MID PENN BANCORP INC
Form 10-K
March 20, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

OR

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

For the transition period from to

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania	25-1666413
(State or Other Jurisdiction of	(I.R.S. Employer

Incorporation or Organization)	Identification Number)
349 Union Street	
Millersburg, Pennsylvania (Address of Principal Executive Offices)	17061 (Zip Code)

Registrant's telephone number, including area code 1.866.642.7736

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1.00 par value per share	The NASDAQ Stock Market LLC

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

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

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates computed by reference to the closing price of the common equity of $15.82 per share, as reported by NASDAQ, on June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter was approximately $55,307,574.

As of March 6, 2015, the registrant had 4,221,680 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be used in connection with the 2015 Annual Meeting of Shareholders is incorporated herein by reference in partial response to Part III, hereof.

MID PENN BANCORP, INC.

FORM 10-K

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MID PENN BANCORP, INC.

PART I

ITEM 1. BUSINESS

The disclosures set forth in this Item are qualified by the section captioned "Special Cautionary Notice Regarding Forward-Looking Statements" contained in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

Mid Penn Bancorp, Inc.

Mid Penn Bancorp, Inc. is a one-bank holding company, incorporated in the Commonwealth of Pennsylvania in August 1991. Mid Penn Bancorp, Inc. and its wholly owned subsidiaries are collectively referred to herein as "Mid Penn" or the "Corporation." On December 31, 1991, Mid Penn acquired, as part of the holding company formation, all of the outstanding common stock of Mid Penn Bank (the "Bank"), and the Bank became a wholly owned subsidiary of Mid Penn. Mid Penn's primary business is to supervise and coordinate the business of its subsidiaries and to provide them with capital and resources.

Mid Penn Insurance Services, LLC is a wholly-owned subsidiary of Mid Penn Bank that provides a wide range of personal and commercial insurance products.

Mid Penn's consolidated financial condition and results of operations consist almost entirely of that of Mid Penn Bank, which is managed as a single business segment. At December 31, 2014, Mid Penn had total consolidated assets of $755,657,000, total deposits of $637,922,000, and total shareholders' equity of $59,130,000.

As of December 31, 2014, Mid Penn Bancorp, Inc. did not own or lease any properties. Mid Penn Bank owns or leases the banking offices as identified in Part I, Item 2.

All Mid Penn employees are employed by the Bank. At December 31, 2014, the Bank had 187 full-time and 16 part-time employees. The Bank and its employees are not subject to a collective bargaining agreement, and the Bank believes it enjoys good relations with its personnel.

Mid Penn Bank

Millersburg Bank, the predecessor to the Bank, was organized in 1868, and became a state chartered bank in 1931, obtaining trust powers in 1935, at which time its name was changed to Millersburg Trust Company. In 1971, Millersburg Trust Company adopted the name “Mid Penn Bank.” On March 1, 2015, in connection with the acquisition of Phoenix Bancorp, Inc. (“Phoenix”) by Mid Penn, Miners Bank, Phoenix’s wholly-owned banking subsidiary, merged with and into the Bank, with the Bank surviving and Miners Bank’s four branches operating as “Miners Bank, a Division of Mid Penn Bank”. The Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (the “FDIC”) supervise the Bank. Mid Penn’s and the Bank’s legal headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061. The Bank presently has 19 offices located in Cumberland, Dauphin, Lancaster, Luzerne, Northumberland, and Schuylkill Counties, Pennsylvania.

Mid Penn’s primary business consists of attracting deposits and loans from its network of community banking offices operated by the Bank. The Bank engages in full-service commercial banking and trust business, making available to the community a wide range of financial services, including, but not limited to, installment loans, personal loans, mortgage and home equity loans, secured and unsecured commercial and consumer loans, lines of credit, construction financing, farm loans, community development and local government loans and various types of time and demand deposits. Deposits of the Bank are insured by the Deposit Insurance Fund (the “DIF”) of the FDIC to the maximum extent provided by law. In addition, the Bank provides a full range of trust and retail investment services. The Bank also offers other services such as Internet banking, telephone banking, cash management services, automated teller services and safe deposit boxes.

Acquisition of Phoenix Bancorp, Inc.

On March 1, 2015, Mid Penn acquired Phoenix, a bank holding company headquartered in Pottsville, Pennsylvania, by merger. Phoenix shareholders received either 3.167 shares of Mid Penn’s common stock or $51.60 in cash in exchange for each share of Phoenix common stock. Holders of contingent rights issued by Phoenix received approximately 0.414 shares of Mid Penn’s common stock as settlement of such rights. As a result, Mid Penn issued approximately 724,000 shares of common stock with an acquisition date fair value of approximately $11,294,000, based on Mid Penn’s closing stock price of $15.60 on February 27, 2015, and cash of approximately $2,949,000. Based on the merger agreement, outstanding stock appreciation rights of Phoenix were settled in cash in accordance with their terms. Including an insignificant amount of cash paid in lieu of fractional shares, the fair value of total consideration paid was approximately $14,243,000. The acquisition of Phoenix significantly expanded Mid Penn’s presence in Schuylkill County, Pennsylvania and established a presence in Luzerne County, Pennsylvania.

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Business Strategy

The Bank's services are provided to small and middle-market businesses, consumers, nonprofit organizations, municipalities, and real estate investors through 19 full service banking facilities. Mid Penn's primary market currently, and historically, has lower unemployment than the U.S. as a whole. This is due in part to a diversified manufacturing and services base and the presence of state government offices, which help shield the primary market from national trends. At December 31, 2014, the seasonally adjusted unemployment rate for the Harrisburg/Carlisle area, Mid Penn's primary market area, was 4.2% versus the seasonally adjusted national unemployment rate of 5.6%

The Bank seeks to develop long-term customer relationships, maintain high quality service and provide quick responses to customer needs. Mid Penn believes that an emphasis on local relationship building and its conservative approach to lending are important factors in the success and growth of Mid Penn.

The Bank seeks credit opportunities of good quality within its target market that exhibit positive historical trends, stable cash flows and secondary sources of repayment from tangible collateral. The Bank extends credit for the purpose of obtaining and continuing long-term relationships. Lenders are provided with detailed underwriting policies for all types of credit risks accepted by the Bank and must obtain appropriate approvals for credit extensions in excess of conservatively assigned lending limits. The Bank also maintains strict documentation requirements and extensive credit quality assurance practices in order to identify credit portfolio weaknesses as early as possible so any exposures that are discovered might be reduced.

Lending Activities

The Bank offers a variety of loan products to its customers, including loans secured by real estate and commercial and consumer loans. The Bank's lending objectives are as follows:

- to establish a diversified commercial loan portfolio; and
- to provide a satisfactory return to Mid Penn's shareholders by properly pricing loans to include the cost of funds, administrative costs, bad debts, local economic conditions, competition, customer relationships, the term of the loan, credit risk, collateral quality and a reasonable profit margin.

Credit risk is managed through portfolio diversification, underwriting policies and procedures and loan monitoring practices. The Bank generally secures its loans with real estate with such collateral values dependent and subject to change based on real estate market conditions within its market area. As of December 31, 2014, the Bank's highest concentration of credit is in commercial real estate. Most of the Bank's business activity with customers is located in Central Pennsylvania, specifically in Dauphin, southern Northumberland, western Schuylkill, and eastern Cumberland Counties.

Investment Activities

Mid Penn's investment portfolio is used to improve earnings through investments of funds in higher-yielding assets than overnight funding alternatives, while maintaining asset quality, which provides the necessary balance sheet liquidity for Mid Penn. Mid Penn does not have any significant concentrations within investment securities.

Mid Penn's entire portfolio of investment securities is considered available for sale. As such, the investments are recorded on the balance sheet at fair value. Mid Penn's investments include US Treasury, agency and municipal securities that derive fair values relative to investments of the same type with similar maturity dates. As the interest rate environment changes, Mid Penn's fair value of existing securities will change. This difference in value, or unrealized gain, amounted to $2,462,000 as of December 31, 2014. A majority of the investments are high quality United States and municipal securities that, if held to maturity, are expected to result in no loss to the Bank.

For additional information with respect to Mid Penn's business activities, see Part II, Item 7 of this report, which is incorporated herein by reference.

Sources of Funds

The Bank primarily uses deposits and borrowings to finance lending and investment activities. Borrowing sources include advances from the Federal Home Loan Bank of Pittsburgh (the "FHLB") and overnight borrowings from the Bank's customers and correspondent banks. All borrowings, except for lines of credit with the Bank's correspondent banks, require collateral in the form of loans or securities. Collateral levels, therefore, limit borrowings and the available lines of credit extended by the Bank's creditors. As a result, deposits remain critical to the future funding and growth of the business. Deposit growth within the banking industry has been subject to strong competition from a variety of financial services companies. This competition may require financial institutions to adjust their product offerings and pricing to adequately grow deposits.

Competition

The banking business is highly competitive, and the profitability of Mid Penn depends principally upon the Bank's ability to compete in its market area. The Bank actively competes with other financial services companies for deposit, loan, and trust business. Competitors include other commercial banks, credit unions, savings banks, savings and loan associations, insurance companies, securities brokerage firms, finance companies, mutual funds, and service alternatives via the Internet. Financial institutions compete primarily on the quality of services rendered, interest rates on loans and deposits, service charges, the convenience of banking facilities, location and hours of operation and, in the case of loans to larger commercial borrowers, relative lending limits.

Many competitors are significantly larger than the Bank and have significantly greater financial resources, personnel and locations from which to conduct business. In addition, the Bank is subject to banking regulations while certain competitors may not be. There are relatively few barriers for companies wanting to enter into the financial services industry. For more information, see the "Supervision and Regulation" section below.

Mid Penn has been able to compete effectively with other financial institutions by emphasizing customer service. Mid Penn's customer service model is based on convenient hours, efficient and friendly employees, local decision making, and quality products. The Gramm-Leach-Bliley Act ("GLB"), which broke down many barriers between the banking, securities and insurance industries, has significantly affected the competitive environment in which Mid Penn operates.

The flow of cash into mutual funds, much of which is made through tax deferred investment vehicles such as 401(k) plans, have, until recently, had been a popular savings vehicle for investors. The recent economic turmoil has negatively impacted the returns on many of these investments and impacted the manner in which investors distribute their funds across investment alternatives. The safety of traditional bank products has again become an attractive option during this period of market volatility. Mid Penn's ability to attract funds in the future will be impacted by the public's appetite for the safety of insured or local investments versus the returns offered by alternative choices as part of their personal investment mix.

Supervision and Regulation

General

Bank holding companies and banks are extensively regulated under both Federal and state laws. The regulation and supervision of Mid Penn and the Bank are designed primarily for the protection of depositors, the DIF, and the monetary system, and not Mid Penn or its shareholders. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance on deposits, the imposition of civil money penalties, and removal and prohibition orders. If a banking regulator takes any enforcement action, the value of an equity investment in Mid Penn could be substantially reduced or eliminated.

Federal and state banking laws contain numerous provisions affecting various aspects of the business and operations of Mid Penn and the Bank. Mid Penn is subject to, among others, the regulations of the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and the Bank is subject to, among others, the regulations of the Pennsylvania Department of Banking and Securities and the FDIC. The insurance activities of Mid Penn Insurance Services, LLC are subject to regulations by the insurance departments of the various states in which it conducts business including principally the Pennsylvania Department of Insurance. The descriptions below of, and references to, applicable statutes and regulations are not intended to be complete descriptions of these provisions or their effects on Mid Penn or the Bank. They are summaries only and are qualified in their entirety by reference to such statutes and regulations.

Holding Company Regulation

Mid Penn is a registered bank holding company subject to supervision and regulation by the Federal Reserve. As such, it is subject to the Bank Holding Company Act of 1956 ("BHCA") and many of the Federal Reserve's regulations promulgated thereunder. The Federal Reserve has broad enforcement powers over bank holding companies, including the power to impose substantial fines and civil penalties.

The BHCA requires Mid Penn to file an annual report with the Federal Reserve regarding the holding company and its subsidiary bank. The Federal Reserve Board also makes examinations of the holding company. The Bank is not a member of the Federal Reserve System; however, the Federal Reserve possesses cease-and-desist powers over bank holding companies and their subsidiaries where their actions would constitute an unsafe or unsound practice or violation of law. The Federal Reserve Board also makes policy that guides the declaration and distribution of dividends by bank holding companies.

The BHCA restricts a bank holding company's ability to acquire control of additional banks. In addition, the BHCA restricts the activities in which bank holding companies may engage directly or through non-bank subsidiaries.

Gramm-Leach-Bliley Financial Modernization Act

Under GLB, bank holding companies, such as Mid Penn, that meet certain management, capital, and Community Reinvestment Act standards, are permitted to become financial holding companies and, by doing so, to affiliate with securities firms and insurance companies and to engage in other activities that are financial in nature, incidental to such financial activities, or complementary to such activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized under the FDIC Improvement Act's prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act. The required filing is a declaration that the bank holding company wishes to become a financial holding company and meets all applicable requirements. Mid Penn has not elected to become a financial holding company at this time.

No prior regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities permitted under GLB. Activities cited by GLB as being financial in nature include:

- securities underwriting, dealing and market making;
- sponsoring mutual funds and investment companies;
- insurance underwriting and agency;
- merchant banking activities; and
- activities that the Federal Reserve has determined to be closely related to banking.

In addition to permitting financial services providers to enter into new lines of business, the law allows firms the freedom to streamline existing operations and to potentially reduce costs. The Act may increase both opportunity as well as competition. Many community banks are less able to devote the capital and management resources needed to facilitate broad expansion of financial services including insurance and brokerage services.

Bank Regulation

The Bank, a Pennsylvania-chartered institution, is subject to supervision, regulation and examination by the Pennsylvania Department of Banking and Securities and the FDIC. The deposits of the Bank are insured by the FDIC to the maximum extent provided by law. The FDIC assesses deposit insurance premiums the amount of which depends in part on the condition of the Bank. Moreover, the FDIC may terminate deposit insurance of the Bank under certain circumstances. The federal and state banking regulatory agencies have broad enforcement powers over depository institutions under their jurisdiction, including the power to terminate deposit insurance, to impose fines and other civil and criminal penalties, and to appoint a conservator or receiver if any of a number of conditions is met. In addition, the Bank is subject to a variety of local, state and federal laws that affect its operations.

Banking regulations include, but are not limited to, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans, compensation standards, payment of dividends, and the safety and soundness of banking practices.

Capital Requirements

Under risk-based capital requirements for bank holding companies, Mid Penn is required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) of eight percent. Through December 31, 2014, at least half of the total capital is to be composed of common equity, retained earnings and qualifying perpetual preferred stock, less goodwill (“Tier 1 Capital” and together with Tier 2 Capital, “Total Capital”). The remainder may consist of subordinated debt, non-qualifying preferred stock and a limited amount of the loan loss allowance (“Tier 2 Capital”).

In addition, the Federal Reserve has established minimum leverage ratio requirements for bank holding companies. These requirements provide for a minimum leverage ratio of Tier 1 Capital to adjusted average quarterly assets (“leverage ratio”) equal to 3% for bank holding companies that meet certain specified criteria, including having the highest regulatory rating. All other bank holding companies will generally be required to maintain a leverage ratio of at least 4-5%. The requirements also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the requirements indicate that the Federal Reserve will continue to consider a “Tangible Tier 1 Leverage Ratio” (deducting all intangibles) in evaluating proposals for expansion or new activity. The Federal Reserve has not advised Mid Penn of any specific minimum Tier 1 leverage ratio.

In January 2015, the Federal Reserve proposed to raise the asset size threshold for determining the applicability of its Small Bank Holding Company Policy Statement, as required by recent federal legislation adopted in December 2014, from $500 million to $1 billion and, so long as certain qualitative factors are met, to be regulated under such policy, which allows simplified reporting requirements and less stringent capital standards that reflect the traditional banking services provided by such smaller banks.

The Bank is subject to similar capital requirements adopted by the FDIC. The FDIC has not advised the Bank of any specific minimum leverage ratios.

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The capital ratios of Mid Penn and the Bank are described in Note 16 to Mid Penn's Consolidated Financial Statements, which are included herein.

Banking regulators continue to indicate their desire to further develop capital requirements applicable to banking organizations. Changes to capital requirements could materially affect the profitability of Mid Penn or the fair value of Mid Penn stock.

Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The phase-in period for community banking organizations begins January 1, 2015. The final rules call for the following capital requirements:

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

In addition, the final rules establishes a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations will begin on January 1, 2016.

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

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

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

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

Under the new rules, mortgage servicing 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 assessed the impact of these changes on the regulatory ratios of Mid Penn and the Bank on the capital, operations, liquidity and earnings of Mid Penn and the Bank, and concluded that the new rules will not have a material negative effect.

Safety and Soundness Standards

The federal banking regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards for depository institutions such as the Bank. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies adopted regulations that authorize an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If the institution fails to submit an acceptable compliance plan or fails to implement an accepted plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions be taken, including restricting asset growth, restricting interest rates paid on deposits, and requiring an increase in the institution’s ratio of tangible equity to assets.

Payment of Dividends and Other Restrictions

Mid Penn is a legal entity separate and distinct from its subsidiary, the Bank. There are various legal and regulatory limitations on the extent to which the Bank can, among other things, finance, or otherwise supply funds to, Mid Penn. Specifically, dividends from the Bank are the principal source of Mid Penn's cash funds and there are certain legal restrictions under Pennsylvania law and Pennsylvania banking regulations on the payment of dividends by state-chartered banks. The relevant regulatory agencies also have authority to prohibit Mid Penn and the Bank from engaging in what, in the opinion of such regulatory body, constitutes an unsafe or unsound banking practice. The payment of dividends could, depending upon the financial condition of Mid Penn and the Bank, be deemed to constitute such an unsafe or unsound practice.

Prompt Corrective Action

In addition to the required minimum capital levels described above, federal law establishes a system of "prompt corrective actions" which federal banking agencies are required to take, and certain actions which they have discretion to take, based upon the capital category into which a federally regulated depository institution falls. Regulations set forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution, which is not adequately capitalized. Under the rules, an institution will be deemed to be "adequately capitalized" if it exceeds the minimum federal regulatory capital requirements. However, it will be deemed "undercapitalized" if it fails to meet the minimum capital requirements, "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0%, or a leverage ratio that is less than 3.0%, and "critically undercapitalized" if the institution has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

The prompt corrective action rules require an undercapitalized institution to file a written capital restoration plan, along with a performance guaranty by its holding company or a third party. In addition, an undercapitalized institution becomes subject to certain automatic restrictions including a prohibition on payment of dividends, a limitation on asset growth and expansion, in certain cases, a limitation on the payment of bonuses or raises to senior executive officers, and a prohibition on the payment of certain "management fees" to any "controlling person". Institutions that are classified as undercapitalized are also subject to certain additional supervisory actions, including increased reporting burdens and regulatory monitoring, a limitation on the institution's ability to make acquisitions, open new branch offices, or engage in new lines of business, obligations to raise additional capital, restrictions on transactions with affiliates, and restrictions on interest rates paid by the institution on deposits. In certain cases, bank regulatory agencies may require replacement of senior executive officers or directors, or sale of the institution to a willing purchaser. If an institution is deemed "critically undercapitalized" and continues in that category for four quarters, the statute requires, with certain narrowly limited exceptions, that the institution be placed in receivership.

Deposit Insurance

The FDIC insures deposits of the Bank through the DIF. The FDIC maintains the DIF by assessing depository institutions an insurance premium. The amount each institution is assessed is based upon a variety of factors that include the balance of insured deposits as well as the degree of risk the institution poses to the insurance fund. The FDIC insures deposits up to $250,000. The Bank pays an insurance premium into the DIF based on the quarterly average daily deposit liabilities net of certain exclusions. The FDIC uses a risk-based premium system that assesses higher rates on those institutions that pose greater risks to the DIF. The FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Subsequently, the rate for each institution within a risk category may be adjusted depending upon different factors that either enhance or reduce the risk the institution poses to the DIF, including the unsecured debt, secured liabilities and brokered deposits related to each institution. Finally, certain risk multipliers may be applied to the adjusted assessment.

Beginning with the second quarter of 2011, as mandated by the Dodd-Frank Act, the assessment base that the FDIC will use to calculate assessment premiums will be a bank's average assets minus average tangible equity. As the asset base of the banking industry is larger than the deposit base, the range of assessment rates will change to a low of 2.5 basis points through a high of 45 basis points, per $100 of assets; however, the dollar amount of total actual premiums is expected to be roughly the same.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the DIF to achieve a reserve ratio of 1.35% of Insurance Fund insured deposits by September 2020. In addition, the FDIC has established a "designated reserve ratio" of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over $10 billion in asset size more than banks under that size. Those new formulas began in the second quarter of 2011, but did not affect the Bank. Under the Dodd-Frank Act, the FDIC is authorized to make reimbursements from the insurance fund to banks if the reserve ratio exceeds 1.50%, but the FDIC has adopted the "designated reserve ratio" of 2.0% and has announced that any reimbursements from the fund are indefinitely suspended.

Consumer Protection Laws

A number of laws govern the relationship between the Bank and its customers. For example, the Community Reinvestment Act is designed to encourage lending by banks to persons in low and moderate income areas. The Home Mortgage Disclosure Act and the Equal Credit Opportunity Act attempt to minimize lending decisions based on impermissible criteria, such as race or gender. The Truth-in-Lending Act and

the Truth-in-Savings Act require banks to provide certain disclosure of relevant terms related to loans and savings accounts, respectively. Anti-tying restrictions (which prohibit conditioning the availability or terms of credit on the purchase of another banking product) further restrict the Bank's relationships with its customers.

Privacy Laws

The federal banking regulators have issued a number of regulations governing the privacy of consumer financial and customer information. The regulations limit the disclosure by financial institutions, such as Mid Penn and the Bank, of nonpublic personal information about individuals who obtain financial products or services for personal, family, or household purposes. Subject to certain exceptions allowed by law, the regulations cover information sharing between financial institutions and nonaffiliated third parties. More specifically, the regulations require financial institutions to:

- provide initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal financial information to nonaffiliated third parties and affiliates;
- provide annual notices of their privacy policies to their current customers;
- provide a reasonable method for consumers to "opt out" of disclosures to nonaffiliated third parties.

Affiliate Transactions

Transactions between Mid Penn and the Bank and its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An "affiliate" of a bank or savings institution is any company or entity that controls, is controlled by, or is under common control with the bank or savings institution. Generally, a subsidiary of a depository institution that is not also a depository institution is not treated as an affiliate of the bank for purposes of Sections 23A and 23B. Sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

The USA Patriot Act

In 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA Patriot Act") was signed into law. The USA Patriot Act broadened the application of anti-money laundering regulations to apply to additional types of financial institutions, such as broker-dealers, and strengthened the ability of the U.S. government to detect and prosecute international money laundering and the financing of terrorism. The principal provisions of Title III of the USA Patriot Act require that regulated financial institutions, including state-chartered banks:

- establish an anti-money laundering program that includes training and audit components;
- comply with regulations regarding the verification of the identity of any person seeking to open an account;
- take additional required precautions with non-U.S. owned accounts; and
- perform certain verification and certification of money laundering risk for their foreign correspondent banking relationships.

The USA Patriot Act also expanded the conditions under which funds in a U.S. interbank account may be subject to forfeiture and increased the penalties for violation of anti-money laundering regulations. Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal and reputational consequences for the institution. The Bank has adopted policies, procedures and controls to address compliance with the requirements of the USA Patriot Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA Patriot Act and implementing regulations.

Anti-Money Laundering and Anti-Terrorism Financing

Under Title III of the USA Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including Mid Penn and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial institutions, regulators, and law enforcement authorities is encouraged for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing. The effectiveness of a financial institution in combating money-laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank.

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JOBS Act

In 2012, the Jumpstart Our Business Startups Act (the “JOBS Act”) became law. The JOBS Act is aimed at facilitating capital raising by smaller companies and banks and bank holding companies by implementing the following changes:

- raising the threshold requiring registration under the Securities Exchange Act of 1934 (the "Exchange Act") for banks and bank holdings companies from 500 to 2,000 holders of record;
- raising the threshold for triggering deregistration under the Exchange Act for banks and bank holding companies from 300 to 1,200 holders of record;
- raising the limit for Regulation A offerings from $5 million to $50 million per year and exempting some Regulation A offerings from state blue sky laws;
- permitting advertising and general solicitation in Rule 506 and Rule 144A offerings;
- allowing private companies to use "crowdfunding" to raise up to $1 million in any 12-month period, subject to certain conditions; and
- creating a new category of issuer, called an "Emerging Growth Company," for companies with less than $1 billion in annual gross revenue, which will benefit from certain changes that reduce the cost and burden of carrying out an equity IPO and complying with public company reporting obligations for up to five years.

While the JOBS Act is not expected to have any immediate application to Mid Penn, management will continue to monitor the implementation rules for potential effects which might benefit the Corporation.

Dodd-Frank Act

The Dodd-Frank Act, which became law in July 2010, significantly changes regulation of financial institutions and the financial services industry, including: creating a Financial Services Oversight Council to identify emerging systemic risks and improve interagency cooperation; centralizing responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, which will be responsible for implementing, examining and enforcing compliance with federal consumer financial laws; permanently raising the current standard maximum deposit insurance amount to $250,000; establishing strengthened capital standards for banks, and disallowing certain trust preferred securities from qualifying as Tier 1 capital (subject to certain grandfather provisions for existing trust preferred securities); establishing new minimum mortgage underwriting standards; granting the Federal Reserve the power to regulate debit card interchange fees; and implementing corporate governance changes. Many aspects of the Dodd-Frank Act are subject to rulemaking that will take effect over several years, thus making it difficult to assess the impact of the statute on the financial industry, including Mid Penn, at this time.

It is difficult to predict at this time the specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions' operations is presently unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

Small Business Lending Fund

In connection with its acquisition of Phoenix, Mid Penn issued 1,750 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series C, having a $1,000 liquidation preference per share (the "SBLF Preferred Shares"), to the U.S. Department of the Treasury ("Treasury"). The SBLF Preferred Shares qualify as Tier 1 Capital.

The terms of the SBLF Preferred Shares impose limits on the ability of Mid Penn to pay dividends and repurchase shares of common stock. Under the terms of the SBLF Preferred Shares, no repurchases may be effected, and no dividends may be declared or paid on preferred shares ranking pari passu with the SBLF Preferred Shares (such as Mid Penn's 7% Non-Cumulative, Non-Voting, Non-Convertible Perpetual Preferred Stock, Series B), junior preferred shares, or other junior securities (including the common stock) during the current quarter and for the next three quarters following the failure to declare and pay dividends on the SBLF Preferred Shares, except that, in any such quarter in which the dividend is paid, dividend payments on shares ranking pari passu may be paid to the extent necessary to avoid any resulting material covenant breach.

Under the terms of the SBLF Preferred Shares, Mid Penn may only declare and pay a dividend on the common stock or other stock junior to the SBLF Preferred Shares, or repurchase shares of any such class or series of stock, if, after payment of such dividend, the dollar amount of Mid Penn's Tier 1 Capital would be at least $9.7 million, excluding any subsequent net charge-offs and any redemption of the SBLF Preferred Shares (the "Tier 1 Dividend Threshold").

Dividends are payable quarterly on January 1, April 1, July 1 and October 1 of each year. The dividend rate on the SBLF Preferred will remain fixed at 1.00% until January 2016, when it will increase to 9.00%.

Effects of Government Policy and Potential Changes in Regulation

Changes in regulations applicable to Mid Penn or the Bank, or shifts in monetary or other government policies, could have a material effect on our business. Mid Penn's and the Bank's business is also affected by the state of the financial services industry in general. As a result of legal and industry changes, management believes that the industry will continue to experience an increased rate of change as the financial services industry strives for greater product offerings, market share and economies of scale.

From time to time, legislation is enacted that has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, and before various bank regulatory agencies. Mid Penn cannot predict the likelihood of any major changes or the impact such changes might have on Mid Penn and/or the Bank. Various congressional bills and other proposals have proposed a sweeping overhaul of the banking system, including provisions for: limitations on deposit insurance coverage; changing the timing and method financial institutions use to pay for deposit insurance; expanding the power of banks by removing the restrictions on bank underwriting activities; and tightening the regulation of bank derivatives activities; and allowing commercial enterprises to own banks.

Mid Penn's earnings are, and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The monetary policies of the Federal Reserve have had, and will likely continue to have, an impact on the operating results of commercial banks because of the Federal Reserve's power to implement national monetary policy to, among other things, curb inflation or combat recession. The Federal Reserve has a major impact on the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of, among other things, the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

From time to time, various types of federal and state legislation have been proposed that could result in additional regulation of, and restrictions on, the business of Mid Penn and the Bank. As a consequence of the extensive regulation of commercial banking activities in the United States, the Bank's business is particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business. Congress is currently debating major legislation that may fundamentally change the regulatory oversight of banking institutions in the United States. Whether any legislation will be enacted or additional regulations will be adopted, and how they might impact Mid Penn cannot be determined at this time.

Environmental Laws

Management does not anticipate that compliance with environmental laws and regulations will have any material effect on Mid Penn's capital, expenditures, earnings, or competitive position. However, environmentally related hazards have become a source of high risk and potentially unlimited liability for financial institutions.

Additionally, the Pennsylvania Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act provides, among other things, protection to lenders from environmental liability and remediation costs under the environmental laws for releases and contamination caused by others. A lender who engages in activities involved in the routine practices of commercial lending, including, but not limited to, the providing of financial services, holding of security interests, workout practices, foreclosure or the recovery of funds from the sale of property shall not be liable under the environmental acts or common law equivalents to the Pennsylvania Department of Environmental Resources or to any other person by virtue of the fact that the lender engages in such commercial lending practice. A lender, however, will be liable if it, its employees or agents, directly cause an immediate release or directly exacerbate a release of regulated substance on or from the property, or known and willfully compelled the borrower to commit an action which caused such release or violate an environmental act. The Pennsylvania Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act does not limit federal liability which still exists under certain circumstances.

Corporate Governance

The Sarbanes-Oxley Act of 2002 and related regulations adopted by the SEC and Nasdaq address the following other issues: corporate governance, auditor independence and accounting standards, executive compensation, insider loans, whistleblower protection, and enhanced and timely disclosure of corporate information. Mid Penn has prepared policies, procedures, and systems designed to ensure compliance with these regulations.

Available Information

Mid Penn's common stock is registered under Section 12(b) of the Securities Exchange Act of 1934 and is traded on the NASDAQ Stock Market under the trading symbol MPB. Mid Penn is subject to the informational requirements of the Exchange Act, and, accordingly, files reports, proxy statements and other information with the Securities and Exchange Commission. The reports, proxy statements and other information filed with the SEC are available for inspection and copying at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

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Mid Penn is an electronic filer with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's Internet site address is www.sec.gov.

Mid Penn's headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061, and its telephone number is 1-866-642-7736. Mid Penn's Internet address is midpennbank.com. Mid Penn makes available through its website, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably practicable after filing with the Securities and Exchange Commission. Mid Penn has adopted a Code of Ethics that applies to all employees. This document is also available on Mid Penn's website. The information included on our website is not a part of this document.

ITEM 1A. RISK FACTORS

Mid Penn is subject to interest rate risk

Mid Penn's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond Mid Penn's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest Mid Penn receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) Mid Penn's ability to originate loans and obtain deposits, (ii) the fair value of Mid Penn's financial assets and liabilities, and (iii) the average duration of Mid Penn's mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, Mid Penn's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on Mid Penn's results of operations. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn is subject to lending risk

As of December 31, 2014, approximately 72.0% of Mid Penn's loan portfolio consisted of commercial and industrial, construction and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because Mid Penn's loan portfolio contains a significant number of commercial and industrial, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan and lease losses and an increase in loan charge-offs, all of which could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn's allowance for possible loan and lease losses may be insufficient

Mid Penn maintains an allowance for possible loan and lease losses, which is a reserve established through provisions for possible losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan and lease losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan and lease losses inherently involves a high degree of subjectivity and requires Mid Penn to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem credits and other factors, both within and outside of Mid Penn's control, may require an increase in the allowance. In addition, bank regulatory agencies periodically review Mid Penn's allowance for possible loan and lease losses and may require an increase in the provision for possible loan and lease losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance, Mid Penn may need additional provisions to increase the allowance for possible loan and lease losses. Any increases in the allowance will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on Mid Penn's financial condition and results of operations.

