MID PENN BANCORP INC
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania (State or Other Jurisdiction of	25-1666413 (I.R.S. Employer
Incorporation or Organization)	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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files) Yes No

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company

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

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

As of November 6, 2018, the registrant had 8,457,023 shares of common stock outstanding.

MID PENN BANCORP, INC.

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

MID PENN BANCORP, INC.

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)	September 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$ 31,110	$ 19,795
Interest-bearing balances with other financial institutions	5,241	3,028
Federal funds sold	25,734	691
Total cash and cash equivalents	62,085	23,514
Investment securities available for sale, at fair value	110,527	93,465
Investment securities held to maturity, at amortized cost (fair value $167,120 and $100,483)	171,521	101,356
Loans held for sale	3,181	1,040
Loans and leases, net of unearned interest	1,567,286	910,404
Less: Allowance for loan and lease losses	(8,229)	(7,606)
Net loans and leases	1,559,057	902,798
Bank premises and equipment, net	25,467	16,168
Cash surrender value of life insurance	16,610	13,042
Restricted investment in bank stocks	3,373	4,384
Foreclosed assets held for sale	1,101	189
Accrued interest receivable	7,491	4,564
Deferred income taxes	4,432	1,888
Goodwill	62,767	3,918
Core deposit and other intangibles, net	7,708	434
Other assets	8,960	3,594
Total Assets	$ 2,044,280	$ 1,170,354
LIABILITIES & SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	$ 271,142	$ 163,714
Interest-bearing demand	438,928	349,241
Money Market	356,729	246,220
Savings	224,746	62,770
Time	470,920	201,623

Total Deposits	1,762,465	1,023,568
Short-term borrowings	1,771	34,611
Long-term debt	18,064	12,352
Subordinated debt	27,088	17,338
Accrued interest payable	2,262	645
Other liabilities	10,795	6,137
Total Liabilities	1,822,445	1,094,651
Shareholders' Equity:		
Series D preferred stock, par value $1.00; liquidation value $1,000; authorized 3,404 shares;		
9% cumulative dividend; 3,404 and 0 shares issued and outstanding at September 30, 2018		
and December 31, 2017, respectively	3,404	—
Common stock, par value $1.00; authorized 10,000,000 shares; 8,457,023 and 4,246,216		
shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	8,457	4,242
Additional paid-in capital	177,421	40,970
Retained earnings	36,244	32,565
Accumulated other comprehensive loss	(3,691)	(2,074)
Total Shareholders’ Equity	221,835	75,703
Total Liabilities and Shareholders' Equity	$ 2,044,280	$ 1,170,354

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

MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
INTEREST INCOME				
Interest and fees on loans and leases	$17,715	$10,213	$41,125	$29,864
Interest on interest-bearing balances	26	5	52	12
Interest on federal funds sold	78	23	399	97
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	965	617	2,601	1,636
State and political subdivision obligations, tax-exempt	636	240	1,695	820
Other securities	163	52	411	159
Total Interest Income	19,583	11,150	46,283	32,588
INTEREST EXPENSE				
Interest on deposits	3,183	1,425	6,960	3,906
Interest on short-term borrowings	38	30	50	43
Interest on long-term and subordinated debt	451	179	1,070	538
Total Interest Expense	3,672	1,634	8,080	4,487
Net Interest Income	15,911	9,516	38,203	28,101
PROVISION FOR LOAN AND LEASE LOSSES	100	—	225	225
Net Interest Income After Provision for Loan and Lease Losses	15,811	9,516	37,978	27,876
NONINTEREST INCOME				
Income from fiduciary activities	325	217	851	613
Service charges on deposits	242	175	667	554
Net gain on sales of investment securities	30	22	132	42
Earnings from cash surrender value of life insurance	76	65	205	196
Mortgage banking income	197	230	558	646
ATM debit card interchange income	317	233	908	689
Merchant services income	90	84	261	250
Net gain on sales of SBA loans	68	262	477	703
Other income	820	276	1,312	669
Total Noninterest Income	2,165	1,564	5,371	4,362
NONINTEREST EXPENSE				
Salaries and employee benefits	6,680	4,277	16,286	12,666
Occupancy expense, net	1,063	631	2,730	1,872
Equipment expense	579	398	1,531	1,149
Pennsylvania bank shares tax expense	131	170	473	500
FDIC Assessment	187	197	508	585
Legal and professional fees	272	218	752	584
Marketing and advertising expense	274	139	693	377
Software licensing	602	397	1,628	1,096
Telephone expense	177	120	480	379
Loss on sale or write-down of foreclosed assets	45	—	48	88

Intangible amortization	341	25	837	78
Merger and acquisition expense	3,039	243	4,955	467
Other expenses	1,874	1,145	5,268	3,479
Total Noninterest Expense	15,264	7,960	36,189	23,320
INCOME BEFORE PROVISION FOR INCOME TAXES	2,712	3,120	7,160	8,918
Provision for income taxes	548	871	1,213	2,330
NET INCOME	$2,164	$2,249	$5,947	$6,588
Series D preferred stock dividends	38	—	38	—
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$2,126	$2,249	$5,909	$6,588
PER COMMON SHARE DATA:				
Basic and Diluted Earnings Per Common Share	$0.28	$0.53	$0.89	$1.56
Cash Dividends Paid	$0.15	$0.13	$0.55	$0.49

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

MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(Dollars in thousands)	Three Months Ended September 30, 2018	2017
Net income	$2,164	$2,249
Other comprehensive (loss) income:		
Unrealized losses arising during the period on available-for-sale securities, net of income taxes of ($157) and ($1), respectively	(589)	(1)
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of ($6) and ($7), respectively (a)	(23)	(15)
Change in defined benefit plans, net of income taxes of $66 and ($2), respectively (b)	247	(3)
Reclassification adjustment for settlement gains on benefit plans, net of income taxes of ($25) and $0, respectively (c)	(92)	—
Total other comprehensive (loss)	(457)	(19)
Total comprehensive income	$1,707	$2,230

(Dollars in thousands)	Nine Months Ended September 30, 2018	2017
Net income	$5,947	$6,588
Other comprehensive (loss) income:		
Unrealized (losses) gains arising during the period on available-for-sale securities, net of income tax impact of ($730) and $956, respectively	(2,746)	1,858
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income tax impact of $(28) and $(14), respectively (a)	(104)	(28)
Change in defined benefit plans, net of income tax impact of $423 and ($2), respectively (b)	1,591	(7)

Reclassification adjustment for settlement gains on benefit plans, net of income taxes of ($104) and $0, respectively (c)	(393)	—
Total other comprehensive (loss) income	(1,652)	1,823
Total comprehensive income	$4,295	$8,411

(a) Amounts are included in net gain on sales of investment securities on the Consolidated Statements of Income as a separate element within total noninterest income.
(b) The change in defined benefit plans includes several components of net periodic benefit costs, including service costs, interest costs, expected return on plan assets, and amortization of prior service costs. Please reference Note 9 – Defined Benefit Plans, for the classification of these components on Consolidated Statements of Income.
(c) Amounts are included in other income on the Consolidated Statements of Income within total noninterest income.

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

MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

For the Nine Months Ended September 30, 2018 and 2017

(Dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, January 1, 2018	$ —	$ 4,242	$ 40,970	$ 32,565	$ (2,074)	$ 75,703
Impact of adoption of new accounting standard (a)	—	—	—	(44)	35	(9)
Balance at January 1, 2018, adjusted	—	4,242	40,970	32,521	(2,039)	75,694
Net income	—	—	—	5,947	—	5,947
Total other comprehensive loss, net of taxes	—	—	—	—	(1,652)	(1,652)
Series D preferred stock issued in connection with the First Priority acquisition	3,404	—	—	—	—	3,404
Series D preferred stock dividends	—	—	—	(38)		(38)
Common stock dividends declared	—	—	—	(2,186)	—	(2,186)
Common stock issued to Scottdale shareholders (1,878,827 shares) (b)	—	1,879	62,302	—	—	64,181
Common stock issued to First Priority shareholders (2,320,800 shares) (c)	—	2,321	73,801	—	—	76,122
Employee Stock Purchase Plan (2,640 shares)	—	2	82	—	—	84
Director Stock Purchase Plan (2,893 shares)		3	89	—	—	92
Restricted stock activity (9,647 shares)	—	10	177	—	—	187
Balance, September 30, 2018	$ 3,404	$ 8,457	$ 177,421	$ 36,244	$ (3,691)	$ 221,835
Balance, January 1, 2017	$ —	$ 4,233	$ 40,688	$ 28,399	$ (2,853)	$ 70,467
Net income	—	—	—	6,588	—	6,588
Total other comprehensive income, net of taxes	—	—	—	—	1,823	1,823
Common stock dividends declared	—	—	—	(1,653)	—	(1,653)
	—	3	73	—	—	76

Employee Stock Purchase Plan (2,747 shares)						
Director Stock Purchase Plan (714 shares)		1	20	—	—	21
Restricted stock activity (3,996 shares)	—	4	65	—	—	69
Balance, September 30, 2017	$ —	$ 4,241	$ 40,846	$ 33,334	$ (1,030)	$ 77,391

(a) Represents the impact of adopting Accounting Standard Update ASU 2016-01. See Note 4 to the consolidated financial statements for more information.

(b) Shares issued on January 8, 2018 as a result of the acquisition of The Scottdale Bank & Trust Company ("Scottdale"). See Note 3 to the consolidated financial statements for more information.

