Section 1: 10-Q (10-Q)

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, 2019

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	**25-1666413**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*
349 Union Street Millersburg, Pennsylvania	**17061**
(Address of Principal Executive Offices)	*(Zip Code)*

Registrant's telephone number, including area code **1.866.642.7736**

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $1.00 par value per share	MPB	The NASDAQ Stock Market LLC

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 7, 2019, the registrant had 8,478,461 shares of common stock outstanding.

FORM 10-Q

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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 wholly-owned banking subsidiary.

MID PENN BANCORP, INC.

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)	September 30, 2019	December 31, 2018
ASSETS		
Cash and due from banks	$ 54,756	$ 24,600
Interest-bearing balances with other financial institutions	4,393	4,572
Federal funds sold	101,730	10,893
Total cash and cash equivalents	160,879	40,065
Investment securities available for sale, at fair value	52,419	111,923
Investment securities held to maturity, at amortized cost (fair value $173,722 and $166,582)	170,472	168,370
Loans held for sale, at fair value	7,115	1,702
Loans and leases, net of unearned interest	1,710,434	1,624,067
Less: Allowance for loan and lease losses	(9,316)	(8,397)
Net loans and leases	1,701,118	1,615,670
Bank premises and equipment, net	23,357	25,303
Bank premises and equipment held for sale	1,274	—
Operating lease right of use asset	10,416	—
Finance lease right of use asset	3,492	—
Cash surrender value of life insurance	16,804	16,691
Restricted investment in bank stocks	6,105	6,646
Accrued interest receivable	8,414	8,244
Deferred income taxes	3,922	4,696
Goodwill	62,840	62,840
Core deposit and other intangibles, net	6,109	7,221
Foreclosed assets held for sale	130	1,017
Other assets	14,033	7,593
Total Assets	$ 2,248,899	$ 2,077,981
LIABILITIES & SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	$ 298,885	$ 269,870
Interest-bearing demand	465,745	384,834
Money Market	486,131	375,648
Savings	180,927	209,345
Time	458,405	486,329
Total Deposits	1,890,093	1,726,026
Short-term borrowings	12,000	43,100
Long-term debt	62,971	48,024
Subordinated debt	27,067	27,082
Operating lease liability	11,534	—
Accrued interest payable	2,823	2,262
Other liabilities	7,799	8,278
Total Liabilities	2,014,287	1,854,772
Shareholders' Equity:		
Common stock, par value $1.00 per share; 20,000,000 shares authorized; 8,478,461 shares issued and outstanding at September 30, 2019; 10,000,000 shares authorized, 8,459,918 shares issued and outstanding at December 31, 2018	8,478	8,460
Additional paid-in capital	177,994	177,565
Retained earnings	48,009	39,562
Accumulated other comprehensive income (loss)	131	(2,378)
Total Shareholders' Equity	234,612	223,209
Total Liabilities and Shareholders' Equity	$ 2,248,899	$ 2,077,981

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,	
	2019	2018	2019	2018
INTEREST INCOME				
Interest and fees on loans and leases	$ 22,573	$ 17,715	$ 65,865	$ 41,125
Interest on interest-bearing balances	23	26	80	52
Interest on federal funds sold	506	78	704	399
Interest and dividends on investment securities:				
U.S. Treasury and government agencies	701	965	2,433	2,601
State and political subdivision obligations, tax-exempt	495	636	1,698	1,695
Other securities	215	163	597	411
Total Interest Income	24,513	19,583	71,377	46,283
INTEREST EXPENSE				
Interest on deposits	5,830	3,183	15,692	6,960
Interest on short-term borrowings	69	38	458	50
Interest on long-term and subordinated debt	847	451	2,384	1,070
Total Interest Expense	6,746	3,672	18,534	8,080
Net Interest Income	17,767	15,911	52,843	38,203
PROVISION FOR LOAN AND LEASE LOSSES	565	100	1,155	225
Net Interest Income After Provision for Loan and Lease Losses	17,202	15,811	51,688	37,978
NONINTEREST INCOME				
Income from fiduciary activities	386	325	1,092	851
Service charges on deposits	230	242	665	667
ATM debit card interchange income	434	317	1,148	908
Mortgage banking income	1,091	197	2,605	558
Net gain on sales of SBA loans	275	68	710	477
Merchant services income	115	90	304	261
Earnings from cash surrender value of life insurance	79	76	236	205
Net gain on sales of investment securities	46	30	70	132
Other income	347	826	1,096	1,382
Total Noninterest Income	3,003	2,171	7,926	5,441
NONINTEREST EXPENSE				
Salaries and employee benefits	8,425	6,680	23,970	16,286
Occupancy expense, net	1,232	1,063	3,977	2,730
Equipment expense	671	579	1,956	1,531
Pennsylvania bank shares tax expense	359	131	740	473
FDIC Assessment	(131)	187	542	508
Legal and professional fees	311	272	1,204	752
Marketing and advertising expense	238	274	643	693
Software licensing and utilization	1,150	949	3,282	2,634
Telephone expense	150	177	465	480
(Gain) loss on sale or write-down of foreclosed assets	(36)	45	(22)	48
Intangible amortization	355	341	1,078	837
Merger and acquisition expense	—	3,039	—	4,955
Other expenses	1,959	1,533	5,947	4,332
Total Noninterest Expense	14,683	15,270	43,782	36,259
INCOME BEFORE PROVISION FOR INCOME TAXES	5,522	2,712	15,832	7,160
Provision for income taxes	709	548	2,539	1,213
NET INCOME	4,813	2,164	13,293	5,947
Series D preferred stock dividends	—	38	—	38
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 4,813	$ 2,126	$ 13,293	$ 5,909
PER COMMON SHARE DATA:				
Basic and Diluted Earnings Per Common Share	$ 0.57	$ 0.28	$ 1.57	$ 0.89
Cash Dividends Paid	$ 0.18	$ 0.15	$ 0.61	$ 0.55

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,	
	2019	2018
Net income	$ 4,813	$ 2,164
Other comprehensive income (loss):		
Unrealized income (losses) arising during the period on available-for-sale securities, net of income taxes of $51 and ($157), respectively	190	(589)
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of ($9) and ($6), respectively (a)	(37)	(23)
Change in defined benefit plans, net of income taxes of ($61) and $66, respectively (b)	(231)	248
Reclassification adjustment for settlement gains and activity related to benefit plans, net of income taxes of ($4) and ($25), respectively (c)	(17)	(93)
Total other comprehensive income (loss)	(95)	(457)
Total comprehensive income	$ 4,718	$ 1,707

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
Net income	$ 13,293	$ 5,947
Other comprehensive income (loss):		
Unrealized income (losses) arising during the period on available-for-sale securities, net of income taxes of $847 and ($730), respectively	3,188	(2,746)
Reclassification adjustment for net gain on sales of available-for-sale securities included in net income, net of income taxes of ($14) and $(28), respectively (a)	(56)	(104)
Change in defined benefit plans, net of income tax impact of ($145) and $422, respectively (b)	(545)	1,592
Reclassification adjustment for settlement gains and activity related to benefit plans, net of income taxes of ($21) and ($105), respectively (c)	(78)	(394)
Total other comprehensive income (loss)	2,509	(1,652)
Total comprehensive income	$ 15,802	$ 4,295

(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 consists primarily of unrecognized actuarial (losses) gains on defined benefit plans during the period.

(c) The reclassification adjustment for benefit plans includes settlement gains, amortization of prior service costs, and amortization of net gain or loss. Amounts are included in other income on the Consolidated Statements of Income within total noninterest income. Please reference Note 12 – Defined Benefit Plans, for more information.

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

MID PENN BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2019	$ —	$ 8,460	$ 177,565	$ 39,562	$ (2,378)	$ 223,209
Impact of adoption of new accounting standard (a)	—	—	—	316	—	316
Balance at January 1, 2019, adjusted	—	8,460	177,565	39,878	(2,378)	223,525
Net income	—	—	—	4,077	—	4,077
Total other comprehensive income, net of taxes	—	—	—	—	1,807	1,807
Common stock dividends declared	—	—	—	(2,113)	—	(2,113)
Employee Stock Purchase Plan (1,152 shares)	—	1	27	—	—	28
Director Stock Purchase Plan (1,361 shares)	—	1	32	—	—	33
Restricted stock activity	—	—	80	—	—	80
Balance, March 31, 2019	$ —	$ 8,462	$ 177,704	$ 41,842	$ (571)	$ 227,437
Net income	—	—	—	4,403	—	4,403
Total other comprehensive income, net of taxes	—	—	—	—	797	797
Common stock dividends declared	—	—	—	(1,524)	—	(1,524)
Employee Stock Purchase Plan (1,411 shares)	—	2	34	—	—	36
Director Stock Purchase Plan (1,336 shares)	—	1	32	—	—	33
Restricted stock activity	—	—	80	—	—	80
Balance, June 30, 2019	$ —	$ 8,465	$ 177,850	$ 44,721	$ 226	$ 231,262
Net income	—	—	—	4,813	—	4,813
Total other comprehensive loss, net of taxes	—	—	—	—	(95)	(95)
Common stock dividends declared	—	—	—	(1,525)	—	(1,525)
Employee Stock Purchase Plan (1,249 shares)	—	1	30	—	—	31
Director Stock Purchase Plan (1,397 shares)	—	1	34	—	—	35
Restricted stock activity (10,637 shares)	—	11	80	—	—	91
Balance, September 30, 2019	**$ —**	**$ 8,478**	**$ 177,994**	**$ 48,009**	**$ 131**	**$ 234,612**

(a) Represents the impact of adopting Accounting Standard Update ASU 2016-02. See Note 15 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 CHANGES IN SHAREHOLDERS' EQUITY, CONTINUED (UNAUDITED)

(Dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (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	—	—	—	1,004	—	1,004
Total other comprehensive loss, net of taxes	—	—	—	—	(1,867)	(1,867)
Common stock issued to Scottdale shareholders (1,878,827 shares) (b)	—	1,879	62,302	—	—	64,181
Employee Stock Purchase Plan (736 shares)	—	1	23	—	—	24
Director Stock Purchase Plan (938 shares)	—	1	29	—	—	30
Restricted stock activity	—	—	58	—	—	58
Balance, March 31, 2018	$ —	$ 6,123	$ 103,382	$ 33,525	$ (3,906)	$ 139,124
Net income	—	—	—	2,779	—	2,779
Total other comprehensive income, net of taxes	—	—	—	—	672	672
Employee Stock Purchase Plan (919 shares)	—	1	31	—	—	32
Director Stock Purchase Plan (881 shares)	—	1	30	—	—	31
Common stock dividends declared	—	—	—	(918)	—	(918)
Restricted stock activity	—	—	55	—	—	55
Balance, June 30, 2018	$ —	$ 6,125	$ 103,498	$ 35,386	$ (3,234)	$ 141,775
Net income	—	—	—	2,164	—	2,164
Total other comprehensive loss, net of taxes	—	—	—	—	(457)	(457)
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 issued to First Priority shareholders (2,320,800 shares) (c)	—	2,321	73,801	—	—	76,122
Employee Stock Purchase Plan (985 shares)	—	1	28	—	—	29
Director Stock Purchase Plan (1,074 shares)	—	1	30	—	—	31
Common stock dividends declared	—	—	—	(1,268)	—	(1,268)
Restricted stock activity (9,467 shares)	—	9	64	—	—	73
Balance, September 30, 2018	**$ 3,404**	**$ 8,457**	**$ 177,421**	**$ 36,244**	**$ (3,691)**	**$ 221,835**

(a) Represents the impact of adopting Accounting Standard Update ASU 2016-01. See Note 2 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 4 to the consolidated financial statements for more information.

(c) Shares issued on July 31,2018 as a result of the acquisition of First Priority Financial Corp. ("First Priority"). See Note 3 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,	
	2019	2018
Operating Activities:		
Net Income	$ 13,293	$ 5,947
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	1,155	225
Depreciation	2,101	1,671
Amortization of intangibles	1,078	837
Net amortization of security discounts/premiums	547	308
Amortization of operating lease right of use assets	1,244	—
Amortization of finance lease right of use asset	105	—
Gain on sales of investment securities	(70)	(132)
Earnings on cash surrender value of life insurance	(253)	(205)
Mortgage loans originated for sale	(116,313)	(35,437)
Proceeds from sales of mortgage loans originated for sale	113,505	33,854
Gain on sale of mortgage loans	(2,605)	(558)
SBA loans originated for sale	(11,187)	(6,061)
Proceeds from sales of SBA loans originated for sale	11,897	6,539
Gain on sale of SBA loans	(710)	(477)
Loss on write-down or disposal of property, plant, and equipment	163	70
(Gain) loss on sale or write-down of foreclosed assets	(22)	48
Stock compensation expense	251	187
Deferred income tax (benefit) expense	(682)	3,526
(Increase) decrease in accrued interest receivable	(170)	355
Increase in other assets	(6,407)	(4,400)
Increase in accrued interest payable	561	528
Net change in operating lease liability	(1,332)	—
Increase (decrease) in other liabilities	1,044	(535)
Net Cash Provided By Operating Activities	7,193	6,290
Investing Activities:		
Proceeds from the sale of available-for-sale securities	69,377	155,626
Proceeds from the maturity or call of available-for-sale securities	8,860	15,483
Purchases of available-for-sale securities	(14,911)	(21,142)
Proceeds from the maturity or call of held-to-maturity securities	18,892	8,961
Purchases of held-to-maturity securities	(21,328)	(72,877)
Net cash received from acquisitions	—	72,616
Redemptions of restricted investment in bank stock	541	3,345
Net increase in loans and leases	(87,000)	(75,111)
Proceeds from bank owned life insurance	140	—
Purchases of bank premises and equipment	(1,592)	(8,397)
Proceeds from the sale of foreclosed assets	1,306	194
Net Cash (Used In) Provided By Investing Activities	(25,715)	78,698
Financing Activities:		
Net increase in deposits	164,067	23,970
Net decrease in short-term borrowings	(31,100)	(67,165)
Common stock dividends paid	(5,162)	(3,246)
Employee Stock Purchase Plan	95	84
Director Stock Purchase Plan	101	92
Net change in finance lease liability	(26)	—
Proceeds from the issuance of long-term debt	13,500	—
Long-term debt repayment	(2,139)	(152)
Net Cash Provided By (Used In) Financing Activities	139,336	(46,417)
Net increase in cash and cash equivalents	120,814	38,571
Cash and cash equivalents, beginning of period	40,065	23,514
Cash and cash equivalents, end of period	$ 160,879	$ 62,085

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued)

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	$ 17,973	$ 6,463
Cash paid for income taxes	3,735	225
Supplemental Noncash Disclosures:		
Initial recognition of operating lease right of use assets	$ 11,661	$ —
Initial recognition of operating lease liabilities	12,866	—
Initial recognition of finance lease right of use asset	3,597	—
Initial recognition of finance lease liability	3,597	—
Common stock issued to Scottdale shareholders	—	1,879
Common stock issued to First Priority shareholders	—	2,321
Asset transferred to bank premises and equipment held for sale	1,274	—
Loans transferred to foreclosed assets held for sale	397	1,018

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

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
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) The nine months ended September 30, 2018 reflect 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 3 and 4 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, 2018 and December 31, 2018 balances have been reclassified, when necessary, to conform to the 2019 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. Except for adjustments made related to the adoption of new accounting standards, 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, 2018.

