313	(2,676)
Net decrease in time deposits	(4,438)	(12,812)
Net (decrease) increase in short-term borrowings	(16,213)	27,512
Series B preferred stock dividend paid	(175)	(134)
Common stock dividend paid	(524)	(174)
Series B preferred stock issuance	-	120
Employee Stock Purchase Plan	25	28
Warrant repurchase	-	(58)
Proceeds from long-term debt borrowings	10,000	-
Repayment of long-term debt	(91)	(10,776)

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

Net Cash Provided By Financing Activities	16,897	1,030
Net increase (decrease) in cash and cash equivalents	3,256	(5,078)
Cash and cash equivalents, beginning of year	8,623	15,473
Cash and cash equivalents, end of period	\$ 11,879	\$ 10,395

Supplemental Disclosures of Cash Flow Information:

Interest paid	\$ 2,020	\$ 2,592
Income taxes paid	870	100

Supplemental Noncash Disclosures:

Loan transfers to foreclosed assets held for sale	\$ 678	\$ 1,262
---	--------	----------

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

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

(1) Basis of Presentation

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

Certain information and disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Mid Penn believes the information presented is not misleading and the disclosures are adequate. For comparative purposes, the June 30, 2013 and December 31, 2013 balances have been reclassified, when necessary, to conform to the 2014 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Mid Penn’s Annual Report on Form 10-K for the year ended December 31, 2013.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2014, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

(2) Investment Securities

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

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

Accounting Standards Codification (“ASC”) Topic 320, Investments – Debt and Equity Securities, clarifies the interaction of the factors that should be considered when determining whether a debt security is

other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment.

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

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.



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

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

At June 30, 2014 and December 31, 2013, amortized cost, fair value, and unrealized gains and losses on investment securities are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2014				
Available for sale securities:				
U.S. Treasury and U.S. government agencies	\$ 26,356	\$ 708	\$ 16	\$ 27,048
Mortgage-backed U.S. government agencies	34,858	400	155	35,103
State and political subdivision obligations	78,030	1,765	685	79,110
Equity securities	1,550	48	23	1,575
	\$ 140,794	\$ 2,921	\$ 879	\$ 142,836

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2013				
Available for sale securities:				
U.S. Treasury and U.S. government agencies	\$ 12,134	\$ 700	\$ -	\$ 12,834
Mortgage-backed U.S. government agencies	39,481	349	438	39,392
State and political subdivision obligations	70,770	744	2,476	69,038
Equity securities	1,550	20	31	1,539
	\$ 123,935	\$ 1,813	\$ 2,945	\$ 122,803

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

Investment securities having a fair value of \$137,919,000 at June 30, 2014 and \$114,600,000 at December 31, 2013, were pledged to secure public deposits and other borrowings.

Mid Penn realized gross gains of \$0 on sales of securities available for sale during the three months ended June 30, 2014 and realized \$150,000 during the first six months of 2014. Mid Penn realized gross gains of \$112,000 on sales of securities available for sale during the three and six months ended June 30, 2013. Mid Penn realized gross losses on the sale of securities available for sale of \$0 during the three and six months ended June 30, 2014 and June 30, 2013.

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

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013.

(Dollars in thousands) June 30, 2014	Number of Securities	Less Than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available for sale securities:							
U.S. Treasury and U.S. government agencies	5	\$ 6,780	\$ 16	\$ -	\$ -	\$ 6,780	\$ 16
Mortgage-backed U.S. government agencies	17	3,977	11	5,902	144	9,879	155
State and political subdivision obligations	52	6,051	32	19,453	653	25,504	685
Equity securities	1	-	-	550	23	550	23
Total temporarily impaired available for sale securities	75	\$ 16,808	\$ 59	\$ 25,905	\$ 820	\$ 42,713	\$ 879

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

(Dollars in thousands)		Less Than 12 Months		12 Months or More		Total	
December 31, 2013	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available for sale securities:							
Mortgage-backed U.S. government agencies	29	\$ 9,799	\$ 182	\$ 9,866	\$ 256	\$ 19,665	\$ 438
State and political subdivision obligations	90	39,611	2,150	4,288	326	43,899	2,476
Equity securities	1	-	-	550	31	550	31
Total temporarily impaired available for sale securities	120	\$ 49,410	\$ 2,332	\$ 14,704	\$ 613	\$ 64,114	\$ 2,945

Management evaluates securities for other-than-temporary impairment at least 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, the Corporation 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 with school districts and municipal authorities throughout the U.S. 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 June 30, 2014, 74 debt securities and 1 equity security with unrealized losses depreciated 2.06% from their amortized cost basis. Securities in an unrealized loss position for twelve months or longer at June 30, 2014 totaled \$820,000, of which the majority was attributed to state and political subdivision obligations with \$653,000 in unrealized losses. At December 31, 2013, 119 debt securities and 1 equity security with unrealized losses depreciated 4.59% from their amortized cost basis. At December 31, 2013, securities in an unrealized loss position for twelve months or longer totaled \$613,000 of which the majority was attributed to mortgage,-backed U.S. government agencies and state and political subdivision obligations with \$256,000 and \$326,000 in unrealized losses, respectively.

Because Mid Penn does not intend to sell these investments and it is not likely it will be required to sell these investments before a recovery of fair value, which may be maturity, Mid Penn does not consider the securities with unrealized losses to be other-than-temporarily impaired as losses relate to changes in interest rates and not erosion of

credit quality.

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

(Dollars in thousands)	June 30, 2014	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 1,786	\$ 1,831
Due after 1 year but within 5 years	15,294	15,949
Due after 5 years but within 10 years	44,762	45,555
Due after 10 years	42,544	42,823
	104,386	106,158
Mortgage-backed securities	34,858	35,103
Equity securities	1,550	1,575
	\$ 140,794	\$ 142,836

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

(3) Loans and Allowance for Loan and Lease Losses

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

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

For all classes of loans, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days or more past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan and lease losses. 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 more traditional investments.

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.

#### Lease financing

Mid Penn originates leases for select commercial and state and municipal government lessees. The nature of the leased asset is often subject to rapid depreciation in salvage value over a relatively short time frame or may be of an industry specific nature, making appraisal or liquidation of the asset difficult. These factors have led the Bank to severely curtail the origination of new leases to state or municipal government agencies where default risk is extremely limited and to only the most credit-worthy commercial customers.

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

These commercial customers are primarily leasing fleet vehicles for use in their primary line of business, mitigating some of the asset value concerns within the portfolio. Leasing has been a declining percentage of the Mid Penn's portfolio since 2006, representing 0.25% of the portfolio at June 30, 2014.

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 an attorney's title opinion or title insurance and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Bank generally contain a "due on sale" clause allowing the Bank to declare the unpaid principal balance due and payable upon the sale of the security property.

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

Consumer, including home equity

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

The largest component of Mid Penn's consumer loan portfolio consists of fixed rate home equity loans and variable rate home equity lines of credit. Substantially all home equity loans and lines of credit are secured by second mortgages on principal residences. The Bank will lend amounts, which, together with all prior liens, typically may be up to 85% of the appraised value of the property securing the loan. Home equity term loans may have maximum terms up to 20 years while home equity lines of credit generally have maximum terms of five years.

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 continues to be weak and property values deteriorate.



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

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

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include changes in economic conditions, fluctuations in loan quality measures, changes in the experience of the lending staff and loan review systems, growth or changes in the mix of loans originated, 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 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. This methodology assumes the borrower cannot or will not continue to make

additional payments. At that time the loan would be considered collateral dependent as the discounted cash flow (“DCF”) method indicates no operating income is available for repaying the loan; therefore, all impaired loans are deemed to be collateral dependent, except as noted below.

By definition, troubled debt restructurings are considered impaired. Impairment for troubled debt restructured loans still accruing interest is tested each quarter for both the most effective impairment method to be utilized, and the level of impairment. As of June 30, 2014, there were seven accruing troubled debt restructured loans among six relationships. Five loans to unrelated borrowers represented \$782,000 in accruing troubled debt restructurings evaluated for impairment using the estimated fair value of the collateral securing the loan, while the remaining two accruing troubled debt restructurings representing \$1,482,000, were evaluated for impairment using the discounted cash flow methodology. As of December 31, 2013, there were five accruing troubled debt restructured loans to unrelated borrowers representing \$833,000. All five loans were evaluated for impairment using the estimated value of the collateral securing the loans.

In addition, Mid Penn’s rating system assumes any loans classified as substandard non-accrual to be impaired, and all of these loans are considered collateral dependent; therefore, all of Mid Penn’s impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

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. In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. If the loan is secured, it will undergo a 90 day waiting period to ensure the collateral shortfall identified in the evaluation is accurate and then charged down by the specific allocation. Once the charge down is taken, the remaining balance remains an impaired loan with the original terms and interest rate intact (not restructured).

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

Commercial loans secured by real estate 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 and a 90 day waiting period begins to ensure the accuracy of the collateral shortfall. The loan is then charged down by the specific allocation. Once the charge down is taken, the remaining balance remains an impaired loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans (including home equity loans and other consumer loans) are recommended for charge-off after reaching delinquency of 90 days and the loan is not in the process of collection. The entire balance of the consumer loan is recommended for charge-off at this point.

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

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days of the credit being classified as impaired. Prior to receipt of the updated real estate valuation Mid Penn will use the most current existing real estate valuation to determine any potential allowance issues; however no allowance recommendation will be made until which time Mid Penn is in receipt of the updated valuation. The credit department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no significant time lapses noted with the above processes.

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

For impaired loans with no valuation allowance required, Mid Penn's practice of obtaining independent third party market valuations on the subject property within 30 days of being placed on non-accrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case

analysis of the impaired loans.

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 18 months for possible revaluation by an independent third party.