(c) Shares issued on July 31, 2018 as a result of the acquisition of First Priority Financial Corp. ("First Priority"). See Note 2 to the consolidated financial statements for more information.

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

MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)	Nine Months Ended September 30, 2018	2017
Operating Activities:		
Net Income	$5,947	$6,588
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	225	225
Depreciation	1,671	1,075
Amortization of intangibles	837	78
Net amortization (accretion) of security discounts/premiums	308	(770)
Gain on sales of investment securities	(132)	(42)
Earnings on cash surrender value of life insurance	(205)	(196)
Mortgage loans originated for sale	(35,437)	(33,500)
Proceeds from sales of mortgage loans originated for sale	33,854	34,327
Gain on sale of mortgage loans	(558)	(646)
SBA loans originated for sale	(6,061)	(8,902)
Proceeds from sales of SBA loans originated for sale	6,539	9,604
Gain on sale of SBA loans	(477)	(703)
Loss (gain) on disposal of property, plant, and equipment	70	(10)
Loss on sale or write-down of foreclosed assets	48	88
Stock compensation expense	187	69
Deferred income tax benefit	3,526	1,016
Decrease (increase) in accrued interest receivable	355	(231)
Increase in other assets	(4,400)	(1,311)
Increase in accrued interest payable	528	425
(Decrease) increase in other liabilities	(535)	2,288
Net Cash Provided By Operating Activities	6,290	9,472
Investing Activities:		
Proceeds from the sale of available-for-sale securities	155,626	52,314
Proceeds from the maturity or call of available-for-sale securities	15,483	7,046
Purchases of available-for-sale securities	(21,142)	(15,196)
Proceeds from the maturity or call of held-to-maturity securities	8,961	—
Purchases of held-to-maturity securities	(72,877)	(86,092)
Net cash received from acquisitions	72,616	—
Redemptions (purchases) of restricted investment in bank stock	3,345	(1,292)
Net increase in loans and leases	(75,111)	(63,400)
Proceeds from the sale of bank premises and equipment held for sale	—	2,201
Purchases of bank premises and equipment	(8,397)	(4,558)
Proceeds from the sale of foreclosed assets	194	136
Net Cash Provided by (Used In) Investing Activities	78,698	(108,841)
Financing Activities:		
Net increase in deposits	23,970	91,302

Net (decrease) increase in short-term borrowings	(67,165)	20,000
Common stock dividends paid	(3,246)	(1,653)
Employee Stock Purchase Plan	84	76
Director Stock Purchase Plan	92	21
Long-term debt repayment	(152)	(166)
Net Cash (Used In) Provided By Financing Activities	(46,417)	109,580
Net increase in cash and cash equivalents	38,571	10,211
Cash and cash equivalents, beginning of period	23,514	45,973
Cash and cash equivalents, end of period	$62,085	$56,184

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued)

(Dollars in thousands)	Nine Months Ended September 30, 2018	2017
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$6,463	$4,062
Income taxes paid	$225	$3,165
Supplemental Noncash Disclosures:		
Loan transfers to foreclosed assets held for sale	$1,018	$33

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

(Dollars in thousands)	Nine Months Ended September 30, 2018	2017
Assets Acquired:		
Securities	$177,016	$—
Loans	582,392	—
Restricted stock	2,334	—
Property and equipment	2,643	—
Foreclosed assets	136	—
Deferred income taxes	4,168	—
Accrued interest receivable	3,282	—
Core deposit intangible	7,976	—
Cash surrender value of life insurance	3,363	
Other assets	1,100	—
	$784,410	$—
Liabilities Assumed:		
Deposits	$714,927	$—
Borrowings	$49,939	
Accrued interest payable	1,089	—
Other liabilities	6,213	—
	$772,168	$—
Equity Assumed:		
Preferred stock	$3,404	$—
	$3,404	$—

(a) This disclosure includes the impact of both the acquisition of The Scottdale Bank and Trust Company, effective January 8, 2018, and the acquisition of First Priority Financial Corp., effective July 31, 2018. Please reference Notes 2 and 3 for more information.

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

(1) Basis of Presentation

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

Certain information and disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Mid Penn believes the information presented is not misleading and the disclosures are adequate. For comparative purposes, the September 30, 2017 and December 31, 2017 balances have been reclassified, when, and if necessary, to conform to the 2018 presentation. Such reclassifications had no impact on net income. The results of operations for interim periods are not necessarily indicative of operating results expected for the full year. In the opinion of management, all adjustments necessary for fair presentation of the periods presented have been reflected in the accompanying consolidated financial statements. All such adjustments are of a normal, recurring nature. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

On July 31, 2018, Mid Penn completed its acquisition of First Priority Financial Corp. ("First Priority"), pursuant to the previously announced Agreement and Plan of Merger dated as of January 16, 2018. First Priority was merged with and into Mid Penn, with Mid Penn being the surviving corporation. Refer to Note 2, Acquisition of First Priority Financial Corp., as well as the Company's Current Report on Form 8-K filed on August 1, 2018, for more information.

On January 8, 2018, Mid Penn completed its acquisition of The Scottdale Bank & Trust Company ("Scottdale"), a Pennsylvania bank and trust company, through the merger of Scottdale with and into Mid Penn Bank pursuant to the previously announced Agreement and Plan of Merger, dated as of March 29, 2017, among Mid Penn, Mid Penn Bank and Scottdale. Refer to Note 3, Acquisition of The Scottdale Bank & Trust Company, as well as the Company's Current Report on Form 8-K filed on January 8, 2018, for more information.

The comparability of the financial condition and results of operations as of and for the three and nine months ended September 30, 2018 and 2017, in general, have been materially impacted by the acquisitions of First Priority and Scottdale.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2018, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

(2) Acquisition of First Priority Financial Corp.

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

Pursuant to the merger agreement between Mid Penn and First Priority, the common shareholders of First Priority received 0.3481 shares of Mid Penn common stock for each share of First Priority common stock owned. Additionally, outstanding options to purchase First Priority common stock at the time of the merger were converted into the right to receive cash at a per-option value of $11.07 less the applicable exercise price, without interest. As a result of the acquisition, Mid Penn's fulfillment of the merger consideration requirements resulted in (i) the issuance of 2,320,800 shares of Mid Penn common stock, (ii) the payment $3,801,000 related to cashing out the stock options, and (iii) cash paid of $6,000 in lieu of fractional shares, resulting in a combined fair value of total consideration paid of $79,929,000.

The assets and liabilities of First Priority were recorded on the consolidated balance sheet of the Company at their estimated fair value as of July 31, 2018, and their results of operations have been included in the consolidated income statement of the Company since such date. First Priority has been fully integrated into Mid Penn; therefore, the amount of revenue and earnings of First Priority included in the consolidated income statement since the acquisition date is impracticable to provide.

Included in the purchase price was $39,659,000 of goodwill, a core deposit intangible of $2,832,000, and a trade name intangible of $205,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense related to the First Priority acquisition for the five years beginning 2018 through 2022 is estimated to be $215,000, $493,000, $442,000, $390,000, and $339,000 per year, respectively, and $953,000 in total for the five years after 2022.

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The allocation of the purchase price is as follows:

(Dollars in thousands)	
Assets acquired:	
Cash and cash equivalents	$11,398
Investment securities	62,977
Restricted stock	2,237
Loans	511,623
Goodwill	39,659
Core deposit intangible	2,832
Trade name intangible	205
Premises and equipment	1,147
Foreclosed assets	125
Deferred income taxes	3,118
Accrued interest receivable	2,293
Other assets	4,197
Total assets acquired	641,811
Liabilities assumed:	
Deposits	504,946
Borrowings	49,939
Accrued interest payable	1,073
Other liabilities	2,520
Total liabilities assumed	558,478
Equity acquired:	
Preferred stock	3,404
Total equity acquired and liabilities assumed	561,882
Consideration paid	$79,929
Cash paid	$3,807
Fair value of common stock issued	76,122

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

(Dollars in thousands)	
Total purchase price (consideration paid)	$79,929
Net assets acquired:	

Cash and cash equivalents	11,398
Investment securities	62,977
Restricted stock	2,237
Loans	511,623
Core deposit intangible	2,832
Trade name intangible	205
Premises and equipment	1,147
Foreclosed assets	125
Deferred income taxes	3,118
Accrued interest receivable	2,293
Other assets	4,197
Deposits	(504,946)
Borrowings	(49,939)
Accrued interest payable	(1,073)
Other liabilities	(2,520)
Preferred stock	(3,404)
	40,270
Goodwill	$39,659

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

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

(Dollars in thousands)	
Gross amortized cost basis at January 8, 2018	$521,644
Market rate adjustment	(3,023)
Credit fair value adjustment on pools of homogeneous loans	(6,742)
Credit fair value adjustment on impaired loans	(256)
Fair value of purchased loans at January 8, 2018	$511,623

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

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

(Dollars in thousands)	
Contractually required principal and interest at acquisition	$1,855
Contractual cash flows not expected to be collected (nonaccretable discount)	(858)
Expected cash flows at acquisition	997
Interest component of expected cash flows (accretable discount)	(125)
Fair value of acquired loans	$872

The following table presents pro forma information as if the merger between Mid Penn and First Priority had been completed on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn merged with First Priority at the beginning of 2017. The supplemental pro forma earnings for nine months ended September 30, 2018 excludes $3,661,000 of merger related costs related to the First Priority acquisition, which included approximately $1,475,000 of severance and retention bonus expenses. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, expense efficiencies, or other factors.