The comparability of the financial condition and results of operations as of and for the three and nine months ended September 30, 2019 and 2018, in general, have been materially impacted by the acquisitions of First Priority Financial Corp. ("First Priority") on July 31, 2018 and the acquisition of The Scottdale Bank & Trust Company ("Scottdale") on January 8, 2018. Refer to Note 3, *Acquisition of First Priority Financial Corp,* and Note 4, *Acquisition of The Scottdale Bank & Trust Company,* for additional information.

Mid Penn has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2019, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the issuance date of these consolidated financial statements.

(2) Summary of Significant Accounting Policies

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

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 difference between 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 statement 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 Company will recover the cost basis of the investment.

In instances when a determination is made that other-than-temporary impairment exists but the Company 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.

Equity Securities

As a result of the adoption of ASU 2016-01, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* on January 1, 2018, Mid Penn reports its equity securities with readily determinable fair values 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. 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 income or loss, net of tax. The adoption of ASU 2016-01 on January 1, 2018 resulted in net unrealized losses of $44,000 being reclassified out of accumulated other comprehensive loss and into retained earnings as reflected on the Consolidated Statement of Changes in Shareholders' Equity for the period ended September 30, 2018.

As of September 30, 2019 and December 31, 2018, Mid Penn's equity securities consisted of Community Reinvestment Act funds totaling $509,000 and $492,000, respectively. No equity securities were sold during the three and nine month periods ended September 30, 2019 or September 30, 2018.

Loans

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 Loans

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 Loans

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 Loans

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, Federal Home Loan Bank, 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 the required 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 funded and held in the Bank's portfolio, the interest rate on the residential mortgage would be increased to compensate for the added portfolio risk.

Consumer Loans, Including Home Equity Credits

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 $134,000 at September 30, 2019 and $159,000 at December 31, 2018.

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, or earlier in the event of either 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 relevant analyses and 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 classified as substandard nonaccrual, doubtful, having probable loss 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 determined to be 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. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, or earlier in the event of either bankruptcy or if there is an amount deemed uncollectible. 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 collateral valuations on all impaired loans secured 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, the independent third party market valuations on the subject property obtained by Mid Penn 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 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 acquired entity's related allowance for loan losses. The fair value of the acquired 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 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 at the date of acquisition 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.

Foreclosed Assets Held for Sale

Foreclosed assets held for sale consist primarily of real estate acquired through, or in lieu of, foreclosure in settlement of debt, and are recorded at fair value less the selling costs at the date of transfer, establishing a new cost basis. Any valuation adjustments required at the date of transfer are charged to the allowance for loan losses. Subsequent to acquisition, foreclosed assets are carried at fair value less estimated costs of disposal, based upon periodic evaluations that consider changes in market conditions and development and disposal costs. Operating results from assets acquired in satisfaction of debt, including rental income less operating costs and gains or losses on the sale of, or the periodic evaluation of foreclosed assets, are recorded in noninterest expense. As of September 30, 2019, Mid Penn had $86,000 of residential real estate held in other real estate owned and $104,000 in loans for which formal foreclosure proceedings were in process. As of December 31, 2018, Mid Penn had $844,000 of residential real estate held in other real estate owned and $211,000 in loans for which formal foreclosure proceedings were in process.

Leases

Mid Penn leases certain premises and equipment, and as of January 1, 2019 for all leases in effect upon adoption of Accounting Standards Update 2016-02, "*Leases*" (Topic 842) as well as any leases commencing thereafter, Mid Penn has recognized a right-of-use asset and a related lease liability for each distinct lease agreement. The lease right-of-use asset consists of the amount of the initial measurement of the lease liability, adjusted for (i) any lease payments made to the lessor at or before the commencement date, minus any lease incentives received, and (ii) any initial direct costs incurred by the lessee (defined as costs of a lease that would not have been incurred had the lease not been executed). The related lease liability is equal to the present value of the future lease payments, discounted using the rate implicit in the lease (or if that rate cannot be readily determined, the lessee's incremental borrowing rate). Given that the rate implicit in the lease is rarely available, all lease liability amounts were calculated using Mid Penn's incremental borrowing rate at lease inception, on a collateralized basis, for a similar term. For operating leases existing prior to January 1, 2019, the rate for the remaining lease term as of January 1, 2019 was used.

Operating lease expense, recognized as a component of occupancy expense on the Consolidated Statements of Income, consists of a single lease cost calculated so that the remaining cost of the lease is allocated over the remaining lease term on a straight-line basis. Operating lease expense also includes variable lease payments not included in the lease liability, and any impairment of the right-of-use asset. Finance lease expense consists of the amortization of the right-of-use asset, recognized as a component of occupancy expense on the Consolidated Statements of Income, and interest expense on the lease liability, which is recorded as a component of other interest expense on the Consolidated Statements of Income.

In assessing whether a contract contains a lease, Mid Penn reviews third-party agreements to determine if the contract conveys the right to control the use of identified property, plant, or equipment (defined as an identified asset by Topic 842) for a period of time in exchange for consideration, and grants Mid Penn the right to both (i) obtain substantially all of the economic benefits from the identified asset's use, and (ii) direct the use of the identified asset throughout the term of the agreement.

Upon identification that a lease agreement exists, Mid Penn performs an assessment of the consideration to be paid related to the identified asset and quantifies both the (i) lease components, consisting of consideration paid to transfer a good or service to Mid Penn, and (ii) non-lease components, consisting of consideration paid for distinct elements of the contract that are not related to securing the use of the leased asset, such as property taxes, common area maintenance, utilities, and insurance. Mid Penn has made an accounting policy election to segregate lease and non-lease components in the determination of lease consideration used in the calculation of the right-of-use asset and liability for leases of property.

Many of Mid Penn’s lease agreements include options to extend or renew contracts subsequent to the expiration of the initial lease term. These renewal and extension options were not included in the calculation of the right-of-use assets and lease liabilities as Mid Penn is not reasonably certain that these renewals and extensions will be utilized. Additionally, for leases that contain escalation clauses related to consumer or other price indices, Mid Penn includes the known lease payment amount as of the commencement date in the calculation of right-of-use assets and related lease liabilities. Subsequent increases in rental payments over the known amount at the commencement date due to increase in the indices will be expensed as incurred.

None of Mid Penn’s lease agreements include residual value guarantees or material variable lease payments. Mid Penn does not have material restrictions or covenants imposed by leases that would impact Mid Penn’s ability to pay dividends or cause Mid Penn to incur additional financial obligations.

Investment in Limited Partnership

Mid Penn is a limited partner in a partnership that provides low-income housing in Enola, Pennsylvania. The carrying value of Mid Penn’s investment in the limited partnership was $201,000 at September 30, 2019, and $233,000 at December 31, 2018, net of amortization, using the straight-line method. The investment in this limited partnership is reported in other assets on the Consolidated Balance Sheets, and Mid Penn’s maximum exposure to loss is limited to the carrying value of the investment.

During the second quarter of 2018, Mid Penn entered into a commitment to purchase an additional limited partnership interest in a low-income housing project to construct thirty-seven apartments and common amenities in Dauphin County, Pennsylvania. All of the units are intended to qualify for Federal Low-Income Housing Tax Credits (“LIHTCs”) as provided for in Section 42 of the Internal Revenue Code of 1986, as amended. Mid Penn’s limited partner capital contribution commitment is $7,579,000, which will be paid in installments over the course of construction of the low-income housing facilities. Each installment payment is conditional upon both Mid Penn’s review and approval of the installment payment certificate and continued compliance with the terms of the original partnership agreement. The investment in the limited partnership will be reported in other assets on the Consolidated Balance Sheet and will be amortized over a ten year period once the facilities become operational and begin to be occupied. The project has been conditionally awarded $861,000 in annual LIHTCs by the Pennsylvania Housing Finance Agency, with a total anticipated LIHTC amount of $8,613,000 to be awarded to Mid Penn over the ten year amortization period. Mid Penn’s commitment to initiate investments in the limited partnership interest was conditional upon (i) the review and approval of all closing documents, (ii) an opinion letter for tax counsel to the Partnership that the project qualifies for the LIHTCs, and (iii) review and approval by Mid Penn of other documents it deemed necessary. All such initial conditions were satisfied and Mid Penn began funding the investment during 2018. The total investment in this limited partnership was $5,810,000 and $1,710,000 on September 30, 2019 and December 31, 2018, respectively, and was included in the reported balance of other assets on the Consolidated Balance Sheet.

Core Deposit Intangible

Core deposit intangible is a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The carrying amount of core deposit intangible was $5,860,000 and $6,893,000 at September 30, 2019 and December 31, 2018, respectively. Core deposit amortization expense is reflected in the Consolidated Statements of Income in intangible amortization and was $1,033,000 and $816,000 for the nine months ended September 30, 2019 and 2018, respectively. The amount of core deposit amortization expense was $338,000 and $328,000 for the three months ended September 30, 2019 and 2018, respectively. The core deposit intangible for each respective acquisition (Phoenix in March 2015; Scottdale in January 2018; and First Priority in July 2018) is being amortized over a ten-year period starting at the respective acquisition date and using a sum-of-the-year’s digits basis. Core deposit intangible assets are subject to impairment testing whenever events or changes in circumstances indicate the need for such evaluation.

Goodwill

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with past business acquisitions. The goodwill balance was the same at both September 30, 2019 and December 31, 2018, and was comprised of (i) $39,744,000 related to the July 31, 2018 First Priority acquisition, (ii) $19,178,000 related to the January 8, 2018 Scottdale acquisition and (iii) $3,918,000 recorded as a result of the Phoenix acquisition in 2015. Goodwill is evaluated annually for impairment; however, if certain events occur which indicate goodwill might be impaired between annual tests, goodwill would be tested for impairment when such events occur. In making a potential impairment assessment of goodwill, Mid Penn considers a number of factors including operating results, business plans, economic projections, anticipated future cash flows, current market data, stock price, etc. There are inherent uncertainties related to these factors and Mid Penn’s judgment in applying them to the analysis of goodwill impairment. Mid Penn did not identify any impairment on its outstanding goodwill from its most recent evaluation, which was performed as of October 31, 2018 using a qualitative analysis. Changes in economic and operating conditions could result in goodwill impairment in future periods.

Revenue from Contracts with Customers

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. Topic 606 applies primarily to transactional-based non-interest income revenue streams and excludes mortgage banking income, earnings from cash surrender value of life insurance, and gains on SBA loans.

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

Income from Fiduciary Activities

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

Service Charges on Deposits

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

ATM Debit Card Interchange Income

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

Merchant Services Income

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

Other Income

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

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

Comprehensive Income

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

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

(Dollars in thousands)	Unrealized Loss on Securities	Defined Benefit Plans	Accumulated Other Comprehensive Income (Loss)
Balance - September 30, 2019	$ (110)	$ 241	$ 131
Balance - December 31, 2018	$ (3,242)	$ 864	$ (2,378)

Earnings Per Common Share

Earnings per common 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 earnings per common share.

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income	$ 4,813	$ 2,164	$ 13,293	$ 5,947
Less: Dividends on Series D preferred stock	—	38	—	38
Net income available to common shareholders	$ 4,813	$ 2,126	$ 13,293	$ 5,909
Weighted average common shares outstanding	8,473,080	7,695,469	8,465,249	6,604,027
Basic and diluted earnings per common share	$ 0.57	$ 0.28	$ 1.57	$ 0.89

Weighted average common shares outstanding increased for the three and nine months ended September 30, 2019 when compared to the same periods in 2018 primarily as a result of the issuance of 2,320,800 shares of Mid Penn common stock on July 31, 2018 in connection with the First Priority acquisition. There were no dilutive securities impacting the calculation of earnings per common share for the periods ended September 30, 2019 and 2018.

(3) Acquisition of First Priority Financial Corp.

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

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

The acquisition of First Priority resulted in the recognition and recording of intangible assets including $39,744,000 of goodwill, a core deposit intangible of $2,832,000, and a trade name intangible of $205,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require.

The allocation of the purchase price is as follows:

(Dollars in thousands)

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

The following table summarizes the final 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		3,140
Accrued interest receivable		2,293
Other assets		4,197
Deposits		(504,946)
Borrowings		(49,939)
Accrued interest payable		(1,073)
Other liabilities		(2,627)
Preferred stock		(3,404)
		40,185
Goodwill	$	39,744

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 certain 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 July 31, 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 July 31, 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, 2018. 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 2018. The supplemental pro forma earnings for the nine months ended September 30, 2018 exclude $3,661,000 of merger-related costs related to the First Priority acquisition, of which $714,000 was not deductible for federal income tax purposes. Merger-related costs included approximately $1,475,000 of severance and retention bonus expenses for the nine months ended September 30, 2018. 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, 2018	Nine Months Ended September 30, 2018
Net interest income after loan loss provision	$ 17,373	$ 48,914
Noninterest income	2,220	5,754
Noninterest expense	13,543	41,352
Net income	5,502	10,995
Net income per common share	0.70	1.49

(4) 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 impact on the 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.