Competition from other financial institutions may adversely affect Mid Penn's profitability

Mid Penn's banking subsidiary faces substantial competition in originating both commercial and consumer loans. This competition comes principally from other banks, credit unions, savings institutions, mortgage banking companies and other lenders. Many of its competitors enjoy advantages, including greater financial resources and higher lending limits, a wider geographic presence, more accessible branch office

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locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. This competition could reduce Mid Penn's net income by decreasing the number and size of loans that its banking subsidiary originates and the interest rates it may charge on these loans.

In attracting business and consumer deposits, its banking subsidiary faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of Mid Penn's competitors enjoy advantages, including greater financial resources, more aggressive marketing campaigns, better brand recognition, and more convenient branch locations. These competitors may offer higher interest rates than Mid Penn, which could decrease the deposits that Mid Penn attracts or require Mid Penn to increase its rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect Mid Penn's ability to generate the funds necessary for lending operations. As a result, Mid Penn may need to seek other sources of funds that may be more expensive to obtain and could increase its cost of funds.

Mid Penn's banking subsidiary also competes with non-bank providers of financial services, such as brokerage firms, consumer finance companies, credit unions, insurance agencies and governmental organizations, which may offer more favorable terms. Some of its non-bank competitors are not subject to the same extensive regulations that govern its banking operations. As a result, such non-bank competitors may have advantages over Mid Penn's banking subsidiary in providing certain products and services. This competition may reduce or limit Mid Penn's margins on banking services, reduce its market share and adversely affect its earnings and financial condition.

We have shares of preferred stock outstanding which have preference over the common stock as to dividends and liquidation distributions, among other preferential rights

As of the date hereof, we have issued and outstanding 5,000 shares of 7% Non-Cumulative, Non-Voting, Non-Convertible Perpetual Preferred Stock, Series B, par value $1.00 per share (the "Series B Preferred Stock") and, in connection with the acquisition of Phoenix, the SBLF Preferred Shares. The Series B Preferred Stock and the SBLF Preferred Shares afford holders thereof a preference to assets upon liquidation and an annual dividend which rights impact the outstanding shares of common stock.   The dividends declared on the Series B Preferred Stock and the SBLF Preferred Shares reduce income available to common shareholders and Mid Penn's earnings per common share. In the event of a liquidation of Mid Penn's assets, holders of Series B Preferred Stock and the SBLF Preferred Shares will have a right to receive as a liquidation payment any remaining assets of Mid Penn prior to any distributions to holders of the common stock, and the holders of the Series B Preferred Stock and the SBLF Preferred Shares may be able to block actions otherwise approved by the holders of the common stock if such action is adverse to their rights.

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

Basel III targets higher levels of base capital, certain capital buffers and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements are phased in over the next decade and may change substantially before final implementation, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. The direction of the Basel III implementation activities or other regulatory viewpoints could require additional capital to support our business risk profile prior to final implementation of the Basel III standards. If Mid Penn is required to maintain higher levels of capital, Mid Penn may have fewer opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to Mid Penn and adversely impact our financial condition and results of operations.

If Mid Penn's information systems are interrupted or sustain a breach in security, those events may negatively affect Mid Penn's financial performance and reputation

In conducting its business, Mid Penn relies heavily on its information systems. Maintaining and protecting those systems is difficult and expensive, as is dealing with any failure, interruption, or breach in security of these systems, whether due to acts or omissions by Mid Penn or by a third party, and whether intentional or not. Any such failure, interruption, or breach could result in failures or disruptions in Mid Penn's customer relationship management, general ledger, deposit, loan and other systems. A breach of Mid Penn's information security may result from fraudulent activity committed against Mid Penn or its clients, resulting in financial loss to Mid Penn or its clients, or privacy breaches against Mid Penn's clients. Such fraudulent activity may consist of check fraud, electronic fraud, wire fraud, "phishing", social engineering or other deceptive acts. The policies, procedures, and technical safeguards put in place by Mid Penn to prevent or limit the effect of any failure, interruption, or security breach of its information systems may be insufficient to prevent or remedy the effects of any such occurrences. The occurrence of any failures, interruptions, or security breaches of Mid Penn's information systems could damage Mid Penn's reputation, cause Mid Penn to incur additional expenses, result in online services or other businesses, subject Mid Penn to regulatory sanctions or additional regular scrutiny, or expose Mid Penn to civil litigation and possible financial liability, any of which could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn's controls and procedures may fail or be circumvented

Management periodically reviews and updates Mid Penn's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of Mid Penn's controls and

procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on Mid Penn's business, results of operations, and financial condition.

Mid Penn's ability to pay dividends on its common stock, Series B Preferred Stock and SBLF Preferred Shares depends primarily on dividends from its banking subsidiary, which is subject to regulatory limits

Mid Penn is a bank holding company and its operations are conducted by its subsidiaries. Its ability to pay dividends on its common stock, Series B Preferred Stock and SBLF Preferred Shares depends on its receipt of dividends from the Bank. Dividend payments from its banking subsidiary are subject to legal and regulatory limitations, generally based on net profits, and retained earnings, imposed by the various banking regulatory agencies. The ability of the Bank to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements. There is no assurance that Mid Penn's subsidiaries will be able to pay dividends in the future or that Mid Penn will generate adequate cash flow to pay dividends in the future. Federal Reserve policy, which applies to Mid Penn as a registered bank holding company, also provides that dividends by bank holding companies should generally be paid out of current earnings looking back over a one-year period. Mid Penn's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

The terms of the SBLF Preferred Shares impose limits on the ability of Mid Penn to pay dividends and repurchase shares of common stock. Under the terms of the SBLF Preferred Shares, no repurchases may be effected, and no dividends may be declared or paid on preferred shares ranking pari passu with the SBLF Preferred Shares (such as the Series B Preferred Stock), junior preferred shares, or other junior securities (including the common stock) during the current quarter and for the next three quarters following the failure to declare and pay dividends on the SBLF Preferred Shares, except that, in any such quarter in which the dividend is paid, dividend payments on shares ranking pari passu may be paid to the extent necessary to avoid any resulting material covenant breach.

Under the terms of the SBLF Preferred Shares, Mid Penn may only declare and pay a dividend on the common stock or other stock junior to the SBLF Preferred Shares, or repurchase shares of any such class or series of stock, if, after payment of such dividend, the dollar amount of Mid Penn's Tier 1 Capital would be at least $9.7 million, excluding any subsequent net charge-offs and any redemption of the SBLF Preferred Shares.

The 1.00% dividend rate on the SBLF Preferred Shares will remain fixed at this level until January 2016, when it will increase to 9.00%

The per annum dividend rate on the SBLF Preferred Shares is fixed at 1.00% until January 2016, when it will increase to 9.00%. Depending on Mid Penn's financial condition at the time, this increase in the dividend rate could have a material negative effect on its liquidity and results of operations.

Mid Penn's profitability depends significantly on economic conditions in central Pennsylvania

Unlike larger or regional lenders that are more geographically diversified, Mid Penn's success is dependent to a significant degree on economic conditions in central Pennsylvania, especially in eastern Cumberland, Dauphin, northwestern Lancaster, western Luzerne, southern Northumberland, and Schuylkill Counties, which Mid Penn defines as our primary market. The banking industry is affected by general economic conditions including the effects of inflation, recession, unemployment, real estate values, trends in the national and global economics, and other factors beyond our control. An economic recession or a delayed recovery over a prolonged period of time in Central Pennsylvania area could cause an increase in the level of the Bank's non-performing assets and loan and lease losses, thereby causing operating losses, impairing liquidity, and eroding capital. Mid Penn cannot assure you that adverse changes in the local economy would not have a material adverse effect on Mid Penn's consolidated financial condition, results of operations, and cash flows.

Mid Penn may not be able to attract and retain skilled people

Mid Penn's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by Mid Penn can be intense and Mid Penn may not be able to hire people or to retain them. The unexpected loss of services of one or more of Mid Penn's key personnel could have a material adverse impact on Mid Penn's business because of their skills, knowledge of Mid Penn's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

Mid Penn is subject to claims and litigation pertaining to fiduciary responsibility

From time to time, customers make claims and take legal action pertaining to Mid Penn's performance of its fiduciary responsibilities. Whether customer claims and legal action related to Mid Penn's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to Mid Penn they may result in significant financial liability and/or adversely affect the market perception of Mid Penn and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on Mid Penn's business, which, in turn, could have a material adverse effect on Mid Penn's financial condition and results of operations.

The trading volume in Mid Penn's common stock is less than that of other larger financial services companies

Mid Penn's common stock is listed for trading on NASDAQ; the trading volume in its common stock, however, is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of Mid Penn's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which Mid Penn has no control. Given the lower trading volume of Mid Penn's common stock, significant sales of Mid Penn's common stock, or the expectation of these sales, could cause Mid Penn's stock price to fall.

Mid Penn operates in a highly regulated environment and may be adversely affected by changes in federal, state and local laws and regulations

Mid Penn is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal, state or local legislation could have a substantial impact on Mid Penn and its operations. Additional legislation and regulations that could significantly affect Mid Penn's powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on its financial condition and results of operations. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on Mid Penn's results of operations and financial condition.

The potential exists for additional federal or state laws and regulations, or changes in policy, affecting many aspects of our operations, including capital levels, lending and funding practices, and liquidity standards. New laws and regulations may increase our costs of regulatory compliance and of doing business and otherwise affect our operations, and may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge and our ongoing operations, costs and profitability.

The soundness of other financial institutions may adversely affect Mid Penn

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. Mid Penn has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose Mid Penn to credit risk in the event of a default by a counterparty or client. In addition, Mid Penn's credit risk may be exacerbated when the collateral held by Mid Penn cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to Mid Penn. Any such losses could have a material adverse effect on the Mid Penn's financial condition and results of operations.

Prior levels of market volatility were unprecedented and future volatility may have materially adverse effects on our liquidity and financial condition

In the recent past, the capital and credit markets experienced extreme volatility and disruption for more than two years. In some cases, the markets exerted downward pressure on stock prices, security prices, and credit availability for certain issuers without regard to their underlying financial strength. If such levels of market disruption and volatility return, there can be no assurance that we will not experience adverse effects, which may be material, on our liquidity, financial condition, and profitability.

Mid Penn's banking subsidiary may be required to pay higher FDIC insurance premiums or special assessments which may adversely affect its earning

Poor economic conditions and the resulting bank failures have increased the costs of the FDIC and depleted the DIF. Additional bank failures may prompt the FDIC to increase its premiums above the recently increased levels or to issue special assessments. Mid Penn generally is unable to control the amount of premiums or special assessments that its subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on our results of operations, financial condition, and our ability to continue to pay dividends on our common stock at the current rate or at all.

Pennsylvania Business Corporation Law and various anti-takeover provisions under our articles and bylaws could impede the takeover of Mid Penn

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire Mid Penn, even if the acquisition would be advantageous to shareholders. In addition, we have various anti-takeover measures in place under our articles of incorporation and bylaws, including a supermajority vote requirement for mergers, a staggered board of directors, and the absence of cumulative voting. Any one or more of these measures may impede the takeover of Mid Penn without the approval of our board of directors and may prevent our shareholders from taking part in a transaction in which they could realize a premium over the current market price of our common stock.

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Mid Penn may need to or be required to raise additional capital in the future, and capital may not be available when needed and on terms favorable to current shareholders

Federal banking regulators require Mid Penn and its subsidiary bank to maintain adequate levels of capital to support their operations. These capital levels are determined and dictated by law, regulation, and banking regulatory agencies. In addition, capital levels are also determined by Mid Penn's management and board of directors, based on capital levels that they believe are necessary to support Mid Penn's business operations.

If Mid Penn raises capital through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and could dilute the per share book value and earnings per share of its common stock. Furthermore, a capital raise through issuance of additional shares may have an adverse impact on Mid Penn's stock price. New investors also may have rights, preferences and privileges senior to Mid Penn's current shareholders, which may adversely impact its current shareholders.

Mid Penn's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside of its control, and on its financial performance. Accordingly, Mid Penn cannot be certain of its ability to raise additional capital on acceptable terms and acceptable time frames or to raise additional capital at all. If Mid Penn cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect Mid Penn's financial condition and results of operations.

If we conclude that the decline in the value of any of our investment securities is other than temporary, we are required to write down the value of that security through a charge to earnings

We review our investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of our investment securities has declined below its carrying value, we are required to assess whether the decline is other than temporary. If we conclude that the decline is other than temporary, we are required to write down the value of that security through a charge to earnings. Changes in the expected cash flows of these securities and/or prolonged price declines have resulted and may result in our concluding in future periods that there is additional impairment of these securities that is other than temporary, which would require a charge to earnings to write down these securities to their fair value. Due to the complexity of the calculations and assumptions used in determining whether an asset is impaired, the impairment disclosed may not accurately reflect the actual impairment in the future.

Mid Penn's operations of its business, including its interaction with customers, are increasingly done via electronic means, and this has increased its risks related to cyber security

Mid Penn is exposed to the risk of cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. Mid Penn has observed an increased level of attention in the industry focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, policies and procedures are in place to prevent or limit the effect of the possible security breach of its information systems and it has insurance against some cyber-risks and attacks. While Mid Penn has not incurred any material losses related to cyber-attacks, nor is it aware of any specific or threatened cyber-incidents as of the date of this report, it may incur substantial costs and suffer other negative consequences if it falls victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

Mid Penn is subject to environmental liability risk associated with lending activities

A significant portion of Mid Penn's loan portfolio is secured by real property. During the ordinary course of business, Mid Penn may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, Mid Penn may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require Mid Penn to incur substantial expenses and may materially reduce the affected property's value or limit Mid Penn's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws, may increase Mid Penn's exposure to environmental liability. Although Mid Penn has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn's financial performance may suffer if its information technology is unable to keep pace with its growth or industry developments

Effective and competitive delivery of Mid Penn's products and services is increasingly dependent upon information technology resources and processes, both those provided internally as well as those provided through third party vendors. In addition to better serving customers, the effective use of technology increases efficiency and enables Mid Penn to reduce costs. Mid Penn's future success will depend, in part, upon its

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ability to address the needs of its customers by using technology to provide products and services to enhance customer convenience, as well as to create additional efficiencies in its operations. Many of Mid Penn's competitors have greater resources to invest in technological improvements. Additionally, as technology in the financial services industry changes and evolves, keeping pace becomes increasingly complex and expensive for Mid Penn. There can be no assurance that Mid Penn will be able to effectively implement new technology-driven products and services, which could reduce its ability to compete effectively.

Future credit downgrades of the United States Government due to issues relating to debt and the deficit may adversely affect the Mid Penn

As a result of failure of the federal government to reach agreement over federal debt and the ongoing issues connected with the debt ceiling, certain rating agencies placed the United States government's long-term sovereign debt rating on their equivalent of negative watch and announced the possibility of a rating downgrade. The rating agencies, due to constraints related to the rating of the United States, also placed government-sponsored enterprises in which Mid Penn invests and receives lines of credit on negative watch and a downgrade of the United States' credit rating would trigger a similar downgrade in the credit rating of these government sponsored enterprises. Furthermore, the credit rating of other entities, such as state and local governments, may also be downgraded should the United States credit rating be downgraded. The impact that a credit rating downgrade may have on the national and local economy could have an adverse effect on Mid Penn's financial condition and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

MID PENN BANCORP, INC.

ITEM 2. PROPERTIES

With the exception of the Market Square Office, Derry Street Loan Administrative Office, River Chase Administrative Office, Simpson Ferry Road Office, and the Elizabethtown Office, the Bank owns the properties listed below, as well as certain parking facilities related to its banking offices, all of which are free and clear of any lien. The Bank's main office and all branch offices are located in Pennsylvania. All of these properties are in good condition and are deemed by management to be adequate for the Bank's purposes. The table below sets forth the location of each of the Bank's properties at December 31, 2014.