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net interest income after loan loss provision	$17,373	$11,089	$48,914	$41,480
Noninterest income	2,220	1,688	5,754	5,000
Noninterest expense	13,543	10,677	41,532	37,757
Net income	5,502	1,533	10,995	6,368
Net income per common share	0.70	0.25	1.49	0.97

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

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

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

income statement since the acquisition date is impracticable to provide.

Included in the purchase price was goodwill of $19,189,000 and a core deposit intangible of $4,940,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years’ digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. Core deposit intangible amortization expense related to the Scottdale acquisition for the five years beginning 2018 through 2022 is estimated to be $898,000, $808,000, $719,000, $629,000, and $539,000 per year, respectively, and $1,347,000 in total for the five years after 2022.

The allocation of the purchase price is as follows:

(Dollars in thousands)	
Assets acquired:	
Cash and cash equivalents	$67,817
Investment securities	114,039
Restricted stock	97
Loans	70,769
Goodwill	19,189
Core deposit intangible	4,940
Premises and equipment	1,496
Foreclosed assets	11

Deferred income taxes	1,050
Accrued interest receivable	989
Other assets	266
Total assets acquired	280,663
Liabilities assumed:	
Deposits	209,981
Accrued interest payable	16
Other liabilities	3,693
Total liabilities assumed	213,690
Consideration paid	$66,973
Cash paid	$2,792
Fair value of common stock issued	64,181

Accounting Standards Codification ("ASC") Topic 805, Business Combinations, allows for adjustments to goodwill for a period of up to one year after the merger date for information that becomes available that reflects circumstances at the merger date.

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

(Dollars in thousands)

Total purchase price (consideration paid)	$66,973
Net assets acquired:	
Cash and cash equivalents	67,817
Investment securities	114,039
Restricted stock	97
Loans	70,769
Core deposit intangible	4,940
Premises and equipment	1,496
Foreclosed assets	11
Deferred income taxes	1,050
Accrued interest receivable	989
Other assets	266
Deposits	(209,981)
Accrued interest payable	(16)
Other liabilities	(3,693)
	47,784
Goodwill	$19,189

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

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

(Dollars in thousands)

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

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

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

(Dollars in thousands)	
Contractually required principal and interest at acquisition	$2,586
Contractual cash flows not expected to be collected (nonaccretable discount)	(1,010)
Expected cash flows at acquisition	1,576
Interest component of expected cash flows (accretable discount)	(305)
Fair value of acquired loans	$1,271

The following table presents pro forma information as if the merger between Mid Penn Bank and Scottdale had been completed on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mid Penn Bank merged with Scottdale at the beginning of 2017. The supplemental pro forma earnings for the nine months ended September 30, 2018 exclude both (i) adjustments to estimate the eight day impact of Scottdale due to immateriality and impracticality and (ii) $1,294,000 of merger related costs incurred in 2018 related to the Scottdale acquisition, which included approximately $518,000 of severance and retention bonus expenses. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, expense efficiencies, or other factors.

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net interest income after loan loss provision	$15,811	$11,074	$37,978	$32,455
Noninterest income	2,165	1,658	5,371	4,729
Noninterest expense	15,232	9,411	34,895	28,759
Net income	2,196	2,424	7,109	6,150
Net income per common share	0.29	0.40	1.16	1.01

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

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

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

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

Mid Penn had no securities considered by management to be other-than-temporarily impaired as of September 30, 2018, December 31, 2017, or September 30, 2017, and did not record any securities impairment charges in the respective periods ended on these dates. Mid Penn does not consider the securities with unrealized losses on the respective dates to be other-than-temporarily impaired as the unrealized losses were deemed to relate to changes in interest rates, and not erosion of credit quality.

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

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The amortized cost, fair value, and unrealized gains and losses on investment securities at September 30, 2018 and December 31, 2017 are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2018				
Available-for-sale debt securities:				
U.S. Treasury and U.S. government agencies	$ 40,590	$ —	$ 2,640	$ 37,950
Mortgage-backed U.S. government agencies	41,677	-	1,490	40,187
State and political subdivision obligations	33,306	54	2,213	31,147
Corporate debt securities	1,250	-	7	1,243
Total available-for-sale debt securities	116,823	54	6,350	110,527
Held-to-maturity debt securities:				
U.S. Treasury and U.S. government agencies	16,480	5	261	16,224
Mortgage-backed U.S. government agencies	69,344	2	1,998	67,348
State and political subdivision obligations	84,154	19	2,157	82,016
Corporate debt securities	1,543	—	11	1,532
Total held-to-maturity debt securities	171,521	26	4,427	167,120
Total	$ 288,344	$ 80	$ 10,777	$ 277,647

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

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

Equity securities consist of Community Reinvestment Act funds and, as of September 30, 2018 and December 31, 2017, Mid Penn had $488,000 and $506,000, respectively, in equity securities recorded at fair value. Prior to January 1, 2018, equity securities were stated at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss, net of tax. At December 31, 2017, net unrealized gains of $44,000 had been recognized in accumulated other comprehensive loss. On January 1, 2018, with the adoption of ASU 2016-01, these unrealized gains and losses were reclassified out of accumulated other comprehensive loss and into retained earnings and subsequent changes in fair value are now recognized in net income and the fair value of securities is presented in other assets. No equity securities were sold during the three and nine months ended September 30, 2018.

Investment securities having a fair value of $240,070,000 at September 30, 2018 and $141,465,000 at December 31, 2017 were pledged to secure public deposits, some trust account holdings, and certain other borrowings.

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Gross realized gains and losses on sales of available-for-sale debt securities for the three and nine months ended September 30, 2018 and 2017 are shown in the table below.

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Realized gains	$ 30	$ 46	$ 141	$ 246
Realized losses	-	(24)	(9)	(204)
Net gains	$ 30	$ 22	$ 132	$ 42

The following tables present gross unrealized losses and fair value of debt security investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2018 and December 31, 2017.

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
September 30, 2018	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Available-for-sale debt securities:									
U.S. Treasury and U.S. government agencies	1	$484	$ 4	21	$37,466	$ 2,636	22	$37,950	$ 2,640
Mortgage-backed U.S. government agencies	12	18,385	360	18	21,777	1,130	30	40,162	1,490
State and political subdivision obligations	14	7,144	285	45	20,283	1,928	59	27,427	2,213
Corporate debt securities	1	993	7	—	—	—	1	993	7
Total temporarily impaired available-for-sale debt securities	28	27,006	656	84	79,526	5,694	112	106,532	6,350
Held-to-maturity debt securities:									
U.S. Treasury and U.S. government agencies	4	9,313	206	2	4,942	55	6	14,255	261
Mortgage-backed U.S. government agencies	35	49,974	1,279	12	16,406	719	47	66,380	1,998
State and political subdivision obligations	171	69,513	1,730	20	7,147	427	191	76,660	2,157
Corporate debt securities	1	1,532	11	—	—	—	1	1,532	11
	211	130,332	3,226	34	28,495	1,201	245	158,827	4,427

Total temporarily impaired held-to-maturity debt securities									
Total	239	$157,338	$ 3,882	118	$108,021	$ 6,895	357	$265,359	$ 10,777

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

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

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

At both September 30, 2018 and December 31, 2017, the majority of available-for-sale securities and held-to-maturity securities in an unrealized loss position were obligations of state and political subdivisions, U.S. Treasury and agency securities, and mortgage-backed U.S. government agencies.

The table below illustrates the maturity distribution of investment securities at amortized cost and fair value as of September 30, 2018.

(Dollars in thousands)	Available-for-sale		Held-to-maturity	
	Amortized	Fair	Amortized	Fair
September 30, 2018	Cost	Value	Cost	Value
Due in 1 year or less	$-	$-	$3,084	$3,080
Due after 1 year but within 5 years	19,586	18,828	15,466	15,163
Due after 5 years but within 10 years	43,451	40,271	82,415	80,337
Due after 10 years	12,109	11,241	1,212	1,192
	75,146	70,340	102,177	99,772
Mortgage-backed securities	41,677	40,187	69,344	67,348
	$116,823	$110,527	$171,521	$167,120

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(5) Loans and Allowance for Loan and Lease Losses

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

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

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

Commercial and Industrial

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

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

Commercial and industrial loans typically are made on the basis of the borrower’s ability to make repayment from the cash flow of the borrower’s business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself, which, in turn, is likely to be dependent upon the general economic environment. Mid Penn’s commercial and industrial loans are usually, but not always, secured by business assets and personal guarantees. However, the collateral securing the loans may depreciate over time, may be difficult to appraise, and may fluctuate in value based on the success of the business.

Commercial Real Estate and Commercial Real Estate - Construction

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

Residential Mortgage

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

In underwriting residential mortgage loans, the Bank evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by Mid Penn are appraised by independent fee appraisers. The Bank generally requires borrowers to obtain title insurance and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Bank generally contain a "due on sale" clause allowing the Bank to declare the unpaid principal balance due and payable upon the sale of the security property.