The acquisition of Scottdale resulted in the recognition and recording of intangible assets including goodwill of $19,178,000 and a core deposit intangible of $4,940,000. The core deposit intangible will be amortized over a ten-year period using a sum of the years' digits basis. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require.

The allocation of the purchase price is as follows:

(Dollars in thousands)

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

The following table summarizes the final 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		(3,682)
		47,795
Goodwill	$	19,178

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 measures as if the merger between Mid Penn Bank and Scottdale had been completed on January 1, 2018. 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 2018. 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, of which $205,000 was not deductible for federal income tax purposes. Merger-related costs in the nine months ended September 30, 2018 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	2018
Net interest income after loan loss provision	$ 15,811	$ 37,978
Noninterest income	2,165	5,371
Noninterest expense	15,232	34,895
Net income	2,196	7,109
Net income per common share	0.29	1.16

(5) Investment Securities

The majority of the investment portfolio is comprised of securities issued by U.S. government agencies and state and political subdivision obligations. The amortized cost, fair value, and unrealized gains and losses on investment securities at September 30, 2019 and December 31, 2018 are as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2019				
Available-for-sale debt securities:				
U.S. Treasury and U.S. government agencies	$ 32,611	$ 33	$ 111	$ 32,533
Mortgage-backed U.S. government agencies	16,638	8	135	16,511
State and political subdivision obligations	1,059	—	4	1,055
Corporate debt securities	2,250	70	—	2,320
Total available-for-sale debt securities	52,558	111	250	52,419
Held-to-maturity debt securities:				
U.S. Treasury and U.S. government agencies	19,421	39	20	19,440
Mortgage-backed U.S. government agencies	67,472	521	119	67,874
State and political subdivision obligations	82,051	2,820	—	84,871
Corporate debt securities	1,528	9	—	1,537
Total held-to-maturity debt securities	170,472	3,389	139	173,722
Total	$ 223,030	$ 3,500	$ 389	$ 226,141

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

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 9, *Fair Value Measurement*, for more information on the fair value of investment securities.

Investment securities having a fair value of $172,084,000 at September 30, 2019 and $214,239,000 at December 31, 2018 were pledged to secure public deposits, some trust account holdings, and certain other borrowings. Mid Penn also obtains letters of credit from the Federal Home Loan Bank of Pittsburgh (“FHLB”) to secure certain public deposits. These FHLB letter of credit commitments totaled $155,700,000 as of September 30, 2019 and $36,850,000 as of December 31, 2018.

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, 2019 and December 31, 2018.

(Dollars in thousands)	Less Than 12 Months			12 Months or More			Total		
September 30, 2019	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	3	$ 6,988	$ 12	7	$ 11,940	$ 99	10	$ 18,928	$ 111
Mortgage-backed U.S. government agencies	1	627	2	14	11,277	133	15	11,904	135
State and political subdivision obligations	2	1,025	4	0	—	—	2	1,025	4
Total temporarily impaired available-for-sale debt securities	6	$ 8,640	$ 18	21	$ 23,217	$ 232	27	$ 31,857	$ 250
Held-to-maturity debt securities:									
U.S. Treasury and U.S. government agencies	3	$ 7,447	$ 15	1	$ 2,994	$ 5	4	$ 10,441	$ 20
Mortgage-backed U.S. government agencies	7	11,239	15	15	13,403	104	22	24,642	119
Total temporarily impaired held-to-maturity debt securities	10	$ 18,686	$ 30	16	$ 16,397	$ 109	26	$ 35,083	$ 139
Total	16	$ 27,326	$ 48	37	$ 39,614	$ 341	53	$ 66,940	$ 389

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

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 of the security has been less than amortized cost, as well as the overall financial condition 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. At both September 30, 2019 and December 31, 2018, the majority of available-for-sale securities and held-to-maturity securities in an unrealized loss position were mortgage-backed U.S. government agencies, obligations of state and political subdivisions, and U.S. Treasury and agency securities.

Mid Penn had no securities considered by management to be other-than-temporarily impaired as of September 30, 2019, December 31, 2018, or September 30, 2018, 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 be temporary changes in value related to market movements in interest yields at various periods similar to the maturity dates of holdings in the investment portfolio, and not reflective of an erosion of credit quality.

Gross realized gains and losses on sales of available-for-sale debt securities for the three and nine months ended September 30, 2019 and 2018 are shown in the table below.

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Realized gains	$ 64	$ 30	$ 133	$ 141
Realized losses	(18)	—	(63)	(9)
Net gains	$ 46	$ 30	$ 70	$ 132

The table below illustrates the maturity distribution of investment securities at amortized cost and fair value as of September 30, 2019.

(Dollars in thousands)	Available-for-sale		Held-to-maturity	
September 30, 2019	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in 1 year or less	$ —	$ —	$ 3,990	$ 3,992
Due after 1 year but within 5 years	19,457	19,403	19,663	19,926
Due after 5 years but within 10 years	16,463	16,505	79,347	81,930
Due after 10 years	—	—	—	—
	35,920	35,908	103,000	105,848
Mortgage-backed securities	16,638	16,511	67,472	67,874
	$ 52,558	$ 52,419	$ 170,472	$ 173,722

(6) <u>Loans and Allowance for Loan and Lease Losses</u>

The types of loans in Mid Penn's portfolio, summarized by those rated as "pass" (net of deferred fees and costs of $948,000 as of September 30, 2019 and $647,000 as of December 31, 2018), and the loans classified as "special mention" and "substandard" within Mid Penn's internal risk rating system as of September 30, 2019 and December 31, 2018, are as follows:

(Dollars in thousands) September 30, 2019	Pass	Special Mention	Substandard	Total
Commercial and industrial	$ 307,083	$ 11,068	$ 2,249	$ 320,400
Commercial real estate	875,155	8,974	7,931	892,060
Commercial real estate - construction	177,111	—	40	177,151
Lease financing	—	—	—	—
Residential mortgage	242,076	56	1,597	243,729
Home equity	69,181	—	59	69,240
Consumer	7,854	—	—	7,854
	$ 1,678,460	$ 20,098	$ 11,876	$ 1,710,434

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

Mid Penn had no loans classified as doubtful as of September 30, 2019 and December 31, 2018.

Impaired loans by loan portfolio class as of September 30, 2019 and December 31, 2018 are summarized as follows:

(Dollars in thousands)	September 30, 2019			December 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	$ —	$ —	$ —	$ —	$ —	$ —
Commercial real estate	1,787	2,087	—	2,007	2,276	—
Commercial real estate - construction	40	61	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	881	896	—	657	811	—
Home equity	26	27	—	30	106	—
Consumer	—	—	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:						
Commercial and industrial	$ 5	$ 5	$ —	$ 28	$ 28	$ —
Commercial real estate	1,643	1,643	—	1,563	1,563	—
Commercial real estate - construction	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—
Residential mortgage	494	494	—	1,208	1,208	—
Home equity	4	4	—	4	4	—
Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial and industrial	$ —	$ —	$ —	$ 4,527	$ 4,635	$ 500
Commercial real estate	537	578	336	721	721	204
Commercial real estate - construction	—	—	—	367	370	38
Lease financing	—	—	—	—	—	—
Residential mortgage	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total Impaired Loans:						
Commercial and industrial	$ 5	$ 5	$ —	$ 4,555	$ 4,663	$ 500
Commercial real estate	3,967	4,308	336	4,291	4,560	204
Commercial real estate - construction	40	61	—	367	370	38
Lease financing	—	—	—	—	—	—
Residential mortgage	1,375	1,390	—	1,865	2,019	—
Home equity	30	31	—	34	110	—
Consumer	—	—	—	—	—	—

The average recorded investment of impaired loans and related interest income recognized for the three and nine months ended September 30, 2019 and 2018 are summarized as follows:

	Three Months Ended			
	September 30, 2019		September 30, 2018	
(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	1,917	—	1,872	—
Commercial real estate - construction	40	4	—	—
Lease financing	—	—	—	—
Residential mortgage	889	7	780	11
Home equity	27	—	17	—
Consumer	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:				
Commercial and industrial	$ 11	$ —	$ 24	$ —
Commercial real estate	1,630	—	1,470	7
Commercial real estate - construction	—	—	—	—
Lease financing	—	—	—	—
Residential mortgage	1,055	—	677	—
Home equity	4	—	1	—
Consumer	—	—	—	—
With an allowance recorded:				
Commercial and industrial	$ 38	$ —	$ 4,425	$ —
Commercial real estate	617	—	703	—
Commercial real estate - construction	—	—	367	—
Lease financing	—	—	—	—
Residential mortgage	—	—	—	—
Home equity	—	—	—	—
Consumer	—	—	—	—
Total Impaired Loans:				
Commercial and industrial	$ 49	$ —	$ 4,449	$ —
Commercial real estate	4,164	—	4,045	7
Commercial real estate - construction	40	4	367	—
Lease financing	—	—	—	—
Residential mortgage	1,944	7	1,457	11
Home equity	31	—	18	—
Consumer	—	—	—	—

(Dollars in thousands)	Nine Months Ended			
	September 30, 2019		September 30, 2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial and industrial	$ —	$ —	$ —	$ —
Commercial real estate	2,697	11	3,040	3
Commercial real estate - construction	40	—	—	—
Lease financing	—	—	—	—
Residential mortgage	1,151	21	769	27
Home equity	38	—	148	—
Consumer	—	—	—	—
With no related allowance recorded and acquired with credit deterioration:				
Commercial and industrial	$ 22	$ —	$ 21	$ —
Commercial real estate	1,602	—	1,365	23
Commercial real estate - construction	—	—	—	—
Lease financing	—	—	—	—
Residential mortgage	1,152	—	726	—
Home equity	4	—	—	—
Consumer	—	—	—	—
With an allowance recorded:				
Commercial and industrial	$ 1,202	$ 3	$ 4,424	$ —
Commercial real estate	633	—	456	—
Commercial real estate - construction	183	—	367	—
Lease financing	—	—	—	—
Residential mortgage	—	—	—	—
Home equity	—	—	—	—
Consumer	—	—	—	—
Total Impaired Loans:				
Commercial and industrial	$ 1,224	$ 3	$ 4,445	$ —
Commercial real estate	4,932	11	4,861	26
Commercial real estate - construction	223	—	367	—
Lease financing	—	—	—	—
Residential mortgage	2,303	21	1,495	27
Home equity	42	—	148	—
Consumer	—	—	—	—

Nonaccrual loans by loan portfolio class, including loans acquired with credit deterioration, as of September 30, 2019 and December 31, 2018 are summarized as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Commercial and industrial	$ 5	$ 4,555
Commercial real estate	3,967	4,291
Commercial real estate - construction	40	367
Residential mortgage	884	1,502
Home equity	30	34
	$ 4,926	$ 10,749

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. The classes of the loan portfolio summarized by the past due status as of September 30, 2019 and December 31, 2018 are summarized as follows:

(Dollars in thousands) September 30, 2019	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans Receivable > 90 Days and Accruing
Commercial and industrial	$ 301	$ —	$ —	$ 301	$ 320,094	$ 320,395	$ —
Commercial real estate	230	—	1,745	1,975	888,442	890,417	—
Commercial real estate - construction	—	—	40	40	177,111	177,151	—
Lease financing	—	—	—	—	—	—	—
Residential mortgage	35	87	365	487	242,748	243,235	—
Home equity	—	18	—	18	69,218	69,236	—
Consumer	—	—	—	—	7,854	7,854	—
<u>Loans acquired with credit deterioration:</u>							
Commercial and industrial	—	—	5	5	—	5	—
Commercial real estate	—	—	1,612	1,612	31	1,643	—
Commercial real estate - construction	—	—	—	—	—	—	—
Lease financing	—	—	—	—	—	—	—
Residential mortgage	—	17	158	175	319	494	—
Home equity	—	—	—	—	4	4	—
Consumer	—	—	—	—	—	—	—
Total	$ 566	$ 122	$ 3,925	$ 4,613	$ 1,705,821	$ 1,710,434	$ —

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

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, 2019	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, 2019	$ 2,448	$ 5,312	$ 45	$ —	$ 476	$ 482	$ 7	$ 1	$ 8,771
Charge-offs	(12)	(42)	—	—	(3)	—	(9)	—	(66)
Recoveries	1	41	—	—	2	1	1	—	46
Provisions	6	544	1	—	(7)	13	6	2	565
Ending balance, September 30, 2019	$ 2,443	$ 5,855	$ 46	$ —	$ 468	$ 496	$ 5	$ 3	$ 9,316

(Dollars in thousands) As of, and for the nine months ended, September 30, 2019	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, 2019	$ 2,391	$ 4,703	$ 75	$ —	$ 453	$ 528	$ 7	$ 240	$ 8,397
Charge-offs	(217)	(53)	(40)	—	(3)	—	(57)	—	(370)
Recoveries	44	74	—	—	2	2	12	—	134
Provisions	225	1,131	11	—	16	(34)	43	(237)	1,155
Ending balance, September 30, 2019	2,443	5,855	46	—	468	496	5	3	9,316
Individually evaluated for impairment	—	336	—	—	—	—	—	—	336
Ending balance: collectively evaluated for impairment	$ 2,443	$ 5,519	$ 46	$ —	$ 468	$ 496	$ 5	$ 3	$ 8,980
Loans receivables:									
Ending balance	$ 320,400	$ 892,060	$ 177,151	$ —	$ 243,729	$ 69,240	$ 7,854	$ —	$1,710,434
Ending balance: individually evaluated for impairment	—	2,324	40	—	881	26	—	—	3,271
Ending balance: acquired with credit deterioration	5	1,643	—	—	494	4	—	—	2,146
Ending balance: collectively evaluated for impairment	$ 320,395	$ 888,093	$ 177,111	$ —	$ 242,354	$ 69,210	$ 7,854	$ —	$1,705,017