Property Location	Description of Property	Property Location	Description of Property
Millersburg Office 349 Union Street Millersburg, PA 17061	Main Office & Branch Office	Lykens Office 550 Main Street Lykens, PA 17048	Branch Office
Elizabethville Office 4642 State Route 209 Elizabethville, PA 17023	Branch Office	Allentown Boulevard Office 5500 Allentown Boulevard Harrisburg, PA 17112	Branch Office
Dalmatia Office 132 School House Road Dalmatia, PA 17017	Branch Office	Market Square Office 17 N. Second Street Harrisburg, PA 17101	Branch Office
Carlisle Pike Office 4622 Carlisle Pike Mechanicsburg, PA 17050	Branch Office	Steelton Office 51 South Front Street Steelton, PA 17113	Branch Office
Derry Street Office 4509 Derry Street Harrisburg, PA 17111	Branch Office	Middletown Office 1100 Spring Garden Drive Middletown, PA 17057	Branch Office
Front Street Office 2615 North Front Street Harrisburg, PA 17110	Branch Office	Camp Hill Office 2101 Market Street Camp Hill, PA 17011	Branch Office
Tower City Office 545 East Grand Avenue	Branch Office	Operations Center 894 N. River Road	Operations Center

Tower City, PA 17980		Halifax, PA 17032	
Dauphin Office 1001 Peters Mountain Road Dauphin, PA 17018	Branch Office	River Chase Administrative Office 4311 North Front Street, Ste. 101 Harrisburg, PA 17110	Administrative Office
Derry Street Loan Administrative Office 4099 Derry Street Harrisburg, PA 17111	Administrative Office	Elizabethtown Office 2305 South Market Street Elizabethtown, PA 17022	Branch Office
Simpson Ferry Road Office* 5288 Simpson Ferry Road Mechanicsburg, PA 17055			

* Mid Penn anticipates opening a branch at this location in May 2015.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation's common stock is traded on the NASDAQ Stock Market under the symbol MPB. The following table shows the range of high and low sale prices for the Corporation's stock and cash dividends paid for the quarters indicated.

	High	Low	Cash Dividends Paid
Quarter Ended:			
March 31, 2014	$ 14.97	$ 13.25	$ 0.05
June 30, 2014	16.00	14.00	0.10
September 30, 2014	16.33	15.05	0.10

December 31, 2014	15.95	15.06	0.20
March 31, 2013	$ 11.60	$ 10.15	$ -
June 30, 2013	11.34	9.80	0.05
September 30, 2013	12.70	10.80	0.05
December 31, 2013	14.85	11.38	0.15

Transfer Agent: Computershare, Attn: Shareholder Services, P.O. Box 30170, College Station, TX 77842-3170. Phone: 1-800-368-5948.

Number of Shareholders: As of March 6, 2015, there were approximately 1,611 shareholders of record of Mid Penn's common stock.

Dividends: Cash dividends of $0.45 were paid in 2014, while $0.25 was paid in both 2013 and 2012.

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

Annual Meeting: The Annual Meeting of the Shareholders of Mid Penn is expected to be held at 10:00 a.m. on Tuesday, May 12, 2015, at 31 Bunker Hill Road, Halifax, PA 17032.

Accounting, Auditing and Internal Control Complaints: Information on how to report a complaint regarding accounting, internal accounting controls or auditing matters is available at Mid Penn's website: midpennbank.com.

Stock Performance Graph

Index	Period Ending 12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
Mid Penn Bancorp, Inc.	100.00	72.89	75.04	114.24	149.43	166.80
Russell 3000	100.00	116.93	118.13	137.52	183.66	206.72
Mid-Atlantic Custom Peer Group*	100.00	109.30	109.36	127.36	150.73	164.07

*Mid-Atlantic Custom Peer Group consists of Mid-Atlantic commercial banks with assets less than $1B.

Source : SNL Financial LC, Charlottesville, VA
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www.snl.com

A detailed list of the Banks comprising the Mid-Atlantic Custom Peer Group is incorporated herein by reference to Exhibit 99.1, which is attached to this Annual Report on Form 10-K.

MID PENN BANCORP, INC.

ITEM 6. SELECTED FINANCIAL DATA

Summary of Selected Financial Data

(Dollars in thousands, except per share data)	2014	2013	2012	2011	2010
INCOME:					
Total Interest Income	$ 30,627	$ 28,983	$ 30,366	$ 31,545	$ 30,148
Total Interest Expense	4,427	5,057	7,125	9,522	10,642
Net Interest Income	26,200	23,926	23,241	22,023	19,506
Provision for Loan and Lease Losses	1,617	1,685	1,036	1,205	2,635
Noninterest Income	3,248	3,290	3,683	2,996	3,414
Noninterest Expense	20,668	19,391	19,693	18,048	17,121
Income Before Provision for Income Taxes	7,163	6,140	6,195	5,766	3,164
Provision for Income Taxes	1,462	1,201	1,244	1,223	416
Net Income	5,701	4,939	4,951	4,543	2,748
Series A Preferred Stock Dividends and Discount Accretion	-	14	514	514	514
Series B Preferred Stock Dividends	350	309	-	-	-
Net Income Available to Common Shareholders	5,351	4,616	4,437	4,029	2,234
COMMON STOCK DATA PER SHARE:					
Earnings Per Common Share (Basic)	$ 1.53	$ 1.32	$ 1.27	$ 1.16	$ 0.64
Earnings Per Common Share (Fully Diluted)	1.53	1.32	1.27	1.16	0.64
Cash Dividends	0.45	0.25	0.25	0.20	-
Book Value Per Common Share	15.48	13.71	13.57	12.47	10.98
Tangible Book Value Per Common Share	15.13	13.35	13.19	12.10	10.58
AVERAGE SHARES OUTSTANDING (BASIC)	3,495,705	3,491,653	3,486,543	3,481,414	3,479,780
AVERAGE SHARES OUTSTANDING (FULLY DILUTED)	3,495,705	3,491,653	3,486,543	3,481,414	3,479,780
AT YEAR-END:					
Available For Sale Investment Securities	$ 141,634	$ 122,803	$ 154,295	$ 159,043	$ 70,702
Loans and Leases, Net of Unearned Interest	571,533	546,462	484,220	482,717	467,735

Allowance for Loan and Lease Losses	6,716	6,317	5,509	6,772	7,061
Total Assets	755,657	713,125	705,200	715,383	637,457
Total Deposits	637,922	608,130	625,461	634,055	554,982
Short-term Borrowings	578	23,833	-	-	1,561
Long-term Debt	52,961	23,145	22,510	22,701	27,883
Shareholders' Equity	59,130	52,916	52,220	53,452	48,201
RATIOS:					
Return on Average Assets	0.78%	0.71%	0.69%	0.66%	0.44%
Return on Average Shareholders' Equity	9.95%	9.37%	8.78%	8.96%	5.71%
Cash Dividend Payout Ratio	29.41%	18.94%	19.69%	17.24%	0.00%
Allowance for Loan and Lease Losses to Loans and Leases	1.18%	1.16%	1.14%	1.40%	1.51%
Average Shareholders' Equity to Average Assets	7.80%	7.56%	7.98%	7.37%	7.73%

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain of the matters discussed in this document may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Mid Penn to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words “expect,” “anticipate,” “intend,” “plan,” “believe,” “estimate,” and sim expressions are intended to identify such forward-looking statements.

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

· the effects of future economic conditions on Mid Penn and its customers;
· governmental monetary and fiscal policies, as well as legislative and regulatory changes;
· future actions or inactions of the United States government, including a failure to increase the government debt limit or a prolonged shutdown of the federal government;
· possible impacts of the capital and liquidity requirements of Basel III standards and other regulatory pronouncements, regulations and rules;
· the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, Financial Accounting Standards Board, and other accounting standard setters;
· the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
· the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in Mid Penn’s market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
· the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
· technological changes;
· acquisitions and integration of acquired businesses, including Phoenix, which may take longer or be more costly to complete than anticipated, including as a result of unexpected factors or events;
· the anticipated cost savings and other synergies of acquisitions, including Phoenix, may take longer to be realized or may not be achieved in their entirety, and attrition in key client, partner and other relationships relating to such acquisition may be greater than expected;
· results of the regulatory examination and supervision process;
· loss of certain key officers;
·

the failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;

- acts of war or terrorism;
- our ability to maintain compliance with the exchange rules of the NASDAQ Stock Market LLC.;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- volatilities in the securities markets;
- disruptions due to flooding, severe weather, or other natural disasters or Acts of God; and
- slow economic conditions.

All written or oral forward-looking statements attributable to Mid Penn are expressly qualified in their entirety by these cautionary statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of Mid Penn's consolidated financial statements and should be read in conjunction with the Consolidated Financial Statements of the Corporation and Notes thereto and other detailed information appearing elsewhere in this Annual Report. Mid Penn is not aware of any known trends, events, uncertainties or of any current recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on Mid Penn's liquidity, capital resources or operations.

Critical Accounting Estimates

Mid Penn's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and conform to general practices within the banking industry. Application of these principles involves significant judgments and estimates by management that have a material impact on the carrying value of certain assets and liabilities. The judgments and estimates that we used are based on historical experiences and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and estimates that we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

Management of the Corporation considers the accounting judgments relating to the allowance for loan and lease losses and the evaluation of the Corporation’s investment securities for other-than-temporary impairment, to be the accounting areas that require the most subjective and complex judgments.

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

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

Financial Summary

The consolidated earnings of Mid Penn are derived primarily from the operations of its wholly owned subsidiary, Mid Penn Bank.

2014 versus 2013

Mid Penn’s net income available to common shareholders of $5,351,000 for the year 2014 reflects an increase of $735,000, or 15.9%, over the $4,616,000 for the year 2013. This represents net income in 2014 of $1.53 per common share compared to $1.32 per common share in 2013.

Net income available to common shareholders for both the fourth quarter and year of 2014 was impacted by $573,000 in merger and acquisition expenses incurred in conjunction with the acquisition of Phoenix Bancorp, Inc. Excluding these charges and the corresponding tax impact, net income available to common shareholders for the twelve months ended December 31, 2014 would have been $5,760,000, an increase of $1,144,000, or 24.8%, over the twelve months ended December 31, 2013.

Total assets of Mid Penn grew $42,532,000, or 6.0% in 2014 to close the year at $755,657,000, compared to $713,125,000 at the end of 2013. The majority of the asset growth was centered in the loan portfolio, which increased $25,071,000, or 4.6%, to $571,533,000. Mid Penn's investment portfolio also increased $18,831,000, or 15.3%, to $141,634,000.

Total deposits increased $29,792,000, or 4.9%, from $608,130,000 at the end of 2013 to $637,922,000 at December 31, 2014. This was part of a comprehensive effort to improve Mid Penn's overall funding mix by reducing reliance on higher-priced money market and certificate of deposit funds and placing greater emphasis on less expensive demand deposits and savings balances. As a result of these efforts, demand deposits and savings comprise 49.5% of total deposits at the end of 2014 versus 45.9% of total deposits at the end of 2013. Mid Penn also had increased its long-term debt by $29,816,000, or 128.8%, to $52,961,000 by the end of 2014 to take advantage of low long-term borrowing rates and to provide funds to increase earning assets. This increase in long-term debt reduced Mid Penn's short-term borrowing position $23,255,000, or 97.6%, to $578,000 at the end of 2014.

Mid Penn's return on average shareholders' equity, ("ROE"), a widely recognized performance indicator in the financial industry, was 9.95% in 2014 and 9.37% in 2013. Return on average assets ("ROA"), another performance indicator, was 0.78% in 2014 and 0.71% in 2013.

Mid Penn's performance during 2014 improved over the results reported in 2013. This improvement was the result of increasing earning assets, improving cost of funds, improvement in nonperforming loans, and consistent management of controllable expenses throughout 2014.

Net interest margin improved to 3.99% in 2014 from 3.80% in 2013. This improvement was driven by a 15 basis point improvement in the rate on supporting liabilities to 0.71% in 2014 from 0.86% in 2013. This improvement allowed average interest spread to increase to 3.91% from 3.70% in 2013 and net interest income on a tax equivalent basis to increase to $27,968,000 in 2014 from $25,250,000 in 2013. This increase was achieved in spite of the substantial pool of nonperforming loans being carried on the balance sheet. The amount of interest income lost on this pool of troubled loans in 2014 amounted to $798,000. Further discussion of net interest margin can be found in the Net Interest Income section below.

Total nonperforming assets decreased $1,168,000 from $12,675,000 in 2013 to $11,507,000 at the end of 2014. Decreasing nonaccrual loans were the leading source of improvement in nonperforming assets. Further discussion of these components can be found in the Credit Quality, Credit Risk, and Allowance for Loan and Lease Losses section below.

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Net charge-offs increased to $1,218,000 in 2014 from $877,000 during 2013, mainly due to the impact of two large recoveries in 2013 totaling $429,000. Gross charge-offs fell $145,000 from $1,473,000 in 2013 to $1,328,000 in 2014. Mid Penn decreased provision for loan and lease losses from $1,685,000 in 2013 to $1,617,000 in 2014. This was largely driven by decreasing balances of nonperforming assets within the portfolio. Further discussion of these issues can be found in the Provision for Loan and Lease Losses section below.

The Mid Penn's tier one capital (to risk weighted assets) of $56,560,000, or 10.1%, and total capital (to risk weighted assets) of $63,336,000, or 11.4%, at December 31, 2014, are above the regulatory requirements. Tier one capital consists primarily of the Bank's shareholders' equity and any qualifying preferred stock. Total capital also includes qualifying subordinated debt, if any, and the allowance for loan and lease losses, within permitted limits. Risk-weighted assets are determined by assigning various levels of risk to different categories of assets and off-balance sheet activities.

2013 versus 2012

Mid Penn's net income available to common shareholders of $4,616,000 for the year 2013 reflected an increase of $179,000, or 4.0%, over the $4,437,000 for the year 2012. This represented net income in 2013 of $1.32 per common share compared to $1.27 per common share in 2012.

Total assets of Mid Penn grew $7,925,000, or 1.1%, in 2013 to close the year at $713,125,000, compared to $705,200,000 at year-end 2012. The majority of the asset growth was centered in the loan portfolio, which increased $62,242,000, or 12.9%, to $546,462,000. This loan growth was supported by a decrease in investments, which fell to $122,803,000, or 20.4%, from $154,295,000 at the end of 2012.

Total deposits decreased $17,331,000, or 2.8%, from $625,461,000 at the end of 2012 to $608,130,000 at December 31, 2013. This was part of a comprehensive effort to improve Mid Penn's overall funding mix by reducing reliance on higher-priced money market and certificate of deposit funds and placing greater emphasis on less expensive demand deposits and savings balances. As a result of these efforts, demand deposits and savings comprised 45.9% of total deposits at the end of 2013 versus 40.2% of total deposits at the end of 2012. Mid Penn also had shifted to a short-term borrowing position of $23,833,000 as part of its funding strategy by the end of 2013.

Mid Penn's ROE, a widely recognized performance indicator in the financial industry, was 9.37% in 2013 and 8.78% in 2012. ROA, another performance indicator, was 0.71% in 2013 and 0.69% in 2012.

Mid Penn's performance during 2013 improved over the results reported in 2012. This improvement was the result of increased loan production, improving cost of funds, improvement in nonperforming loans, and consistent management of controllable expenses throughout 2013.

Net interest margin improved to 3.80% in 2013 from 3.63% in 2012. This improvement was driven by a 34 basis point improvement in the rate on supporting liabilities to 0.86% in 2013 from 1.20% in 2012. This improvement allowed average interest spread to increase to 3.70% from 3.49% in 2012 and net interest income on a tax equivalent basis to increase to $25,250,000 in 2013 from $24,494,000 in 2012. This increase was achieved in spite of the substantial pool of nonperforming loans being carried on the balance sheet. The amount of interest income lost on this pool of troubled loans in 2013 amounted to $861,000.

Total nonperforming assets decreased $425,000 from $13,100,000 in 2012 to $12,675,000 at the end of 2013. Decreasing nonaccrual loans were the leading source of improvement in nonperforming assets.

Net charge-offs decreased to $877,000 in 2013 from $2,299,000 during 2012. Mid Penn increased provision for loan and lease losses from $1,036,000 in 2012 to $1,685,000 in 2013. This was largely driven by the increase in loans in the overall portfolio.

Mid Penn's tier one capital (to risk weighted assets) of $52,693,000, or 9.9%, and total capital (to risk weighted assets) of $59,100,000, or 11.1%, at December 31, 2013, are above the regulatory requirements.

Net Interest Income

Net interest income, Mid Penn's primary source of revenue, represents the difference between interest income and interest expense. Net interest income is affected by changes in interest rates and changes in average balances (volume) in the various interest-sensitive assets and liabilities.

