MID PENN BANCORP INC
Form 10-K
March 17, 2016

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, 2015

OR

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

For the transition period from to

Commission file number 1-13677

MID PENN BANCORP, INC.

(Exact Name of Registrant as Specified in its Charter)

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

Registrant's telephone number, including area code 1.866.642.7736

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 $15.48 per share, as reported by The NASDAQ Stock Market LLC ("NASDAQ"), on June 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter was approximately $65,382,799.

As of February 16, 2016, the registrant had 4,226,717 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be used in connection with the 2016 Annual Meeting of Shareholders is incorporated herein by reference in partial response to Part III, hereof.

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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 was a wholly-owned subsidiary of Mid Penn Bank that provided a wide range of personal and commercial insurance products. Due to the lack of activity within this subsidiary, the decision was made to exit this line of business, effective March 1, 2016.

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, 2015, Mid Penn had total consolidated assets of $931,724,000, total deposits of $777,043,000, and total shareholders' equity of $70,068,000.

As of December 31, 2015, 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, 2015, the Bank had 229 full-time and 23 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 in Schuylkill and Luzerne Counties, Pennsylvania 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 20 retail banking properties 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, 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 online banking, telephone banking, cash management services, automated teller services and safe deposit boxes.

Business Strategy

The Bank’s services are provided to small and middle-market businesses, consumers, nonprofit organizations, municipalities, and real estate investors through 20 full service retail banking properties. Two of Mid Penn’s primary markets currently, and historically, have 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 markets from national trends. At December 31, 2015, the unadjusted unemployment rate for the Harrisburg/Carlisle and Lancaster areas, two of Mid Penn’s primary markets, were 3.2% and 3.0%, respectively, versus the seasonally adjusted national unemployment rate of 5.0%. The unadjusted unemployment rate for Mid Penn’s other primary market in the Scranton/Wilkes-Barre/Hazleton area was also below the national unemployment rate at 4.6% at December 31, 2015.

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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. 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, 2015, 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 eastern Cumberland, Dauphin, northwestern Lancaster, western Luzerne, southern Northumberland, and Schuylkill Counties.

Investment Activities

Mid Penn's investment portfolio is used to improve earnings through investments 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 $2,371,000 as of December 31, 2015. 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 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 were 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.

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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, 2015, 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 raised 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 18 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 began January 1, 2015. The final rules called for the following minimum capital requirements (which include the impact of the capital conservation buffer effective January 1, 2016):

	Effective January 1,	
	2015	2016
Common equity tier 1 capital to risk-weighted assets	4.5%	5.125%
Tier 1 capital to risk-weighted assets	6.0%	6.625%
Total capital to risk-weighted assets	8.0%	8.625%
Leverage ratio	4.0%	4.0%

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 began on January 1, 2016 at the 0.625% level. Implementation of the deductions and other adjustments to common equity tier 1 capital began on January 1, 2015 and will be phased-in over a three-year period (beginning at 40% on January 1, 2015, 60% on January 1, 2016 and an additional 20% per year thereafter).

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

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

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

Under the new rules, mortgage servicing assets (“MSAs”) and certain deferred tax assets (“DTAs”) are subject to stricter limitations than those applicable under the 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 on Mid Penn’s financial condition.

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.

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Payment of Dividends and Other Restrictions

Mid Penn is a legal entity separate and distinct from its subsidiary, the Bank. There are various legal and regulatory limitations on the extent to which the Bank can, among other things, finance, or otherwise supply funds to, Mid Penn. Specifically, dividends from the Bank are the principal source of Mid Penn's cash funds and there are certain legal restrictions under Pennsylvania law and Pennsylvania banking regulations on the payment of dividends by state-chartered banks. The relevant regulatory agencies also have authority to prohibit Mid Penn and the Bank from engaging in what, in the opinion of such regulatory body, constitutes an unsafe or unsound banking practice. 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 uses to calculate assessment premiums is a bank's average assets minus average tangible equity.   As the asset base of the banking industry is larger than the deposit base, the range of assessment rates is a low of 2.5 basis points and a high of 45 basis points, per $100 of assets.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the DIF to achieve a reserve ratio of 1.35% of Insurance Fund insured deposits by September 2020. In addition, the FDIC has established a "designated reserve ratio" of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over $10 billion in asset size more than banks under that size. 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. Antitying 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, 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.

Dodd-Frank Act

The Dodd-Frank Act, which became law in July 2010, significantly changed 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.