Mid Penn does not currently, or plan in the future to, use automated valuation methodologies as a method of valuing real estate collateral.

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

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

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, an interest rate below the going market rate for similarly structured credits, or an extension of a loan's stated maturity date. Non-accrual 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.

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

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.

The classes of the loan portfolio, summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within Mid Penn's internal risk rating system as of June 30, 2014 and December 31, 2013 are as follows:

(Dollars in thousands) June 30, 2014	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$ 103,355	\$ 878	\$ 1,497	\$ -	\$ 105,730
Commercial real estate	273,742	5,564	11,400	-	290,706
Commercial real estate - construction	51,332	361	-	-	51,693
Lease financing	1,358	-	-	-	1,358
Residential mortgage	66,149	232	992	-	67,373
Home equity	27,368	88	158	-	27,614
Consumer	4,141	-	-	-	4,141
	\$ 527,445	\$ 7,123	\$ 14,047	\$ -	\$ 548,615

(Dollars in thousands) December 31, 2013	Pass	Special Mention	Substandard	Doubtful	Total
---	------	--------------------	-------------	----------	-------

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

Commercial and industrial	\$ 103,330	\$ 938	\$ 1,576	\$ -	\$ 105,844
Commercial real estate	277,232	2,771	12,771	-	292,774
Commercial real estate - construction	45,265	382	-	-	45,647
Lease financing	1,356	-	-	-	1,356
Residential mortgage	69,447	27	356	-	69,830
Home equity	26,056	96	169	-	26,321
Consumer	4,690	-	-	-	4,690
	\$ 527,376	\$ 4,214	\$ 14,872	\$ -	\$ 546,462

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

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

Impaired loans by loan portfolio class as of June 30, 2014 and December 31, 2013 are summarized as follows:

(Dollars in thousands)	June 30, 2014			December 31, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	\$ 191	\$ 675	\$ -	\$ 185	\$ 671	\$ -
Commercial real estate	2,130	5,249	-	2,596	5,898	-
Residential mortgage	939	991	-	266	282	-
Home equity	32	827	-	27	792	-
With an allowance recorded:						
Commercial and industrial	\$ 71	\$ 201	\$ 63	\$ 115	\$ 243	\$ 42
Commercial real estate	7,104	7,381	1,163	7,649	7,972	1,860
Residential mortgage	-	-	-	25	25	25
Home equity	44	44	6	49	49	6
Total:						
Commercial and industrial	\$ 262	\$ 876	\$ 63	\$ 300	\$ 914	\$ 42
Commercial real estate	9,234	12,630	1,163	10,245	13,870	1,860
Residential mortgage	939	991	-	291	307	25
Home equity	76	871	6	76	841	6

Average recorded investment of impaired loans and related interest income recognized for the three months ended June 30, 2014 and June 30, 2013 are summarized as follows:

(Dollars in thousands)	Three Months Ended			
	June 30, 2014		June 30, 2013	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
With no related allowance recorded:				
Commercial and industrial	\$ 193	\$ -	\$ 35	\$ -
Commercial real estate	2,175	346	4,891	47
Residential mortgage	958	-	-	-
Home equity	54	-	122	-
With an allowance recorded:				
Commercial and industrial	\$ 72	\$ -	\$ 205	\$ -
Commercial real estate	7,133	-	9,136	-
Commercial real estate - construction	-	-	54	-

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

Residential mortgage	-	-	84	-
Home equity	45	-	55	-
Total:				
Commercial and industrial	\$ 265	\$ -	\$ 240	\$ -
Commercial real estate	9,308	346	14,027	47
Commercial real estate - construction	-	-	54	-
Residential mortgage	958	-	84	-
Home equity	99	-	177	-



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

(Dollars in thousands)	Six Months Ended		June 30, 2013	
	Average	Interest	Average	Interest
	Recorded	Income	Recorded	Income
	Investmen	Recognized	Investment	Recognized
With no related allowance recorded:				
Commercial and industrial	\$ 195	\$ -	\$ 35	\$ -
Commercial real estate	2,199	346	4,930	64
Residential mortgage	961	-	-	-
Home equity	55	-	122	-
With an allowance recorded:				
Commercial and industrial	\$ 73	\$ -	\$ 205	\$ -
Commercial real estate	7,182	-	9,150	-
Commercial real estate - construction	-	-	54	-
Residential mortgage	-	-	111	-
Home equity	46	-	55	-
Total:				
Commercial and industrial	\$ 268	\$ -	\$ 240	\$ -
Commercial real estate	9,381	346	14,080	64
Commercial real estate - construction	-	-	54	-
Residential mortgage	961	-	111	-
Home equity	101	-	177	-

Non-accrual loans by loan portfolio class as of June 30, 2014 and December 31, 2013 are summarized as follows:

(Dollars in thousands)	June 30, 2014	December 31, 2013
Commercial and industrial	\$ 262	\$ 300
Commercial real estate	7,199	9,648
Residential mortgage	1,177	803
Home equity	188	126
	\$ 8,826	\$ 10,877

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

The performance and credit quality of the loan portfolio is also monitored by the analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The classes of the loan portfolio summarized by the past due status as of June 30, 2014 and December 31, 2013 are summarized as follows:

(Dollars in thousands)

June 30, 2014

	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	\$ 34	\$ 290	\$ 252	\$ 576	\$ 105,154	\$ 105,730	\$ -
Commercial real estate	1,585	-	6,572	8,157	282,549	290,706	-
Commercial real estate - construction	-	-	-	-	51,693	51,693	-
Lease financing	-	-	-	-	1,358	1,358	-
Residential mortgage	84	237	1,125	1,446	65,927	67,373	-
Home equity	204	-	163	367	27,247	27,614	-
Consumer	-	-	-	-	4,141	4,141	-
Total	\$ 1,907	\$ 527	\$ 8,112	\$ 10,546	\$ 538,069	\$ 548,615	\$ -

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

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

(Dollars in thousands)

December 31, 2013

	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	\$ 291	\$ 38	\$ 300	\$ 629	\$ 105,215	\$ 105,844	\$ -
Commercial real estate	1,472	570	8,241	10,283	282,491	292,774	-
Commercial real estate - construction	-	-	-	-	45,647	45,647	-
Lease financing	-	-	-	-	1,356	1,356	-
Residential mortgage	952	-	785	1,737	68,093	69,830	-
Home equity	9	50	99	158	26,163	26,321	-
Consumer	24	12	-	36	4,654	4,690	-
Total	\$ 2,748	\$ 670	\$ 9,425	\$ 12,843	\$ 533,619	\$ 546,462	\$ -

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

(Dollars in thousands)

As of, and for the period ended, June 30, 2014	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, April 1, 2014	\$ 1,190	\$ 3,986	\$ 13	\$ 1	\$ 541	\$ 429	\$ 68	\$ 195	\$ 6,423
Charge-offs	(1)	(494)	-	-	(27)	(43)	(10)	-	(575)
Recoveries	3	2	-	-	-	-	2	-	7
Provisions	149	(36)	6	-	78	97	3	(22)	275
Ending balance, June 30, 2014	\$ 1,341	\$ 3,458	\$ 19	\$ 1	\$ 592	\$ 483	\$ 63	\$ 173	\$ 6,130

Beginning balance, January 1, 2014	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
2014	\$ 1,187	\$ 4,006	\$ 9	\$ -	\$ 581	\$ 441	\$ 72	\$ 21	\$ 6,317
Charge-offs	(41)	(862)	-	-	(86)	(43)	(26)	-	(1,058)
Recoveries	6	2	-	-	-	-	41	-	49

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

Provisions	189	312	10	1	97	85	(24)	152	822
Ending balance, June 30, 2014	\$ 1,341	\$ 3,458	\$ 19	\$ 1	\$ 592	\$ 483	\$ 63	\$ 173	\$ 6,130
Ending balance: individually evaluated for impairment	\$ 63	\$ 1,163	\$ -	\$ -	\$ -	\$ 6	\$ -	\$ -	\$ 1,232
Ending balance: collectively evaluated for impairment	\$ 1,278	\$ 2,295	\$ 19	\$ 1	\$ 592	\$ 477	\$ 63	\$ 173	\$ 4,898
Loans receivables: Ending balance	\$ 105,730	\$ 290,706	\$ 51,693	\$ 1,358	\$ 67,373	\$ 27,614	\$ 4,141	\$ -	\$ 548,615
Ending balance: individually evaluated for impairment	\$ 262	\$ 9,234	\$ -	\$ -	\$ 939	\$ 76	\$ -	\$ -	\$ 10,511
Ending balance: collectively evaluated for impairment	\$ 105,468	\$ 281,472	\$ 51,693	\$ 1,358	\$ 66,434	\$ 27,538	\$ 4,141	\$ -	\$ 538,104

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

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

(Dollars in thousands)

As of, and for the period ended, June 30, 2013	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, April 1, 2013	\$ 1,281	\$ 3,543	\$ 39	\$ 1	\$ 603	\$ 349	\$ 105	\$ (51)	\$ 5,870
Charge-offs	-	(93)	-	-	(22)	-	(10)	-	(125)
Recoveries	9	2	8	-	23	2	63	-	107
Provisions	(41)	367	(11)	-	56	58	(67)	53	415
Ending balance, June 30, 2013	\$ 1,249	\$ 3,819	\$ 36	\$ 1	\$ 660	\$ 409	\$ 91	\$ 2	\$ 6,267