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

(Dollars in thousands)	Income and Rates on a Taxable Equivalent Basis for Years Ended								
	December 31, 2014			December 31, 2013			December 31, 2012		
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates
ASSETS:									
Interest Earning Balances	$ 6,839	$ 41	0.60%	$ 14,818	$ 109	0.74%	$ 26,092	$ 236	0.90%
Investment Securities:									
Taxable	62,214	1,501	2.41%	68,524	617	0.90%	99,906	1,154	1.16%
Tax-Exempt	74,508	3,303	4.43%	66,147	2,911	4.40%	55,033	2,609	4.74%
Total Securities	136,722			134,671			154,939		
Federal Funds Sold	30	-	0.00%	3,580	11	0.31%	6,197	16	0.26%
Loans and Leases, Net	554,970	27,427	4.94%	508,638	26,639	5.24%	483,977	27,599	5.70%
Restricted Investment in Bank Stocks	3,063	123	4.02%	2,545	20	0.79%	2,772	5	0.18%
Total Earning Assets	701,624	32,395	4.62%	664,252	30,307	4.56%	673,977	31,619	4.69%
Cash and Due from Banks	8,460			8,156			8,057		
Other Assets	24,152			25,472			24,422		
Total Assets	$ 734,236			$ 697,880			$ 706,456		
LIABILITIES & SHAREHOLDERS' EQUITY:									
Interest Bearing Deposits:									
NOW	$ 216,656	777	0.36%	$ 182,118	659	0.36%	$ 126,171	458	0.36%
Money Market	201,281	1,088	0.54%	202,393	1,194	0.59%	236,434	1,992	0.84%

Savings	30,953	16	0.05%	29,597	15	0.05%	28,632	14	0.05%
Time	127,071	1,971	1.55%	148,863	2,568	1.73%	180,356	3,683	2.04%
Short-term Borrowings	14,813	55	0.37%	10,533	26	0.25%	1,044	3	0.29%
Long-term Debt	30,889	520	1.68%	16,268	595	3.66%	22,605	975	4.31%
Total Interest Bearing Liabilities	621,663	4,427	0.71%	589,772	5,057	0.86%	595,242	7,125	1.20%
Demand Deposits	49,814			49,318			47,670		
Other Liabilities	5,491			6,051			7,184		
Shareholders' Equity	57,268			52,739			56,360		
Total Liabilities and Shareholders' Equity	$ 734,236			$ 697,880			$ 706,456		
Net Interest Income		$ 27,968			$ 25,250			$ 24,494	
Net Yield on Interest Earning Assets:									
Total Yield on Earning Assets			4.62%			4.56%			4.69%
Rate on Supporting Liabilities			0.71%			0.86%			1.20%
Average Interest Spread			3.91%			3.70%			3.49%
Net Interest Margin			3.99%			3.80%			3.63%

Interest and average rates are presented on a fully taxable equivalent basis, using an effective tax rate of 34%. For purposes of calculating loan yields, average loan balances include nonaccrual loans.

Loan fees of $749,000, $1,020,000, and $1,148,000 are included with interest income in Table 1 for the years 2014, 2013 and 2012, respectively.

TABLE 2: VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

(Dollars in thousands)	2014 Compared to 2013 Increase (Decrease) Due to Change In:			2013 Compared to 2012 Increase (Decrease) Due to Change In:		
Taxable Equivalent Basis	Volume	Rate	Net	Volume	Rate	Net
INTEREST INCOME:						
Interest Bearing Balances	$ (59)	$ (9)	$ (68)	$ (102)	$ (25)	$ (127)
Investment Securities:						
Taxable	(57)	941	884	(363)	(174)	(537)
Tax-Exempt	368	24	392	527	(225)	302
Total Investment Securities	311	965	1,276	164	(399)	(235)
Federal Funds Sold	(11)	-	(11)	(7)	2	(5)
Loans and Leases, Net	2,427	(1,639)	788	1,406	(2,366)	(960)
Restricted Investment Bank Stocks	4	99	103	-	15	15
Total Interest Income	2,672	(584)	2,088	1,462	(2,774)	(1,312)
INTEREST EXPENSE:						
Interest Bearing Deposits:						
NOW	125	(7)	118	203	(2)	201
Money Market	(6)	(100)	(106)	(286)	(512)	(798)
Savings	-	1	1	-	1	1
Time	(376)	(221)	(597)	(643)	(472)	(1,115)
Total Interest Bearing Deposits	(257)	(327)	(584)	(726)	(985)	(1,711)
Short-term Borrowings	11	18	29	27	(4)	23
Long-term Debt	535	(610)	(75)	(273)	(107)	(380)
Total Interest Expense	289	(919)	(630)	(972)	(1,096)	(2,068)
NET INTEREST INCOME	$ 2,383	$ 335	$ 2,718	$ 2,434	$ (1,678)	$ 756

The effect of changing volume and rate has been allocated entirely to the rate column. Tax-exempt income is shown on a tax equivalent basis assuming a federal income tax rate of 34%.

During 2014, taxable equivalent net interest income increased $2,718,000, or 10.8%, as compared to an increase of $756,000, or 3.1%, in 2013. The average balances, effective interest differential, and interest yields for the years ended December 31, 2014, 2013, and 2012 and the components of net interest income, are presented in Table 1. A comparative presentation of the changes in net interest income for 2014 compared to 2013, and 2013 compared to

2012, is provided in Table 2. This analysis indicates the changes in interest income and interest expense caused by the volume and rate components of interest earning assets and interest bearing liabilities.

The yield on earning assets increased to 4.62% in 2014 from 4.56% in 2013. The yield on earning assets for 2012 was 4.69%. The change in the yield on earning assets was due primarily to increases in market interest rates on investment securities and loan volume in 2014. The increase in loan volume masked the decline in the average rate, which decreased from 5.24% in 2013 to 4.94% in 2014. The average "prime rate" for 2014, 2013, and 2012 was 3.25%. The yield on earning assets in 2014 was also negatively impacted by the loss of interest on nonperforming loans. During 2014, this loss of interest amounted to $798,000. Had this interest been included in Mid Penn's earnings, the yield on earning assets would have increased by 12 basis points.

Interest expense decreased by $630,000, or 12.5%, in 2014 as compared to a decrease of $2,068,000, or 29.0%, in 2013. The cost of interest bearing liabilities decreased to 0.71% in 2014 from 0.86% in 2013. The cost of interest bearing liabilities for 2012 was 1.20%. The reduction in the cost of interest bearing liabilities was due to changes in market interest rates and Mid Penn's ability to replace higher-cost time deposits with lower-cost demand deposits.

Included in the net interest income increase for the year ended December 31, 2014 is $324,000 in recaptured nonaccrual interest from two large commercial real estate loans to a commercial borrower that were returned to accruing status in June 2014, and does not have a material impact on Mid Penn's consolidated financial statements.

Net interest margin, on a tax equivalent basis was 3.99% in 2014 compared to 3.80% in 2013 and 3.63% in 2012. The interest rate impact of earning assets and funding sources due to changes in interest rates can be reasonably estimated at current interest rate levels, the options selected by customers, and the future mix of the loan, investment, and deposit products in the Bank's portfolios, may significantly change the estimates used in the simulation models. In addition, our net interest income may be impacted by further interest rate actions of the Federal Reserve. Management continues to monitor the net interest margin closely.

Provision for Loan and Lease Losses

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

Mid Penn has maintained the allowance for loan and lease losses in accordance with Mid Penn’s assessment process, which took into consideration the risk characteristics of the loan and lease portfolio and shifting collateral values from December 31, 2013 to December 31, 2014. For the year ended December 31, 2014, the provision for loan and lease losses was $1,617,000, as compared to $1,685,000 for the year ended December 31, 2013. The allowance for loan and lease losses as a percentage of total loans was 1.18% at December 31, 2014, compared to 1.16% at December 31, 2013 and 1.14% at December 31, 2012.

For the year ended December 31, 2014, Mid Penn had net charge-offs of $1,218,000 compared to net charge-offs of $877,000 during the year ended December 31, 2013. Loans charged off during 2014 were comprised of 15 commercial real estate loans totaling $1,057,000. Eight of these loans totaling $441,000 were to three borrowers with the remaining loans to unrelated borrowers. In addition, there were charge-offs for five residential real estate loans to unrelated borrowers totaling $133,000, three commercial and industrial loans to unrelated borrowers totaling $62,000, and one home equity loan representing $43,000 of the total charged off during 2014. The remaining $33,000 was comprised of various consumer loans to unrelated borrowers.

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.

Several factors contributed to the decrease in provision expense in 2014. The first element was the required quantitative allowance on loans deemed impaired within the portfolio. While total impaired loans increased $17,000, from $10,912,000 at December 31, 2013 to $10,929,000 at December 31, 2014, the specific reserves required on these impaired loans decreased $299,000, from $1,933,000 at December 31, 2013 to $1,634,000 at December 31, 2014 due to improved collateral coverage within this group of loans. The second element was the required quantitative allowance on classified loans within the portfolio that are not deemed to be impaired. Loans internally classified as special mention increased from $4,214,000 at December 31, 2013 to $6,145,000 at December 31, 2014, or an increase of $1,931,000. Loans internally classified as substandard but not impaired decreased $527,000 from $3,960,000 at December 31, 2013 to $3,433,000 at December 31, 2014. These changes resulted in a net increase in special mention and classified loans of $1,404,000 during 2014. This increase was coupled with an increase in the historical loss experience within these segments of the portfolio based upon current experience in the portfolio, which resulted in an increase in the quantitative allowance for classified loans of $422,000. The final element was the qualitative segment of the allowance for loan and lease losses increased $87,000 to $3,769,000 at December 31, 2014, from $3,682,000 at December 31, 2013. This increase was primarily the result of the growth in the overall loan and lease portfolio. The combination of the shifting components and migrating loss experience resulted in an overall increase of $210,000 in required balances in the allowance for loan and lease losses. The impact of the required reserves, coupled with the specific mix of loan charge-off and recoveries during the year led to a slight decline in the provision for loan and lease losses during 2014 versus 2013.

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

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

(Dollars in thousands)	Years ended December 31,				
	2014	2013	2012	2011	2010
Balance, beginning of year	$ 6,317	$ 5,509	$ 6,772	$ 7,061	$ 7,686
Loans and leases charged off:					
Commercial real estate, construction and land development	1,057	936	499	545	1,413
Commercial, industrial and agricultural	62	183	834	546	787
Real estate - residential	133	167	195	310	858
Consumer	76	187	860	142	146
Leases	-	-	-	44	230
Total loans and leases charged off	1,328	1,473	2,388	1,587	3,434
Recoveries on loans and leases previously charged off:					
Commercial real estate, construction and land development	13	286	15	26	21
Commercial, industrial and agricultural	14	193	31	10	3
Real estate - residential	20	23	-	19	70
Consumer	63	92	43	32	80
Leases	-	2	-	6	-
Total loans and leases recovered	110	596	89	93	174
Net charge-offs	1,218	877	2,299	1,494	3,260
Provision for loan and lease losses	1,617	1,685	1,036	1,205	2,635
Balance, end of year	$ 6,716	$ 6,317	$ 5,509	$ 6,772	$ 7,061

	Years ended December 31,				
	2014	2013	2012	2011	2010
Ratio of net charge-offs during the year to average loans and leases outstanding during					

the year, net of unearned discount	0.22%	0.17%	0.48%	0.31%	0.69%
Allowance for loan and lease losses as a percentage of total loans and leases at December 31	1.18%	1.16%	1.14%	1.40%	1.51%
Allowance for loan and lease losses as a percentage of non-performing assets at December 31	58.36%	49.84%	42.05%	50.91%	35.05%

Noninterest Income

2014 versus 2013

Income from fiduciary activities for 2014 was $552,000, a $60,000, or 12.2% increase from $492,000 in 2013. This revenue source is comprised of fees generated by Mid Penn's Trust department and fees from the sale of third-party mutual funds and annuities to the Bank's retail and commercial customers. Assets under management in the areas of Trust and Wealth Management increased from $26,054,000 at the end of 2013 to $46,859,000 at the end of 2014 due to more active marketing of these services to potential customers. This increase in assets under management, which are not a component of Mid Penn's consolidated balance sheets, accounted for the increased fee income during 2014.

Mid Penn recognized gains on sale of investment securities in 2014 of $168,000 as a result of efforts to position the portfolio to provide improved earnings and cash flow in support of future loan growth, down $52,000 from the $220,000 recorded in 2013.

Mortgage refinancing activity decreased $35,000 or 10.1% to $313,000 during 2014 from $348,000 in 2013 due to mortgage rate increases. While home purchase activity improved throughout the year, it did not rebound enough to compensate for the decline throughout our market area during the first quarter of 2014 due to harsh winter weather conditions.

Merchant services revenue, which is derived from the interchange fee income received as a result of customers utilizing Mid Penn as their credit card processor, decreased to $254,000 in 2014, a decline of $76,000, or 23.0%, compared to $330,000 in 2013. The decrease was mainly due to increased competition in this business line as more financial institutions pursued additional revenue sources, which hindered Mid Penn's ability to price as it did in 2013.

During 2014, Mid Penn began selling the guaranteed portion of Small Business Association ("SBA") loans in the secondary market. This new business activity generated $119,000 in fee income during the year.

The decline in other income of $72,000, or 12.3% from 2013 can be traced to the recognition in 2013 of a refund of collection costs on a previously troubled loan and a refund of previously paid sales taxes.

2013 versus 2012

Income from fiduciary activities for 2013 was $492,000, an $83,000, or 14.4%, decrease from $575,000 in 2012. Fees from third-party mutual fund and annuity sales were $267,000 in 2013 and $389,000 in 2012. This decline in fee revenue was responsible for the variance from 2012.

Mid Penn recognized gains on sale of investment securities in 2013 of $220,000 and $267,000 in 2012 as a result of efforts to position the portfolio to provide improved earnings and cash flow in support of future loan growth.

Mortgage banking income suffered from increasing mortgage rates earlier in the year, which effectively shut off the flow of customers seeking to refinance their existing mortgages from higher rates. Mortgage banking income for 2013 was $348,000, a decrease of $327,000, or 48.4%, from $675,000 in 2012.

Merchant services revenue increased to $330,000 in 2013, an increase of $74,000, or 28.9%, compared to $256,000 for 2012. Sales efforts in this area were also very positive in 2013, adding to the enhanced revenue.

TABLE 4: NONINTEREST INCOME

(Dollars in thousands)	Years ended December 31,		
	2014	2013	2012
Income from fiduciary activities	$ 552	$ 492	$ 575
Service charges on deposits	584	576	565
Net gain on sales of investment securities	168	220	267
Earnings from cash surrender value of life insurance	201	231	247
Mortgage banking income	313	348	675
ATM debit card interchange income	544	508	472
Merchant services income	254	330	256
Gain on sales of SBA loans	119	-	-
Other income	513	585	626
Total Noninterest Income	$ 3,248	$ 3,290	$ 3,683

Noninterest Expense

2014 versus 2013

Occupancy expense increased $185,000 to $1,313,000 in 2014. This expense area was negatively impacted by harsh weather conditions during the first and early second quarters of 2014. Increased snow removal and heating costs were incurred during this period.

Pennsylvania Bank Shares tax expense decreased $99,000 to $365,000 in 2014 due to a statutory change in the calculation method.

Legal and professional fees decreased from $705,000 in 2013 to $516,000 in 2014, due to a decrease in consultant expenses over the same period last year, which included one-time set-up fees associated with the migration of Mid Penn's core banking data from an in-house environment to a service bureau hosted platform in 2013.

Loss (gain) on sale/write-down of foreclosed assets went from $302,000 of income in 2013 to $204,000 of expense in 2014 due to the write-down of foreclosed assets as a result of updated appraisals on subject properties within the portfolio during 2014 and the recognition of a $340,000 gain on the sale of a property during the second quarter of 2013.

One-time merger and acquisition expenses of $573,000 in connection with the acquisition of Phoenix were incurred during 2014.

2013 versus 2012

Salaries and employee benefits represented the major component of noninterest expense. During 2013, increases in the workforce primarily included adding experienced team members to add depth to the sales and support areas of Mid Penn. In 2013, Mid Penn also recognized a full year of salary and employee benefits expense from the 2012 additions within the support functions throughout the Corporation to enhance controls and support future growth. Commissions paid to employees in the retail investment and mortgage banking lines of business in 2013 were down $192,000 from 2012 due to reduced activity in both of these business lines.