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.

MID PENN BANCORP, INC.

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 NASDAQ under the trading symbol MPB. Mid Penn is subject to the informational requirements of the Exchange Act, and, accordingly, files reports, proxy statements and other information with the 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. Mid Penn is an electronic filer with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's Internet site address is www.sec.gov.

Mid Penn's headquarters are located at 349 Union Street, Millersburg, Pennsylvania 17061, and its telephone number is 1-866-642-7736. Mid Penn's website is midpennbank.com. 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, 2015, approximately 70.0% 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 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.

The Basel III capital requirements will 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 through January 1, 2019, 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. Mid Penn may be required to maintain higher levels of capital than historically maintained, thus potentially reducing 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.

MID PENN BANCORP, INC.

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 becoming inoperable, subject Mid Penn to regulatory sanctions or additional regulatory scrutiny, or expose Mid Penn to civil litigation and possible financial liability, any of which could have a material adverse effect on Mid Penn's financial condition and results of operations.

Mid Penn'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 and principal and interest on its subordinated notes depends primarily on dividends from its banking subsidiary, which is subject to regulatory limits

Mid Penn is a bank holding company and its operations are conducted by its subsidiaries. Its ability to pay dividends on its common stock and subordinated notes, depends on its receipt of dividends from the Bank. Dividend payments from its banking subsidiary are subject to legal and regulatory limitations, generally based on net profits, and retained earnings, imposed by the 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 5.15% interest rate on our subordinated notes will remain fixed at this level until December 2020, when it will float to prime plus 0.50%

The per annum interest rate our subordinated notes is fixed at 5.15% until December 2020, when it will float at the Wall Street Journal's prime rate plus 0.50%, provided that the interest rate applicable will at no times be less than 4.0%. Depending on Mid Penn's financial condition at the time, an increase in the interest 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 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 earnings

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.

MID PENN BANCORP, INC.

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.

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 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 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 Operations Center, Front Street Administrative Office, Simpson Ferry Office, Elizabethtown Office, Frackville Office, Hazleton Office, Rockwood Center, and the Halifax ATM, 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, 2015.

Property Location	Description of Property	Property Location	Description of Property
Millersburg Office 349 Union Street Millersburg, PA 17061	Main Office & Branch Office	Middletown Office 1100 Spring Garden Drive Middletown, PA 17057	Branch Office
Elizabethville Office 4642 State Route 209 Elizabethville, PA 17023	Branch Office	Steelton Office 51 South Front Street Steelton, PA 17113	Branch Office
Dalmatia Office 132 School House Road Dalmatia, PA 17017	Branch Office	Camp Hill Office 2101 Market Street Camp Hill, PA 17011	Branch Office
Tower City Office 545 East Grand Avenue Tower City, PA 17980	Branch Office	Elizabethtown Office 2305 South Market Street Elizabethtown, PA 17022	Branch Office
Simpson Ferry Road Office 5288 Simpson Ferry Road Mechanicsburg, PA 17055	Branch Office	Minersville Office Route 901 Pottsville/Minersville Hwy. Minersville, PA 17954	Branch Office
Derry Street Office 4509 Derry Street Harrisburg, PA 17111	Branch Office	Frackville Office 504 South Lehigh Avenue Frackville, PA 17931	Branch Office
		Tremont Office	

Dauphin Office 1001 Peters Mountain Road Dauphin, PA 17018	Branch Office	29 East Main Street Tremont, PA 17981	Branch Office
Carlisle Pike Office 4622 Carlisle Pike Mechanicsburg, PA 17050	Branch Office	Hazleton Office 641 State Route 93 Conyngham, PA 18219	Branch Office
Lykens Office 550 Main Street Lykens, PA 17048	Branch Office	Halifax Operations Center 894 N. River Road Halifax, PA 17032	Operations Center
Front Street Office 2615 North Front Street Harrisburg, PA 17110	Branch Office	Derry Street Loan Operations Center 4099 Derry Street Harrisburg, PA 17111	Operations Center
Allentown Boulevard Office 5500 Allentown Boulevard Harrisburg, PA 17112	Branch Office	Front Street Administrative Office 4311 North Front Street, Ste. 101 Harrisburg, PA 17110	Administrative Office
Market Square Office 17 N. Second Street Harrisburg, PA 17101	Branch Office	Rockwood Center 1504 Route 61 South Pottsville, PA 17901	Administrative Office
Gordon ATM 300 Hobart Street Gordon, PA 17936	ATM Only	Halifax ATM 3777 Peters Mountain Road Halifax, PA 17032	ATM Only

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, 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 NASDAQ 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, 2015	$ 16.09	$ 15.35	$ 0.10
June 30, 2015	16.50	15.24	0.10
September 30, 2015	16.94	15.32	0.12
December 31, 2015	17.00	15.60	0.12

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

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 February 16, 2016, there were approximately 1,620 shareholders of record of Mid Penn's common stock.