(Dollars in thousands)

December 31, 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:									
Ending balance	$ 2,391	$ 4,703	$ 75	$ —	$ 453	$ 528	$ 7	$ 240	$ 8,397
Ending balance: individually evaluated for impairment	500	204	38	—	—	—	—	—	742
Ending balance: collectively evaluated for impairment	$ 1,891	$ 4,499	$ 37	$ —	$ 453	$ 528	$ 7	$ 240	$ 7,655
Loans receivable:									
Ending balance	$ 286,518	$ 861,369	$ 142,173	$ 53	$ 253,543	$ 70,096	$ 10,315	$ —	$1,624,067
Ending balance: individually evaluated for impairment	4,527	2,728	367	—	811	30	—	—	8,463
Ending balance: acquired with credit deterioration	28	1,563	—	—	1,208	4	—	—	2,803
Ending balance: collectively evaluated for impairment	$ 281,963	$ 857,078	$ 141,806	$ 53	$ 251,524	$ 70,062	$ 10,315	$ —	$1,612,801

(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, September 30, 2018	2,340	4,821	134	—	469	436	5	24	8,229
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

The recorded investments in troubled debt restructured loans at September 30, 2019 and December 31, 2018 are as follows:

(Dollars in thousands) September 30, 2019	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial real estate	$ 2,670	$ 2,571	$ 1,894
Residential mortgage	677	675	497
	$ 3,347	$ 3,246	$ 2,391

(Dollars in thousands) December 31, 2018	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial and industrial	$ 4,110	$ 4,460	$ 4,302
Commercial real estate	2,940	2,841	2,201
Residential mortgage	677	675	516
Home equity	14	14	1
	$ 7,741	$ 7,990	$ 7,020

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 and generally involve modifications from the original loan agreements including either a reduction in the amount of principal payments for certain or extended periods, interest rate reductions, and/or the intent for the loan to be repaid as collateral is sold.

Mid Penn's troubled debt restructured loans at September 30, 2019 totaled $2,391,000 and included $1,894,000 attributable to eight loans among three relationships which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. One large relationship accounted for $1,423,000 of the total $1,894,000 of these nonaccrual impaired troubled debt restructured loans. The remaining troubled debt restructurings were three loans totaling $497,000 representing accruing impaired residential mortgage loans to unrelated borrowers in compliance with the terms of the modification.

Mid Penn's troubled debt restructured loans at December 31, 2018 totaled $7,020,000, and included $6,503,000 attributable to ten loans among five relationships which were classified as nonaccrual impaired based upon a collateral evaluation in accordance with the guidance on impaired loans. Two large relationships accounted for $5,463,000 of the total $6,503,000 in nonaccrual impaired troubled debt restructured loans. The remaining four loans totaling $517,000 represented accruing impaired loans to unrelated borrowers in compliance with the terms of the modification, with three loans being accruing impaired residential mortgages to unrelated borrowers totaling $516,000 and one loan being an accruing impaired home equity loan of $1,000. As of December 31, 2018, there were no defaulted troubled debt restructured loans, as all troubled debt restructured loans were current with respect to their associated forbearance agreements. There were also no defaults on troubled debt restructured loans within twelve months of restructure during 2018.

The decrease in the troubled debt restructured loan balance when comparing September 30, 2019 to December 31, 2018 was largely due to the successful workout of two nonaccrual troubled debt restructured loans totaling $4,572,000 during the nine months ended September 30, 2019. There were no troubled debt restructured loans added during the three or nine months ended September 30, 2019 or 2018. As a result of management evaluations at September 30, 2019, September 30, 2018, and December 31, 2018, management believes that any necessary specific allocations or charge-offs were taken as appropriate. There were no charge-offs associated with existing troubled debt restructured loan relationships for the three or nine months ended September 30, 2019 or 2018. There were no troubled debt restructured loans that defaulted within twelve months of restructure during the three or nine months ended September 30, 2019 and 2018.

The following tables provide activity for the accretable yield of acquired impaired loans from the Phoenix Bancorp, Inc. (March 2015), Scottdale (January 2018), and First Priority (July 2018) acquisitions for the three and nine months ended September 30, 2019.

(Dollars in thousands)

	Three Months Ended September 30,	
	2019	2018
Accretable yield, beginning of period	$ 197	$ 300
Acquisition of impaired loans	—	125
Accretable yield amortized to interest income	(55)	(61)
Accretable yield, end of period	$ 142	$ 364

	Nine Months Ended September 30,	
	2019	2018
Accretable yield, beginning of period	$ 309	$ 67
Acquisition of impaired loans	—	430
Accretable yield amortized to interest income	(167)	(133)
Accretable yield, end of period	$ 142	$ 364

(7) Bank Premises and Equipment Held For Sale

As of September 30, 2019, bank premises and equipment held for sale totaled $1,274,000 and consisted of the land and facility for one full service retail banking property. These assets were classified as held for sale due to both (i) Mid Penn's intent to sell the existing retail office building and land upon relocation of the full service branch staff and operations to a nearby leased facility, and (ii) satisfaction of all the criteria for held-for-sale presentation as stated in ASC 360, *Property, Plant, and Equipment*. An impairment charge of $105,000 to adjust the carrying value of the property to reflect the lower of cost or market value was recorded in the first quarter of 2019 and is reflected in the results for the nine month period ended September 30, 2019. The impairment charge is included in other expenses on the Consolidated Statements of Income. The Bank had executed an agreement to sell the property with settlement to occur prior to September 30, 2019. During the third quarter of 2019, the Bank extended the agreement to sell the property with settlement to occur prior to December 31, 2019.

(8) Leases

On January 1, 2019, Mid Penn adopted ASU No. 2016-02 *"Leases"* (Topic 842), and all subsequent ASUs that modified Topic 842, which primarily affected the accounting treatment for operating lease agreements in which Mid Penn is the lessee. As of the January 1, 2019 adoption date, Mid Penn leased twenty-four branch locations under non-cancelable operating leases, which expire at various dates through the year ending December 31, 2035. Three of Mid Penn's operating leases are with related parties. Subsequent to the adoption of Topic 842, Mid Penn entered into a lease agreement for one facility under a non-cancelable finance lease, which commenced March 1, 2019 and expires February 28, 2039.

In 2016, Mid Penn entered into two subleasing agreements with unrelated parties on one of its properties under an operating lease. Both subleases included escalation clauses. The first sublease agreement began on April 1, 2016, while the second sublease began on July 1, 2016. One sublease was terminated during the first quarter of 2019 due to the bankruptcy of the tenant. The remaining sublease ends on March 31, 2021.

Operating and finance lease right-of-use assets, as well as operating lease liabilities, are presented as separate line items on the Consolidated Balance Sheet, while finance lease liabilities are classified as a component of long term debt. Mid Penn has elected not to include short-term leases (i.e., leases with initial terms of twelve months or less) or equipment leases (deemed immaterial) on the Consolidated Balance Sheet.

There were no sale and leaseback transactions or leveraged leases as of September 30, 2019. During the third quarter of 2019, the Bank entered into a lease agreement for a new branch location commencing on October 1, 2019 and amended a previously existing lease agreement to extend the term of the original lease with the new lease term commencing November 1, 2019.

Below is a summary of the operating and finance lease right-of-use assets and related lease liabilities, as well as the weighted average lease term (in years) and weighted average discount rate for each of the lease classifications as of September 30, 2019.

(Dollars in thousands)	September 30, 2019	
	Operating Leases	Finance Lease
Right of use asset	$ 10,416	$ 3,492
Lease liability	$ 11,534	$ 3,571
Weighted average remaining lease term (in years)	9.17	19.42
Weighted average discount rate	3.43%	3.81%

A summary of lease costs during the three and nine months ended September 30, 2019 are presented below. Interest expense on finance lease liabilities is included in other interest expense, while all other lease costs are included in occupancy expense on Mid Penn's Consolidated Statements of Income.

(Dollars in thousands)	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Finance lease cost:		
Amortization of right-of-use asset	$ 45	$ 105
Interest expense on lease liability	34	80
Total finance lease cost	79	185
Operating lease cost	515	1,545
Short-term lease cost	—	—
Variable lease cost	—	—
Sublease income	(6)	(18)
Total lease costs	$ 588	$ 1,712

A summary of cash paid for amounts included in the measurement of lease liabilities is presented below.

(Dollars in thousands)	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from finance leases	$ 80
Operating cash flows from operating leases	1,633
Financing cash flows from finance leases	26

A maturity analysis of operating and finance lease liabilities and a reconciliation of the undiscounted cash flows to the total operating and finance lease liability amounts is presented below.

(Dollars in thousands)	September 30, 2019	
	Operating Leases	Finance Lease
Lease payments due:		
Within one year	$ 530	$ 54
After one but within two years	1,965	216
After two but within three years	1,603	217
After three but within four years	1,464	217
After four but within five years	1,245	217
After five years	6,691	4,244
Total undiscounted cash flows	13,498	5,165
Discount on cash flows	(1,964)	(1,594)
Total lease liability	$ 11,534	$ 3,571

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

(Dollars in thousands)	Lease Obligation	Sublease Rental Income	Net Rental Expense
2019	2,171	81	2,090
2020	1,970	81	1,889
2021	1,603	20	1,583
2022	1,464	—	1,464
2023	1,245	—	1,245
thereafter	6,691	—	6,691
	$ 15,144	$ 182	$ 14,962

(9) 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).

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, 2019 or 2018.

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, 2019 using:		
Assets:	Total carrying value at September 30, 2019	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	$ 32,533	$ —	$ 32,533	$ —
Mortgage-backed U.S. government agencies	16,511	—	16,511	—
State and political subdivision obligations	1,055	—	1,055	—
Corporate debt securities	2,320	—	2,320	—
Other assets:				
Equity securities	509	509	—	—
Total	$ 52,928	$ 509	$ 52,419	$ —

(Dollars in thousands)		Fair value measurements at December 31, 2018 using:		
Assets:	Total carrying value at December 31, 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	$ 41,572	$ —	$ 41,572	$ —
Mortgage-backed U.S. government agencies	38,849	—	38,849	—
State and political subdivision obligations	29,256	—	29,256	—
Corporate debt securities	2,246	—	2,246	—
Other assets:				
Equity securities	492	492	—	—
Total	$ 112,415	$ 492	$ 111,923	$ —

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, 2019 using:		
Assets:	Total carrying value at September 30, 2019	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired Loans	$ 879	$ —	$ —	$ 879
Bank Premises and Equipment Held for Sale	1,274	—	—	1,274
Foreclosed Assets Held for Sale	130	—	—	130

(Dollars in thousands)		Fair value measurements at December 31, 2018 using:		
Assets:	Total carrying value at December 31, 2018	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired Loans	$ 4,935	$ —	$ —	$ 4,935
Foreclosed Assets Held for Sale	581	—	—	581

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, 2019	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
Impaired Loans	$ 879	Appraisal of collateral (a), (b)	Appraisal adjustments (b)	0% - 69%	36%
Bank Premises and Equipment Held for Sale	1,274	Negotiated sales contract (c)	Selling costs (c)	2% - 2%	2%
Foreclosed Assets Held for Sale	130	Appraisal of collateral (a), (b)	Appraisal adjustments (b)	24% - 27%	25%

(Dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements				
December 31, 2018	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
Impaired Loans	$ 4,935	Appraisal of collateral (a), (b)	Appraisal adjustments (b)	26% - 100%	40%
Foreclosed Assets Held for Sale	581	Appraisal of collateral (a), (b)	Appraisal adjustments (b)	17% - 17%	17%

(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) Fair value was determined through a negotiated sales contract executed during the first quarter of 2019, adjusted for selling costs. See Note 7 – Bank Premises and Equipment Held For Sale for more information.

Mid Penn uses the following methodologies and assumptions to estimate the fair value of certain assets and liabilities.

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

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

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.

The following table summarizes the carrying value and fair value of financial instruments at September 30, 2019 and December 31, 2018.

(Dollars in thousands)	September 30, 2019		December 31, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	$ 160,879	$ 160,879	$ 40,065	$ 40,065
Available-for-sale investment securities	52,419	52,419	111,923	111,923
Held-to-maturity investment securities	170,472	173,722	168,370	166,582
Equity securities	509	509	492	492
Loans held for sale	7,115	7,115	1,702	1,702
Net loans and leases	1,701,118	1,738,201	1,615,670	1,622,287
Restricted investment in bank stocks	6,105	6,105	6,646	6,646
Accrued interest receivable	8,414	8,414	8,244	8,244
Financial liabilities:				
Deposits	$ 1,890,093	1,894,019	$ 1,726,026	$ 1,725,674
Short-term borrowings	12,000	12,000	43,100	43,100
Long-term debt (a)	59,400	54,330	48,024	44,585
Subordinated debt	27,067	25,304	27,082	24,881
Accrued interest payable	2,823	2,823	2,262	2,262

(a) Long-term debt excludes finance lease obligations.

The Bank's outstanding and unfunded credit commitments and financial standby letters of credit were deemed to have no significant fair value as of September 30, 2019 and December 31, 2018.

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, 2019 and December 31, 2018. 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.