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

Consumer, Including Home Equity

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

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

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

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

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

Allowance for Loan and Lease Losses

The allowance for credit losses ("allowance") consists of (i) the allowance for loan and lease losses, and (ii) the reserve for unfunded lending commitments. The allowance for loan and lease losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated balance sheet. The reserve for unfunded lending commitments was $171,000 at September 30, 2018 and $105,000 at December 31, 2017. The allowance is increased by the provision for loan and lease losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

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

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

The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include changes in economic conditions, fluctuations in loan quality measures, changes in collateral values, changes in the experience of the lending staff and loan review systems, changes in lending policies and procedures (including underwriting standards), changes in the mix and volume of loans originated, the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio, shifting industry or portfolio concentrations, and other relevant factors.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Acquired Loans

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

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

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

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

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

The classes of the loan portfolio, summarized by the pass rating (net of deferred fees and costs of $443,000 as of September 30, 2018 and $464,000 as of December 31, 2017), and the classified ratings of special mention and substandard within Mid Penn's internal risk rating system as of September 30, 2018 and December 31, 2017, are as follows:

(Dollars in thousands) September 30, 2018	Pass	Special Mention	Substandard	Total
Commercial and industrial	$259,870	$2,106	$ 7,174	$269,150
Commercial real estate	801,897	1,917	9,008	812,822
Commercial real estate - construction	145,001	—	367	145,368
Lease financing	132	—	—	132
Residential mortgage	252,997	148	2,241	255,386
Home equity	73,753	—	96	73,849
Consumer	10,579	—	—	10,579
	$1,544,229	$4,171	$ 18,886	$1,567,286

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

Mid Penn had no loans classified as doubtful as of September 30, 2018 and December 31, 2017.

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Impaired loans by loan portfolio class as of September 30, 2018 and December 31, 2017 are summarized as follows:

	September 30, 2018			December 31, 2017		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	$—	$ —	$ —	$—	$ 13	$ —
Commercial real estate	2,033	2,553	—	3,424	4,056	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	832	940	—	760	877	—
Home equity	25	126	—	260	295	—
Consumer	—	—	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:						
Commercial and industrial	$28	$ 28	$ —	$—	$ —	$ —
Commercial real estate	1,456	1,456	—	555	555	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	1,264	1,264	—	306	306	—
Home equity	4	4	—	—	—	—
Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial and industrial	$4,527	$ 4,635	$ 489	$4,434	$ 4,460	$ 136
Commercial real estate	857	872	243	1,423	1,589	293
Commercial real estate - construction	367	370	38	487	492	100
Lease financing	—	—	—	—	—	—
Residential mortgage	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total Impaired Loans:						
Commercial and industrial	$4,555	$ 4,663	$ 489	$4,434	$ 4,473	$ 136
Commercial real estate	4,346	4,881	243	5,402	6,200	293
Commercial real estate - construction	367	370	38	487	492	100
Lease financing	—	—	—	—	—	—
Residential mortgage	2,096	2,204	—	1,066	1,183	—
Home equity	29	130	—	260	295	—
Consumer	—	—	—	—	—	—

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The average recorded investment of impaired loans and related interest income recognized for the three and nine months ended September 30, 2018 and 2017 are summarized as follows:

	Three Months Ended			
	September 30, 2018		September 30, 2017	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial and industrial	$ —	$ —	$ —	$ —
Commercial real estate	1,872	—	751	—
Commercial real estate - construction	—	—	42	—
Lease financing	—	—	—	—
Residential mortgage	780	11	847	—
Home equity	17	—	294	3
Consumer	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:				
Commercial and industrial	$ 24	$ —	$ —	$ —
Commercial real estate	1,470	7	570	—
Commercial real estate - construction	—	—	—	—
Lease financing	—	—	—	—
Residential mortgage	677	—	318	—
Home equity	1	—	—	—
Consumer	—	—	—	—
With an allowance recorded:				
Commercial and industrial	$ 4,425	$ —	$ 2,230	$ —
Commercial real estate	703	—	2,148	—
Commercial real estate - construction	367	—	487	—
Lease financing	—	—	—	—
Residential mortgage	—	—	66	—
Home equity	—	—	—	—
Consumer	—	—	—	—
Total Impaired Loans:				
Commercial and industrial	$ 4,449	$ —	$ 2,230	$ —
Commercial real estate	4,045	7	3,469	—
Commercial real estate - construction	367	—	529	—
Lease financing	—	—	—	—
Residential mortgage	1,457	11	1,231	—
Home equity	18	—	294	3
Consumer	—	—	—	—

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(Dollars in thousands)	Nine Months Ended September 30, 2018 Average Recorded Investment	Interest Income Recognized	September 30, 2017 Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial and industrial	$—	$ —	$16	$ —
Commercial real estate	3,040	3	551	279
Commercial real estate - construction	—	—	164	—
Lease financing	—	—	—	—
Residential mortgage	769	27	852	18
Home equity	148	—	184	5
Consumer	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:				
Commercial and industrial	$21	$ —	$—	$ —
Commercial real estate	1,365	23	682	110
Commercial real estate - construction	—	—	—	—
Lease financing	—	—	—	—
Residential mortgage	726	—	339	—
Home equity	—	—	—	—
Consumer	—	—	—	—
With an allowance recorded:				
Commercial and industrial	$4,424	$ —	$892	$ —
Commercial real estate	456	—	2,446	—
Commercial real estate - construction	367	—	390	—
Lease financing	—	—	—	—
Residential mortgage	—	—	53	—
Home equity	—	—	—	—
Consumer	—	—	—	—
Total Impaired Loans:				
Commercial and industrial	$4,445	$ —	$908	$ —
Commercial real estate	4,861	26	3,679	389
Commercial real estate - construction	367	—	554	—
Lease financing	—	—	—	—
Residential mortgage	1,495	27	1,244	18
Home equity	148	—	184	5
Consumer	—	—	—	—

Nonaccrual loans by loan portfolio class as of September 30, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)	September 30, 2018	December 31, 2017
Commercial and industrial	$ 4,555	$ 4,434
Commercial real estate	3,910	4,902
Commercial real estate - construction	367	487
Residential mortgage	1,490	492
Home equity	29	260
	$ 10,351	$ 10,575

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The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. As of September 30, 2018 and December 31, 2017, Mid Penn had no accruing loans past due greater than 90 days. The classes of the loan portfolio summarized by the past due status as of September 30, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands) September 30, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
Commercial and industrial	$-	$ 4	$4,302	$4,306	$264,816	$269,122
Commercial real estate	710	—	273	983	810,383	811,366
Commercial real estate - construction	—	—	367	367	145,001	145,368
Lease financing	—	—	—	—	132	132
Residential mortgage	409	—	290	699	253,423	254,122
Home equity	24	25	19	68	73,777	73,845
Consumer	—	18	—	18	10,561	10,579
Loans acquired with credit deterioration:						
Commercial and industrial	—	23	—	23	5	28
Commercial real estate	—	—	991	991	465	1,456
Commercial real estate - construction	—	—	—	—	-	-
Lease financing	—	—	—	—	-	-
Residential mortgage	—	—	237	237	1,027	1,264
Home equity	—	—	4	4	-	4
Consumer	—	—	—	—	-	-
Total	$1,143	$ 70	$6,483	$7,696	$1,559,590	$1,567,286

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

Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	$5,306	$612	$4,831	$10,749	$899,655	$ 910,404

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

(Dollars in thousands) As of, and for the three months ended, September 30, 2018	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, July 1, 2018	$2,120	$4,723	$146	$ -	$441	$420	$4	$ 335	$8,189
Charge-offs	(12)	(34)	-	-	(10)	-	(11)	-	(67)
Recoveries	-	2	-	-	-	-	5	-	7
Provisions	232	130	(12)	-	38	16	7	(311)	100
Ending balance, September 30, 2018	$2,340	$4,821	$134	$ -	$469	$436	$5	$ 24	$8,229

(Dollars in thousands) As of, and for the nine months ended, September 30, 2018	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, January 1, 2018	$1,795	$4,435	$178	$ -	$428	$423	$3	$ 344	$7,606
Charge-offs	(142)	(34)	(40)	-	(14)	(167)	(21)	-	(418)
Recoveries	1	807	-	-	-	-	8	-	816
Provisions	686	(387)	(4)	-	55	180	15	(320)	225
Ending balance,	2,340	4,821	134	-	469	436	5	24	8,229

September 30, 2018									
Individually evaluated for impairment	489	243	38	-	-	-	-	-	770
Ending balance: collectively evaluated for impairment	$ 1,851	$ 4,578	$ 96	$ -	$ 469	$ 436	$ 5	$ 24	$ 7,459
Loans receivables:									
Ending balance	$ 269,150	$ 812,822	$ 145,368	$ 132	$ 255,386	$ 73,849	$ 10,579	$ -	$ 1,567,286
Ending balance: individually evaluated for impairment	4,527	2,890	367	-	832	25	-	-	8,641
Ending balance: acquired with credit deterioration	28	1,456	-	-	1,264	4	-	-	2,752
Ending balance: collectively evaluated for impairment	$ 264,595	$ 808,476	$ 145,001	$ 132	$ 253,290	$ 73,820	$ 10,579	$ -	$ 1,555,893

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(Dollars in thousands) December 31, 2017	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Allowance for loan and lease losses:									
Beginning balance, January 1, 2017	$ 1,795	$ 4,435	$ 178	$ -	$ 428	$ 423	$ 3	$ 344	$ 7,606
individually evaluated for impairment	136	293	100	-	-	-	-	-	529
Ending balance: collectively evaluated for impairment	$ 1,659	$ 4,142	$ 78	$ -	$ 428	$ 423	$ 3	$ 344	$ 7,077
Loans receivable:									
Beginning balance, January 1, 2017	$ 188,033	$ 515,012	$ 62,336	$ 229	$ 99,033	$ 41,893	$ 3,868	$ -	$ 910,404
Individually evaluated for impairment	4,434	4,847	487	-	760	260	-	-	10,788
Acquired with credit deterioration	-	555	-	-	306	-	-	-	861
Ending balance: collectively evaluated for impairment	$ 183,599	$ 509,610	$ 61,849	$ 229	$ 97,967	$ 41,633	$ 3,868	$ -	$ 898,755