Dividends: Cash dividends of $0.44 were paid in 2015, while $0.45 was paid in 2014, and $0.25 in 2013. The declaration of cash dividends on Mid Penn's common stock is at the discretion of its Board of Directors, and any decision to declare a dividend is based on a number of factors, including, but not limited to, earnings, prospects, financial condition, regulatory capital levels, applicable covenants under any credit agreements and other contractual restrictions, Pennsylvania law, federal and Pennsylvania bank regulatory law, and other factors deemed relevant.

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

Annual Meeting: The Annual Meeting of the Shareholders of Mid Penn is expected to be held at 10:00 a.m. on Tuesday, May 3, 2016, 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.

MID PENN BANCORP, INC.

Stock Performance Graph

	Period Ending					
Index	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15
Mid Penn Bancorp, Inc.	100.00	102.95	156.74	205.02	228.85	243.52
Russell 3000	100.00	101.03	117.61	157.07	176.79	177.64
Mid-Atlantic Custom Peer Group*	100.00	98.67	114.76	134.66	144.73	154.25

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

Source : SNL Financial LC, Charlottesville, VA

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)	2015	2014	2013	2012	2011
INCOME:					
Total Interest Income	$ 36,490	$ 30,627	$ 28,983	$ 30,366	$ 31,545
Total Interest Expense	4,607	4,427	5,057	7,125	9,522
Net Interest Income	31,883	26,200	23,926	23,241	22,023
Provision for Loan and Lease Losses	1,065	1,617	1,685	1,036	1,205
Noninterest Income	4,087	3,248	3,290	3,683	2,996
Noninterest Expense	26,733	20,668	19,391	19,693	18,048
Income Before Provision for Income Taxes	8,172	7,163	6,140	6,195	5,766
Provision for Income Taxes	1,644	1,462	1,201	1,244	1,223
Net Income	6,528	5,701	4,939	4,951	4,543
Series A Preferred Stock Dividends and Discount Accretion	-	-	14	514	514
Series B Preferred Stock Dividends and Redemption Premium	473	350	309	-	-
Series C Preferred Stock Dividends	17	-	-	-	-
Net Income Available to Common Shareholders	6,038	5,351	4,616	4,437	4,029
COMMON STOCK DATA PER SHARE:					
Earnings Per Common Share (Basic)	$ 1.47	$ 1.53	$ 1.32	$ 1.27	$ 1.16
Earnings Per Common Share (Fully Diluted)	1.47	1.53	1.32	1.27	1.16
Cash Dividends	0.44	0.45	0.25	0.25	0.20
Book Value Per Common Share	16.58	15.48	13.71	13.57	12.47
AVERAGE SHARES OUTSTANDING (BASIC):	4,106,548	3,495,705	3,491,653	3,486,543	3,481,414
AVERAGE SHARES OUTSTANDING (FULLY DILUTED):	4,106,548	3,495,705	3,491,653	3,486,543	3,481,414
AT YEAR-END:					
Available For Sale Investment Securities	$ 135,721	$ 141,634	$ 122,803	$ 154,295	$ 159,043

Loans and Leases, Net of Unearned Interest	739,191	571,533	546,462	484,220	482,717
Allowance for Loan and Lease Losses	6,168	6,716	6,317	5,509	6,772
Total Assets	931,724	755,657	713,125	705,200	715,383
Total Deposits	777,043	637,922	608,130	625,461	634,055
Short-term Borrowings	31,596	578	23,833	-	-
Long-term Debt	40,305	52,961	23,145	22,510	22,701
Subordinated Debt	7,500	-	-	-	-
Shareholders' Equity	70,068	59,130	52,916	52,220	53,452
RATIOS:					
Return on Average Assets	0.74%	0.78%	0.71%	0.69%	0.66%
Return on Average Shareholders' Equity	9.16%	9.95%	9.37%	8.78%	8.96%
Cash Dividend Payout Ratio	29.93%	29.41%	18.94%	19.69%	17.24%
Allowance for Loan and Lease Losses to Loans and Leases	0.83%	1.18%	1.16%	1.14%	1.40%
Average Shareholders' Equity to Average Assets	8.06%	7.80%	7.56%	7.98%	7.37%