(Dollars in thousands)			Fair Value Measurements		
September 30, 2019	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	$ 170,472	$ 173,722	$ —	$ 173,722	$ —
Net loans and leases	1,701,118	1,738,201	—	—	1,738,201
Financial instruments - liabilities					
Deposits	$ 1,890,093	$ 1,894,019	$ —	$ 1,894,019	$ —
Long-term debt (a)	59,400	54,330	—	54,330	—
Subordinated debt	27,067	25,304	—	25,304	—

(Dollars in thousands)			Fair Value Measurements		
December 31, 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	$ 168,370	$ 166,582	$ —	$ 166,582	$ —
Net loans and leases	1,615,670	1,622,287	—	—	1,622,287
Financial instruments - liabilities					
Deposits	$ 1,726,026	$ 1,725,674	$ —	$ 1,725,674	$ —
Long-term debt	48,024	44,585	—	44,585	—
Subordinated debt	27,082	24,881	—	24,881	—

(a) Long-term debt excludes finance lease obligations.

(10) Guarantees and Commitments

Guarantees

In the normal course of business, Mid Penn makes various commitments and incurs certain contingent liabilities which are not reflected in the accompanying consolidated financial statements. The commitments include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Mid Penn evaluates each customer's 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 $27,757,000 and $20,839,000 of standby letters of credit outstanding as of September 30, 2019 and December 31, 2018, respectively. Mid Penn does not anticipate any losses because of these transactions. The amount of the liability as of September 30, 2019 and December 31, 2018 for payment under standby letters of credit issued was not material.

Commitments

During the second quarter of 2018, Mid Penn entered into a commitment to purchase an additional limited partnership interest in a low-income housing project to construct thirty-seven apartments and common amenities in Dauphin County, Pennsylvania. All of the units are intended to qualify for Federal Low-Income Housing Tax Credits ("LIHTCs") as provided for in Section 42 of the Internal Revenue Code of 1986, as amended. Mid Penn's limited partner capital contribution commitment is $7,579,000, which will be paid in installments over the course of construction of the low-income housing facilities. Each installment payment is conditional upon both Mid Penn's review and approval of the installment payment certificate and continued compliance with the terms of the original partnership agreement. The investment in the limited partnership will be reported in other assets on the Consolidated Balance Sheet and will be amortized over a ten year period once the facilities become operational and begin to be occupied. The project has been conditionally awarded $861,000 in annual LIHTCs by the Pennsylvania Housing Finance Agency, with a total anticipated LIHTC amount of $8,613,000 to be awarded to Mid Penn over the ten year amortization period. Mid Penn's commitment to initiate investments in the limited partnership interest was conditional upon (i) the review and approval of all closing documents, (ii) an opinion letter for tax counsel to the Partnership that the project qualifies for the LIHTCs, and (iii) review and approval by Mid Penn of other documents it deemed necessary. All such initial conditions were satisfied and Mid Penn began funding the investment during 2018. The total investment in this limited partnership was $5,810,000 and $1,710,000 on September 30, 2019 and December 31, 2018, respectively, and was included in the reported balance of other assets on the Consolidated Balance Sheet.

(11) 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, which is amortized through interest expense until the maturity date of November 30, 2025. 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 $119,000 at September 30, 2019 and $143,000 at December 31, 2018.

(12) 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, 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, 2019. A December 31 measurement date for the plan is used.

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		Other Benefits	
	2019	2018	2019	2018
Service cost	$ 36	$ 82	$ -	$ 1
Interest cost	65	107	5	4
Expected return on plan assets	(63)	(106)	—	—
Amortization (accretion) of prior service cost	—	4	(5)	(5)
Amortization of net (gain) or loss	(15)	—	(1)	—
Settlement gain	—	(117)	—	—
Net periodic benefit (income) expense	$ 23	$ (30)	$ (1)	$ —

(Dollars in thousands)	Nine Months Ended September 30,			
	Pension Benefits		Other Benefits	
	2019	2018	2019	2018
Service cost	$ 107	$ 242	$ 2	$ 3
Interest cost	194	322	13	13
Expected return on plan assets	(190)	(317)	—	—
Amortization (accretion) of prior service cost	—	13	(15)	(15)
Amortization of net (gain) or loss	(44)	—	(3)	—
Settlement gain	(37)	(497)	—	—
Net periodic benefit expense (income)	$ 30	$ (237)	$ (3)	$ 1

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 amortization of (gain) loss are reported as a component of other income.

(13) Preferred Stock

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

The terms of the Mid Penn Preferred Stock were no less favorable than those of the First Priority Preferred Stock as in effect immediately prior to the Merger. Dividends were payable quarterly on February 15, May 15, August 15 and November 15 of each year. The dividend rate on the Mid Penn Preferred Stock was fixed at 9%. For the three and nine months ended September 30, 2018, Mid Penn accrued $38,000 of Mid Penn Preferred Stock dividends which were subsequently paid on November 15, 2018.

During the fourth quarter of 2018, the Federal Reserve Bank approved Mid Penn's request to redeem all 3,404 shares of the Mid Penn Preferred Stock at the $1,000 liquidation value. The redemption of the $3,404,000 of the Mid Penn Preferred Stock was completed and final preferred stock dividend payments were made on December 14, 2018. Accordingly, no preferred stock was outstanding at either December 31, 2018 or September 30, 2019, and no preferred stock dividends were paid during the first nine months of 2019.

(14) 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 recipients are 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, 2019, a total of 57,655 restricted shares were granted under the Plan, of which 2,346 shares were forfeited and available for reissuance, 27,270 shares were vested, and the remaining 28,039 shares were unvested. No shares were forfeited during the nine months ended September 30, 2019, while 490 shares were forfeited due to a voluntary termination of an employee during the nine months ended September 30, 2018. The Plan shares granted and vested resulted in $90,000 in share-based compensation expense for the three months ended September 30, 2019, while $74,000 of share-based compensation expense was recorded for the three months ended September 30, 2018. Compensation expense related to the Plan was $250,000 and $187,000 for the nine months ended September 30, 2019 and 2018, respectively.

(15) Recent Accounting Pronouncements

Accounting Standards Adopted in 2019

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.

Mid Penn adopted this standard in the first quarter of 2019 using the option to apply the transition provisions of the new standard at the adoption date instead of the earliest period presented as provided in ASU 2018-11. Additionally, Mid Penn elected to apply all practical expedients as provided in ASU 2016-02, with the exception of the hindsight practical expedient, which was not elected. As a result of the adoption of this standard, effective January 1, 2019, Mid Penn recognized (i) an operating lease ROU asset of $11,661,000, (ii) an operating lease liability of $12,866,000, and (iii) an opening adjustment to retaining earnings of $316,000 to eliminate the remaining balance of the deferred sale/leaseback gain on two retail branch locations which had originally been recorded in 2016. The operating lease liability represents the present value of future payments on twenty-four leased properties within the Mid Penn footprint as of the January 1, 2019 adoption date, while the ROU asset reflects the lease liability, adjusted for deferred/accrued rent balances and the balance of acquisition accounting fair value adjustments of the respective properties as of the adoption date of January 1, 2019.

Subsequent to the adoption of Topic 842, Mid Penn entered into a lease agreement for one facility under a non-cancelable finance lease, which commenced March 1, 2019. As a result of this lease agreement, Mid Penn recognized (i) a finance lease ROU asset of $3,582,000 and (ii) a finance lease liability of $3,601,000 included in the reported amount of long-term debt.

The adoption of this standard did not have a material impact on the Consolidated Statements of Income or the Consolidated Statements of Cash Flow. See Note 8 - *Leases* for more information.

In March 2019, the FASB issued ASU No. 2019-01, *"Leases: Codification Improvements."* This ASU (1) states that for lessors that are not manufacturers or dealers, the fair value of the underlying asset is its cost, less any volume or trade discounts, as long as there is not a significant amount of time between acquisition of the asset and lease commencement; (2) clarifies that lessors in the scope of ASC 842 (such as the Company) must classify principal payments received from sales-type and direct financing leases in investing activities in the statement of cash flows; and (3) clarifies the transition guidance related to certain interim disclosures provided in the year of adoption. To coincide with the adoption of ASU No. 2016-02, the Company elected to early adopt ASU 2019-01 on January 1, 2019. The adoption of this ASU did not have a material impact on the Company's Consolidated Financial Statements.

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") as more fully described in Note 14. 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 adopted this standard on January 1, 2019 and the adoption of this ASU did 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.

Accounting Standards Pending Adoption

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 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.

In May 2019, FASB issued ASU 2019-05, *Financial Instruments-Credit Losses (Topic 326): Targeted Transition Relief,* which provides transition relief for ASU 2016-13 by providing entities with an alternative to irrevocably elect the fair value option for eligible financial assets measured at amortized cost upon adoption of the new credit losses standard. For those entities that have not yet adopted ASU 2016-13, the effective dates for adoption of ASU 2019-05 is the same as those in ASU 2016-13.

ASU 2016-13 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.

In July 2019, FASB voted to propose a delay in the implementation date of ASU 2016-13 for smaller reporting companies (SRCs) until January 1, 2023. The effective date for larger SEC filers would remain unchanged at January 1, 2020. In October 2019, FASB approved and finalized the delay of the implementation date for SRCs as proposed. Mid Penn is considered a SRC as of the most recent measurement date of June 30, 2019; therefore, pending release of this ASU, the approval of this deferral results in Mid Penn delaying the adoption of ASU 2016-13 by three years from January 1, 2020 to January 1, 2023. Mid Penn will continue to monitor our status as an SRC through the January 1, 2023 adoption date.

Mid Penn is currently evaluating the details of this ASU and the impact the guidance will have on Mid Penn's consolidated financial statements. Mid Penn expects that it is possible that the ASU may result in an increase in the allowance for credit losses resulting from the change to expected losses for the estimated life of the financial asset, including an allowance for debt securities. The amount of the change in the allowance for credit losses, if any, resulting from the new guidance will be impacted by the portfolio composition and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption. Mid Penn will continue to collect the required data elements needed to perform the calculation in advance of the January 1, 2023 adoption date.

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.

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

The following is Management's Discussion and Analysis of Consolidated Financial Condition as of September 30, 2019, compared to year-end 2018, and the Results of Operations for the three and nine months ended September 30, 2019, compared to the same periods in 2018. For comparative purposes, the September 30, 2018 and December 31, 2018 balances have been reclassified when, and if necessary, to conform to the 2019 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, 2018 (the "2018 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 2018 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 and the yield curve 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 and changes to data security systems including those with third-party information technology providers;
- 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.

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 $4,813,000 or $0.57 per common share, for the quarter ended September 30, 2019, compared to net income of $2,126,000 or $0.28 per common share for the quarter ended September 30, 2018. During the nine months ended September 30, 2019, net income was $13,293,000 or $1.57 per common share, versus $5,909,000 or $0.89 per common share, for the nine months ended September 30, 2018.

Net income as a percent of average assets (return on average assets, or "ROA") and net income as a percentage of 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,	
	2019	2018	2019	2018
Return on average assets	0.87%	0.46%	0.83%	0.51%
Return on average equity	8.19%	4.34%	7.76%	4.94%

The results for the three and nine months ended September 30, 2019 and 2018, in general, were materially impacted by the acquisitions of Scottdale and First Priority. Please refer to Notes 3 and 4 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, 2019 and 2018.

The following tables include average balances, amounts, and rates of interest income and expense, interest rate spread, and net interest margin for the three months ended September 30, 2019 and 2018.

(Dollars in thousands)	Average Balances, Income and Interest Rates on a Taxable Equivalent Basis — For the Three Months Ended September 30, 2019			September 30, 2018		
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates
ASSETS:						
Interest Bearing Balances	$ 4,687	$ 23	1.95%	$ 6,432	$ 26	1.60%
Investment Securities:						
Taxable	139,423	791	2.25%	174,938	1,073	2.43%
Tax-Exempt	84,888	627 (a)	2.93%	109,627	805 (a)	2.91%
Total Securities	224,311	1,418	2.51%	284,565	1,878	2.62%
Federal Funds Sold	94,800	506	2.12%	15,413	78	2.01%
Loans and Leases, Net	1,689,378	22,649 (b)	5.32%	1,398,731	17,786 (b)	5.04%
Restricted Investment in Bank Stocks	6,296	125	7.88%	3,675	55	5.94%
Total Earning Assets	2,019,472	24,721	4.86%	1,708,816	19,823	4.60%
Cash and Due from Banks	33,183			31,570		
Other Assets	148,447			97,523		
Total Assets	$ 2,201,102			$ 1,837,909		
LIABILITIES & SHAREHOLDERS' EQUITY:						
Interest-bearing Demand	$ 431,928	1,178	1.08%	$ 383,550	667	0.69%
Money Market	470,643	2,073	1.75%	333,777	836	0.99%
Savings	182,537	158	0.34%	209,673	179	0.34%
Time	460,324	2,421	2.09%	400,414	1,501	1.49%
Total Interest-bearing Deposits	1,545,432	5,830	1.50%	1,327,414	3,183	0.95%
Short-term Borrowings	9,284	69	2.95%	8,290	38	1.82%
Long-term Debt	63,601	456	2.84%	16,199	114	2.79%
Subordinated Debt	27,068	391	5.73%	23,537	337	5.68%
Total Interest-bearing Liabilities	1,645,385	6,746	1.63%	1,375,440	3,672	1.06%
Noninterest-bearing Demand	299,889			256,917		
Other Liabilities	22,755			11,339		
Shareholders' Equity	233,073			194,213		
Total Liabilities & Shareholders' Equity	$ 2,201,102			$ 1,837,909		
Net Interest Income (taxable equivalent basis)		$ 17,975			$ 16,151	
Taxable Equivalent Adjustment		(208)			(240)	
Net Interest Income		$ 17,767			$ 15,911	
Total Yield on Earning Assets			4.86%			4.60%
Rate on Supporting Liabilities			1.63%			1.06%
Average Interest Spread			3.23%			3.54%
Net Interest Margin			3.53%			3.75%

(a) Includes tax-equivalent adjustments on interest from tax-free municipal securities of $132,000 and $169,000 for the three months ended September 30, 2019 and 2018, respectively. Tax-equivalent adjustments were calculated using statutory tax rate of 21% at September 30, 2019 and 2018.