Beginning balance, January 1, 2013	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Charge-offs	(21)	(118)	-	-	(126)	-	(15)	-	(280)
Recoveries	16	5	8	-	23	5	71	-	128
Provisions	(44)	820	(36)	-	182	61	(66)	(7)	910
Ending balance, June 30, 2013	\$ 1,249	\$ 3,819	\$ 36	\$ 1	\$ 660	\$ 409	\$ 91	\$ 2	\$ 6,267
Ending balance: individually evaluated for impairment	\$ 82	\$ 1,871	\$ 28	\$ -	\$ 29	\$ 10	\$ -	\$ -	\$ 2,020
Ending balance: collectively evaluated for impairment	\$ 1,167	\$ 1,948	\$ 8	\$ 1	\$ 631	\$ 399	\$ 91	\$ 2	\$ 4,247

Loans

receivables:

Ending balance	\$ 85,573	\$ 299,029	\$ 38,840	\$ 1,596	\$ 63,340	\$ 24,338	\$ 5,942	\$ -	\$ 518,658
Ending balance: individually evaluated for impairment	\$ 238	\$ 13,906	\$ 54	\$ -	\$ 84	\$ 175	\$ -	\$ -	\$ 14,457
	\$ 85,335	\$ 285,123	\$ 38,786	\$ 1,596	\$ 63,256	\$ 24,163	\$ 5,942	\$ -	\$ 504,201

Ending balance:  
collectively  
evaluated for  
impairment

(Dollars in  
thousands)

As of December 31, 2013	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:									
Ending balance:	\$ 1,187	\$ 4,006	\$ 9	\$ -	\$ 581	\$ 441	\$ 72	\$ 21	\$ 6,317
Ending balance: individually evaluated for impairment	\$ 42	\$ 1,860	\$ -	\$ -	\$ 25	\$ 6	\$ -	\$ -	\$ 1,933
Ending balance: collectively evaluated for impairment	\$ 1,145	\$ 2,146	\$ 9	\$ -	\$ 556	\$ 435	\$ 72	\$ 21	\$ 4,384
Loans receivables:									
Ending balance:	\$ 105,844	\$ 292,774	\$ 45,647	\$ 1,356	\$ 69,830	\$ 26,321	\$ 4,690	\$ -	\$ 546,462
Ending balance: individually evaluated for impairment	\$ 300	\$ 10,245	\$ -	\$ -	\$ 291	\$ 76	\$ -	\$ -	\$ 10,912
Ending balance: collectively evaluated for impairment	\$ 105,544	\$ 282,529	\$ 45,647	\$ 1,356	\$ 69,539	\$ 26,245	\$ 4,690	\$ -	\$ 535,550



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

The recorded investments in troubled debt restructured loans at June 30, 2014 and December 31, 2013 are as follows:

(Dollars in thousands) June 30, 2014	Pre-Modification	Post-Modification	
	Outstanding Recorded Investment	Outstanding Recorded Investment	Recorded Investment
Commercial and industrial	\$ 40	\$ 35	\$ 28
Commercial real estate	11,189	9,443	8,268
Residential mortgage	1,141	1,100	939
Home equity	50	7	7
	\$ 12,420	\$ 10,585	\$ 9,242

(Dollars in thousands) December 31, 2013	Pre-Modification	Post-Modification	
	Outstanding Recorded Investment	Outstanding Recorded Investment	Recorded Investment
Commercial and industrial	\$ 40	\$ 35	\$ 29
Commercial real estate	10,581	8,686	7,470
Residential mortgage	423	417	266
	\$ 11,044	\$ 9,138	\$ 7,765

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

Mid Penn's troubled debt restructured loans at June 30, 2014 totaled \$9,242,000, of which, \$2,264,000 represented seven accruing loans among six unrelated relationships. Two loans belong to a borrower who was upgraded and moved to accruing status during the quarter. These two loans accounted for \$1,482,000 of the total accruing troubled debt restructured loan balance. One other large commercial real estate loan represented \$553,000, while the remaining four loans are residential mortgages, all in compliance with the terms of the modification. The remaining \$6,978,000, representing 15 loans, are nonaccrual impaired loans, and resulted in a collateral evaluation in accordance with the guidance on impaired loans. Of these 15 loans, one business relationship accounted for five loans totaling \$606,000, another commercial relationship accounted for two loans totaling \$589,000, and a residential real estate relationship accounted for two loans totaling \$547,000. The remaining five loans to unrelated borrowers totaled \$5,236,000. Included in the \$5,236,000 are two large commercial real estate loans with balances of \$3,135,000 and \$1,557,000.

At December 31, 2013, troubled debt restructured loans totaled \$7,765,000, of which, \$833,000, representing five loans to unrelated borrowers, are accruing residential mortgages in compliance with the terms of the modification. Of



the \$833,000, four are accruing residential mortgages totaling \$235,000 and one is an accruing commercial real estate loan totaling \$598,000. The remaining \$6,932,000, representing 12 loans, are nonaccrual impaired loans, and resulted in a collateral evaluation in accordance with the guidance on impaired loans. Of these 12 loans, two large unrelated commercial real estate relationships accounted for two loans totaling \$4,819,000, one business relationship accounted for five loans totaling \$609,000, a large commercial participation totaling \$1,473,000 accounted for three loans, and the remaining two unrelated loans totaled \$31,000.

As a result of the evaluations at June 30, 2014 and June 30, 2013, a specific allocation and, subsequently, charge-offs have been appropriately taken in the opinion of management. As of June 30, 2014 and June 30, 2013, charge-offs associated with troubled debt restructured loans while under forbearance agreement totaled \$0 and there were no defaulted troubled debt restructured loans as all troubled debt restructured loans were current with respect to their associated forbearance agreements. As of June 30, 2014, one forbearance agreement was negotiated during 2008, 10 forbearance agreements were negotiated during 2009, one forbearance agreement was negotiated in 2010, five forbearance agreements were negotiated in 2013, and five forbearance agreements were negotiated in 2014.

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

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

The following tables summarize loans whose terms have been modified resulting in troubled debt restructurings during the three and six months ended June 30, 2014 and June 30, 2013.

(Dollars in thousands) June 30, 2014	Three and Six Months Ended			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial real estate	2	\$ 1,057	\$ 757	\$ 752
Residential mortgage	2	718	683	682
Home equity	1	50	7	7
	5	\$ 1,825	\$ 1,447	\$ 1,441

(Dollars in thousands) June 30, 2013	Three Months Ended			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial real estate	3	\$ 6,091	\$ 5,588	\$ 5,588
Residential mortgage	1	14	14	14
	4	\$ 6,105	\$ 5,602	\$ 5,602

(Dollars in thousands) June 30, 2013	Six Months Ended			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial real estate	3	\$ 6,091	\$ 5,588	\$ 5,588
Residential mortgage	2	74	74	74
	5	\$ 6,165	\$ 5,662	\$ 5,662

(4) 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. An asset's or liability's placement in the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement or disclosure.

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

The fair value hierarchy is as follows:

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

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

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

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

There were no transfers of assets between fair value Level 1 and Level 2 for the three or six months ended June 30, 2014. The following tables illustrate the assets measured at fair value on a recurring basis segregated by hierarchy fair value levels.

(Dollars in thousands)	Total carrying value at June 30, 2014	Fair value measurements at June 30, 2014 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
U.S. Treasury and U.S. government agencies	\$ 27,048	\$ -	\$ 27,048	\$ -
Mortgage-backed U.S. government agencies	35,103	-	35,103	-
State and political subdivision obligations	79,110	-	79,110	-
Equity securities	1,575	527	1,048	-
	\$ 142,836	\$ 527	\$ 142,309	\$ -

(Dollars in thousands)	Fair value measurements at December 31, 2013 using:			
	Total	Quoted prices in active markets December 31, 2013	Significant other observable inputs (Level 1)	Significant unobservable inputs (Level 2) (Level 3)
Assets:				
U.S. Treasury and U.S. government agencies	\$ 12,834	\$ -	\$ 12,834	\$ -
Mortgage-backed U.S. government agencies	39,392	-	39,392	-
State and political subdivision obligations	69,038	-	69,038	-
Equity securities	1,539	519	1,020	-
	\$ 122,803	\$ 519	\$ 122,284	\$ -

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)	Fair value measurements at June 30, 2014 using:			
	Total	Quoted prices in active markets June 30, 2014	Significant other observable inputs (Level 1)	Significant unobservable inputs (Level 2) (Level 3)
Assets:				
Impaired Loans	\$ 6,999	\$ -	\$ -	\$ 6,999
Foreclosed Assets Held for Sale	420	-	-	420
Mortgage Servicing Rights	218	-	-	218

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

(Dollars in thousands)	Fair value measurements at December 31, 2013 using:			
	Total carrying value at December 31, 2013	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Impaired Loans	\$ 6,535	\$ -	\$ -	\$ 6,535
Foreclosed Assets Held for Sale	465	-	-	465
Mortgage Servicing Rights	223	-	-	223

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 as of June 30, 2014 and December 31, 2013.

(Dollars in thousands) Quantitative Information about Level 3 Fair Value Measurements					
	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
June 30, 2014					
Impaired Loans	\$ 6,999	Appraisal of collateral (1)	Appraisal adjustments (2)	10% - 95%	28%
Foreclosed Assets Held for Sale	420	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	15% - 40%	24%
Mortgage Servicing Rights	218	Multiple of annual service fee	Estimated prepayment speed based on rate and term	280% - 400%	356%

(Dollars in thousands) Quantitative Information about Level 3 Fair Value Measurements					
	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
December 31, 2013					
Impaired Loans	\$ 6,535	Appraisal of collateral (1)	Appraisal adjustments (2)	10% - 95%	25%
Foreclosed Assets Held for Sale	465	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	15% - 40%	24%
	223			240% - 400%	349%

Mortgage Servicing Rights	Multiple of annual service fee	Estimated prepayment speed based on rate and term
---------------------------	--------------------------------	---

- (1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not observable.
- (2) 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.
- (3) Includes qualitative adjustments by management and estimated liquidation expenses.