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(Dollars in thousands) As of, and for the three months ended, September 30, 2017	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Allowance for loan and lease losses:									
Beginning balance, July 1, 2017	$ 1,628	$ 4,981	$ 140	$ 1	$ 539	$ 404	$ 4	$ 16	$ 7,713
Charge-offs	-	(207)	-	-	(7)	(20)	(5)	-	(239)
Recoveries	5	22	-	-	-	-	1	-	28
Provisions	166	(326)	36	(1)	7	53	5	60	-
Ending balance, September 30, 2017	$ 1,799	$ 4,470	$ 176	$ -	$ 539	$ 437	$ 5	$ 76	$ 7,502

(Dollars in thousands) As of, and for the nine months ended, September 30, 2017	Commercial and industrial	Commercial real estate	Commercial real estate - construction	Lease financing	Residential mortgage	Home equity	Consumer	Unallocated	Total
Allowance for loan and lease losses:									
Beginning balance, January 1, 2017	$ 1,580	$ 4,323	$ 144	$ 1	$ 541	$ 379	$ 3	$ 212	$ 7,183
Charge-offs	(12)	(237)	-	-	(25)	(20)	(21)	-	(315)
Recoveries	11	383	-	-	4	5	6	-	409
Provisions	220	1	32	(1)	19	73	17	(136)	225
Ending balance, September 30, 2017	1,799	4,470	176	-	539	437	5	76	7,502
Individually evaluated for impairment	150	375	100	-	66	-	-	-	691

Ending balance: collectively evaluated for impairment	$ 1,649	$ 4,095	$ 76	$ -	$ 473	$ 437	$ 5	$ 76	$ 6,811
Loans receivables:									
Ending balance	$ 182,857	$ 490,603	$ 58,074	$ 259	$ 101,073	$ 40,350	$ 4,170	$ -	$ 877,386
Ending balance: individually evaluated for impairment	4,460	2,148	487	-	856	261	-	-	8,212
Ending balance: acquired with credit deterioration	-	569	-	-	315	-	-	-	884
Ending balance: collectively evaluated for impairment	$ 178,397	$ 487,886	$ 57,587	$ 259	$ 99,902	$ 40,089	$ 4,170	$ -	$ 868,290

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The recorded investments in troubled debt restructured loans at September 30, 2018 and December 31, 2017 are as follows:

(Dollars in thousands) September 30, 2018	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial and industrial	$ 4,110	$ 4,460	$ 4,303
Commercial real estate	2,940	2,841	2,229
Residential mortgage	677	675	522
Home equity	14	14	2
	$ 7,741	$ 7,990	$ 7,056

(Dollars in thousands) December 31, 2017	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial and industrial	$ 4,110	$ 4,460	$ 4,434
Commercial real estate	5,735	5,581	4,593
Residential mortgage	677	675	540
Home equity	14	14	4
	$ 10,536	$ 10,730	$ 9,571

Mid Penn entered into forbearance or modification 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 September 30, 2018 totaled $7,056,000, and included four loans totaling $524,000 representing accruing impaired loans to unrelated borrowers in compliance with the terms of the modification, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling $522,000 and one loan being an accruing impaired home equity loan of $2,000. The remaining $6,532,000 of troubled debt restructurings was attributable to ten loans among five relationships which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for $5,463,000 of the total $6,532,000 in nonaccrual impaired troubled debt restructured loans.

At December 31, 2017, Mid Penn’s troubled debt restructured loans totaled $9,571,000, and included four loans totaling $544,000 representing accruing impaired loans in compliance with the terms of the modification, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling $540,000, and one loan being an accruing impaired home equity loan of $4,000. The remaining $9,027,000 of troubled debt restructured loans is attributable to fifteen loans among seven relationships, which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for $7,284,000 of the $9,027,000 in nonaccrual impaired troubled debt restructured loans. As of December 31, 2017, there was $66,000 of charge-offs associated with troubled debt restructured loans while under a forbearance agreement. As of December 31, 2017, there were no defaulted troubled debt restructured loans, as all troubled debt restructured loans were current with respect to their associated forbearance agreements. There were also no defaults on troubled debt restructured loans within twelve months of restructure during 2017.

One nonaccrual commercial real estate relationship was modified as a troubled debt restructured loan during the three and nine months ended September 30, 2018. The pre-modification and post-modification recorded investment balances for this loan were $270,000. The loan was modified to require payments of interest only for a period of six months. No charge-offs were taken at the time of modification, and the September 30, 2018 recorded investment balance of this loan was $270,000.

Two troubled debt restructured loans were added during the three and nine months ended September 30, 2017. One nonaccrual impaired commercial and industrial troubled debt restructured loan was added as a result of the consolidation of four existing Mid Penn Bank loans with a pre-modification outstanding recorded investment of $4,110,000, as well as other obligations of $350,000 with the same borrower. This loan had a post-modification recorded investment of $4,460,000, and a September 30, 2017 recorded investment amount of $4,460,000. No charge-offs were taken at the time of modification. One nonaccrual impaired commercial real estate loan was added with a pre-modification outstanding recorded investment of $362,000, a post-modification recorded investment of $300,000, and a September 30, 2017 recorded investment amount of $299,000. This modification consolidated two existing Mid Penn Bank loans.

As a result of management evaluations as of September 30, 2018, December 31, 2017, and September 30, 2017, any specific allocations and charge-offs have been taken as deemed appropriate. There were no charge-offs associated with existing troubled debt restructured loan relationships for the three or nine months ended September 30, 2018. There were no troubled debt restructured loans that defaulted within twelve months of restructure during the three and nine months ended September 30, 2018 and 2017.

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As of September 30, 2018, Mid Penn had $1,027,000 of residential real estate held in other real estate owned. There were four consumer mortgage loans secured by residential real estate properties totaling $193,000 for which formal foreclosure proceedings were in process. As of December 31, 2017, Mid Penn had $42,000 of residential real estate held in other real estate owned, and $308,000 in loans for which formal foreclosure proceedings were in process.

The following tables provide activity for the accretable yield of acquired impaired loans from the Phoenix Bancorp, Inc. (2015), Scottdale (January 2018), and First Priority (July 2018) acquisitions for the three and nine months ended September 30, 2018.

(Dollars in thousands)

Accretable yield, July 1, 2018	$300
Acquisition of impaired loans	125
Accretable yield amortized to interest income	(61)
Reclassification from nonaccretable difference (a)	-
Accretable yield, September 30, 2018	$364

(Dollars in thousands)

Accretable yield, January 1, 2018	$67
Acquisition of impaired loans	$430
Accretable yield amortized to interest income	(133)
Reclassification from nonaccretable difference (a)	-
Accretable yield, September 30, 2018	$364

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

(6) 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.

Inputs to valuation techniques refer to the assumptions that market participants would use in measuring the fair value of an 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. 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).

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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 during the nine months ended September 30, 2018 or 2017.

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

(Dollars in thousands)		Fair value measurements at September 30, 2018 using:		
Assets:	Total carrying value at September 30, 2018	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	$ 37,950	$ -	$ 37,950	$ -
Mortgage-backed U.S. government agencies	40,187	-	40,187	-
State and political subdivision obligations	31,147	-	31,147	-
Corporate debt securities	1,243	-	1,243	-
Other assets:				
Equity securities	488	488	-	-
Loans held for sale	3,181	3,181	-	-
Total	$ 114,196	$ 3,669	$ 110,527	$ -

(Dollars in thousands)		Fair value measurements at December 31, 2017 using:		
Assets:	Total carrying value at December 31, 2017	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale securities:				
U.S. Treasury and U.S. government agencies	$ 38,730	$ -	$ 38,730	$ -
Mortgage-backed U.S. government agencies	25,831	-	25,831	-
State and political subdivision obligations	27,043	-	27,043	-
Corporate debt securities	1,355	-	1,355	-
Other assets:				
Equity securities	506	506	-	-
Loans held for sale	1,040	1,040	-	-

Total	$ 94,505	$ 1,546	$ 92,959	$ -

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 September 30, 2018 using:		
Assets:	Total carrying value at September 30, 2018	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired Loans	$ 4,995	$ -	$ -	$ 4,995
Foreclosed Assets Held for Sale	581	-	-	581
Mortgage Servicing Rights	107	-	-	107

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

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

(Dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements				
September 30, 2018	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
Impaired Loans	$ 4,995	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	26% - 100%	36%
Foreclosed Assets Held for Sale	581	Appraisal of collateral (a), (c)	Appraisal adjustments (b)	17% - 17%	17%
Mortgage Servicing Rights	107	Multiple of annual service fee	Estimated prepayment speed based on rate and term	70% - 100%	99%

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

(a) Fair value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not observable.

(b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal. Higher downward adjustments are caused by negative changes to the collateral or

conditions in the real estate market, actual offers or sales contracts received, or age of the appraisal.
(c) Includes qualitative adjustments by management and estimated liquidation expenses.

Mid Penn uses the following methodologies and assumptions 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.

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.

Held-to-Maturity Securities:

The fair values of held-to-maturity securities are based on a market approach using observable inputs such as benchmark yields and securities, reported trades, issuer spreads, current bids and offers, monthly payment information and collateral performance.

Loans Held for Sale:

The fair values of mortgage loans originated and intended for sale in the secondary market are carried at fair value, as determined by outstanding commitments from investors.