(b) Includes tax-equivalent adjustments on interest from tax-free municipal loans of $76,000 and $71,000 for the three months ended September 30, 2019 and 2018, respectively. Tax-equivalent adjustments were calculated using statutory tax rate of 21% at September 30, 2019 and 2018.

(Dollars in thousands on a Taxable Equivalent Basis)	Three months ended September 30, 2019 vs. 2018 Increase (decrease)		
	Volume	Rate	Net
INTEREST INCOME:			
Interest Bearing Balances	$ (7)	$ 4	$ (3)
Investment Securities:			
Taxable	(218)	(64)	(282)
Tax-Exempt	(182)	4	(178)
Total Securities	(400)	(60)	(460)
Federal Funds Sold	402	26	428
Loans and Leases, Net	3,696	1,167	4,863
Restricted Investment Bank Stocks	39	31	70
Total Interest Income	3,730	1,168	4,898
INTEREST EXPENSE:			
Interest Bearing Deposits:			
Interest Bearing Demand	84	427	511
Money Market	343	894	1,237
Savings	(23)	2	(21)
Time	225	695	920
Total Interest Bearing Deposits	629	2,018	2,647
Short-term Borrowings	5	26	31
Long-term Debt	334	8	342
Subordinated Debt	51	3	54
Total Interest Expense	1,019	2,055	3,074
NET INTEREST INCOME	$ 2,711	$ (887)	$ 1,824

Taxable-equivalent net interest income was $17,975,000 for the three months ended September 30, 2019, an increase of $1,824,000 or 11 percent compared to the three months ended September 30, 2018. Net interest income during the third quarter of 2019 was positively influenced by the full-quarter impact of the loans and investment securities acquired during the First Priority transaction on July 31, 2018, as well as organic growth occurring after September 30, 2018.

For the three months ended September 30, 2019, Mid Penn's tax-equivalent net interest margin was 3.53% compared to 3.75% for the three months ended September 30, 2018. This decrease in net interest margin was driven by successful growth in deposits in both the third quarter and full-year 2019, as Mid Penn had a higher average balance of demand deposits and liquid assets which were temporarily invested in overnight federal funds sold in anticipation of redeployment of some of this excess funding for future loan growth, repayment of maturing wholesale borrowings, and near-term redemptions of brokered CDs. The net interest margin was also impacted by an increase in the cost of deposits, particularly money market accounts and time deposits.

The following tables include average balances, amounts, and rates of interest income and expense, interest rate spread, and net interest margin for the nine months ended September 30, 2019 and 2018.

(Dollars in thousands)	Average Balances, Income and Interest Rates on a Taxable Equivalent Basis					
	For the Nine Months Ended					
	September 30, 2019			September 30, 2018		
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates
ASSETS:						
Interest Bearing Balances	$ 5,287	$ 80	2.02%	$ 4,993	$ 52	1.39%
Investment Securities:						
Taxable	154,617	2,718	2.35%	163,900	2,824	2.30%
Tax-Exempt	97,814	2,149 (a)	2.94%	100,305	2,145 (a)	2.86%
Total Securities	252,431	4,867	2.58%	264,205	4,969	2.51%
Federal Funds Sold	42,855	704	2.20%	31,327	399	1.70%
Loans and Leases, Net	1,661,695	66,103 (b)	5.32%	1,131,410	41,320 (b)	4.88%
Restricted Investment in Bank Stocks	6,094	312	6.85%	3,141	188	8.00%
Total Earning Assets	1,968,362	72,066	4.90%	1,435,076	46,928	4.37%
Cash and Due from Banks	29,539			29,801		
Other Assets	144,918			78,126		
Total Assets	$ 2,142,819			$ 1,543,003		
LIABILITIES & SHAREHOLDERS' EQUITY:						
Interest-bearing Demand	$ 404,712	3,015	1.00%	$ 368,362	1,687	0.61%
Money Market	429,421	5,433	1.69%	288,064	1,917	0.89%
Savings	191,027	495	0.35%	183,617	329	0.24%
Time	472,872	6,749	1.91%	277,239	3,027	1.46%
Total Interest-bearing Deposits	1,498,032	15,692	1.40%	1,117,282	6,960	0.83%
Short-term Borrowings	21,606	458	2.83%	3,775	50	1.77%
Long-term Debt	56,016	1,217	2.90%	13,598	263	2.59%
Subordinated Debt	27,074	1,167	5.76%	19,403	807	5.56%
Total Interest-bearing Liabilities	1,602,728	18,534	1.55%	1,154,058	8,080	0.94%
Noninterest-bearing Demand	288,362			216,037		
Other Liabilities	22,745			12,849		
Shareholders' Equity	228,984			160,059		
Total Liabilities & Shareholders' Equity	$ 2,142,819			$ 1,543,003		
Net Interest Income (taxable equivalent basis)		$ 53,532			$ 38,848	
Taxable Equivalent Adjustment		(689)			(645)	
Net Interest Income		$ 52,843			$ 38,203	
Total Yield on Earning Assets			4.90%			4.37%
Rate on Supporting Liabilities			1.55%			0.94%
Average Interest Spread			3.35%			3.44%
Net Interest Margin			3.64%			3.62%

(a) Includes tax-equivalent adjustments on interest from tax-free municipal securities of $451,000 and $450,000 for the nine months ended September 30, 2019 and 2018, respectively. Tax-equivalent adjustments were calculated using statutory tax rate of 21% at September 30, 2019 and 2018.

(b) Includes tax-equivalent adjustments on interest from tax-free municipal loans of $238,000 and $195,000 for the nine months ended September 30, 2019 and 2018, respectively. Tax-equivalent adjustments were calculated using statutory tax rate of 21% at September 30, 2019 and 2018.

(Dollars in thousands on a Taxable Equivalent Basis)	Nine months ended September 30, 2019 vs. 2018 Increase (decrease)		
	Volume	Rate	Net
INTEREST INCOME:			
Interest Bearing Balances	$ 3	$ 25	$ 28
Investment Securities:			
Taxable	(160)	54	(106)
Tax-Exempt	(53)	57	4
Total Securities	(213)	111	(102)
Federal Funds Sold	147	158	305
Loans and Leases, Net	19,366	5,417	24,783
Restricted Investment Bank Stocks	177	(53)	124
Total Interest Income	19,480	5,658	25,138
INTEREST EXPENSE:			
Interest Bearing Deposits:			
Interest Bearing Demand	166	1,162	1,328
Money Market	941	2,575	3,516
Savings	13	153	166
Time	2,136	1,586	3,722
Total Interest Bearing Deposits	3,256	5,476	8,732
Short-term Borrowings	236	172	408
Long-term Debt	820	134	954
Subordinated Debt	319	41	360
Total Interest Expense	4,631	5,823	10,454
NET INTEREST INCOME	$ 14,849	$ (165)	$ 14,684

Taxable-equivalent net interest income was $53,532,000 for the nine months ended September 30, 2019, an increase of $14,684,000 or 38 percent compared to the nine months ended September 30, 2018. Net interest income for the nine months ended September 30, 2019 was positively influenced by the full-year impact of the loans and investment securities acquired during the First Priority transaction on July 31, 2018.

For the nine months ended September 30, 2019, Mid Penn's tax-equivalent net interest margin was 3.64% versus 3.62% for the nine months ended September 30, 2018. Year-over-year increases in yields on interest-earning assets and growth in noninterest-bearing deposits more than offset the impact of both (i) the rising cost of both deposit and borrowed funds as a result of the FOMC rate increases in 2018, and (ii) the higher volume of wholesale funding sources, including brokered time deposits and subordinated debt assumed in the First Priority acquisition, and other short-term borrowings added since September 30, 2018 to support liquidity and interest rate management while also partially funding loan growth.

Although the effective interest rate impact on earning assets and funding sources can be reasonably estimated at current interest rate levels, the interest-bearing product and pricing options selected by customers, and the future mix of the loan, investment, and deposit products in the Bank's portfolios, may significantly change the estimates used in Mid Penn's asset and liability management and related interest rate risk simulation models. In addition, our net interest income may be impacted by further interest rate actions of FOMC.

Provision for Loan Losses

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

Mid Penn has maintained the allowance in accordance with Mid Penn's assessment process, which takes into consideration, among other relevant factors, the risk characteristics of the loan portfolio, the growth in the loan portfolio during the first nine months of 2019, and shifting collateral values from December 31, 2018 to September 30, 2019.

Management performs a monthly evaluation of the adequacy of the loan and lease loss allowance and based on this evaluation, a loan loss provision of $565,000 and $100,000 was recorded for the three months ended September 30, 2019 and 2018, respectively. During the nine months ended September 30, 2019, the loan loss provision was $1,155,000 compared to $225,000 for the nine months ended September 30, 2018. The allowance for loan and lease losses as a percentage of total loans was 0.54% at September 30, 2019, 0.52% at December 31, 2018, and 0.53% at September 30, 2018. This ratio reflects the impact of the entire portfolio of First Priority loans being added after September 30, 2018 at fair value with no accompanying loan and lease loss allowance in accordance with purchase accounting GAAP. For further discussion of factors affecting the provision for loan and lease losses, please see *Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses* in the Financial Condition section of this Management's Discussion and Analysis.

Noninterest Income

During the three months ended September 30, 2019, noninterest income totaled $3,003,000, an increase of $832,000 or 38 percent, compared to noninterest income of $2,171,000 for the three months ended September 30, 2018. For the nine months ended September 30, 2019, noninterest income totaled $7,926,000, an increase of $2,485,000 or 46 percent, compared to noninterest income of $5,441,000 for the same period in 2018.

The following components of noninterest income showed significant changes:

(Dollars in Thousands)	Three Months Ended September 30,			
	2019	2018	$ Variance	% Variance
Income from fiduciary activities	$ 386	$ 325	$ 61	19%
ATM debit card interchange income	434	317	117	37%
Mortgage banking income	1,091	197	894	454%
Merchant services income	115	90	25	28%
Net gain on sales of SBA loans	275	68	207	304%
Net gain on sales of investment securities	46	30	16	53%
Other income	347	826	(479)	-58%

(Dollars in Thousands)	Nine Months Ended September 30,			
	2019	2018	$ Variance	% Variance
Income from fiduciary activities	$ 1,092	$ 851	$ 241	28%
ATM debit card interchange income	1,148	908	240	26%
Mortgage banking income	2,605	558	2,047	367%
Merchant services income	304	261	43	16%
Net gain on sales of SBA loans	710	477	233	49%
Net gain on sales of investment securities	70	132	(62)	-47%
Other income	1,096	1,382	(286)	-21%

Mortgage banking income was $2,605,000 for the nine months ended September 30, 2019, an increase of $2,047,000 or over 350 percent compared to mortgage banking income of $558,000 for the nine months ended September 30, 2018. Longer-term mortgage interest rates have declined significantly in the first nine months of 2019, resulting in a higher level of mortgage originations and secondary-market loan sales during the first nine months of 2019 when compared to the same period in 2018. Additionally, Mid Penn expanded its team of residential mortgage originators in southeastern Pennsylvania during the first quarter of 2019, contributing to the larger volume of mortgage loans originated and sold in the nine months ended September 30, 2019.

Income from fiduciary activities was $1,092,000 for the nine months ended September 30, 2019, an increase of $241,000 or 28 percent, compared to fiduciary income of $851,000 for the nine months ended September 30, 2018. These additional revenues were attributed to continued growth in trust assets under management, and increased sales of retail investment products, as a result of successful business development efforts by Mid Penn's trust and wealth management team.

ATM debit card interchange income was $1,148,000 for the nine months ended September 30, 2019, an increase of $240,000 or 26 percent compared to interchange income of $908,000 for the nine months ended September 30, 2018. The increase resulted from increasing card-transaction usage across our customer base, as well as the added volume from demand deposit accounts assumed in the First Priority acquisition.

Net gains on sales of SBA loans were $710,000 for the nine months ended September 30, 2019, an increase of $233,000 or 49 percent compared to net gains on sales of SBA loans of $477,000 during the same period in 2018. The increase reflects a higher volume of loans settling in 2019 despite less favorable SBA loan rates year-over-year.

For the nine months ended September 30, 2019, merchant services income totaled $304,000, an increase of $43,000 or 16 percent, compared $261,000 for the nine months ended September 30, 2018, reflecting an increase in the volume of business customers utilizing merchant services to process their debit card transactions, cash advances, and other related products.

Other income was $1,096,000 for the nine months ended September 30, 2019, a decrease of $286,000 compared to other income of $1,382,000 for the nine months ended September 30, 2018. Although wire transfer, letter of credit, and other fees increased in 2019, these were more than offset by

a decline in pension settlement gain income year over year. During the first three quarters of 2018, Mid Penn recognized $497,000 of defined benefit pension plan settlement gains from certain plan participants receiving lump sum benefit payouts (the plan and related liabilities were assumed as a result of the Scottdale acquisition). During the first three quarters of 2019, a lower amount of pension plan lump sum payouts occurred, with related settlement gains totaling $37,000. Pension settlement gains are not expected to be a recurring item on a going-forward basis.

Net gains on sales of securities were $70,000 for the nine months ended September 30, 2019, a decrease of $62,000 compared to net gains on sales of securities of $132,000 for the nine months ended September 30, 2018. During the first three quarters of 2018, some investment securities acquired from Scottdale were subsequently sold at gains to ensure that the overall portfolio was in alignment with Mid Penn's investment management objectives. The volume of investment sales, and realized gains, were less during the first nine months of 2019, with such sales related primarily in support of interest rate risk and liquidity management.

Noninterest Expense

Noninterest expense for the three months ended September 30, 2019 totaled $14,683,000, a decrease of $587,000 or 4 percent compared to noninterest expenses of $15,270,000 for the three months ended September 30, 2018. For the nine months ended September 30, 2019, noninterest expense totaled $43,782,000, an increase of $7,523,000 or 21 percent, compared to noninterest expense of $36,259,000 for the same period in 2018. The increase in noninterest expense for the nine-month period was driven by both (i) the impact of the staff, facilities, and technology licensing costs added as a result of the acquisition of First Priority in July 2018, and (ii) the 2019 expansion of Mid Penn's mortgage banking division in the southeastern Pennsylvania market.