FDIC assessment decreased $548,000 to $486,000 in 2013. Prior to 2011, assessments were calculated based on the total deposits of a financial institution. Beginning in the second quarter of 2011, the assessment base was changed from deposits to average total assets less tangible equity. This resulted in significant savings for Mid Penn. In addition, 2013 reflects the recognition of a refund of $139,000 in overbillings from the FDIC due to an error by the FDIC in Mid Penn's assessment calculation.

Legal and professional fees increased to $705,000 in 2013 from $604,000 in 2012. This increase was primarily related to consultants used in the information technology area to improve the Bank's network capabilities and successfully migrate to a service bureau processing environment.

Software licensing increased from $648,000 in 2012 to $947,000 in 2013. During 2013, Mid Penn incurred one-time charges of $26,000 associated with the migration its core banking data processing software from an in-house environment to a service bureau hosted platform. This migration allowed for staffing reductions in the information technology and operations areas of $39,000 for part of the year in 2013. The remaining increase was due to new service contracts on software to comply with various regulatory requirements and to expand the Bank's online loan and deposit application capabilities.

Mid Penn recognized a gain on sale or write-down on foreclosed assets of $302,000 in 2013. During 2013, Mid Penn recognized a gain of $340,000 on the sale of a repossessed property. This gain was offset by Mid Penn's ongoing analysis of the carrying values of repossessed properties and the adjustment of their values to current market rates.

Loan collection costs decreased to $214,000 in 2013 from $369,000 in 2012. Other real estate owned ("OREO") expense increased to $290,000 in 2013 from $253,000 in 2012. These items represented the costs associated with working through collection efforts on the pool of nonperforming assets within the loan portfolio. While decreasing in total during 2013, they continued to be at historically elevated levels due to the size and nature of the nonperforming assets pool.

ATM debit card processing and internet banking expenses both increased in recent years due to increasing customer demand for these banking services.

TABLE 5: NONINTEREST EXPENSE

(Dollars in thousands)	Years ended December 31,		
	2014	2013	2012
Salaries and employee benefits	$ 10,879	$ 10,788	$ 10,518
Occupancy expense, net	1,313	1,128	1,077
Equipment expense	1,205	1,299	1,234
Pennsylvania Bank Shares tax expense	365	464	462
FDIC Assessment	542	486	1,034
Legal and professional fees	516	705	604
Director fees and benefits expense	377	319	335
Marketing and advertising expense	308	253	378
Software licensing	965	947	648
Telephone expense	467	436	411
Loss (gain) on sale/write-down of foreclosed assets	204	(302)	96
Intangible amortization	27	29	45
Loan collection costs	288	214	369
Merger and acquisition expense	573	-	-
ATM debit card processing expense	310	202	171
Internet banking expense	319	252	240
Meals, travel, and lodging expense	273	271	266
Data processing	251	130	102
Insurance	141	129	126
OREO expense	172	290	253
Investor services	72	68	76
Other expenses	1,101	1,283	1,248
Total Noninterest Expense	$ 20,668	$ 19,391	$ 19,693

Investments

Mid Penn’s investment portfolio is utilized to provide liquidity and managed to maximize return within reasonable risk parameters.

Mid Penn’s entire portfolio of investment securities is considered available for sale. As such, the investments are recorded at fair value. Our investments are valued at a market price relative to investments of the same type with similar maturity dates. As the interest rate environment of these securities changes, the value of securities changes accordingly.

As of December 31, 2014, the unrealized gain on investment securities resulted in an increase in shareholders' equity of $1,625,000 (unrealized gain on securities of $2,462,000 less deferred income taxes of $837,000). At December 31, 2013, the unrealized loss on investment securities resulted in a decrease in shareholders' equity of $747,000 (unrealized loss on securities of $1,132,000 less deferred income taxes of $385,000). Mid Penn does not have any significant concentrations within its portfolio of investment securities. Table 6 provides a summary of our available for sale investment securities.

TABLE 6: FAIR VALUE OF INVESTMENT SECURITIES

(Dollars in thousands)	December 31,		
	2014	2013	2012
U.S. Treasury and U.S. government agencies	$ 27,066	$ 12,834	$ 17,740
Mortgage-backed U.S. government agencies	33,776	39,392	66,686
State and political subdivision obligations	79,171	69,038	69,479
Equity securities	1,621	1,539	390
	$ 141,634	$ 122,803	$ 154,295

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

TABLE 7: INVESTMENT MATURITY AND YIELD

(Dollars in thousands) As of December 31, 2014	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
U.S. Treasury and U.S. government agencies	$ -	$ 8,841	$ 18,225	$ -	$ 27,066
Mortgage-backed U.S. government agencies	-	1,802	3,821	28,153	33,776
State and political subdivision obligations	2,201	7,050	29,271	40,649	79,171
	$ 2,201	$ 17,693	$ 51,317	$ 68,802	$ 140,013

Weighted Average Yields	One Year and Less	After One Year thru Five Years	After Five Years thru Ten Years	After Ten Years	Total
U.S. Treasury and U.S. government agencies	-	3.60%	2.48%	-	2.85%
Mortgage-backed U.S. government agencies	-	3.94%	3.64%	3.63%	3.65%
State and political subdivision obligations	7.29%	4.88%	4.76%	4.77%	4.85%
	7.29%	4.14%	3.87%	4.30%	4.17%

Loans

At December 31, 2014, loans and leases totaled $571,533,000, a $25,071,000 or 4.6% increase from December 31, 2013. During 2014, Mid Penn experienced a net increase in commercial real estate and commercial/industrial loans of approximately $28,178,000. This increase was attributed to the increase in lending opportunities to credit-worthy borrowers within the markets Mid Penn serves as well as enhancements to the lending sales team during 2014.

At December 31, 2014, loans, net of unearned income, represented 79.0% of earning assets as compared to 80.2% on December 31, 2013, and 72.4% on December 31, 2012.

The Bank's loan portfolio is diversified among individuals and small and medium-sized businesses generally located within the Bank's trading area of eastern Cumberland, Dauphin, northwestern Lancaster, western Luzerne, southern Northumberland, and Schuylkill Counties. Commercial real estate, construction and land development loans are collateralized mainly by mortgages on the income-producing real estate or land involved. Commercial, industrial and agricultural loans are made to business entities and may be secured by business assets, including commercial real estate, or may be unsecured. Residential real estate loans are secured by liens on the residential property. Consumer loans include installment loans, lines of credit and home equity loans. The Bank has no concentration of credit to any one borrower. The Bank’s highest concentration of credit is in Commercial Real Estate financings.

A distribution of the Bank's loan portfolio according to major loan classification is shown in Table 8.

TABLE 8: LOAN PORTFOLIO

(Dollars in thousands)	December 31, 2014 Amount	%	2013 Amount	%	2012 Amount	%	2011 Amount	%	2010 Amount	%
Commercial real estate, construction and land development	$ 289,378	50.6	$ 274,279	50.2	$ 255,231	52.7	$ 249,204	51.6	$ 252,915	54.0
Commercial, industrial and agricultural	120,326	21.0	107,492	19.7	79,228	16.4	78,656	16.3	70,295	15.0
Real estate - residential	159,004	27.8	160,294	29.3	143,243	29.6	146,846	30.4	136,048	29.1
Consumer	3,018	0.6	4,646	0.8	6,770	1.4	8,327	1.7	8,922	1.9
Total Loans	571,726	100.0	546,711	100.0	484,472	100.0	483,033	100.0	468,180	100.0
Unearned income	(193)		(249)		(252)		(316)		(445)	
Loans net of unearned discount	571,533		546,462		484,220		482,717		467,735	
Allowance for loan and lease losses	(6,716)		(6,317)		(5,509)		(6,772)		(7,061)	
Net loans	$ 564,817		$ 540,145		$ 478,711		$ 475,945		$ 460,674	

Mid Penn's maturity and rate sensitivity information related to the loan portfolio is reflected in Table 9.

TABLE 9: LOAN MATURITY AND INTEREST SENSITIVITY

(Dollars in thousands) As of December 31, 2014	One Year and Less	After One Year thru Five Years	After Five Years	Total
Commercial real estate, construction and land development	$ 23,085	$ 33,987	$ 232,306	$ 289,378
Commercial, industrial and agricultural	3,561	29,742	87,023	120,326
Real estate - residential mortgages	4,326	15,069	139,609	159,004
Consumer	35	1,344	1,446	2,825
	$ 31,007	$ 80,142	$ 460,384	$ 571,533

Rate Sensitivity				
Predetermined rate	$ 30,890	$ 67,607	$ 377,563	$ 476,060
Floating or adjustable rate	117	12,535	82,821	95,473
	$ 31,007	$ 80,142	$ 460,384	$ 571,533

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

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

TABLE 10: NONPERFORMING ASSETS

(Dollars in thousands)	December 31, 2014	2013	2012	2011	2010
Nonperforming Assets:					
Nonaccrual loans	$ 8,907	$ 10,877	$ 11,831	$ 11,800	$ 17,228
Accruing troubled debt restructured loans	2,035	833	426	571	2,323
Total nonperforming loans	10,942	11,710	12,257	12,371	19,551
Foreclosed real estate	565	965	843	931	596
Total nonperforming assets	11,507	12,675	13,100	13,302	20,147
Accruing loans 90 days or more past due	-	-	-	-	19
Total risk elements	$ 11,507	$ 12,675	$ 13,100	$ 13,302	$ 20,166
Nonperforming loans as a % of total loans outstanding	1.91%	2.14%	2.53%	2.56%	4.18%
Nonperforming assets as a % of total loans outstanding and other real estate	2.01%	2.32%	2.71%	2.76%	4.31%
Ratio of allowance for loan losses to nonperforming loans	61.37%	53.94%	44.95%	54.74%	36.12%

Mid Penn assesses a specific allocation for both commercial loans and commercial real estate loans prior to charging down or charging off the loan. Once the charge down is taken, the remaining balance remains a nonperforming loan with the original terms and interest rate intact and is not treated as a restructured credit. During 2014, nonperforming loans declined $768,000 from $11,710,000 at December 31, 2013. This improvement has been the result of slight improvement in some sectors of the general economy and maintaining a close relationship with troubled borrowers as they navigate their plan toward a resolution of credit issues.

Mid Penn's troubled debt restructured loans at December 31, 2014 totaled $8,746,000 of which, $2,035,000 are accruing loans in compliance with the terms of the modification. $6,711,000 of the troubled debt restructured loans are included in nonaccrual loans. As a result of the evaluation, a specific allocation and, subsequently, charge offs have been taken as appropriate. Further discussion of troubled debt restructured loans can be found in Note 7 to Mid Penn's Consolidated Financial Statements, which are included in Item 8. As of December 31, 2014, there were no defaulted troubled debt restructured loans as all troubled debt restructured loans were current with respect to their associated forbearance agreements.

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

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

TABLE 11: PARTIALLY CHARGED OFF LOANS

(Dollars in thousands)

	December 31, 2014	December 31, 2013
Period ending total loans outstanding (net of unearned income)	$ 571,533	$ 546,462
Allowance for loan and lease losses	6,716	6,317
Total Nonperforming loans	10,942	11,710
Nonperforming and impaired loans with partial charge-offs	2,441	2,103
Ratio of nonperforming loans with partial charge-offs to total loans	0.43%	0.38%
Ratio of nonperforming loans with partial charge-offs to total nonperforming loans	22.31%	17.96%
Coverage ratio net of nonperforming loans with partial charge-offs	79.00%	65.75%
Ratio of total allowance to total loans less nonperforming loans with partial charge-offs	1.18%	1.16%

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

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

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

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

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

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

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

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

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

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

As of December 31, 2014, Mid Penn had several unrelated loan relationships, with an aggregate carrying balance of \$10,929,000, deemed impaired. This pool of loans was further broken down into a group of loans with an aggregate carrying balance of \$7,388,000 for which specific allocations totaling \$1,634,000 were included within the loan loss reserve for these loans. The remaining \$3,541,000 of loans required no specific allocation within the loan loss reserve. The \$10,929,000 pool of impaired loan relationships was comprised of \$8,925,000 in commercial real estate relationships, \$1,146,000 in residential relationships, \$618,000 in commercial and industrial relationships, and \$240,000 in home equity relationships. There were specific allocations of \$1,382,000 against the commercial real estate relationships. \$885,000 of this total was between two unrelated relationships. There was also \$137,000 against the commercial and industrial relationships and \$115,000 against the home equity relationships. Management currently believes that the specific reserves are adequate to cover probable future losses related to these relationships

The allowance for loan losses is a reserve established in the form of a provision expense for loan and lease losses and is reduced by loan charge-offs net of recoveries. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risk on a monthly basis so that an appropriate allowance is maintained. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance for loan and lease losses to the Board of Directors, indicating any changes in the allowance since the last review. In making the evaluation, management considers the results of recent regulatory examinations, which typically include a review of the allowance for loan and lease losses 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 local, regional, and national economic and business conditions affecting the collectability of the portfolio, the values of underlying collateral, and the condition of various market segments;
- changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified loans;
- changes in the experience, ability, and depth of lending management and other relevant staff as well as the quality of the institution's loan review system;
- changes in the nature and volume of the portfolio and the terms of loans generally offered; and
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

While the allowance for loan and lease losses is maintained at a level believed to be adequate by management to provide for probable losses inherent in the loan and lease portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods.

Management believes, based on information currently available, that the allowance for loan and lease losses of $6,716,000 as of December 31, 2014 is adequate to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

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

TABLE 12: ALLOCATION OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES

(Dollars in thousands)	December 31, 2014	2013	2012	2011	2010
Commercial real estate, construction and land development	$ 3,958	$ 4,015	$ 3,122	$ 3,567	$ 3,775
Commercial, industrial and agricultural	1,395	1,187	1,299	2,276	2,448
Real estate - residential	450	581	635	362	219

Consumer	688	513	444	424	424
Unallocated	225	21	9	143	195
	$ 6,716	$ 6,317	$ 5,509	$ 6,772	$ 7,061

The growth in the loan portfolio during 2014, as well as increases in historical loss factors in the special mention and substandard portions of the portfolio, necessitated a larger allowance in 2014. See also the discussion in the Provision for Loan and Lease Losses section.

The allowance for loan and lease losses at December 31, 2014 was $6,716,000, or 1.18%, of total loans less unearned discount as compared to $6,317,000, or 1.16%, at December 31, 2013, and $5,509,000, or 1.14%, at December 31, 2012.

Deposits and Other Funding Sources

Mid Penn's primary source of funds are deposits. Total deposits at December 31, 2014 increased by $29,792,000, or 4.9%, over December 31, 2013, which decreased by $17,331,000, or 2.8%, over December 31, 2012. Average balances and average interest rates applicable to the major classifications of deposits for the years ended December 31, 2014, 2013, and 2012 are presented in Table 13.

Average short-term borrowings for 2014 were $14,813,000 as compared to $10,533,000 in 2013. These borrowings consisted of federal funds purchased.

At December 31, 2014, the Bank had $4,462,000 in brokered deposits, an increase of $1,712,000, or 62.3%, over December 31, 2013, which decreased by $1,378,000, or 33.4%, over the same period in 2012.

TABLE 13: DEPOSITS BY MAJOR CLASSIFICATION

(Dollars in thousands)	December 31,					
	2014		2013		2012	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits	$ 49,814	0.00%	$ 49,318	0.00%	$ 47,670	0.00%
Interest-bearing demand deposits	216,656	0.36%	182,118	0.36%	126,171	0.36%
Money market	201,281	0.54%	202,393	0.59%	236,434	0.84%
Savings	30,953	0.05%	29,597	0.05%	28,632	0.05%
Time	127,071	1.55%	148,863	1.73%	180,356	2.04%
	$ 625,775	0.62%	$ 612,289	0.72%	$ 619,263	0.99%

The maturity distribution of time deposits of $100,000 or more is reflected in Table 14.

TABLE 14: MATURITY OF TIME DEPOSITS $100,000 OR MORE

(Dollars in thousands)	December 31,		
	2014	2013	2012
Three months or less	$ 4,506	$ 4,745	$ 7,207
Over three months to twelve months	21,308	16,953	18,340
Over twelve months	22,604	24,230	32,763
	$ 48,418	$ 45,928	$ 58,310

Capital Resources

Shareholders' equity, or capital, is evaluated in relation to total assets and the risk associated with those assets. The detailed computation of the Bank's regulatory capital ratios can be found in Note 16 of Item 8, Notes to Consolidated Financial Statements. The greater a corporation's capital resources, the more likely it is to meet its cash obligations and absorb unforeseen losses. Too much capital, however, indicates that not enough of the corporation's earnings have been invested in the continued growth of the business or paid to shareholders. The buildup makes it difficult for a corporation to offer a competitive return on the shareholders' capital going forward. For these reasons capital adequacy has been, and will continue to be, of paramount importance.