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;
- the continued failure of the Commonwealth of Pennsylvania to pass its 2015-2016 budget;
- an increase in the Pennsylvania Bank Shares Tax to which Mid Penn Bank's capital stock is currently subject, or imposition of any additional taxes on the capital stock of Mid Penn or Mid Penn Bank;
- impacts of the capital and liquidity requirements imposed by 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;
- our ability to implement business strategies, including our acquisition strategy;
- our acquisition strategy may not be successful in locating advantageous targets or acquiring targets at advantageous prices;
- our ability to successfully integrate any banks, companies, assets, liabilities, customers, systems and management personnel we acquire into our operations and our ability to realize related revenue synergies and cost savings within

expected time frames;

- potential goodwill impairment charges, future impairment charges and fluctuations in the fair values of reporting units or of assets in the event projected financial results are not achieved within expected time frames;
- our ability to attract and retain qualified management and personnel;
- results of the regulator examination and supervision process;
- 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 NASDAQ;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- disruptions due to flooding, severe weather, or other natural disasters of Acts of God;
- volatilities in the securities markets; 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. The comparability of the financial condition of Mid Penn as of December 31, 2015 compared to December 31, 2014, and the results of operations for the year ended 2015 compared to 2014 and 2013, in general, have been impacted by the acquisition of Phoenix on March 1, 2015. The assets and liabilities of Phoenix were recorded on the consolidated balance sheet at their established fair value as of March 1, 2015, and their results of operations have been included in the consolidated income statement since that date.

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, the evaluation of the Corporation’s investment securities for other-than-temporary impairment, the valuation of the Corporation’s goodwill for impairment, and the valuation of assets acquired and liabilities assumed in business combinations, to be the accounting areas that require the most subjective and complex judgments.

The allowance for loan and lease losses represents management’s estimate of probable incurred credit losses inherent in the loan and lease portfolio. Determining the amount of the allowance for loan and lease losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, 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.

Goodwill recorded in connection with acquisitions is tested annually for impairment. 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.

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

Financial Summary

The comparability of the financial condition and results of operations as of, and for the years ended 2015 and 2014, in general, have been impacted by the acquisition of Phoenix. The consolidated earnings of Mid Penn are derived primarily from the operations of its wholly owned subsidiary, Mid Penn Bank.

2015 versus 2014

Mid Penn's net income available to common shareholders of $6,038,000 for the year 2015 reflects an increase of $687,000, or 12.8%, over the $5,351,000 for the year 2014. This represents net income in 2015 of $1.47 per common share compared to $1.53 per common share in 2014.

Total assets of Mid Penn grew $176,067,000, or 23.3%, in 2015 to close the year at $931,724,000, compared to $755,657,000 at the end of 2014. This increase was impacted by the inclusion of Phoenix's assets on Mid Penn's balance sheet, as well as growth in the loan portfolio, which increased $167,658,000, or 29.3%, to $739,191,000. Loans attributable to Phoenix included in the growth of the loan portfolio were $91,655,000.

Total deposits increased $139,121,000, or 21.8%, from $637,922,000 at the end of 2014 to $777,043,000 at December 31, 2015. Over the last twelve months, all deposit categories increased, mainly due to the inclusion of Phoenix's deposits, but also due to strong cash management and retail efforts. Long-term debt decreased by $12,656,000, or 23.9%, to $40,305,000 by the end of 2015. Mid Penn increased its short-term borrowing position by $31,018,000 to $31,596,000 at the end of 2015 as a low-cost funding source to fund the increased loan demand and to replace the long-term debt that matured in 2015.

Mid Penn's return on average shareholders' equity, ("ROE"), a widely recognized performance indicator in the financial industry, was 9.30% in 2015 and 9.95% in 2014. Return on average assets ("ROA"), another performance indicator, was 0.74% in 2015 and 0.78% in 2014.

Performance in 2015 was influenced by the March 1, 2015 acquisition of Phoenix, which resulted in increased earning assets and shareholders' equity, as well as an improved cost of funds. Mid Penn also had improvement in nonperforming loans and consistent management of controllable expenses throughout 2015.