The changes were primarily a result of the following components of noninterest expense, which had significant variances when comparing results for periods ending in 2019 versus the corresponding period in 2018:

(Dollars in Thousands)	Three Months Ended September 30,			
	2019	2018	$ Variance	% Variance
Salaries and employee benefits	$ 8,425	$ 6,680	$ 1,745	26%
Occupancy expense, net	1,232	1,063	169	16%
Equipment expense	671	579	92	16%
Pennsylvania bank shares tax expense	359	131	228	174%
FDIC Assessment	(131)	187	(318)	-170%
Legal and professional fees	311	272	39	14%
Software licensing and utilization	1,150	949	201	21%
Intangible amortization	355	341	14	4%
Merger and acquisition expense	—	3,039	(3,039)	-100%
Other expenses	1,959	1,533	426	28%

(Dollars in Thousands)	Nine Months Ended September 30,			
	2019	2018	$ Variance	% Variance
Salaries and employee benefits	$ 23,970	$ 16,286	$ 7,684	47%
Occupancy expense, net	3,977	2,730	1,247	46%
Equipment expense	1,956	1,531	425	28%
Pennsylvania bank shares tax expense	740	473	267	56%
FDIC Assessment	542	508	34	7%
Legal and professional fees	1,204	752	452	60%
Software licensing and utilization	3,282	2,634	648	25%
Intangible amortization	1,078	837	241	29%
Merger and acquisition expense	—	4,955	(4,955)	-100%
Other expenses	5,947	4,332	1,615	37%

Salaries and employee benefits expenses were $23,970,000 during the nine months ended September 30, 2019, an increase of $7,684,000 or 47 percent, versus the same period in 2018, with the increase primarily attributable to (i) the full-year impact of the compensation and benefit costs of the staff additions at the eight office locations added through the First Priority acquisition, effective July 31, 2018, and (ii) the back-office and loan originator staff additions as a result of the expansion of the mortgage banking division.

Occupancy expenses increased $1,247,000 or 46 percent during the first nine months of 2019 compared to the same period in 2018. Similarly, equipment expense increased $425,000 or 28 percent during the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018. These increases related to (i) the incremental facilities operating costs, including rent, utilities, and depreciation expense for the buildings and equipment associated with the acquisition of the First Priority retail offices, and (ii) an investment in a corporate administrative facility to promote long-term operational and processing efficiencies by centralizing several back-office functions supporting the broader franchise.

Pennsylvania bank shares tax expense was $740,000 for the nine months ended September 30, 2019, an increase of $267,000 or 56 percent compared to $473,000 for the nine months ended September 30, 2018. The increase in assessment expense generally reflects the larger total shareholder equity balance (from both acquisition and organic growth activity) upon which the tax is based.

FDIC assessment expense was $542,000 for the nine months ended September 30, 2019, an increase of $34,000 or 7 percent compared to $508,000 for the nine months ended September 30, 2018. The third quarter of 2019 reflects the receipt of $492,000 of FDIC small bank assessment credits which were applied to FDIC assessment expense. Mid Penn received notification from the FDIC that the FDIC's Deposit Insurance Fund reserve ratio met a threshold resulting in the FDIC providing the Bank with the credit, which was applied to assessment liability accruals for both the second and third quarters of 2019. The credit received during 2019 partially offset an increase in total assessment expense when comparing to the same period in 2018, primarily due the year-over-year increase in total average assets of the Bank on which the assessment is based.

Legal and professional fees for the nine months ended September 30, 2019 increased by $452,000 or 60 percent compared to the same period in 2018 due to increased use and costs of third-party providers for information technology support, human resources services, external audit, and loan review services.

Software licensing and utilization costs were $3,282,000 during the nine months ended September 30, 2019, an increase of $648,000 or 25 percent compared to $2,634,000 for the nine months ended September 30, 2018. The increase is a result of additional transaction volume based costs and licensing fees related to the addition of the locations, staff and accounts for the First Priority offices acquired in July 2018, the Pillow branch added in September 2018, and the expanded mortgage banking division added during the first quarter of 2019. Additionally, Mid Penn continued to invest in upgrades to internal systems to enhance data management and storage capabilities given the larger company profile.

Intangible amortization increased from $837,000 during the nine months ended September 30, 2018 to $1,078,000 during the same period in 2019 due to the full nine-month impact of the core deposit intangible asset added from the First Priority acquisition on July 31, 2018.

Other expenses were $5,947,000 during the nine months ended September 30, 2019, an increase of $1,615,000 or 37 percent compared to other expense of $4,332,000 for the same period in 2018. As the First Priority acquisition and organic growth have increased the organization's geographic profile and employee base, several categories within other expense experienced increases, including insurance costs, charitable donations, stationary and supplies, printing, loan collection costs, and directors' fees.

No merger expenses were recorded during the nine months ended September 30, 2019. During the first nine months of 2018, merger and acquisition expenses totaling $4,955,000 were recorded including investment banking fees, merger-related legal and professional fees, severance costs, and information technology conversion/termination costs incurred for the 2018 acquisitions of First Priority and Scottdale.

Income Taxes

The provision for income taxes was $709,000 for the three months ended September 30, 2019 compared to $548,000 for the three months ended September 30, 2018. The third quarter of 2019 reflects a favorable adjustment to income tax expense of $277,000 for certain permanent nonrecurring tax benefits recorded within the current quarter. The effective tax rate for the three months ended September 30, 2019 was 12.8 percent compared to 20.2 percent for the three months ended September 30, 2018. The provision for income taxes was $2,539,000 for the nine months ended September 30, 2019 compared to $1,213,000 for the nine months ended September 30, 2018. The effective tax rate for the nine months ended September 30, 2019 was 16.0 percent compared to 16.9 percent for the nine months ended September 30, 2018.

Generally, Mid Penn's effective tax rate is below the statutory rate due to earnings on tax-exempt loans, investments, and earnings from the cash surrender value of life insurance, as well as the impact of tax credits. The realization of Mid Penn's deferred tax assets is dependent on future earnings. Mid Penn currently anticipates that future earnings will be adequate to fully realize the currently recorded deferred tax assets.

Financial Condition

Overview

Mid Penn's total assets were $2,248,899,000 as of September 30, 2019, reflecting an increase of $170,918,000 or 8 percent compared to total assets of $2,077,981,000 as of December 31, 2018. Asset growth during the first nine months of 2019 was primarily attributable to (i) net organic loan growth, (ii) an increase in liquid assets primarily from demand deposit growth, and (iii) the recording of operating and finance lease right of use assets as a result of Mid Penn's adoption of Accounting Standard Codification (ASC) 842 – *Leases* effective January 1, 2019.

Loans

Total loans at September 30, 2019 were $1,710,434,000 compared to $1,624,067,000 at December 31, 2018, an increase of $83,367,000 or 5 percent since year-end 2018. The majority of the growth was commercial and industrial financing, and commercial real estate credits.

(Dollars in thousands)	September 30, 2019		December 31, 2018	
	Amount	%	Amount	%
Commercial and industrial	$ 320,400	18.7%	$ 286,518	17.6%
Commercial real estate	892,060	52.2%	861,369	53.0%
Commercial real estate - construction	177,151	10.4%	142,173	8.8%
Lease financing	—	0.0%	53	0.0%
Residential mortgage	243,729	14.3%	253,543	15.6%
Home equity	69,240	4.1%	70,096	4.3%
Consumer	7,854	0.5%	10,315	0.3%
	$ 1,710,434	100.0%	$ 1,624,067	100.0%

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

For the nine months ended September 30, 2019, Mid Penn had net loan charge-offs of $236,000 compared to net recoveries of $398,000 during the same period in 2018. The net charge-off position in 2019 was primarily due to a $205,000 charge-off taken on one relationship during the second quarter of 2019. The favorable net recovery position in 2018 was driven by the recovery of $777,000 of principal from the successful workout of a commercial real estate relationship that originally had a large partial charge-off in 2009.

Loans charged off during the first nine months of 2019 totaled $370,000 and included three commercial and industrial loans for $217,000, two commercial real estate (construction) loans for $40,000, two commercial real estate loans for $53,000, five consumer loans for $33,000, one residential mortgage loan for $3,000 and $24,000 in deposit account charge-offs. Mid Penn may need to make future adjustments to the allowance and the provision for loan and lease losses if economic conditions or loan credit quality differs substantially from the assumptions used in making Mid Penn's evaluation of the level of the allowance for loan losses as compared to the balance of outstanding loans.

Changes in the allowance for the nine months ended September 30, 2019 and 2018 are summarized as follows:

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
Balance, beginning of period	$ 8,397	$ 7,606
Loans charged off during period	(370)	(418)
Recoveries of loans previously charged off	134	816
Net (charge-offs) recoveries	(236)	398
Provision for loan and lease losses	1,155	225
Balance, end of period	$ 9,316	$ 8,229
Ratio of net loan charge-offs (recoveries) to average loans outstanding, annualized	0.02%	-0.05%
Ratio of allowance for loan losses to net loans at end of period	0.54%	0.53%

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

The following table presents the change in nonperforming asset categories as of September 30, 2019, December 31, 2018, and September 30, 2018.

(Dollars in thousands)

	September 30, 2019	December 31, 2018	September 30, 2018
Nonperforming Assets:			
Nonaccrual loans	$ 4,926	$ 10,749	$ 10,351
Accruing troubled debt restructured loans	497	517	524
Total nonperforming loans	5,423	11,266	10,875
Foreclosed real estate	130	1,017	1,101
Total non-performing assets	5,553	12,283	11,976
Accruing loans 90 days or more past due	—	—	—
Total risk elements	$ 5,553	$ 12,283	$ 11,976
Nonperforming loans as a % of total loans outstanding	0.32%	0.69%	0.69%
Nonperforming assets as a % of total loans outstanding and other real estate	0.32%	0.76%	0.76%
Ratio of allowance for loan losses to nonperforming loans	171.79%	74.53%	75.67%

In the table above, troubled debt restructured loans that are no longer accruing interest are included in nonaccrual loans. The decrease was primarily due to the successful workout and repayment of a nonaccrual commercial credit relationship totaling $4,302,000 during the first quarter of 2019.

One loan relationship, which accounts for $1,364,000 of the non-performing loan balance as of September 30, 2019, was comprised of three loans collateralized primarily by commercial real estate, as well as certain machinery and equipment. As part of the workout process, the loans in this relationship were modified as troubled debt restructured loans during 2017. During the first nine months of 2018, certain commercial real estate collateral was sold resulting in the principal payoff of three loans within this loan relationship totaling $1,393,000. Given that the fair value of the remaining collateral exceeds the outstanding principal balance, no specific allowance allocation has been assigned to this relationship. Management expects to recover the remaining outstanding balance through the sale of real estate collateral pledged in support of the loans.

The decrease in foreclosed real estate from $1,017,000 at December 31, 2018 to $130,000 at September 30, 2019 was primarily driven by the sale of nine foreclosed real estate properties with proceeds totaling $1,306,000 during the nine months ended September 30, 2019. These sales were offset by the transfer of loans to foreclosed real estate of $397,000.

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

(Dollars in thousands)

	September 30, 2019	December 31, 2018
Period ending total loans outstanding	$ 1,710,434	$ 1,624,067
Allowance for loan and lease losses	9,316	8,397
Total Nonperforming loans	5,423	11,266
Nonperforming and impaired loans with partial charge-offs	342	333
Ratio of nonperforming loans with partial charge-offs to total loans	0.02%	0.02%
Ratio of nonperforming loans with partial charge-offs to total nonperforming loans	6.31%	2.96%
Coverage ratio net of nonperforming loans with partial charge-offs	183.35%	76.80%
Ratio of total allowance to total loans less nonperforming loans with partial charge-offs	0.54%	0.52%

Mid Penn considers a commercial loan or commercial real estate loan to be impaired when it becomes 90 days or more past due and not well-secured or otherwise not probable for collection. This methodology assumes the borrower cannot or will not continue to make additional payments. At that time the loan would be considered collateral dependent as the discounted cash flow method indicates no operating income is available for evaluating the collateral position; therefore, most impaired loans are deemed to be collateral dependent.

Mid Penn evaluates loans for charge-off on a monthly basis. Policies that govern the recommendation for charge-off are unique to the type of loan being considered. Commercial loans rated as nonaccrual or lower will first have a collateral evaluation completed in accordance with the guidance on impaired loans. Once the collateral evaluation has been completed, a specific allocation of allowance is made based upon the results of the evaluation. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In the event the loan is unsecured, the loan would have been charged-off at the recognition of impairment. Commercial real estate loans rated as impaired will also have an initial collateral evaluation completed in accordance with the guidance on impaired loans. An updated real estate valuation is ordered and the collateral evaluation is modified to reflect any variation in value. A specific allocation of allowance is made for any anticipated collateral shortfall. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). The process of charge-off for residential mortgage loans begins upon a loan becoming delinquent for 90 days and not in the process of collection. The existing appraisal is reviewed and a lien search is obtained to determine lien position and any instances of intervening liens. A new appraisal of the property will be ordered if deemed necessary by management and a collateral evaluation is completed. The loan will then be charged down to the value indicated in the evaluation. Consumer loans are recommended for charge-off after reaching delinquency of 90 days and the loan is not 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 both commercial loans and commercial real estate loans. The balance remains a nonperforming loan with the original terms and interest rate intact (not restructured). In addition, Mid Penn takes a preemptive step when any commercial loan or commercial real estate loan becomes classified under its internal classification system. A preliminary collateral evaluation in accordance with the guidance on impaired loans is prepared using the existing collateral information in the loan file. This process allows Mid Penn to review both the credit and documentation files to determine the status of the information needed to make a collateral evaluation. This collateral evaluation is preliminary, but allows Mid Penn to determine if any potential collateral shortfalls exist.