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

Cash and Cash Equivalents:

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

Interest-bearing Balances with other Financial Institutions:

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

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

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 and non-accrual to be impaired, and all of these loans are considered collateral dependent; therefore, all of Mid Penn's impaired loans, whether reporting a specific allocation or not, are considered collateral dependent.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days of the credit being classified as substandard 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 which time Mid Penn is in receipt of the updated valuation.

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

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values over time or changing circumstances by some factor, either positive or negative, from the original values. All collateral values will be assessed by management at least every 18 months for possible revaluation by an independent third party.

Mid Penn does not currently, or plan to in the future, use automated valuation methodologies as a method of valuing real estate collateral.

Loans:



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

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

### Foreclosed Assets Held for Sale:

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

### Accrued Interest Receivable and Payable:

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

### Restricted Investment in Bank Stocks:

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

### Mortgage Servicing Rights:

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

### Deposits:

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

### Short-term Borrowings:

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



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

## Long-term Debt:

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

## Commitments to Extend Credit and Letters of Credit:

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

The following table summarizes the carrying value and fair value of financial instruments at June 30, 2014 and December 31, 2013.

(Dollars in thousands)	June 30, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 11,879	\$ 11,879	\$ 8,623	\$ 8,623
Interest-bearing time balances with other financial institutions	5,872	5,872	7,513	7,513
Investment securities	142,836	142,836	122,803	122,803
Net loans and leases	542,485	547,327	540,145	548,923
Restricted investment in bank stocks	2,729	2,729	2,969	2,969
Accrued interest receivable	2,887	2,887	2,704	2,704
Mortgage servicing rights	218	218	223	223
<b>Financial liabilities:</b>				
Deposits	\$ 632,005	\$ 633,992	\$ 608,130	\$ 610,419
Short-term borrowings	7,620	7,620	23,833	23,833
Long-term debt	33,054	33,185	23,145	22,988
Accrued interest payable	600	600	393	393
<b>Off-balance sheet financial instruments:</b>				
Commitments to extend credit	\$ -	\$ -	\$ -	\$ -
Financial standby letters of credit	-	-	-	-

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of Mid Penn's financial instruments as of June 30, 2014 and December 31, 2013 not previously disclosed. Carrying values approximate fair values for cash and cash equivalents, interest-bearing time balances with other financial institutions,

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

restricted investment in bank stocks, mortgage servicing rights, accrued interest receivable and payable, and short-term borrowings. Other than cash and cash equivalents, which are considered Level 1 Inputs and mortgage servicing rights, which are Level 3 inputs, these instruments are Level 2 Inputs. These tables exclude financial instruments for which the carrying amount approximates fair value.

(Dollars in thousands)	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2014					
Financial instruments - assets					
Net loans and leases	\$ 542,485	\$ 547,327	\$ -	\$ -	\$ 547,327
Financial instruments - liabilities					
Deposits	\$ 632,005	\$ 633,992	\$ -	\$ 633,992	\$ -
Long-term debt	33,054	33,185	-	33,185	-

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

(Dollars in thousands)	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2013					
Financial instruments - assets					
Net loans and leases	\$ 540,145	\$ 548,923	\$ -	\$ -	\$ 548,923
Financial instruments - liabilities					
Deposits	\$ 608,130	\$ 610,419	\$ -	\$ 610,419	\$ -
Long-term debt	23,145	22,988	-	22,988	-

(5) Guarantees

In the normal course of business, Mid Penn makes various commitments and incurs certain contingent liabilities, which are not reflected in the accompanying consolidated financial statements. The commitments include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Mid Penn evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Mid Penn had \$10,611,000 and \$8,458,000 standby letters of credit outstanding as of June 30, 2014 and December 31, 2013, respectively. Mid Penn does not anticipate any losses because of these transactions. The current amount of the liability as of June 30, 2014 for payment under standby letters of credit issued was not material.

(6) Defined Benefit Plans

Mid Penn has an unfunded noncontributory defined benefit retirement plan for directors. The plan provides defined benefits based on years of service. In addition, Mid Penn sponsors a defined benefit health care plan that provides post-retirement medical benefits and life insurance to qualifying full-time employees. These health care and life insurance plans are noncontributory. A December 31 measurement date for the plans is used.

The components of net periodic benefit costs from these benefit plans are as follows:

(Dollars in thousands)	Three Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
	Service cost	\$ 9	\$ 8	\$ 4
Interest cost	12	11	10	8
Amortization of prior service cost	6	6	-	1
Net periodic benefit cost	\$ 27	\$ 25	\$ 14	\$ 14

(Dollars in thousands)	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
	Service cost	\$ 17	\$ 16	\$ 7
Interest cost	25	22	19	17
Amortization of prior service cost	9	11	-	1
Net periodic benefit cost	\$ 51	\$ 49	\$ 26	\$ 27

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

## (7) 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 Plans Liabilities	Accumulated Other Comprehensive (Loss) Income
Balance - June 30, 2014	\$ 1,349	\$ (121)	\$ 1,228
Balance - December 31, 2013	\$ (745)	\$ (127)	\$ (872)

## (8) Preferred Stock

On December 19, 2008, Mid Penn entered into and closed a letter agreement with the United States Department of the Treasury (the "Treasury") pursuant to which the Treasury invested \$10,000,000 in the Mid Penn Bank under the Treasury's Capital Purchase Program (the "CPP"). Under the letter agreement, the Treasury received (1) 10,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock, \$1,000 liquidation preference ("Series A Preferred Stock"), and (2) warrants to purchase up to 73,099 shares of Mid Penn common stock at an exercise price of \$20.52 per share (the "Warrants").

On December 28, 2012, Mid Penn entered into a letter agreement with the Treasury pursuant to which Mid Penn repurchased from the Treasury all 10,000 shares of the Series A Preferred Stock issued to the Treasury which constitutes all of the issued and outstanding shares of Series A Preferred Stock. Mid Penn repurchased the Series A Preferred Stock for a purchase price equal to the aggregate liquidation amount of the Preferred Stock of \$10,000,000, plus accrued but unpaid dividends of \$59,722. All 10,000 shares of Series A Preferred Stock have subsequently been cancelled.

On January 23, 2013, Mid Penn entered into a letter agreement with the Treasury pursuant to which Mid Penn repurchased from the Treasury on that date the Warrants for \$58,479. The Warrants have subsequently been cancelled.

As of the date hereof, Mid Penn has no further financial obligations under the Series A Preferred Stock, the Warrants or the Treasury's CPP.

(9) Stock Issued Under Private Placement Offering

On September 26, 2012, Mid Penn filed with the Pennsylvania Department of State a Statement with Respect to Shares which, effective upon filing, designated a series of preferred stock as "7% Non-Cumulative Non-Voting Non-Convertible Perpetual Preferred Stock, Series B" ("Series B Preferred Stock"), and set forth the voting and other powers, designations, preferences and relative, participating, optional or other rights, and the qualifications, limitations or restrictions of the Series B Preferred Stock.

Sales of Preferred Stock

Mid Penn sold shares of its Series B Preferred Stock, in transactions exempt from registration under the Securities Act of 1933, pursuant to Section 4(a)(2) thereof.

Between September 26, 2012 and December 31, 2012, Mid Penn sold 4,880 shares of its Series B Preferred Stock for total gross proceeds of \$4,880,000, which have been offset by issuance costs of \$50,000. On January 3, 2013, 120 additional shares were sold resulting in total gross proceeds of \$5,000,000 for the Series B Preferred Stock offering.



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

The following table summarizes the Series B Preferred Stock shares sold and the gross proceeds received through the private placement offering as of June 30, 2014:

Period	Shares	Gross Proceeds
September 26, 2012 - September 30, 2012	345	\$ 345,000
October 1, 2012 - December 31, 2012	4,535	4,535,000
January 1, 2013 - December 31, 2013	120	120,000
January 1, 2014 - June 30, 2014	-	-
Total	5,000	\$ 5,000,000

## Terms of the Series B Preferred Stock

The annual dividend rate for the Series B Preferred Stock is 7% per annum of the liquidation preference of the Series B Preferred Stock or \$70.00 per annum for each share of Series B Preferred Stock. The Board of Directors must approve each dividend payment from legally available funds. Dividends are payable to holders of record of the Series B Preferred Stock as they appear on our books on the record dates fixed by our Board of Directors. Dividends on any of Series B Preferred Stock are non-cumulative. If and when dividends are declared, they will be paid on February 15, May 15, August 15, and November 15 of each year. If a dividend payment date is not a business day, the dividend will be paid on the immediately preceding business day but no additional dividend payment will be prorated from the date of purchase to the first dividend payment date over a quarterly dividend period of 90 days.

Mid Penn may redeem shares of its Series B Preferred Stock at its option, in whole or in part, at any time subject to prior approval of the Federal Reserve Board, if then required, at a redemption price of \$1,020 per share of Series B Preferred Stock plus an amount equal to any declared but unpaid dividends and in accordance with the terms and conditions set forth in a Certificate of Designations for the Series B Preferred Stock as filed with the Pennsylvania Department of State.

## (10) Earnings per Common Share

Earnings per share are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during each of the years presented. The following data show the amounts used

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

in computing basic and diluted earnings per share. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted average common shares available from the exercise of all dilutive stock warrants issued to the U.S. Treasury under the provisions of the Capital Purchase Program, based on the average share price of Mid Penn's common stock during the period.

The computations of basic earnings per common share follow:

(Dollars in thousands, except per share data)	Three Months Ended June		Six Months Ended June 30,	
	30, 2014	2013	2014	2013
Net Income	\$ 1,707	\$ 1,366	\$ 3,218	\$ 2,051
Less: Accretion of Series A preferred stock discount	-	-	-	(14)
Dividends on Series B preferred stock	(88)	(87)	(175)	(134)
Net income available to common shareholders	\$ 1,619	\$ 1,279	\$ 3,043	\$ 1,903
Weighted average common shares outstanding	3,495,389	3,491,069	3,494,901	3,490,403
Basic earnings per common share	\$ 0.46	\$ 0.37	\$ 0.87	\$ 0.55

Mid Penn did not have dilutive securities outstanding as of June 30, 2014 and 2013.