Shareholders' equity increased in 2014 by $6,214,000, or 11.7%, following an increase in 2013 of $696,000, or 1.3%, and a decrease in 2012 of $1,232,000, or 2.3%. Capital was positively impacted in 2014 by the net income available to common shareholders of $5,351,000 and the increase in accumulated other comprehensive (loss) income of $2,385,000. Capital was positively impacted in 2013 by the net income available to common shareholders of $4,616,000; however, the increase was muted by an increase in accumulated other comprehensive loss. Capital was negatively impacted in 2012 by the repayment and redemption of the $10,000,000 in the Series A preferred stock, but the impact was softened by the net income available to common shareholders of $4,437,000 and the issuance of the $4,880,000 in Series B preferred stock in 2012. Subsequently, the Series B preferred stock offering of $5,000,000 was completed on January 3, 2013.

Mid Penn's normal intent for dividend payout is to provide quarterly cash returns to shareholders and earnings retention at a level sufficient to finance future growth. The dividends paid on common shares totaled $0.45 for the year ended December 31, 2014, and $0.25 for the years ended December 31, 2013 and December 31, 2012.

The dividend payout ratio, which represents the percentage of annual net income returned to shareholders in the form of cash dividends, was 29.41% for 2014 and 18.94% for 2013.

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

(Dollars in thousands)	Capital Adequacy					
	Actual		Minimum Capital Required		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Corporation						
As of December 31, 2014:						
Tier 1 Capital (to Average Assets)	$ 56,560	7.4%	$ 30,429	4.0%	$ N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	56,560	10.1%	22,295	4.0%	N/A	N/A
Total Capital (to Risk Weighted Assets)	63,336	11.4%	44,590	8.0%	N/A	N/A
Bank						
As of December 31, 2014:						
Tier 1 Capital (to Average Assets)	$ 56,647	7.5%	$ 30,360	4.0%	$ 37,950	5.0%
Tier 1 Capital (to Risk Weighted Assets)	56,647	10.2%	22,295	4.0%	33,442	6.0%
Total Capital (to Risk Weighted Assets)	63,423	11.4%	44,590	8.0%	55,737	10.0%
Corporation						
As of December 31, 2013:						
Tier 1 Capital (to Average Assets)	$ 52,693	7.5%	$ 28,031	4.0%	$ N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	52,693	9.9%	21,234	4.0%	N/A	N/A
Total Capital (to Risk Weighted Assets)	59,100	11.1%	42,467	8.0%	N/A	N/A
Bank						
As of December 31, 2013:						
Tier 1 Capital (to Average Assets)	$ 52,598	7.5%	$ 28,041	4.0%	$ 35,051	5.0%
Tier 1 Capital (to Risk Weighted Assets)	52,598	9.9%	21,234	4.0%	31,850	6.0%
Total Capital (to Risk Weighted Assets)	59,005	11.1%	42,467	8.0%	53,084	10.0%

Capital Purchase Program Participation

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

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

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

As of December 31, 2014, Mid Penn has no further financial obligations under the Series A Preferred Stock, the Warrants, or the Treasury's CPP.

Federal Income Taxes

Federal income tax expense for 2014 was $1,462,000 compared to $1,201,000 in 2013 and $1,244,000 in 2012. The effective tax rate was 20% for 2014, 2013 and 2012.

Liquidity

Mid Penn's asset-liability management policy addresses the management of Mid Penn's liquidity position and its ability to raise sufficient funds to meet deposit withdrawals, fund loan growth and meet other operational needs. Mid Penn utilizes its investments as a source of liquidity, along with deposit growth and increases in repurchase agreements and borrowings. (See Deposits and Other Funding Sources which appears earlier in this discussion.) Liquidity from investments is provided primarily through investments and interest-bearing balances with maturities of one year or less.

The Bank has a line of credit commitment from the FHLB for overnight borrowings up to $40,000,000. This line is collateralized by certain qualifying loans and investment securities of the Bank. The Bank also has unused lines of credit with correspondent banks amounting to $12,500,000 at December 31, 2014.

Major sources of cash in 2014 came from the increase in demand deposits and savings accounts of $37,380,000, the proceeds from long-term debt borrowings of $30,000,000, and $27,314,000 from the maturities and sales of investment securities.

Major uses of cash in 2014 were the purchases of investment securities of $43,633,000, the increase in loans of $27,170,000, and the net decrease in short-term borrowings of $23,255,000.

Major sources of cash in 2013 came from the maturity of investment securities and interest-bearing time deposits totaling $53,151,000, the increase in short-term borrowings of $23,833,000, and the sale of investment securities of $15,118,000.

Major uses of cash in 2013 were the increase in net loans and leases of $65,896,000, the purchases of investment securities of $27,881,000 and decrease in time deposits of $31,280,000.

Aggregate Contractual Obligations

Table 15 represents Mid Penn’s on-and-off balance sheet aggregate contractual obligations to make future payments as of December 31, 2014.

TABLE 15: AGGREGATE CONTRACTUAL OBLIGATIONS

(Dollars in thousands)			Payments Due by Period			
	Financial Statements Note Reference	Total	One Year or Less	One to Three Years	Three to Five Years	More than Five Years
Certificates of deposit	9	$ 124,785	$ 61,178	$ 41,559	$ 20,870	$ 1,178
Long-term debt	11	52,961	15,000	25,000	10,000	2,961
Operating lease obligations	18	2,958	411	880	793	874
Payments under benefit plans	13	1,646	149	321	334	842
		$ 182,350	$ 76,738	$ 67,760	$ 31,997	$ 5,855

We are not aware of any other commitments or contingent liabilities which may have a material adverse impact on Mid Penn’s liquidity or capital resources.

Effects of Inflation

A bank's asset and liability structure is substantially different from that of an industrial company in that virtually all assets and liabilities of a bank are monetary in nature. Management believes the impact of inflation on its financial results depends principally upon Mid Penn's ability to manage the balance sheet sensitivity to changes in interest rates and, by such reaction, mitigate the inflationary impact on performance. Interest rates do not necessarily move in the same direction or at the same magnitude as the prices of other goods and services. As discussed previously, Management seeks to manage the relationship between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

Information shown elsewhere in this Annual Report will assist in the understanding of how Mid Penn is positioned to react to changing interest rates and inflationary trends. In particular, the summary of net liabilities, as well as the composition of loans, investments and deposits should be considered.

Off-Balance Sheet Items

Mid Penn makes contractual commitments to extend credit and extends lines of credit, which are subject to Mid Penn's credit approval and monitoring procedures.

As of December 31, 2014, commitments to extend credit amounted to $125,279,000 as compared to $141,616,000 as of December 31, 2013.

Mid Penn also issues standby letters of credit to its customers. The risk associated with standby letters of credit is essentially the same as the credit risk involved in loan extensions to customers. Standby letters of credit increased to $9,837,000 at December 31, 2014, from $8,458,000 at December 31, 2013.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

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

Management reviews interest rate risk on a quarterly basis. This analysis includes earnings scenarios whereby interest rates are increased and decreased by 100, 200, and 300 basis points. These scenarios, detailed in Table 16, indicate that Mid Penn would experience enhanced net interest income over a one-year time frame due to upward interest rate changes, while a reduction in interest rates would result in a decline in net interest income over a one-year time frame; however, actual results could vary significantly from the calculations prepared by Management. At December 31, 2014, all interest rate risk levels according to the model were within the tolerance limits of the Board approved policy, except for the (100) and (200) scenarios. Management will continue to monitor these scenarios.

TABLE 16: EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES

December 31, 2014			December 31, 2013		
Change in Basis Points	% Change in Net Interest Income	Risk Limit	Change in Basis Points	% Change in Net Interest Income	Risk Limit
300	18.89%	≥ -25%	300	22.98%	≥ -25%
200	14.52%	≥ -15%	200	15.20%	≥ -15%
100	10.10%	≥ -10%	100	7.21%	≥ -10%
0			0		
(100)	-10.66%	≥ -10%	(100)	-5.32%	≥ -10%
(200)	-16.09%	≥ -15%	(200)	-10.37%	≥ -15%
(300)	-21.32%	≥ -25%	(300)	-15.43%	≥ -25%

MID PENN BANCORP, INC.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following audited financial statements are set forth in this Annual Report of Form 10-K on the following pages:

Index to Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Mid Penn Bancorp, Inc.

Millersburg, Pennsylvania

We have audited the accompanying consolidated balance sheets of Mid Penn Bancorp, Inc. and subsidiaries, (the "Corporation") as of December 31, 2014 and 2013 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2014. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mid Penn Bancorp, Inc. and subsidiaries at December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Harrisburg, Pennsylvania

March 20, 2015

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

Mid Penn Bancorp, Inc.

We have audited the accompanying consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows of Mid Penn Bancorp, Inc. and subsidiaries (the "Corporation") for the year ended December 31, 2012. The Corporation's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform, an audit of their internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the Corporation's results of operations and cash flows for the year ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ Baker Tilly Virchow Krause, LLP

Pittsburgh, Pennsylvania

March 25, 2013

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

	December 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$ 8,869	$ 7,407
Interest-bearing balances with other financial institutions	1,013	1,216
Total cash and cash equivalents	9,882	8,623
Interest-bearing time deposits with other financial institutions	5,772	7,513
Available for sale investment securities	141,634	122,803
Loans and leases, net of unearned interest	571,533	546,462
Less: Allowance for loan and lease losses	(6,716)	(6,317)
Net loans and leases	564,817	540,145
Bank premises and equipment, net	12,225	12,469
Restricted investment in bank stocks	3,181	2,969
Foreclosed assets held for sale	565	965
Accrued interest receivable	3,058	2,704
Deferred income taxes	2,125	3,235
Goodwill	1,016	1,016
Core deposit and other intangibles, net	187	249
Cash surrender value of life insurance	8,575	8,374
Other assets	2,620	2,060
Total Assets	$ 755,657	$ 713,125
LIABILITIES & SHAREHOLDERS’ EQUITY		
Deposits:		
Noninterest bearing demand	$ 60,613	$ 48,346
Interest bearing demand	222,712	201,090
Money Market	197,418	196,736
Savings	32,394	29,585
Time	124,785	132,373
Total Deposits	637,922	608,130
Short-term borrowings	578	23,833
Long-term debt	52,961	23,145
Accrued interest payable	349	393
Other liabilities	4,717	4,708
Total Liabilities	696,527	660,209
Shareholders' Equity:		
Series B Preferred stock, par value $1.00; liquidation value $1,000; authorized 5,000 shares; 7% non-cumulative dividend; 5,000 shares issued and outstanding at December 31, 2014 and at December 31, 2013; total redemption value $5,100,000	5,000	5,000
Common stock, par value $1.00; authorized 10,000,000 shares; 3,497,829 shares issued and outstanding at December 31, 2014 and 3,494,397 at December 31, 2013	3,498	3,494
Additional paid-in capital	29,902	29,853

Retained earnings	19,217	15,441
Accumulated other comprehensive income (loss)	1,513	(872)
Total Shareholders’ Equity	59,130	52,916
Total Liabilities and Shareholders' Equity	$ 755,657	$ 713,125

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

MID PENN BANCORP, INC. Consolidated Statements of Comprehensive Income

(Dollars in thousands, except per share data)	Years Ended December 31,		
	2014	2013	2012
INTEREST INCOME			
Interest & fees on loans and leases	$ 26,905	$ 26,305	$ 27,233
Interest on interest-bearing balances	41	109	236
Interest and dividends on investment securities:			
U.S. Treasury and government agencies	1,346	591	1,137
State and political subdivision obligations, tax-exempt	2,180	1,921	1,722
Other securities	155	46	22
Interest on federal funds sold and securities purchased under agreements to resell	-	11	16
Total Interest Income	30,627	28,983	30,366
INTEREST EXPENSE			
Interest on deposits	3,852	4,436	6,147
Interest on short-term borrowings	55	26	3
Interest on long-term debt	520	595	975
Total Interest Expense	4,427	5,057	7,125
Net Interest Income	26,200	23,926	23,241
PROVISION FOR LOAN AND LEASE LOSSES	1,617	1,685	1,036
Net Interest Income After Provision for Loan and Lease Losses	24,583	22,241	22,205
NONINTEREST INCOME			
Income from fiduciary activities	552	492	575
Service charges on deposits	584	576	565
Net gain on sales of investment securities	168	220	267
Earnings from cash surrender value of life insurance	201	231	247
Mortgage banking income	313	348	675
ATM debit card interchange income	544	508	472
Merchant services income	254	330	256
Gain on sales of SBA loans	119	-	-
Other income	513	585	626
Total Noninterest Income	3,248	3,290	3,683
NONINTEREST EXPENSE			
Salaries and employee benefits	10,879	10,788	10,518
Occupancy expense, net	1,313	1,128	1,077
Equipment expense	1,205	1,299	1,234
Pennsylvania Bank Shares tax expense	365	464	462
FDIC Assessment	542	486	1,034
Legal and professional fees	516	705	604
Director fees and benefits expense	377	319	335
Marketing and advertising expense	308	253	378
Software licensing	965	947	648
Telephone expense	467	436	411
Loss (gain) on sale/write-down of foreclosed assets	204	(302)	96
Intangible amortization	27	29	45
Loan collection costs	288	214	369
Merger and acquisition expense	573	-	-
Other expenses	2,639	2,625	2,482

Total Noninterest Expense	20,668	19,391	19,693
INCOME BEFORE PROVISION FOR INCOME TAXES	7,163	6,140	6,195
Provision for income taxes	1,462	1,201	1,244
NET INCOME	5,701	4,939	4,951
Series A preferred stock dividends and discount accretion	-	14	514
Series B preferred stock dividends	350	309	-
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 5,351	$ 4,616	$ 4,437
PER COMMON SHARE DATA:			
Basic Earnings Per Common Share	$ 1.53	$ 1.32	$ 1.27
Diluted Earnings Per Common Share	1.53	1.32	1.27
Cash Dividends Per Common Share	0.45	0.25	0.25

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

MID PENN BANCORP, INC. Consolidated Statements of Comprehensive Income

(Dollars in thousands)	December 31, 2014	2013	2012
Net income	$ 5,701	$ 4,939	$ 4,951
Other comprehensive income (loss):			
Unrealized gains (losses) arising during the period on available for sale securities, net of income taxes of $1,280, ($1,563), and $291, respectively	2,482	(3,033)	565
Reclassification adjustment for net gain on sales of available for sale securities included in net income, net of income taxes of ($57), ($75), and ($91), respectively (1) (3)	(111)	(145)	(176)
Change in defined benefit plans, net of income taxes of $7, $7, and ($6), respectively (2) (3)	14	13	(12)
Total other comprehensive income (loss)	2,385	(3,165)	377
Total comprehensive income	$ 8,086	$ 1,774	$ 5,328

(1) Amounts are included in net gain on sales of investment securities on the Consolidated Statements of Income as a separate component within total noninterest income

(2) Amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income as a separate element within total noninterest expense

(3) Income tax amounts are included in the provision for income taxes in the Consolidated Statements of Income

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

MID PENN BANCORP, INC. Consolidated Statements of Changes in Shareholders’ Equity

(Dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance, January 1, 2012	$ 10,000	$ 3,484	$ 29,830	$ 8,222	$ 1,916	$ 53,452
Net income	-	-	-	4,951	-	4,951
Total other comprehensive income, net of taxes	-	-	-	-	377	377
Common stock dividends	-	-	-	(872)	-	(872)
Employee Stock Purchase Plan (5,175 shares)	-	6	50	-	-	56
Series A Preferred stock redemption	(10,000)	-	-	-	-	(10,000)
Series A Preferred stock dividends	-	-	-	(560)	-	(560)
Series B Preferred stock issuance, net of costs	4,880	-	(50)	-	-	4,830
Amortization of warrant cost	-	-	(14)	-	-	(14)
Balance, December 31, 2012	4,880	3,490	29,816	11,741	2,293	52,220
Net income	-	-	-	4,939	-	4,939
Total other comprehensive loss, net of taxes	-	-	-	-	(3,165)	(3,165)
Common stock dividends	-	-	-	(872)	-	(872)
Employee Stock Purchase Plan (4,713 shares)	-	4	51	-	-	55
Series B Preferred stock issuance	120	-	-	-	-	120
Series B Preferred stock dividends	-	-	-	(309)	-	(309)
Amortization of warrant cost	-	-	(14)	-	-	(14)
Warrant repurchase	-	-	-	(58)	-	(58)
Balance, December 31, 2013	5,000	3,494	29,853	15,441	(872)	52,916
Net income	-	-	-	5,701	-	5,701
Total other comprehensive income, net of taxes	-	-	-	-	2,385	2,385
Common stock dividends	-	-	-	(1,575)	-	(1,575)
Employee Stock Purchase Plan (3,432 shares)	-	4	49	-	-	53
Series B Preferred stock dividends	-	-	-	(350)	-	(350)
Balance, December 31, 2014	$ 5,000	$ 3,498	$ 29,902	$ 19,217	$ 1,513	$ 59,130