Larger groups of small-balance loans, such as residential mortgages and consumer installment loans are collectively evaluated for impairment. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures unless such loans are the subject of a restructuring agreement.

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

It is Mid Penn's policy to obtain updated third party valuations on all impaired loans collateralized by real estate as soon as 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 or private sales. Management reviews the estimates of these third parties and discounts them accordingly based on management's judgment, if deemed necessary.

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

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

Mid Penn had loans with an aggregate balance of $5,417,000 deemed impaired at September 30, 2019. Excluding $2,146,000 in loans acquired with credit deterioration in connection with the closing of the Phoenix Bancorp, Inc. ("Phoenix") acquisition in 2015, and the Scottdale and First Priority acquisitions in 2018, Mid Penn had several loan relationships deemed impaired with an aggregate carrying balance of $3,271,000. This pool of impaired loans was further broken down into a group of loans with an aggregate carrying balance of $537,000, for which specific allocations totaling $336,000 were included within the loan loss reserve for these loans. The remaining $2,734,000 of loans required no specific allocation within the loan loss reserve. Of the $3,271,000 of impaired loan relationships, excluding the loans acquired with credit deterioration from the Phoenix, Scottdale, and First Priority acquisitions, $2,324,000 were commercial real estate relationships, $40,000 were commercial real estate – construction relationships, $881,000 were residential relationships, and $26,000 were home equity relationships. There were specific loan loss reserve allocations of $336,000 against the commercial real estate relationships. Management currently believes that the specific reserves are adequate to cover probable future losses related to these relationships.

The allowance is a reserve established in the form of a provision expense for loan and lease losses and is reduced by loan charge-offs net of recoveries. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risk on a monthly basis so that an appropriate allowance is maintained. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance to the Board of Directors, indicating any changes in the allowance since the last review. In making the evaluation, management considers the results of recent regulatory examinations, which typically include a review of the allowance as an integral part of the examination process. As part of the examination process, federal or state regulatory agencies may require Mid Penn to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

In establishing the allowance, management evaluates on a quantitative basis individual classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. In addition, an allowance for the remainder of the loan and lease portfolio is determined based on historical loss experience within certain components of the portfolio. These allocations may be modified if current conditions indicate that loan and lease losses may differ from historical experience.

In addition, a portion of the allowance is established for losses inherent in the loan and lease portfolio which have not been identified by the quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in historical loss experience. These factors include:

- changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;
- changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans;
- changes in the value of underlying collateral for collateral-dependent loans;
- changes in the experience, ability, and depth of lending management and other relevant staff;
- changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
- changes in the quality of the institution's loan review system;
- changes in the nature and volume of the portfolio and in the terms of loans;
- the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio; and
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

While the allowance is maintained at a level believed to be adequate by management to provide for probable losses inherent in the loan and lease portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. The unallocated component of the allowance for loan and lease losses covers several considerations that are not specifically measurable through either the specific or general components. For example, we believe that we 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. Changes from these various other uncertainties and considerations may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance for loan losses of $9,316,000 is adequate as of September 30, 2019 to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

Liquidity

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

- a growing core deposit base;
- proceeds from the sale or maturity of investment securities;
- proceeds from interest-bearing time deposits with other financial institutions;
- payments received on loans and mortgage-backed securities;
- overnight correspondent bank borrowings on various credit lines; and
- borrowing capacity available from the FHLB, the Federal Reserve Discount Window, and other lines of credit currently available to Mid Penn.

The major sources of cash received in the first nine months of 2019 were from the $164,067,000 net increase in deposits, $113,505,000 of proceeds from sales of mortgage loans originated for sale, and $69,377,000 proceeds from the sale of available-for-sale securities.

Major uses of cash in the first nine months of 2019 were $116,313,000 to fund mortgage loans originated for sale, and $87,000,000 to fund portfolio loan growth (primarily commercial loans), and $36,239,000 to fund the purchase of investment securities.

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

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

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 which is being amortized through interest expense until the maturity date of November 30, 2025. 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.

Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2016. The final rules implemented higher minimum capital requirements, added a new common equity Tier 1 capital requirement, and established criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital. Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity Tier 1 capital above its minimum risk-based capital requirements, which amount (when fully phased in) must be greater than 2.5% of total risk-weighted assets at January 1, 2019. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations began on January 1, 2016 at the initial rate of 0.625%.

A summary of the payout restrictions based on the capital conservation buffer is as follows:

Capital Conservation Buffer (as a % of risk-weighted assets)	Maximum Payout (as a % of eligible retained income)
> 2.5%	No payout limitation applies
≤2.5% and >1.875%	60%
≤1.875% and >1.25%	40%
≤1.25% and >0.625%	20%
≤0.625%	0%

Implementation of the deductions and other adjustments to common equity Tier 1 capital began on January 1, 2016 and were phased-in over a three-year period. The final rules called for the following minimum capital requirements to be considered "well-capitalized" (which include the impact of the capital conservation buffer that was effective January 1, 2016):

	As of January 1,			
	2016	2017	2018	2019
Minimum common equity Tier 1 capital ratio	4.5%	4.5%	4.5%	4.5%
Common equity Tier 1 capital conservation buffer	0.625%	1.25%	1.875%	2.5%
Minimum common equity Tier 1 capital ratio plus capital conservation buffer	5.125%	5.75%	6.375%	7.0%
Phase-in of most deductions from common equity Tier 1 capital	60%	80%	100%	100%
Minimum Tier 1 capital ratio	6.0%	6.0%	6.0%	6.0%
Minimum Tier 1 capital ratio plus capital conservation buffer	6.625%	7.25%	7.875%	8.5%
Minimum total capital ratio	8.0%	8.0%	8.0%	8.0%
Minimum total capital ratio plus capital conservation buffer	8.625%	9.25%	9.875%	10.5%

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

The final rules permanently grandfathered non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010 for inclusion in the Tier 1 capital of banking organizations with total consolidated assets less than $15 billion as of December 31, 2009 and banking organizations that were mutual holding companies as of May 19, 2010.

Consistent with the Dodd-Frank Act, the new rules replaced the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures. Alternatively, banking organizations may use the existing gross-ups approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250% risk weight.

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

Mid Penn has implemented these changes in determining and reporting the regulatory ratios of Mid Penn and the Bank, and has concluded that the new rules do not have a material adverse effect on Mid Penn's financial condition.

Capital Resources

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

Shareholders' equity increased by $11,403,000 or 5 percent from $223,209,000 as of December 31, 2018 to $234,612,000 as of September 30, 2019. The increase in shareholders' equity reflects both (i) the growth in retained earnings through year-to-date net income, net of dividends paid, through the first nine months of 2019, and (ii) the year-to-date accumulated other comprehensive income from the after-tax appreciation in the market value of the available-for-sale investment portfolio. Regulatory capital ratios for both Mid Penn and its banking subsidiary exceeded regulatory "well-capitalized" levels at both September 30, 2019 and 2018.

Banks are evaluated for capital adequacy based on the ratio of capital to risk-weighted assets and total assets. The minimum capital to risk-weighted assets requirements, including the capital conservation buffers, which became effective for Mid Penn and the Bank on January 1, 2016 are illustrated below. At September 30, 2019, regulatory capital ratios for both Mid Penn and the Bank met the definition of a "well-capitalized" institution under the regulatory framework for prompt corrective action, and exceeded the minimum capital requirements under Basel III.

Mid Penn and Mid Penn Bank maintained the following regulatory capital levels, leverage ratios, and risk-based capital ratios as of September 30, 2019 and December 31, 2018:

(Dollars in thousands)	Capital Adequacy					
	Actual:		Minimum Capital Required:		To Be Well-Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Mid Penn Bancorp, Inc.						
As of September 30, 2019:						
Tier 1 Capital (to Average Assets)	$ 164,525	7.7%	$ 85,256	4.0%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	164,525	9.9%	116,641	7.0%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	164,525	9.9%	141,636	8.5%	N/A	N/A
Total Capital (to Risk Weighted Assets)	201,042	12.1%	174,962	10.5%	N/A	N/A
Mid Penn Bank						
As of September 30, 2019:						
Tier 1 Capital (to Average Assets)	$ 181,665	8.5%	$ 85,245	4.0%	$ 106,557	5.0%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	181,665	10.9%	116,621	7.0%	108,291	6.5%
Tier 1 Capital (to Risk Weighted Assets)	181,665	10.9%	141,611	8.5%	133,281	8.0%
Total Capital (to Risk Weighted Assets)	200,615	12.0%	174,931	10.5%	166,601	10.0%
Mid Penn Bancorp, Inc.						
As of December 31, 2018:						
Tier 1 Capital (to Average Assets)	$ 155,662	8.0%	$ 77,499	4.000%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	155,662	10.0%	98,977	6.375%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	155,662	10.0%	122,265	7.875%	N/A	N/A
Total Capital (to Risk Weighted Assets)	191,300	12.3%	153,317	9.875%	N/A	N/A
Mid Penn Bank						
As of December 31, 2018:						
Tier 1 Capital (to Average Assets)	$ 171,776	8.9%	$ 77,230	4.000%	$ 96,537	5.0%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	171,776	11.1%	98,963	6.375%	100,903	6.5%
Tier 1 Capital (to Risk Weighted Assets)	171,776	11.1%	122,248	7.875%	124,189	8.0%
Total Capital (to Risk Weighted Assets)	180,332	11.6%	153,295	9.875%	155,236	10.0%

(a) The minimum amounts and ratios as of September 30, 2019 include the fourth year phase in of the capital conservation buffer of 2.5 percent required by the Basel III framework. At December 31, 2018, the minimum amounts and ratios included the third year phase in of the capital conservation buffer of 1.875 percent required by the Basel III framework.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

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

Management reviews interest rate risk on a quarterly basis. This analysis includes earnings scenarios whereby interest rates are increased and decreased by 100, 200, and 300 basis points. These scenarios, detailed in the table below, indicate that Mid Penn would experience enhanced net interest income over a one-year time frame due to upward interest rate changes, while a reduction in interest rates would result in a decline in net interest income over a one-year time frame; however, actual results could vary significantly from the calculations prepared by management. At September 30, 2019, all interest rate risk levels according to the model were within the tolerance limits of the Board-approved policy.

September 30, 2019			December 31, 2018		
Change in Basis Points	% Change in Net Interest Income	Policy Risk Limit	Change in Basis Points	% Change in Net Interest Income	Policy Risk Limit
300	7.15%	≥ -20%	300	8.09%	≥ -20%
200	4.73%	≥ -15%	200	5.38%	≥ -15%
100	2.38%	≥ -10%	100	2.66%	≥ -10%
0			0		
(100)	-2.51%	≥ -10%	(100)	-2.01%	≥ -10%
(200)	-4.74%	≥ -15%	(200)	-3.49%	≥ -15%
(300)	-8.80%	≥ -20%	(300)	-6.43%	≥ -20%

ITEM 4 – CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Mid Penn maintains controls and procedures designed to ensure that information required to be disclosed in the reports that Mid Penn files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of September 30, 2019, Mid Penn's management, with the participation of the Principal Executive Officer and Principal Financial Officer, concluded that the disclosure controls and procedures were effective as of such date.

Changes in Internal Controls

There were no changes in Mid Penn's internal control over financial reporting that have materially affected, or are reasonable likely to materially affect, Mid Penn's internal control over financial reporting during the three and nine months ended September 30, 2019.

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

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

ITEM 1A – RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2018, to determine if there were material changes applicable to the nine months ended September 30, 2019. There are no material changes from the risk factors as previously disclosed in the Annual Report on Form 10-K.

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

None

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 – MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5 – OTHER INFORMATION

None

ITEM 6 – EXHIBITS

- Exhibit 3(i) – The Registrant's amended Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to Registrant's Quarterly Report on Form 10-Q filed for the quarterly period ended June 30, 2019).
- Exhibit 3(ii) – The Registrant's By-laws (Incorporated by reference to Exhibit 3(ii) to Registrant's Current Report on Form 8-K filed with the SEC on August 30, 2010.)
- Exhibit 31.1 – Certification of Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31.2 - Certification of Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a)/15d-14(a) as added by Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32 – Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 101.INS – XBRL Instance Document
- Exhibit 101.SCH – XBRL Taxonomy Extension Schema
- Exhibit 101.CAL – XBRL Taxonomy Extension Calculation Linkbase
- Exhibit 101.DEF – XBRL Taxonomy Extension Definition Linkbase
- Exhibit 101.LAB – XBRL Taxonomy Extension Label Linkbase
- Exhibit 101.PRE – XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

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

Mid Penn Bancorp, Inc.
(Registrant)

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

Date: November 8, 2019

By: /s/ Michael D. Peduzzi, CPA
Michael D. Peduzzi, CPA
Senior Executive Vice President and
Chief Financial Officer

Date: November 8, 2019

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Section 2: EX-31.1 (EX-31.1)

EXHIBIT 31.1

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO EXCHANGE ACT RULES
13A-14(A)/15D-14(A) AS ADDED BY SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATION**

I, Rory G. Ritrievi, certify that:

1. I have reviewed this report on Form 10-Q of Mid Penn Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s

most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) Significant deficiencies and material weaknesses, if any, in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

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

Date: November 8, 2019

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Section 3: EX-31.2 (EX-31.2)

EXHIBIT 31.2

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO EXCHANGE ACT RULES
13A-14(A)/15D-14(A) AS ADDED BY SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATION**

I, Michael D. Peduzzi, certify that:

1. I have reviewed this report on Form 10-Q of Mid Penn Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) Significant deficiencies and material weaknesses, if any, in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's

internal control over financial reporting.

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

Date: November 8, 2019

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Section 4: EX-32 (EX-32)

EXHIBIT 32

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

In connection with the quarterly report of Mid Penn Bancorp, Inc. (the “Corporation”) on Form 10-Q for the period ending September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Rory G. Ritrievi, President and CEO, and I, Michael D. Peduzzi, Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as added pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: November 8, 2019

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

Date: November 8, 2019

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