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

(11) Recent Accounting Pronouncements

ASU 2014-01: The Financial Accounting Standards Board (“FASB”) has issued Accounting Standards Update (“ASU”) 2014-01, Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force).

The amendments in this Update permit a reporting entity that invests in qualified affordable housing projects to account for the investments using a proportional amortization method if certain conditions are met. The Low Income Housing Tax Credit is a program designed to encourage investment of private capital for use in the construction and rehabilitation of low income housing, which provides certain tax benefits to investors in those projects. If an entity elects the proportional amortization method, it will amortize the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense. Otherwise, the entity would apply either the equity method or the cost method, as appropriate.

Amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. If adopted, the amendments should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments.

ASU 2014-04: The FASB issued ASU 2014-04, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).

The Update clarifies that when an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

Amendments in this Update are effective for public business entities for annual periods and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. If adopted, an entity can elect to adopt the amendments in this update using either a modified retrospective transition method or a prospective transition method.

Mid Penn is evaluating the effects these Updates will have on its consolidated financial statements.

MID PENN BANCORP, INC.

## ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is Management's Discussion of Consolidated Financial Condition as of June 30, 2014, compared to year-end 2013, and the Results of Operations for the three and six months ended June 30, 2014, compared to the same period in 2013.

This discussion should be read in conjunction with the financial tables, statistics, and the audited financial statements and notes thereto included in Mid Penn's Annual Report on Form 10-K for the year ended December 31, 2013. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year.

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Mid Penn to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words "expect", "anticipates", "intend", "plan", "believe", "estimate", and similar expressions are intended to identify such forward-looking statements.

Mid Penn's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- The effects of future economic conditions on Mid Penn and its customers;
- Governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- Future actions or inactions of the United States government, including a failure to increase the government debt limit or a prolonged shutdown of the federal government;
- Possible impacts of the capital and liquidity requirements of Basel III standards and other regulatory pronouncements, regulations and rules;
  - The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, Financial Accounting Standards Board, and other accounting standard setters;
- The risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- The effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn's market area and elsewhere, including institutions operating

locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;

- The costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- Technological changes;
- Acquisitions and integration of acquired businesses;
- Results of the regulatory examination and supervision process;
- Loss of certain key officers;
- The failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;
- Acts of war or terrorism;
- Our ability to maintain compliance with the exchange rules of the NASDAQ Stock Market, Inc.;
- Our ability to maintain the value and image of our brand and protect our intellectual property rights;
- Volatilities in the securities markets;
- Disruptions due to flooding, severe weather, or other natural disasters or Acts of God; and
- Slow economic conditions.

Mid Penn undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in the documents that Mid Penn periodically files with the SEC, including Mid Penn's Annual Report on Form 10-K for the year ended December 31, 2013.

#### 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. 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 Mid Penn used are based on historical experiences and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and estimates that Mid Penn has made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

MID PENN BANCORP, INC.

Management of Mid Penn 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 assessment of goodwill for impairment, and the valuation of deferred tax assets to be the accounting areas that require the most subjective and complex judgments.

The allowance for loan and lease losses represents management's estimate of probable incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance for loan and lease losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan and lease portfolio also represents the largest asset type on the consolidated balance sheet. Throughout the remainder of this report, the terms "loan" or "loans" refers to both loans and leases.

Valuations for the investment portfolio are determined using quoted market prices, where available. If quoted market prices are not available, investment valuation is based on pricing models, quotes for similar investment securities, and observable yield curves and spreads. In addition to valuation, management must assess whether there are any declines in value below the carrying value of the investments that should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of the loss in the consolidated statement of income.

Accounting Standards Codification ("ASC") Topic 350, Intangibles-Goodwill and Other, requires that goodwill for publicly traded companies is not amortized to expense, but rather that it be tested for impairment at least annually. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2013. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur.

Mid Penn recognizes deferred tax assets and liabilities for the future effects of temporary differences and tax credits. Enacted tax rates are applied to cumulative temporary differences based on expected taxable income in the periods in which the deferred tax asset or liability is anticipated to be realized. Future tax rate changes could occur that would require the recognition of income or expense in the consolidated statements of income in the period in which they are enacted. Deferred tax assets must be reduced by a valuation allowance if in management's judgment, it is "more likely than not" that some portion of the asset will not be realized. Management may need to modify their judgment in this regard from one period to another should a material change occur in the business environment, tax legislation, or in any other business factor that could impair Mid Penn's ability to benefit from the asset in the future.

Results of Operations

## Overview

Net income available to common shareholders was \$1,619,000, \$0.46 basic earnings per common share, for the quarter ended June 30, 2014, as compared to net income available to common shareholders of \$1,279,000, or \$0.37 basic earnings per common share, for the quarter ended June 30, 2013, a 26.6% increase. During the six months ended June 30, 2014, net income available to common shareholders was \$3,043,000, or \$0.87 basic earnings per common share, versus \$1,903,000, or \$0.55 basic earnings per common share for the same period in 2013, a 59.9% increase.

Net interest income increased \$904,000, or 15.5%, to \$6,751,000 for the quarter ended June 30, 2014 from \$5,847,000 during the quarter ended June 30, 2013. Through the first six months of 2014, net interest income increased \$1,717,000, or 15.2%, to \$13,023,000 from \$11,306,000 during the same period in 2013.

The provision for loan and lease losses in the second quarter of 2014 was \$275,000, compared to \$415,000 in the second quarter of 2013. During the six months ended June 30, 2014, the provision for loan and lease losses was \$822,000 compared to \$910,000 for the six months ended June 30, 2013.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Return on average assets	0.94%	0.78%	0.90%	0.59%
Return on average equity	12.11%	10.33%	11.67%	7.81%

Total assets increased \$23,355,000 to \$736,480,000 at June 30, 2014, from \$713,125,000 at December 31, 2013. Available for sale investment securities increased \$20,033,000 from \$122,803,000 at December 31, 2013 to \$142,836,000 at June 30, 2014. Due to the strategic increase in public funds deposits, Mid Penn increased the amount of pledgeable investments in its portfolio. Gross loans increased \$2,153,000 during the first six months of 2014, while interest-bearing time deposits with other financial institutions decreased \$1,641,000 from \$7,513,000 at December 31, 2013 to \$5,872,000 at June 30, 2014. Mid Penn has been allowing a substantial portion of maturing interest-bearing time deposits with other financial institutions run off to fund loan growth and purchase higher yielding investment securities. Total deposits increased



## MID PENN BANCORP, INC.

\$23,875,000 from \$608,130,000 at December 31, 2013 to \$632,005,000 at June 30, 2014. Interest bearing demand and money market deposit balances increased \$25,889,000 to \$423,715,000 at June 30, 2014 from \$397,826,000 at December 31, 2013 due to the addition of large cash management, non-profit, and government accounts. Time deposits declined \$4,438,000 from \$132,373,000 at December 31, 2013 as less aggressive certificate of deposit rates have allowed non-relationship time deposits to run off and shifted the funding composition towards lower-cost deposits, including public funds. This strategy, coupled with strong earning assets, has improved margins and provided positive momentum to net interest income during the first half of 2014. Short-term borrowings decreased \$16,213,000 from \$23,833,000 at December 31, 2013 to \$7,620,000 at June 30, 2014, while long-term debt increased \$9,909,000 from \$23,145,000 at December 31, 2013 due to the addition of a \$10,000,000 FHLB Advance borrowing. The long-term debt borrowing was taken as a prudent and planned asset liability management strategy to take advantage of low long-term borrowing rates. This strategy was taken in light of the decrease in short-term borrowings, which is primarily attributed to the increase in deposits, as well as the additional FHLB Advance borrowing, which lessened Mid Penn's need for overnight funds.

## Net Interest Income/Funding Sources

Net interest income, Mid Penn's primary source of revenue, is the amount by which interest income on loans and investments exceeds interest incurred on deposits and borrowings. The amount of net interest income is affected by changes in interest rates and changes in the volume and mix of interest-sensitive assets and liabilities. Net interest income and corresponding yields are presented in the analysis below on a taxable-equivalent basis. Income from tax-exempt assets, primarily loans to or securities issued by state and local governments, is adjusted by an amount equivalent to the federal income taxes which would have been paid if the income received on these assets was taxable at the statutory rate of 34%.

For the three months ended June 30, 2014, Mid Penn's taxable-equivalent net interest margin increased to 4.16%, from 3.73% for the three months ended June 30, 2013. Net interest income, on a taxable-equivalent basis, in the three months ended June 30, 2014, increased to \$7,154,000 from \$6,184,000 during the same three months of 2013. These increases are primarily attributable to the rise in investment security yields from 2.38% to 3.62%, increasing tax-effected investment security income by \$332,000, or 37.8%, as well as the increase in loan volume, which equated to an increase in tax-effected loan income of \$477,000, or 7.2%, during the three months ended June 30, 2014 compared to the same period in 2013.

For the six months ended June 30, 2014, Mid Penn's taxable-equivalent net interest margin increased to 4.08% from 3.63% for the six months ended June 30, 2012. Net interest income, on a taxable equivalent basis, in the first six months of 2014, increased to \$13,809,000 from \$11,969,000 in the first six months of 2013. These increases are primarily attributable to the rise in investment security yields from 2.33% to 3.63%, increasing tax-effected investment security income by \$591,000, or 34.5%, as well as the increase in loan volume, which equated to an increase in tax-effected loan income of \$793,000, or 6.1%, during the six months ended June 30, 2014 compared to the same period in 2013.