Impaired Loans (included in “Net Loans and Leases” in the following tables):

All performing troubled debt restructured loans and loans classified as nonaccrual are deemed to be impaired, and all of these loans are considered collateral dependent; therefore, all of Mid Penn’s impaired loans, whether reporting a specific allowance 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 nonaccrual. Prior to receipt of the updated real estate valuation, Mid Penn will use existing real estate valuations to determine any potential allowance for loan loss issues, and will update the allowance impact calculation upon receipt of the updated real estate valuation.

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

Mid Penn actively monitors the values of collateral on impaired loans. This monitoring may require the modification of collateral values, either in a positive or negative way, due to the passage of time or some other change in one or more valuation inputs. Collateral values for impaired loans will be reassessed by management at least every 12 months for possible revaluation by an independent third party.

Loans:

Loan fair values as of September 30, 2018 are estimated using an exit price approach, which incorporates discounts for credit risk and prepayment risk and considers the value indicated by current market expectations in the estimated fair value of the loan portfolio.

Loan fair values as of December 31, 2017 were calculated using the entrance price approach. Under this approach, variable rate loans that reprice frequently and which entail no significant changes in credit risk had a fair value approximating carrying value. The fair value of other loans was 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.

Long-term and Subordinated Debt:

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

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Commitments to Extend Credit and Letters of Credit:

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present creditworthiness 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 September 30, 2018 and December 31, 2017.

(Dollars in thousands)	September 30, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	$62,085	$62,085	$23,514	$23,514
Available-for-sale investment securities	110,527	110,527	93,465	93,465
Held-to-maturity investment securities	171,521	167,120	101,356	100,483
Loans held for sale	3,181	3,181	1,040	1,040
Net loans and leases	1,559,057	1,551,077	902,798	917,081
Restricted investment in bank stocks	3,373	3,373	4,384	4,384
Accrued interest receivable	7,491	7,491	4,564	4,564
Mortgage servicing rights	107	107	126	126
Financial liabilities:				
Deposits	$1,762,465	$1,759,822	$1,023,568	$1,026,830
Short-term borrowings	1,771	1,771	34,611	34,611
Long-term debt	18,064	15,544	12,352	11,692
Subordinated debt	27,088	27,256	17,338	17,358
Accrued interest payable	2,262	2,262	645	645
Off-balance sheet financial instruments:				
Commitments to extend credit	$-	$-	$-	$-
Financial standby letters of credit	-	-	-	-

The following tables present the carrying amount, fair value, and placement in the fair value hierarchy of Mid Penn's financial instruments as of September 30, 2018 and December 31, 2017. Carrying values approximate fair values for cash and cash equivalents, interest-bearing time balances with other financial institutions, loans held for sale, 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, not previously disclosed.

Fair Value Measurements

(Dollars in thousands) September 30, 2018	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial instruments - assets					
Held-to-maturity investment securities	$171,521	$167,120	$-	$167,120	$ -
Net loans and leases	1,559,057	1,551,077	-	-	1,551,077
Financial instruments - liabilities					
Deposits	$1,762,465	$1,759,822	$-	$1,759,822	$ -
Long-term debt	18,064	15,544	-	15,544	-
Subordinated debt	27,088	27,256	-	27,256	-

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(Dollars in thousands)			Fair Value Measurements		
December 31, 2017	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial instruments - assets					
Held-to-maturity investment securities	$101,356	$100,483	$-	$100,483	$ -
Net loans and leases	902,798	917,081	-	-	917,081
Financial instruments - liabilities					
Deposits	$1,023,568	$1,026,830	$-	$1,026,830	$ -
Long-term debt	12,352	11,692	-	11,692	-
Subordinated debt	17,338	17,358		17,358	

(7) Guarantees and Commitments

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 creditworthiness 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 $22,479,000 and $20,496,000 standby letters of credit outstanding as of September 30, 2018 and December 31, 2017, respectively. Mid Penn does not anticipate any losses because of these transactions. The amount of the liability as of September 30, 2018 and December 31, 2017 for payment under standby letters of credit issued was not material.

During the second quarter of 2018, Mid Penn entered into a commitment to purchase a limited partnership interest in a low-income housing project to construct thirty-seven apartments and common amenities in Dauphin County, Pennsylvania. All of the units are intended to qualify for Federal Low-Income Housing Tax Credits (“LIHTCs”) as provided for in Section 42 of the Internal Revenue Code of 1986, as amended. Mid Penn’s limited partner capital contribution commitment is $7,579,000, which will be paid in installments over the course of construction of the low-income housing facilities. The investment in the limited partnership will be reported in other assets on the Consolidated Balance Sheet and amortized over a ten year period. The project has been conditionally awarded $861,000 in annual LIHTCs by the Pennsylvania Housing Finance Agency, with a total anticipated LIHTC amount of $8,613,000 to be awarded to Mid Penn over the ten year amortization period. Mid Penn’s commitment to purchase the limited partnership interest is conditional upon (i) the review and approval of all closing documents, (ii) an opinion letter for tax counsel to the Partnership that the project qualifies for the LIHTCs, and (iii) review and approval by Mid Penn of other documents it may deem necessary. As of September 30, 2018, the total investment in the limited partnership was $1,472,000 and was reported in other assets on the Consolidated Balance Sheet.

(8) Subordinated Debt

Subordinated Debt Assumed July 2018 with the First Priority Acquisition

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

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

Subordinated Debt Issued December 2017

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

The 2017 Notes bear interest at a rate of 5.25% per year for the first five years and then float at the Wall Street Journal’s Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no times be less than 5.0%. Interest is payable semi-annually in arrears on January 15 and July 15 of each year, beginning on July 15, 2018, for the first five years after issuance and will be payable quarterly in arrears thereafter on January 15, April 15, July 15, and October 15. The 2017 Notes will mature on January 1, 2028 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 21, 2022, and prior to January 1, 2028. Additionally, Mid Penn may redeem the 2017 Notes in whole at any time, or in part from time to time, upon at least 30 days’ notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the 2017 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2017 Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended. In the event of a redemption described in the previous sentence, Mid Penn will redeem the 2017 Notes at 100% of the principal amount of the 2017 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

Holders of the 2017 Notes may not accelerate the maturity of the 2017 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar event of Mid Penn or Mid Penn Bank, its principal banking subsidiary.

Subordinated Debt Issued December 2015

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

The 2015 Notes bear interest at a rate of 5.15% per year for the first five years and then float at the Wall Street Journal’s Prime Rate plus 0.50%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 4.0%. Interest is payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, beginning on January 1, 2016. The 2015 Notes will mature on December 9, 2025 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 9, 2020, and prior to December 9, 2025. Additionally, Mid Penn may redeem the 2015 Notes in whole at any time, or in part from time to time, upon at least 30 days’ notice if: (i) a change or prospective change in law occurs that could prevent Mid Penn from deducting interest payable on the 2015 Notes for U.S. federal income tax purposes; (ii) an event occurs that precludes the 2015 Notes from being recognized as Tier 2 capital for regulatory capital purposes; or (iii) Mid Penn becomes required to register as an investment company under the Investment Company Act of 1940, as amended, in each case at 100% of the principal amount of the 2015 Notes, plus accrued and unpaid interest thereon to but excluding the date of redemption.

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

ASC Subtopic 835-30, Simplifying the Presentation of Debt Issuance Costs, requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability. The unamortized debt issuance costs associated with the 2015 Notes and the 2017 Notes were collectively $151,000 at September 30, 2018 and $162,000 at December 31, 2017.

(9) 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. Mid Penn also 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 and each plan uses a December 31 measurement date.

As a result of the acquisition of Scottdale on January 8, 2018, Mid Penn has assumed a noncontributory defined benefit pension plan covering certain former employees of Scottdale. Mid Penn contributed $600,000 to the defined benefit pension plan during the three and nine months ended September 30, 2018. A December 31 measurement date for the plan is used.

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

(Dollars in thousands)	Three Months Ended September 30, Pension Benefits 2018	2017	Other Benefits 2018	2017
Service cost	$82	$ 9	$1	$ 1
Interest cost	107	11	4	5
Expected return on plan assets	(106)	-	-	-
Amortization (accretion) of prior service cost	4	4	(5)	(6)
Settlement gain	(117)	-	-	-
Net periodic benefit (income) expense	$(30)	$ 24	$-	$ -

(Dollars in thousands)	Nine Months Ended September 30, Pension Benefits 2018	2017	Other Benefits 2018	2017
Service cost	$242	$ 26	$3	$3
Interest cost	322	32	13	15
Expected return on plan assets	(317)	-	-	-
Amortization (accretion) of prior service cost	13	11	(15)	(17)
Settlement gain	(497)	-	-	-
Net periodic benefit (income) expense	$(237)	$ 69	$1	$1

For the three and nine months ended September 30, 2018, service costs are reported as a component of salaries and employee benefits on the Consolidated Statements of Income, while interest costs, expected return on plan assets, amortization (accretion) of prior service cost, and settlement gain are reported as a component of other income. For the three and nine months ended September 30, 2017, service costs were reported as a component of salaries and employee benefits, while interest costs and accretion of prior service costs were reported as a component of other expense.