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

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MID PENN BANCORP, INC. Consolidated Statements of Cash Flows

(Dollars in thousands)	Years Ended December 31,		
	2014	2013	2012
Operating Activities:			
Net Income	$ 5,701	$ 4,939	$ 4,951
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	1,617	1,685	1,036
Depreciation	1,235	1,250	1,153
Amortization (accretion) of intangibles	62	39	(14)
Net amortization of security premiums	1,250	2,557	1,809
Gain on sales of investment securities	(168)	(220)	(267)
Earnings on cash surrender value of life insurance	(201)	(231)	(247)
SBA loans originated for sale	(1,168)	-	-
Proceeds from sales of SBA loans originated for sale	1,287	-	-
Gain on sale of SBA loans	(119)	-	-
Loss (gain) on disposal of property, plant, and equipment	18	(8)	1
Loss (gain) on sale / write-down of foreclosed assets	204	(302)	96
Deferred income tax (benefit) expense	(112)	192	450
(Increase) decrease in accrued interest receivable	(354)	189	174
(Increase) decrease in other assets	(547)	500	424
Decrease in accrued interest payable	(44)	(227)	(444)
Increase in other liabilities	9	319	278
Net Cash Provided By Operating Activities	8,670	10,682	9,400
Investing Activities:			
Net decrease in interest-bearing time deposits with other financial institutions	1,741	16,050	3,914
Proceeds from the maturity of investment securities	13,585	37,101	39,453
Proceeds from the sale of investment securities	13,729	15,118	17,895
Purchases of investment securities	(43,633)	(27,881)	(53,553)
(Purchases) redemptions of restricted investment in bank stock	(212)	(466)	617
Net increase in loans and leases	(27,170)	(65,896)	(6,389)
Purchases of bank premises and equipment	(1,009)	(588)	(995)
Proceeds from sale of bank premises and equipment	-	-	42
Proceeds from sale of foreclosed assets	1,077	2,957	2,579
Net Cash (Used In) Provided By Investing Activities	(41,892)	(23,605)	3,563
Financing Activities:			
Net increase in demand deposits and savings accounts	37,380	13,949	29,645
Net decrease in time deposits	(7,588)	(31,280)	(38,239)
Net (decrease) increase in short-term borrowings	(23,255)	23,833	-
Series A preferred stock dividends paid	-	-	(560)
Series A preferred stock redemption	-	-	(10,000)
Series B preferred stock issuance, net of costs	-	120	4,830
Series B preferred stock dividends paid	(350)	(309)	-
Common stock dividends paid	(1,575)	(872)	(872)
Employee Stock Purchase Plan	53	55	56
Warrant Repurchase	-	(58)	-

Long-term debt repayment	(184)	(14,365)	(191)
Proceeds from long-term debt borrowings	30,000	15,000	-
Net Cash Provided By (Used In) Financing Activities	34,481	6,073	(15,331)
Net increase (decrease) in cash and cash equivalents	1,259	(6,850)	(2,368)
Cash and cash equivalents, beginning of year	8,623	15,473	17,841
Cash and cash equivalents, end of year	$ 9,882	$ 8,623	$ 15,473

Supplemental Disclosures of Cash Flow Information:			
Interest paid	$ 4,471	$ 5,284	$ 7,569
Income taxes paid	$ 1,520	$ 775	$ 1,700
Supplemental Noncash Disclosures:			
Loan transfers to foreclosed assets held for sale	$ 881	$ 2,777	$ 2,587

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

(1) Basis of Presentation

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

Each of Mid Penn’s lines of business are part of the same reporting segment, community banking, whose operating results are regularly reviewed and managed by a centralized executive management group. As a result, Mid Penn has only one reportable segment for financial reporting purposes.

For comparative purposes, the December 31, 2013 and December 31, 2012 balances have been reclassified to conform to the 2014 presentation. Such reclassifications had no impact on net income.

(2) Nature of Business

The Bank engages in a full-service commercial banking and trust business, making available to the community a wide range of financial services, including, but not limited to, installment loans, mortgage and home equity loans, secured and unsecured commercial and consumer loans, lines of credit, construction financing, farm loans, community development loans, loans to non-profit entities and local government loans and various types of time and demand deposits, including but not limited to, checking accounts, savings accounts, clubs, money market deposit accounts, certificates of deposit and IRAs. In addition, the Bank provides a full range of trust services through its Trust Department. Deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) to the extent provided by law.

The financial services are provided to individuals, partnerships, non-profit organizations, and corporations through its 19 offices located in eastern Cumberland, Dauphin, northwestern Lancaster, western Luzerne, southern Northumberland, and Schuylkill Counties.

Mid Penn Insurance Services, LLC, a wholly-owned subsidiary of the Bank, provides a wide array of personal and commercial insurance products. Income from Mid Penn Insurance Services, LLC is not material to Mid Penn.

(3) Summary of Significant Accounting Policies

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

(a)Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses, and the assessment of other-than-temporary impairment of investment securities.

(b)Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, balances due from banks, and federal funds sold, all of which mature within ninety days.

(c)Interest-bearing Time Deposits with Other Financial Institutions

Interest-bearing time deposits with other financial institutions consist of certificates of deposits in other financial institutions with maturities within one year.

(d) Investment Securities

Available for sale securities include debt and equity securities. Debt and equity securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of deferred income taxes, as a component of accumulated other comprehensive income (loss) within shareholders' equity. Realized gains and losses on sales of

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investment securities are computed on the basis of specific identification of the cost of each security. Net gains on sales of investment securities were $168,000 in 2014, $220,000 in 2013, and $267,000 in 2012. Mid Penn had no held to maturity securities in 2014 and 2013.

(e) Loans and Allowance for Loan and Lease Losses

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

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

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

Commercial and industrial

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

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

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

Commercial real estate and commercial real estate - construction

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

Lease financing

Mid Penn originates leases for select commercial and state and municipal government lessees. The nature of the leased asset is often subject to rapid depreciation in salvage value over a relatively short time frame or may be of an industry specific nature, making appraisal or liquidation of the asset difficult. These factors have led the Bank to severely curtail the origination of new leases to state or municipal government agencies where default risk is extremely limited and to only the most credit-worthy commercial customers. These commercial customers are primarily leasing fleet vehicles for use in their primary line of business, mitigating some of the asset value concerns within the portfolio. Leasing has been a declining percentage of the Mid Penn's portfolio since 2006, representing 0.20% of the portfolio at December 31, 2014.

Residential mortgage

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

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

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

Consumer, including home equity

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

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

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

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

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

Allowance for Loan and Lease Losses

The allowance for credit losses consists of the allowance for loan and lease losses and the reserve for unfunded lending commitments. The allowance for loan and lease losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The 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 and was $60,000 at December 31, 2014 and $90,000 at December 31, 2013. The allowance for loan and lease losses is increased by the provision for loan and lease losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan and lease losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(f) Bank Premises and Equipment

Land is carried at cost. Buildings, furniture, fixtures, equipment, land improvements, and leasehold improvements are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method over the estimated useful lives of the assets. Building assets are depreciated using an estimated useful life of five to fifty years. Furniture, fixtures, and equipment are depreciated using an estimated useful life of three to ten years. Land improvements are depreciated over an estimated useful life of ten to twenty years. Leasehold improvements are depreciated using an estimated useful life that is the lesser of the remaining life of the lease or ten to thirty years. Maintenance and normal repairs are charged to expense when incurred, while major additions and improvements are capitalized. Gains and losses on disposals are reflected in current operations.

(g)Restricted Investment in Federal Home Loan Bank Stock

The Bank owns restricted stock investments in the FHLB. Federal law requires a member institution of the FHLB to hold stock according to a predetermined formula. The stock is carried at cost. Total dividends received in 2014 and 2013 totaled $123,000 and $20,000, respectively. During 2014 and 2013, the FHLB performed limited excess capital stock repurchases each calendar quarter. Any future capital stock repurchases will be made on a quarterly basis if conditions warrant such repurchases.

Management evaluates the restricted stock for impairment on an annual basis. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the

FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Management believes no impairment charge is necessary related to the FHLB restricted stock as of December 31, 2014 and 2013.

(h) Foreclosed Assets Held for Sale

Foreclosed assets held for sale consist primarily of real estate acquired through, or in lieu of, foreclosure in settlement of debt and are recorded at fair value less cost to sell at the date of transfer, establishing a new cost basis. Any valuation adjustments required at the date of transfer are charged to the allowance for loan losses. Subsequent to acquisition, foreclosed assets are carried at fair value less costs of disposal, based upon periodic evaluations that consider changes in market conditions and development and disposal costs. Operating results from assets acquired in satisfaction of debt, including rental income less operating costs and gains or losses on the sale of, or the periodic evaluation of foreclosed assets, are recorded in noninterest expense.

(i)Mortgage Servicing Rights

Mortgage servicing rights are recognized as assets upon the sale of a mortgage loan. A portion of the cost of the loan is allocated to the servicing right based upon relative fair value. The fair value of servicing rights is based on the present value of estimated future cash flows of mortgages sold stratified by rate and maturity date. Assumptions that are incorporated in the valuation of servicing rights include assumptions about prepayment speeds on mortgages and the cost to service loans. Servicing rights are reported in other intangibles and are amortized over the estimated period of future servicing income to be received on the underlying mortgage loans. The carrying amount of mortgage servicing rights was

$187,000 and $223,000 at December 31, 2014 and 2013, respectively. Amortization expense is netted against loan servicing fee income and is reflected in the Consolidated Statements of Income in mortgage banking income. Servicing rights are evaluated for impairment based upon estimated fair value as compared to unamortized book value.

(j)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 $408,000 at December 31, 2014 and $452,000 at December 31, 2013, net of amortization, using the straight-line method. Mid Penn's maximum exposure to loss is limited to the carrying value of its investment. The partnership received $46,000 in low-income housing tax credits during 2014, 2013 and 2012.

(k)Income Taxes

Mid Penn accounts for income taxes in accordance with income tax accounting guidance ASC Topic 740, Income Taxes.

Current income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. Mid Penn determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Mid Penn accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50%; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

Mid Penn recognizes interest and penalties on income taxes, if any, as a component of income tax expense.

(l)Core Deposit Intangible

Core deposit intangible is a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangible is being amortized over an 8-year life on a straight-line basis. The core deposit intangible is subject to impairment testing whenever events or changes in circumstances indicate its carrying amount may not reflect benefit.

(m)Goodwill

Goodwill is the excess of the purchase price over the fair value of assets acquired in connection with 2004 and 2006 business acquisitions accounted for as acquisitions. If certain events occur, which indicate goodwill might be impaired between annual tests, goodwill must be tested when such events occur. In making this assessment, Mid Penn considers a number of factors including operating results, business plans, economic projections, anticipated future cash flows, current market data, stock price, etc. There are inherent uncertainties related to these factors and Mid Penn's judgment in applying them to the analysis of goodwill impairment. Changes in economic and operating conditions could result in goodwill impairment in future periods. Mid Penn did not identify any impairment on its outstanding goodwill form its most recent testing, which was performed as of December 31, 2014 using a qualitative analysis. In addition, Mid Penn did not identify any impairment in 2013 or 2012 using a quantitative analysis in accordance with ASC 350.

(n)Bank Owned Life Insurance

Mid Penn is the owner and beneficiary of bank owned life insurance ("BOLI") policies on current and former directors. The earnings from the BOLI policies are an asset that can be liquidated, if necessary, with associated tax costs. However, Mid

Penn intends to hold these policies and, accordingly, Mid Penn has not provided deferred income taxes on the earnings from the increase in cash surrender value.

GAAP requires Split-Dollar Life Insurance Arrangements to have a liability recognized related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement, and a liability for the future death benefit.

(o)Marketing and Advertising Costs

Marketing and advertising costs are expensed as incurred.

(p)Postretirement Benefit Plans

Mid Penn follows the guidance in ASC Topic 715, Compensation-Retirement Benefits related to postretirement benefit plans. This guidance requires additional disclosures about defined benefit pension plans and other postretirement defined benefit plans.

(q)Other Benefit Plan

A funded contributory defined-contribution plan is maintained for substantially all employees. The cost of the Mid Penn defined contribution plan is charged to current operating expenses and is funded annually.

(r)Trust Assets and Income

Assets held by the Bank in a fiduciary or agency capacity for customers of the Trust Department are not included in the consolidated financial statements since such items are not assets of the Bank. Trust income is recognized on the cash basis, which is not materially different than if it were reported on the accrual basis.

(s)Earnings Per Share

Earnings per share are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during each of the years presented. The following data show the amounts used in computing basic and diluted earnings per share. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted average common shares available from the exercise of all dilutive stock warrants issued to the U.S. Treasury under the provisions of the Capital Purchase Program, based on the average share price of Mid Penn's common stock during the period.

The computations of basic earnings per common share follow:

(Dollars in thousands, except per share data)	2014	2013	2012
Net Income	$ 5,701	$ 4,939	$ 4,951
Less: Dividends on Series A preferred stock	-	-	500
Accretion of Series A preferred stock discount	-	14	14
Dividends on Series B preferred stock	350	309	-
Net income available to common shareholders	$ 5,351	$ 4,616	$ 4,437
Weighted average common shares outstanding	3,495,705	3,491,653	3,486,543
Basic earnings per common share	$ 1.53	$ 1.32	$ 1.27

The computations of diluted earnings per common share follow:

(Dollars in thousands, except per share data)	2014	2013	2012
Net income available to common stockholders	$ 5,351	$ 4,616	$ 4,437
Weighted average number of common shares outstanding	3,495,705	3,491,653	3,486,543
Dilutive effect of potential common stock arising from stock warrants:			
Exercise of outstanding stock warrants issued to U.S. Treasury under the Capital Repurchase Program	-	-	-
Adjusted weighted-average common shares outstanding	3,495,705	3,491,653	3,486,543
Diluted earnings per common share	$ 1.53	$ 1.32	$ 1.27

Mid Penn repurchased all warrants in 2013; therefore, there were none remaining as of December 31, 2014 and December 31, 2013. Mid Penn had 73,099 warrants that were anti-dilutive because the fair value of the common stock was below the $20.52 exercise price of these warrants as of December 31, 2012.

(4) Accumulated Other Comprehensive (Loss) Income

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

(Dollars in thousands)	Unrealized Gain (Loss) on Securities	Defined Benefit Plan Liability	Accumulated Other Comprehensive Income (Loss)
Balance - December 31, 2013	$ (745)	$ (127)	$ (872)
Balance - December 31, 2014	$ 1,626	$ (113)	$ 1,513

(5) Restrictions on Cash and Due from Bank Accounts

The Bank is required to maintain reserve balances with the Federal Reserve Bank of Philadelphia. There was no required reserve balance at December 31, 2014 and December 31, 2013 because the Bank had sufficient vault cash available.

(6) Investment Securities

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

Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Unrealized gains and losses on investment securities available for sale are based on the difference between book value and fair value of each security. These gains and losses are credited or charged to other comprehensive income (loss), whereas realized gains and losses flow through Mid Penn's consolidated statements of income.

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

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

related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income (loss).

In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intent and ability to hold the securities until recovery of unrealized losses.

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

(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2014				
Available for sale securities:				
U.S. Treasury and U.S. government agencies	$ 26,343	$ 752	$ 29	$ 27,066
Mortgage-backed U.S. government agencies	33,763	190	177	33,776
State and political subdivision obligations	77,482	2,007	318	79,171
Equity securities	1,584	60	23	1,621
	$ 139,172	$ 3,009	$ 547	$ 141,634

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