Included in the net interest income increase for the three and six months ended June 30, 2014 is \$346,000 in recaptured nonaccrual interest from two large commercial real estate loans to a commercial borrower that were returned to accruing status in June 2014, and does not have a material impact on our interim consolidated financial statements.

Although the effective interest rate impact on earning assets and funding sources can be reasonably estimated at current interest rate levels, the options selected by customers, and the future mix of the loan, investment, and deposit products in the Bank's portfolios, may significantly impact future operating results. In addition, our net interest income may be impacted by further interest rate actions of the Federal Reserve Bank.

#### Provision for Loan Losses

The provision for loan and lease losses is the expense necessary to maintain the allowance for loan and lease losses at a level adequate to absorb management's estimate of probable losses in the loan and lease portfolio. Mid Penn's provision for loan and lease losses is based upon management's monthly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans and leases, analyze delinquencies, ascertain loan and lease growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets Mid Penn serves.

Mid Penn has maintained the allowance for loan and lease losses in accordance with Mid Penn's assessment process, which takes into consideration the risk characteristics of the loan and lease portfolio, the growth in the loan and lease portfolio during the first six months of 2014, and shifting collateral values from December 31, 2013 to June 30, 2014.

Following its model for loan and lease loss allowance adequacy, management recorded a \$275,000 provision for the three months ended June 30, 2014, as compared to a provision of \$415,000 for the three months ended June 30, 2013. During the six months ended June 30, 2014, the provision for loan and lease losses was \$822,000, as compared to \$910,000 for the six months ended June 2013. The allowance for loan and lease losses as a percentage of total loans was 1.12% at June 30, 2014, compared to 1.16% at December 31, 2013. For further discussion of factors affecting the provision for loan and lease losses please see Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses in the Financial Condition section of this Management's Discussion and Analysis.

## MID PENN BANCORP, INC.

## Noninterest Income

Noninterest income decreased \$64,000, or 7.6%, during the second quarter of 2014 versus the same period in 2013. During the six months ended June 30, 2014, noninterest income decreased \$20,000, or 1.2%, versus the same period in 2013. The following components of noninterest income showed significant changes:

(Dollars in Thousands)	Three Months Ended June 30,			
	2014	2013	\$ Variance	% Variance
Income from fiduciary activities	\$ 167	\$ 110	\$ 57	51.8%
Net gain on sales of investment securities	-	112	(112)	-100.0%
Mortgage banking income	75	115	(40)	-34.8%
Other income	113	83	30	36.1%

(Dollars in Thousands)	Six Months Ended June 30,			
	2014	2013	\$ Variance	% Variance
Income from fiduciary activities	\$ 325	\$ 249	\$ 76	30.5%
Net gain on sales of investment securities	150	112	38	33.9%
Mortgage banking income	113	225	(112)	-49.8%
Merchant services income	133	174	(41)	-23.6%
Net gain on sales of SBA loans	78	-	78	NA
Other income	239	286	(47)	-16.4%

Income from fiduciary activities increased during the three and six months ended June 30, 2014 versus the same periods in 2013. This variance is the result of increased sales of third party mutual funds and annuities during 2014 versus 2013. Mid Penn recognized investment security gains in the six months ended June 30, 2014 to take advantage of opportunities to enhance the investment portfolio's overall performance. Mortgage banking income was down during the three and six months ended June 30, 2014. Refinancing activity subsided relative to 2013 due to rate increases, while purchase activity was hampered by harsh winter weather conditions throughout our market area during the first quarter of 2014. Merchant services income was also adversely impacted by harsh weather conditions during the first quarter as merchants lost out on sales due to the lack of traffic. Net gain on sales of SBA loans increased during the six months ended June 30, 2014 versus the same period in 2013 due to Mid Penn beginning the sale of the guaranteed portion of Small Business Association (SBA) loans in the secondary market. Other income increased in the second quarter of 2014 compared to the same period in 2013 primarily due to increases in letter of credit and loan satisfaction fees. Other income decreased for the six months ended June 30, 2014 because 2013's figure included reimbursements from loan collection costs by a commercial borrower and unclaimed funds from the flexible spending and dental reimbursement plans from the 2011-2012 plan year, which were not received in 2014.

## Noninterest Expenses

Noninterest expenses increased \$456,000, or 9.9%, during the second quarter of 2014, versus the same period in 2013. During the six months ended June 30, 2014, noninterest expenses increased \$157,000, or 1.6%, versus the same period in 2013. The changes were primarily a result of the following components of noninterest expense:

(Dollars in Thousands)	Three Months Ended June 30,			
	2014	2013	\$ Variance	% Variance
Salaries and employee benefits	\$ 2,843	\$ 2,685	\$ 158	5.9%
Occupancy expense, net	322	269	53	19.7%
Equipment expense	310	345	(35)	-10.1%
Software licensing	212	246	(34)	-13.8%
Gain on sale/write-down of foreclosed assets	(30)	(303)	273	-90.1%
Other expenses	646	614	32	5.2%

## MID PENN BANCORP, INC.

(Dollars in Thousands)	Six Months Ended June 30,			
	2014	2013	Variance	% Variance
			\$	
Salaries and employee benefits	\$ 5,391	\$ 5,542	\$ (151)	-2.7%
Occupancy expense, net	704	579	125	21.6%
Equipment expense	611	661	(50)	-7.6%
Pennsylvania Bank Shares tax expense	208	261	(53)	-20.3%
FDIC Assessment	271	333	(62)	-18.6%
Legal and professional fees	265	320	(55)	-17.2%
Loss (gain) on sale/write-down of foreclosed assets	57	(322)	379	-117.7%

Salaries and employee benefits increased during the three months ended June 30, 2014 due to the establishment of a bonus pool for employees based upon the strong earnings results during 2014 and would be paid, if earnings performance continues to excel, after the conclusion of the calendar year's results are finalized. Salaries and employee benefits decreased during the six months ended June 30, 2014, primarily due to improved actual medical claims from Mid Penn's self-funded insurance plan. The first half of 2014 also reflects the benefit of lower staffing levels in operational areas derived from the conversion to a hosted computer environment with our primary computer vendor during the fourth quarter of 2013. Occupancy expense increased during the three and six months ended June 30, 2014 due to increases in snow removal costs and heating as a result of the harsh weather conditions during the first and early second quarter. Equipment expense decreased during the three and six months ended June 30, 2014 due to reduced repair and replacement costs on existing equipment. Pennsylvania Bank Shares tax expense decreased during the six months ended June 30, 2014 due to a change in the calculation methodology. FDIC assessments consist of premiums paid by FDIC-insured institutions. The assessments are based on statutory and risk classification factors. FDIC assessments decreased during the six months ended June 30, 2014 mainly due to a reduction in the Bank's risk rating over that period. Software licensing decreased during the three months ended June 30, 2014, primarily due to migration to a hosted computer environment with our primary computer vendor during the fourth quarter of 2013. Legal and professional fees decreased during the six months ended June 30, 2014 due to a decrease in consultant expenses over the same period last year, which included one-time set-up fees associated with the migration of Mid Penn's core banking data from an in-house environment to a service bureau hosted platform. (Gain) loss on sale/write-down of foreclosed assets decreased during the three and six months ended June 30, 2014 versus the same periods in 2013 due to the write-down of foreclosed assets as a result of updated appraisals on subject properties within the portfolio and the recognition of a substantial gain on the sale of a property during the second quarter of 2013. Other expenses increased during the three months ended June 30, 2014 versus the same period in 2013 primarily due to a migration to a per item cost structure associated with the transition to a hosted computer environment with our primary computer vendor during the fourth quarter of 2013.

## Income Taxes

The provision for income taxes was \$475,000 for the three months ended June 30, 2014, as compared to the provision for income taxes of \$292,000 in the same period last year. The effective tax rate for the three months ended June 30, 2014, was 21.8% compared to 17.6% for the three months ended June 30, 2013. The provision for income taxes for

the six months ended June 30, 2014 was \$845,000, as compared to \$384,000 during the same period in 2013. The effective tax rate for the six months ended June 30, 2014 was 20.8% compared 15.8% for the six months ended June 30, 2013. This increase is mainly due to Mid Penn's strong earnings in 2014 coupled with tax-exempt interest representing a smaller percentage of pre-tax income as compared to the same period last year. Generally, our effective tax rate is below the statutory rate due to earnings on tax-exempt loans, investments, and bank-owned life insurance, as well as the impact of tax credits. The realization of deferred tax assets is dependent on future earnings. Mid Penn currently anticipates that future earnings will be adequate to fully utilize deferred tax assets.

## Financial Condition

### Loans

During the first six months of 2014, Mid Penn experienced an increase in loans outstanding of \$2,153,000, or 0.4%. Commercial real estate accounted for the majority of the growth while balances in the residential portfolio declined due to weaker demand in the mortgage market.

(Dollars in thousands)	June 30, 2014		December 31, 2013	
	Amount	%	Amount	%
Commercial real estate, construction and land development	\$ 280,852	51.2%	\$ 274,279	50.2%
Commercial, industrial and agricultural	107,410	19.6%	107,492	19.7%
Residential mortgage	156,535	28.5%	160,294	29.3%
Consumer	3,818	0.7%	4,397	0.8%
	\$ 548,615	100.0%	\$ 546,462	100.0%

## MID PENN BANCORP, INC.

Most of Mid Penn's lending activities are with customers located within the trading area of Dauphin County, lower Northumberland County, western Schuylkill County and eastern Cumberland County, Pennsylvania. This region currently, and historically, has lower unemployment than the U.S. as a whole. This is due in part to a diversified manufacturing and services base and the presence of state government offices which help shield the local area from national trends. At June 30, 2014, the unadjusted unemployment rate for the Harrisburg/Carlisle area was 4.9% versus the seasonally adjusted national unemployment rate of 6.1%.