(10) Accumulated Other Comprehensive Loss

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

(Dollars in thousands)	Unrealized Loss	Defined Benefit Plans	Accumulated Other Comprehensive

	on Securities		Loss
Balance - September 30, 2018	$ (4,974)	$ 1,283	$ (3,691)
Balance - December 31, 2017	$ (2,159)	$ 85	$ (2,074)

(11) Preferred Stock

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

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

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

On November 5, 2018, the Federal Reserve Bank affirmed Mid Penn's request to redeem the Mid Penn Preferred Stock. Mid Penn intends to redeem all 3,404 of the issued and outstanding shares of Mid Penn Fixed Rate Cumulative Perpetual Preferred Stock, Series D during the fourth quarter of 2018. Please reference Note 16 – Subsequent Event, for more information.

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(12) Restricted Common Stock

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

Share-based compensation expense relating to restricted stock is recognized on a straight-line basis over the vesting periods of the awards and is a component of salaries and benefits expense. As of September 30, 2018, a total of 38,109 restricted shares were granted under the Plan, with 16,633 of the granted shares being vested, while the remaining 21,476 granted shares remain unvested. During the nine months ended September 30, 2018, 490 shares were forfeited due to the voluntary termination of an employee. No shares were forfeited during the three months ended September 30, 2018, or the three and nine months ended September 30, 2017. The Plan shares granted and vested resulted in $74,000 in compensation expense for the three months ended September 30, 2018, while $30,000 of share-based compensation expense was recorded for the three months ended September 30, 2017. Compensation expense related to the Plan was $187,000 for the nine months ended September 30, 2018, while it was $69,000 for the same period in 2017.

(13) Revenue Recognition

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

On January 1, 2018, Mid Penn adopted FASB ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU establishes principles for reporting information about the nature, timing, and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods and services to customers. ASU 2014-09 applies primarily to transactional-based non-interest income revenue streams and excludes mortgage banking income, earnings from cash surrender value of life insurance, and gains on SBA loans.

Mid Penn's non-interest income revenue streams of income from fiduciary activities, service charges on deposits, ATM debit charge interchange income, merchant service fees and components of other income are within the scope of Topic 606. Within these various non-interest income streams, Mid Penn enters into business contracts with customers to perform a variety of services. These services include, but are not limited to (i) agreed-upon tasks (e.g. initiating a wire transfer or trust and investment management services), (ii) service of standing ready to provide goods and services (e.g. letter of credit arrangements), and (iii) arranging for another party to transfer goods or services to a customer (e.g. check order fees). Typically, contracts are approved in writing, but can also be approved in accordance with other customary business practices. The majority of the performance obligations of Mid Penn are distinct and are satisfied at a point in time and typically the transaction prices are fixed and are documented in either a fee schedule, such as non-sufficient funds fees or wire fees, or calculated as a percentage of assets under management for trust and wealth management income streams. The transaction price is not recognized in revenue until the service has occurred, or monthly in arrears for assets under management. Mid Penn does not exercise significant judgements in the recognition of income, as typically income is not recognized until the performance obligation has been satisfied. Mid Penn has not recognized any assets from the costs to obtain or fulfill a contract with customers for revenue streams that fall within the guidance of Topic 606.

MID PENN BANCORP, INC.

(14) 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 periods presented. The following data show the amounts used in computing basic earnings per common share.

(Dollars in thousands, except per share data)	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Net income	$2,164	$2,249	$$5,947	$6,588
Less: Dividends on Series D preferred stock	38	-	38	-
Net income available to common shareholders	$2,126	$2,249	$5,909	$6,588
Weighted average common shares outstanding	7,695,469	4,237,965	6,604,027	4,236,604
Basic and diluted earnings per common share	$0.28	$0.53	$$0.89	$1.56

Weighted average shares outstanding increased for the three and nine months ended September 30, 2018 when compared to the same periods in 2017 primarily as a result of both (i) the issuance of 1,878,827 shares of Mid Penn common stock on January 8, 2018 in connection with the Scottdale acquisition, and (ii) the issuance of 2,320,800 shares of Mid Penn common stock on July 31, 2018 in connection with the First Priority acquisition. Mid Penn had no dilutive instruments outstanding during the periods ended September 30, 2018 and 2017.

(15) Recent Accounting Pronouncements

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

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

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

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

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

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

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

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

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

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

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

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

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

Mid Penn occupies certain offices under non-cancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. Mid Penn expects to recognize lease liabilities and ROU assets associated with these lease agreements as required by the ASU; however, the extent of the prospective impact on Mid Penn's consolidated financial statements and the materiality will be dependent upon the extent and type of lease arrangements involving Mid Penn at the time of the adoption of this standard. Mid Penn expects to adopt this standard by applying the transition provisions at the adoption date and utilize the practical expedients made available through ASU 2018-11. Mid Penn is currently gathering the data and information required to adopt the standard effective January 1, 2019.

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

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

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

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

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

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

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

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

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

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

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

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

(16) Subsequent Event

On November 5, 2018, the Federal Reserve Bank affirmed Mid Penn's request to redeem all 3,404 shares of Mid Penn Fixed Rate Cumulative Perpetual Preferred Stock, Series D. Mid Penn intends to redeem the preferred stock during the fourth quarter of 2018. Please reference Note 11 – Preferred Stock, for more information.

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 September 30, 2018, compared to year-end 2017, and the Results of Operations for the three and nine months ended September 30, 2018, compared to the same period in 2017. For comparative purposes, the September 30, 2018 and December 31, 2017 balances have been reclassified, when, and if necessary, to conform to the 2018 presentation. Such reclassifications had no impact on net income. This discussion should be read in conjunction with the financial tables, statistics, and the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Annual Report"). The results of operations for interim periods are not necessarily indicative of operating results expected for the full year.

Caution About Forward-Looking Statements

Forward-looking statements involve risks, uncertainties and assumptions. Although Mid Penn generally does not make forward-looking statements unless Mid Penn's management believes its management has a reasonable basis for doing so, Mid Penn cannot guarantee the accuracy of any forward-looking statements. Actual results may differ materially from those expressed in any forward-looking statements due to a number of uncertainties and risks, including the risks described in this Quarterly Report on Form 10-Q, the 2017 Annual Report, and other unforeseen risks. You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Quarterly Report on Form 10-Q, even if subsequently made available by us on Mid Penn's website or otherwise, and Mid Penn undertakes no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

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 potentially slowing or volatile 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;

- an increase in the Pennsylvania Bank Shares Tax to which Mid Penn Bank’s capital stock is currently subject, or imposition of any additional taxes on Mid Penn or Mid Penn Bank;
- impacts of the capital and liquidity requirements imposed by the Basel III standards and other regulatory pronouncements and rules;
- the effect of changes in accounting policies and practices, as may be adopted by the supervisory 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 and other funding sources, loan demand and yields, values of loan collateral, securities and yields, and interest rate protection agreements;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn’s market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- technological changes;
- our ability to implement business strategies, including our acquisitions of First Priority and Scottdale, and other business acquisition activities and organic branch, product and service expansion strategies;
- our current and future acquisition strategies may not be successful in locating or acquiring advantageous targets at favorable prices;
- our ability to successfully integrate any banks, companies, assets, liabilities, customers, systems and management personnel we acquire into our operations, including those related to our acquisitions of First Priority and Scottdale, and our ability to realize related revenue synergies and cost savings within expected time frames;
- potential goodwill impairment charges, future impairment charges and fluctuations in the fair values of reporting units or of assets in the event projected financial results are not achieved within expected time frames;
- our ability to attract and retain qualified management and personnel;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- results of regulatory examination and supervision processes;
- our ability to maintain compliance with the exchange rules of The NASDAQ Stock Market LLC;
- 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; disruptions due to flooding, severe weather, or other natural disasters or Acts of God; and
- volatility in the securities markets.

The above list of factors that may affect future performance is illustrative, but by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with this understanding of inherent uncertainty.

MID PENN BANCORP, INC.

Critical Accounting Estimates

Mid Penn's consolidated financial statements are prepared in accordance with generally accepted accounting principles 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 that we used are also based on historical experiences and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and estimates that we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations. Management of the Company considers the accounting judgments relating to the allowance, the evaluation of the Company's investment securities for other-than-temporary impairment, the valuation of the Company's goodwill and other merger-related intangible assets for impairment, and the valuation of assets acquired and liabilities assumed in business combinations, to be the accounting areas that require the most subjective and complex judgments.

The allowance represents management's estimate of probable incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance 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 securities 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.

Certain intangible assets generated in connection with acquisitions are periodically assessed for impairment. Goodwill is tested annually for impairment, and if certain events occur which indicate goodwill might be impaired between annual tests, goodwill must be tested when such events occur. In making this assessment, Mid Penn considers a number of factors including operating results, business plans, economic projections, anticipated future cash flows, current market data, stock price, etc. Similarly, the amortized basis of the core deposit intangible asset and trade name intangible are periodically assessed for impairment. There are inherent uncertainties related to these factors and Mid Penn's judgment in applying them to the analysis of core deposit intangible, trade name intangible, and goodwill impairment. Changes in economic and operating conditions could result in goodwill or core deposit intangible or trade name intangible impairment in future periods.

Valuations of assets acquired and liabilities assumed in business combinations are measured at fair value as of the acquisition date. In many cases, determining the fair value of the assets acquired and liabilities assumed requires Mid Penn to estimate cash flows expected to result from these assets and liabilities and to discount these cash flows at appropriate rates of interest, which require the utilization of significant estimates and judgment in accounting for the acquisition.