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

During the first six months of 2014, Mid Penn had net charge-offs of \$1,009,000 compared to net charge-offs of \$152,000 during the same period of 2013. Loans charged off during the first six months of 2014 were comprised of 13 commercial real estate loans spread among eight unrelated relationships totaling \$862,000, three residential real estate loans to unrelated borrowers totaling \$86,000, one home equity loan for \$43,000, one commercial and industrial loan for \$41,000, and five consumer loans to unrelated borrowers totaling \$23,000. The remaining \$3,000 was comprised of deposit account charge-offs. Mid Penn may need to make future adjustments to the allowance and the provision for loan and lease losses if economic conditions or loan credit quality differs substantially from the assumptions used in making Mid Penn's evaluation of the level of the allowance for loan losses as compared to the balance of outstanding loans.

Changes in the allowance for loan and lease losses for the six months ended June 30, 2014 and 2013 are summarized as follows:

(Dollars in thousands)	Six Months Ended June 30,	
	2014	2013
Average total loans outstanding (net of unearned interest)	\$ 546,706	\$ 489,282
Period ending total loans outstanding (net of unearned interest)	548,615	518,658
Balance, beginning of period	6,317	5,509
Loans charged off during period	(1,058)	(280)
Recoveries of loans previously charged off	49	128
Net chargeoffs	(1,009)	(152)
Provision for loan and lease losses	822	910
Balance, end of period	\$ 6,130	\$ 6,267
Ratio of net loans charged off to average loans outstanding (annualized)	0.37%	0.06%

Ratio of allowance for loan losses to net loans at end of period	1.12%	1.21%
--	-------	-------

Other than as described herein, Mid Penn does not believe there are any trends, events or uncertainties that are reasonably expected to have a material impact on future results of operations, liquidity, or capital resources. Further, based on known information, Mid Penn believes that the effects of current and past economic conditions and other unfavorable business conditions may influence certain borrowers' abilities to comply with their repayment terms. Mid Penn continues to monitor closely the financial strength of these borrowers. Mid Penn does not engage in practices which may be used to artificially shield certain borrowers from the negative economic or business cycle effects that may compromise their ability to repay. Mid Penn does not normally structure construction loans with interest reserve components. Mid Penn has not in the past performed any commercial real estate or other type loan workouts whereby an existing loan was restructured into multiple new loans. Also, Mid Penn does not extend loans at maturity solely due to the existence of guarantees, without recognizing the credit as impaired. While the existence of a guarantee may be a mitigating factor in determining the proper level of allowance once impairment has been identified, the guarantee does not affect the impairment analysis.



## MID PENN BANCORP, INC.

At June 30, 2014, total nonperforming loans amounted to \$11,090,000, or 2.02% of loans and leases net of unearned income, as compared to levels of \$11,710,000, or 2.14%, at December 31, 2013 and \$16,885,000, or 3.26%, at June 30, 2013.

(Dollars in thousands)

	June 30, 2014	December 31, 2013	June 30, 2013
Nonperforming Assets:			
Nonaccrual loans	\$ 8,826	\$ 10,877	\$ 16,003
Accruing troubled debt restructured loans	2,264	833	882
Total nonperforming loans	11,090	11,710	16,885
Foreclosed real estate	1,083	965	1,030
Total non-performing assets	12,173	12,675	17,915
Accruing loans 90 days or more past due	-	-	-
Total risk elements	\$ 12,173	\$ 12,675	\$ 17,915
Nonperforming loans as a % of total loans outstanding	2.02%	2.14%	3.26%
Nonperforming assets as a % of total loans outstanding and other real estate	2.21%	2.32%	3.45%
Ratio of allowance for loan losses to nonperforming loans	55.28%	53.94%	41.60%

In the table above, loans renegotiated with borrowers represent Mid Penn's accruing troubled debt restructured loans. Troubled debt restructured loans that are no longer accruing interest are included in nonaccrual loans.

Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact and is not treated as a restructured credit. The following table provides additional analysis of partially charged-off loans.

(Dollars in thousands)

	June 30, 2014	December 31, 2013
Period ending total loans outstanding (net of unearned interest)	\$ 548,615	\$ 546,462

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

Allowance for loan and lease losses	6,130	6,317
Total Nonperforming loans	11,090	11,710
Nonperforming and impaired loans with partial charge-offs	2,704	2,103
Ratio of nonperforming loans with partial charge-offs to total loans	0.49%	0.38%
Ratio of nonperforming loans with partial charge-offs to total nonperforming loans	24.38%	17.96%
Coverage ratio net of nonperforming loans with partial charge-offs	73.10%	65.75%
Ratio of total allowance to total loans less nonperforming loans with partial charge-offs	1.12%	1.16%

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

Mid Penn considers a commercial loan or commercial real estate loan to be impaired when it becomes 90 days or more past due and not in the process of collection. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would be considered collateral dependent as the discounted cash flow (“DCF”) method indicates no operating income is available for evaluating the collateral position; therefore, all 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

## MID PENN BANCORP, INC.

results of the evaluation. In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. If the loan is secured, it will undergo a 90 day waiting period to ensure the collateral shortfall identified in the evaluation is accurate and then charged down by the specific allocation. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). 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 and a 90-day waiting period begins to ensure the accuracy of the collateral shortfall. The loan is then charged down by the specific allocation. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans are recommended for charge-off after reaching delinquency of 90 days and the loan is not in the process of collection. The entire balance 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 prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact (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.

By definition, troubled debt restructurings are considered impaired. Impairment for troubled debt restructured loans still accruing interest is tested each quarter for both the most effective impairment method to be utilized, and the level of impairment. As of June 30, 2014, there were seven accruing troubled debt restructured loans among six relationships. Five loans to unrelated borrowers represented \$782,000 in accruing troubled debt restructurings evaluated for impairment using the estimated fair value of the collateral securing the loan, while the remaining two accruing troubled debt restructurings representing \$1,482,000, were evaluated for impairment using the discounted cash flow methodology. As of December 31, 2013, there were five accruing troubled debt restructured loans to unrelated borrowers representing \$833,000. All five loans were evaluated for impairment using the estimated value of the collateral securing the loans.

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate within 30 days of the credit being classified as substandard non-accrual. Prior to receipt of the updated real estate valuation Mid Penn will use the most current existing real estate valuation to determine any potential allowance issues; however no allowance recommendation will be made until which time Mid Penn is in receipt of the updated valuation. The credit department employs an electronic tracking system to monitor the receipt of and need for updated appraisals. To date, there have been no significant time lapses noted with the above processes.

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

For impaired loans with no valuation allowance required, Mid Penn's practice of obtaining independent third party market valuations on the subject property within 30 days of being placed on non-accrual status sometimes indicates that the loan to value ratio is sufficient to obviate the need for a specific allocation in spite of significant deterioration in real estate values in Mid Penn's primary market area. These circumstances are determined on a case by case analysis of the impaired loans.

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

Mid Penn does not currently, or plan in the future to, use automated valuation methodologies as a method of valuing real estate collateral.

MID PENN BANCORP, INC.

As of June 30, 2014, Mid Penn had several loan relationships, with an aggregate carrying balance of \$10,511,000, deemed impaired. This group of loans is further broken down into a group of loans with an aggregate carrying balance of \$7,219,000 for which specific allocations totaling \$1,232,000 have been included within the allowance for loan and lease losses. The remaining \$3,292,000 of loans requires no specific allocation within the loan loss reserve. The \$10,511,000 of impaired loan relationships is comprised of \$8,538,000 in real estate secured commercial relationships and \$1,973,000 in business relationships. There are specific allocations against the real estate secured group totaling \$978,000, spread among 7 loans to unrelated borrowers. Two large loans to commercial borrowers account for \$381,000 and \$217,000 of the specific allocation against real estate secured loans, while the other five loans account for the remaining \$380,000. The group of impaired business relationships with specific allocations consists of four loans among three relationships with \$254,000 in specific allocations set aside against these credits. One large commercial participation relationship comprised of two loans is responsible for a specific allocation of \$191,000 of the total pool attributable to this segment. Management currently believes that the specific reserves are adequate to cover foreseeable probable 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 an integral part of the examination process.

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 local, regional, and national economic and business conditions affecting the collectability of the portfolio, the values of underlying collateral, and 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 loans.
- Changes in the experience, ability, and depth of lending management and other relevant staff as well as the quality of the institution's loan review system.
- Changes in the nature and volume of the portfolio and the terms of loans generally offered.

- 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 for covering estimated losses in the loan and lease portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance for loan and lease losses of \$6,130,000 is adequate as of June 30, 2014.

### Liquidity

Mid Penn's objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and to provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity provides resources for credit needs of borrowers, for depositor withdrawals and for funding corporate operations. Sources of liquidity are as follows:

- A growing core deposit base;
- Proceeds from the sale or maturity of investment securities;
- Proceeds from interest-bearing time deposits with other financial institutions;
- Payments received on loans and mortgage-backed securities;
- Overnight correspondent bank borrowings on various credit lines; and,
- Borrowing capacity available from the FHLB.

MID PENN BANCORP, INC.

Major sources of cash in the first six months of 2014 came from the increase in demand deposits and savings accounts totaling \$28,313,000, proceeds from long-term debt borrowings of \$10,000,000, and the sale of investment securities of \$7,199,000.

Major uses of cash in the first six months of 2014 were the purchases of investment securities of \$30,111,000 and the decrease in short-term borrowings of \$16,213,000.

Major sources of cash in the first six months of 2013 came from the maturities of investment securities and interest-bearing time deposits with other financial institutions totaling \$34,820,000 and the increase in short-term borrowings of \$27,512,000.

Major uses of cash in the first six months of 2013 were the increase in net loans and leases of \$35,852,000, the purchases of investment securities of \$13,715,000, the decrease in time deposits of \$12,812,000, and the repayment of long-term debt borrowings of \$10,776,000.

Mid Penn believes its core deposits are stable even in periods of changing interest rates. Liquidity is measured and monitored daily, allowing management to better understand and react to balance sheet trends. These measurements indicate that liquidity generally remains stable and exceeds our minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events, or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way.

On a quarterly basis, a comprehensive liquidity analysis is reviewed by the Asset Liability Committee and Board of Directors. The analysis provides a summary of the current liquidity measurements, projections, and future liquidity positions given various levels of liquidity stress. Management also maintains a detailed Contingency Funding Plan designed to respond to an overall decline in the financial condition of the banking industry or a problem specific to Mid Penn.

#### Capital Resources

Shareholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The greater a corporation's capital resources, the more likely it is to meet its cash obligations and absorb unforeseen losses. Too much capital, however, indicates that not enough of the corporation's earnings have been invested in the continued growth of the business or paid to shareholders. The buildup makes it difficult for a corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital adequacy has been, and will

continue to be, of paramount importance.

Shareholders' equity increased during the six months ended June 30, 2014 by \$4,644,000, or 8.8%, from December 31, 2013. Capital has been positively impacted in 2014 by positive earnings available to common shareholders of \$3,043,000 and other comprehensive income of \$2,100,000. All of Mid Penn's investment securities are classified as available for sale, making this portion of the balance sheet more sensitive to the changing market value of investments. Accumulated other comprehensive income associated with the change in investment securities increased \$2,094,000 from December 31, 2013, and accounts for the majority of the change in accumulated other comprehensive income (loss).

Banks are evaluated for capital adequacy based on the ratio of capital to risk-weighted assets and total assets. The risk-based capital standards require all banks to have Tier 1 capital of at least 4.0% and total capital (including Tier 1 capital) of at least 8.0% of risk-weighted assets. The capital standard based on average assets, also known as the "leverage ratio", requires all, but the most highly-rated banks, to have Tier 1 capital of at least 4.0% of total average assets. At June 30, 2014, Mid Penn met the definition of a "well-capitalized" institution.



## MID PENN BANCORP, INC.

Mid Penn maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios as of June 30, 2014 and December 31, 2013.

(Dollars in thousands)	Capital Adequacy				To Be Well-Capitalized Under Prompt Corrective Action Provisions:	
	Actual: Amount	Ratio	Minimum Required: Amount	Capital Ratio	Amount	Ratio
<b>Corporation</b>						
As of June 30, 2014:						
Tier 1 Capital (to Average Assets)	\$ 55,259	7.6%	\$ 28,961	4.0%	\$ N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	55,259	10.3%	21,449	4.0%	N/A	N/A
Total Capital (to Risk Weighted Assets)	61,453	11.5%	42,898	8.0%	N/A	N/A
<b>Bank</b>						
As of June 30, 2014:						
Tier 1 Capital (to Average Assets)	\$ 55,148	7.6%	\$ 28,961	4.0%	\$ 36,201	5.0%
Tier 1 Capital (to Risk Weighted Assets)	55,148	10.3%	21,449	4.0%	32,173	6.0%
Total Capital (to Risk Weighted Assets)	61,342	11.4%	42,898	8.0%	53,622	10.0%
<b>Corporation</b>						
As of December 31, 2013:						
Tier 1 Capital (to Average Assets)	\$ 52,693	7.5%	\$ 28,031	4.0%	\$ N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	52,693	9.9%	21,234	4.0%	N/A	N/A
Total Capital (to Risk Weighted Assets)	59,100	11.1%	42,467	8.0%	N/A	N/A
<b>Bank</b>						
As of December 31, 2013:						
Tier 1 Capital (to Average Assets)	\$ 52,598	7.5%	\$ 28,041	4.0%	\$ 35,051	5.0%
Tier 1 Capital (to Risk Weighted Assets)	52,598	9.9%	21,234	4.0%	31,850	6.0%
Total Capital (to Risk Weighted Assets)	59,005	11.1%	42,467	8.0%	53,084	10.0%

## Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations begins January 1, 2015, while larger institutions (generally those with assets of \$250 billion or more) must begin compliance on January 1, 2014. The final rules call for the following capital requirements:

- A minimum ratio of common tier 1 capital to risk-weighted assets of 4.5%.
- A minimum ratio of tier 1 capital to risk-weighted assets of 6%.
  - A minimum ratio of total capital to risk-weighted assets of 8% (no change from the current rule).
- A minimum leverage ratio of 4%.

In addition, the final rules establishes a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will 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 will begin on January 1, 2016.

Under the proposed rules, accumulated other comprehensive income (AOCI) would have been included in a banking organization's common equity tier 1 capital. The final rules allow community banks to make a one-time election not to include these additional components of 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. The opt-out election must be made in the first call report or FR Y-9 series report that is filed after the financial institution becomes subject to the final rule.

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.

MID PENN BANCORP, INC.

The proposed rules would have modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposures into two categories in order to determine the applicable risk weight. In response to commenter concerns about the burden of calculating the risk weights and the potential negative effect on credit availability, the final rules do not adopt the proposed risk weights but retain the current risk weights for mortgage exposures under the general risk-based capital rules.

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 assts (MSAs) and certain deferred tax assets (DTAs) are subject to stricter limitations than those applicable under the current general risk-based capital rule. The new rules also increase the risk weights for past-due loans, certain risk weights and credit conversion factors.

#### Capital Purchase Program Participation

On December 19, 2008, Mid Penn entered into and closed a letter agreement with the United States Department of the Treasury (the "Treasury") pursuant to which the Treasury invested \$10,000,000 in Mid Penn under the Treasury's Capital Purchase Program (the "CPP"). Under the letter agreement, the Treasury received (1) 10,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock, \$1,000 liquidation preference ("Series A Preferred Stock"), and (2) warrants to purchase up to 73,099 shares of the Mid Penn common stock at an exercise price of \$20.52 per share (the "Warrants").

On December 28, 2012, Mid Penn entered into a letter agreement with the Treasury pursuant to which Mid Penn repurchased from the Treasury all 10,000 shares of the Series A Preferred Stock issued to the Treasury, which constitutes all of the issued and outstanding shares of Series A Preferred Stock. Mid Penn repurchased the Series A Preferred Stock for a purchase price equal to the aggregate liquidation amount of the Preferred Stock of \$10,000,000, plus accrued but unpaid dividends of \$59,722. All 10,000 shares of Series A Preferred Stock have subsequently been cancelled.

On January 23, 2013, Mid Penn entered into a letter agreement with the Treasury pursuant to which Mid Penn repurchased from the Treasury on that date the Warrants for \$58,479. The Warrants have subsequently been cancelled.

As of the date hereof, Mid Penn has no further financial obligations under the Series A Preferred Stock, the Warrants, or the Treasury's CPP.

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

There has been no material change in market risk since December 31, 2013, as reported in Mid Penn's Form 10-K filed with the SEC on March 21, 2014.

### ITEM 4 – CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Mid Penn maintains controls and procedures designed to ensure that information required to be disclosed in the reports that Mid Penn files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of June 30, 2014, Mid Penn's management, with the participation of the Principal Executive Officer and Principal Financial and Accounting Officer, concluded that the disclosure controls and procedures were effective as of such date.

#### Changes in Internal Controls

During the three months ended June 30, 2014, there were no changes in Mid Penn's internal control over financial reporting, that have materially affected, or are reasonable likely to materially affect, Mid Penn's internal control over financial reporting.

MID PENN BANCORP, INC.

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of Mid Penn or its subsidiaries taken as a whole. There are no proceedings pending other than ordinary routine litigation occurring in the normal course of business. In addition, management does not know of any material proceedings contemplated by governmental authorities against Mid Penn or any of its properties.

ITEM 1A – RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2013. There are no material changes from the risk factors as previously disclosed in the Form 10-K.

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 - MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5 – OTHER INFORMATION

None

ITEM 6 – EXHIBITS

- Exhibit 3(i) – The Registrant’s amended Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to Registrant’s Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 11, 2009.)
- Exhibit 3(ii) – Statement with Respect to Shares for Series B Preferred Stock. (Incorporated by reference to Exhibit 3.1 to Registrant’s Current Report on Form 8-K as filed with the Securities and Exchange Commission on September 28, 2012.)
- Exhibit 3(iii) – The Registrant’s By-laws (Incorporated by reference to Exhibit 3(ii) to Registrant’s Current Report on form 8-K filed with the Securities and Exchange Commission on August 30, 2010.)
- Exhibit 11 – Statement re: Computation of Per Share Earnings. (Incorporated by reference to Part I Item 1 of this Quarterly Report on Form 10-Q.)
- Exhibit 31.1 – Certification of Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31.2 - Certification of Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32 – Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 101.LAB – XBRL Taxonomy Extension Label Linkbase
- Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase
- Exhibit 101.INS – XBRL Instance Document
- Exhibit 101.SCH – XBRL Taxonomy Extension Schema
- Exhibit 101.CAL – XBRL Taxonomy Extension Calculation Linkbase
- Exhibit 101.DEF – XBRL Taxonomy Extension Definition Linkbase



MID PENN BANCORP, INC.

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Mid Penn Bancorp, Inc.

(Registrant)

By: /s/ Rory G. Ritrievi  
Rory G. Ritrievi  
President and CEO  
(Principal Executive Officer)

Date: August 14, 2014

By: /s/ Edward P. Williams  
Edward P. Williams  
Interim Principal Financial Officer

Date: August 14, 2014



MID PENN BANCORP, INC.

43

---