Results of Operations

Overview

Net income available to common shareholders was $2,126,000 or $0.28 per common share, for the quarter ended September 30, 2018, compared to net income of $2,249,000 or $0.53 per common share, for the quarter ended September 30, 2017. During the nine months ended September 30, 2018, net income available to common shareholders was $5,909,000 or $0.89 per common share, versus $6,588,000 or $1.56 per common share, for the nine months ended September 30, 2017.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Return on average assets	0.46%	0.81%	0.51%	0.81%
Return on average equity	4.34%	11.75%	4.94%	11.94%

The results for the three and nine months ended September 30, 2018 and 2017 included merger and acquisition expenses resulting from the acquisition of Scottdale, which was announced during the first quarter of 2017 and legally closed on January 8, 2018, and First Priority, which was announced on January 16, 2018 and legally closed on July 31, 2018. Please refer to Notes 2 and 3 to the consolidated financial statements under Item 1 for more information on Mid Penn's completed acquisitions of Scottdale and First Priority.

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 21 percent for the three and nine months ended September 30, 2018 and 34 percent for the three and nine months ended September 30, 2017. The decrease in the statutory rate to 21 percent, which became effective January 1, 2018, was a result of the Tax Cuts and Jobs Act enacted December 22, 2017.

The following tables include average balances, amounts, and rates of interest income and expense, interest rate spread, and net interest margin for the three and nine months ended September 30, 2018 and 2017.

MID PENN BANCORP, INC.

(Dollars in thousands)	Average Balances, Income and Interest Rates on a Taxable Equivalent Basis For the Three Months Ended September 30, 2018					September 30, 2017				
	Average Balance	Interest		Average Rates		Average Balance	Interest		Average Rates	
ASSETS:										
Interest Bearing Balances	$ 6,432	$ 26		1.60	%	$ 2,751	$ 5		0.72	%
Investment Securities:										
Taxable	174,938	1,073		2.43	%	132,926	639		1.91	%
Tax-Exempt	109,627	805	(a)	2.91	%	46,903	363	(a)	3.07	%
Total Securities	284,565	1,878		2.62	%	179,829	1,002		2.21	%
Federal Funds Sold	15,413	78		2.01	%	7,998	23		1.14	%
Loans and Leases, Net	1,398,731	17,786	(b)	5.04	%	866,972	10,314	(b)	4.72	%
Restricted Investment in Bank Stocks	3,675	55		5.94	%	3,173	31		3.88	%
Total Earning Assets	1,708,816	19,823		4.60	%	1,060,723	11,375		4.25	%
Cash and Due from Banks	31,570					24,227				
Other Assets	97,523					35,241				
Total Assets	$ 1,837,909					$ 1,120,191				
LIABILITIES & SHAREHOLDERS' EQUITY:										
Interest-bearing Demand	$ 383,550	667		0.69	%	$ 337,379	370		0.44	%
Money Market	333,777	836		0.99	%	242,485	364		0.60	%
Savings	209,673	179		0.34	%	63,159	9		0.06	%
Time	400,414	1,501		1.49	%	206,483	682		1.31	%
Total Interest-bearing Deposits	1,327,414	3,183		0.95	%	849,506	1,425		0.67	%
Short-term Borrowings	8,290	38		1.82	%	9,378	30		1.27	%
Long-term Debt	16,199	114		2.79	%	13,439	80		2.36	%
Subordinated Debt	23,537	337		5.68	%	7,420	99		5.29	%
Total Interest-bearing Liabilities	1,375,440	3,672		1.06	%	879,743	1,634		0.74	%
Noninterest-bearing Demand	256,917					156,274				
Other Liabilities	11,339					7,348				
Shareholders' Equity	194,213					76,826				
Total Liabilities & Shareholders' Equity	$ 1,837,909					$ 1,120,191				
Net Interest Income (taxable equivalent basis)		$ 16,151					$ 9,741			
Taxable Equivalent Adjustment		(240)					(225)			
Net Interest Income		$ 15,911					$ 9,516			
Total Yield on Earning Assets				4.60	%				4.25	%

Rate on Supporting Liabilities	1.06 %	0.74 %
Average Interest Spread	3.54 %	3.51 %
Net Interest Margin	3.75 %	3.64 %

(a) Includes tax-equivalent adjustments on interest from tax-free municipal securities of $169,000 and $124,000 for the three months ended September 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at September 30, 2018 and 2017, respectively.

(b) Includes tax-equivalent adjustments on interest from tax-free municipal loans of $71,000 and $101,000 for the three months ended September 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at September 30, 2018 and 2017, respectively.

MID PENN BANCORP, INC.

(Dollars in thousands on a Taxable Equivalent Basis)	Three months ended September 30, 2018 vs. 2017 Increase (decrease)		
	Volume	Rate	Net
INTEREST INCOME:			
Interest Bearing Balances	$7	$14	$21
Investment Securities:			
Taxable	202	232	434
Tax-Exempt	485	(43)	442
Total Securities	687	189	876
Federal Funds Sold	21	34	55
Loans and Leases, Net	6,326	1,146	7,472
Restricted Investment Bank Stocks	5	19	24
Total Interest Income	7,046	1,402	8,448
INTEREST EXPENSE:			
Interest Bearing Deposits:			
Interest Bearing Demand	51	246	297
Money Market	137	335	472
Savings	21	149	170
Time	641	178	819
Total Interest Bearing Deposits	850	908	1,758
Short-term Borrowings	(3)	11	8
Long-term Debt	16	18	34
Subordinated Debt	215	23	238
Total Interest Expense	1,078	960	2,038
NET INTEREST INCOME	$5,968	$442	$6,410

Taxable-equivalent net interest income was $16,151,000 for the three months ended September 30, 2018, an increase of $6,410,000 or 66 percent compared to the three months ended September 30, 2017. Net interest income in the third quarter of 2018 was positively impacted by the loans and investment securities acquired in the Scottdale and First Priority transactions.

For the three months ended September 30, 2018, Mid Penn's tax-equivalent net interest margin was 3.75% compared to 3.64% for the three months ended September 30, 2017, as increases in quarterly yields on earning assets, and increases in noninterest-bearing deposits, more than offset the impact of the rising cost of funds as a result of recent Federal Open Market Committee ("FOMC") rate increases, and the costs associated with the assumption of some higher-cost wholesale funding sources in the First Priority transaction.

MID PENN BANCORP, INC.

(Dollars in thousands)	Average Balances, Income and Interest Rates on a Taxable Equivalent Basis For the Nine Months Ended September 30, 2018					September 30, 2017				
	Average Balance	Interest		Average Rates		Average Balance	Interest		Average Rates	
ASSETS:										
Interest Bearing Balances	$ 4,993	$ 52		1.39	%	$ 2,559	$ 12		0.63	%
Investment Securities:										
Taxable	163,900	2,824		2.30	%	117,507	1,709		1.94	%
Tax-Exempt	100,305	2,145	(a)	2.86	%	50,621	1,242	(a)	3.28	%
Total Securities	264,205	4,969		2.51	%	168,128	2,951		2.35	%
Federal Funds Sold	31,327	399		1.70	%	13,288	97		0.98	%
Loans and Leases, Net	1,131,410	41,320	(b)	4.88	%	846,903	30,199	(b)	4.77	%
Restricted Investment in Bank Stocks	3,141	188		8.00	%	2,738	87		4.25	%
Total Earning Assets	1,435,076	46,928		4.37	%	1,033,616	33,346		4.31	%
Cash and Due from Banks	29,801					20,528				
Other Assets	78,126					34,596				
Total Assets	$ 1,543,003					$ 1,088,740				
LIABILITIES & SHAREHOLDERS' EQUITY:										
Interest-bearing Demand	$ 368,362	1,687		0.61	%	$ 332,233	940		0.38	%
Money Market	288,064	1,917		0.89	%	247,730	1,069		0.58	%
Savings	183,617	329		0.24	%	62,693	27		0.06	%
Time	277,239	3,027		1.46	%	194,884	1,870		1.28	%
Total Interest-bearing Deposits	1,117,282	6,960		0.83	%	837,540	3,906		0.62	%
Short-term Borrowings	3,775	50		1.77	%	4,656	43		1.23	%
Long-term Debt	13,598	263		2.59	%	13,496	241		2.39	%
Subordinated Debt	19,403	807		5.56	%	7,417	297		5.35	%
Total Interest-bearing Liabilities	1,154,058	8,080		0.94	%	863,109	4,487		0.70	%
Noninterest-bearing Demand	216,037					141,506				
Other Liabilities	12,849					10,095				
Shareholders' Equity	160,059					74,030				
Total Liabilities & Shareholders' Equity	$ 1,543,003					$ 1,088,740				
Net Interest Income (taxable equivalent basis)		$ 38,848					$ 28,859			
Taxable Equivalent Adjustment		(645)					(758)			
Net Interest Income		$ 38,203					$ 28,101			
Total Yield on Earning Assets				4.37	%				4.31	%

Rate on Supporting Liabilities	0.94	%	0.70	%
Average Interest Spread	3.44	%	3.61	%
Net Interest Margin	3.62	%	3.73	%

(a) Includes tax-equivalent adjustments on interest from tax-free municipal securities of $450,000 and $423,000 for the nine months ended September 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at September 30, 2018 and 2017, respectively.

(b) Includes tax-equivalent adjustments on interest from tax-free municipal loans of $195,000 and $335,000 for the nine months ended September 30, 2018 and 2017, respectively. Tax-equivalent adjustments were calculated using statutory tax rates of 21% and 34% at September 30, 2018 and 2017, respectively.

MID PENN BANCORP, INC.

(Dollars in thousands on a Taxable Equivalent Basis)	Nine months ended September 30, 2018 vs. 2017 Increase (decrease)		
	Volume	Rate	Net
INTEREST INCOME:			
Interest Bearing Balances	$11	$29	$40