Net interest margin improved to 4.03% in 2015 from 3.99% in 2014. This improvement was driven by a decrease in the rate on supporting liabilities to 0.64% in 2015 from 0.71% in 2014, which allowed the average interest spread to increase to 3.94% from 3.91% in 2014. Net interest income on a tax equivalent basis increased to $33,806,000 in 2015 from $27,968,000 in 2014. Included in the net interest income increase for the year ended December 31, 2015 is $558,000 in income from the successful resolution of six legacy Phoenix loans acquired with credit deterioration. The income was the result of recognizing the remaining accretable and nonaccretable discounts on these loans. Further discussion of net interest margin can be found in the Net Interest Income section below.

Total nonperforming assets decreased $5,445,000 from $11,507,000 in 2014 to $6,062,000 at the end of 2015. Decreasing nonaccrual loans were the leading source of improvement in nonperforming assets. Two nonaccrual troubled debt restructured loans to unrelated borrowers that totaled 4,680,000 at December 31, 2014, were resolved in 2015 further aiding in the reduction 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.

Net charge-offs increased to $1,613,000 in 2015 from $1,218,000 during 2014. Gross charge-offs increased $456,000 from $1,328,000 in 2014 to $1,784,000 in 2015 mainly due to the impact of two large charge-offs to unrelated borrowers in 2015 totaling $1,461,000. Mid Penn decreased the provision for loan and lease losses from $1,617,000 in 2014 to $1,065,000 in 2015. 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.

Mid Penn's tier one capital (to risk weighted assets) of $64,089,000, or 9.1%, and total capital (to risk weighted assets) of $77,852,000, or 11.0%, at December 31, 2015, are above the regulatory requirements. Tier one capital consists primarily of Mid Penn's shareholders' equity. Total capital also includes Mid Penn's qualifying subordinated debt 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.

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. 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 ROE was 9.95% in 2014 and 9.37% in 2013. ROA 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.

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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.

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.

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, was above the regulatory requirements.

Net Interest Income

Net interest income, Mid Penn's primary source of earnings, 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, 2015			December 31, 2014			December 31, 2013		
	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates	Average Balance	Interest	Average Rates
ASSETS:									
Interest Bearing Balances	$ 6,377	$ 44	0.69%	$ 6,839	$ 41	0.60%	$ 14,818	$ 109	0.74%
Investment Securities:									
Taxable	67,382	1,604	2.38%	62,214	1,501	2.41%	68,524	617	0.90%
Tax-Exempt	69,996	3,031	4.33%	74,508	3,303	4.43%	66,147	2,911	4.40%
Total Securities	137,378			136,722			134,671		
Federal Funds Sold	535	2	0.37%	30	-	0.00%	3,580	11	0.31%
Loans and Leases, Net	689,870	33,483	4.85%	554,970	27,427	4.94%	508,638	26,639	5.24%
Restricted Investment in Bank Stocks	3,751	249	6.64%	3,063	123	4.02%	2,545	20	0.79%
Total Earning Assets	837,911	38,413	4.58%	701,624	32,395	4.62%	664,252	30,307	4.56%
Cash and Due from Banks	13,263			8,460			8,156		
Other Assets	32,754			24,152			25,472		
Total Assets	$ 883,928			$ 734,236			$ 697,880		
LIABILITIES & SHAREHOLDERS' EQUITY:									
Interest Bearing Deposits:									
NOW	$ 238,141	804	0.34%	$ 216,656	777	0.36%	$ 182,118	659	0.36%
Money Market	208,693	1,122	0.54%	201,281	1,088	0.54%	202,393	1,194	0.59%
Savings	52,895	31	0.06%	30,953	16	0.05%	29,597	15	0.05%
Time	154,335	1,932	1.25%	127,071	1,971	1.55%	148,863	2,568	1.73%
Short-term Borrowings	13,184	47	0.36%	14,813	55	0.37%	10,533	26	0.25%
Long-term Debt	51,267	671	1.31%	30,889	520	1.68%	16,268	595	3.66%
Total Interest Bearing Liabilities	718,515	4,607	0.64%	621,663	4,427	0.71%	589,772	5,057	0.86%

Demand Deposits	87,474		49,814		49,318	
Other Liabilities	6,691		5,491		6,051	
Shareholders' Equity	71,248		57,268		52,739	
Total Liabilities and Shareholders' Equity	$ 883,928		$ 734,236		$ 697,880	
Net Interest Income		$ 33,806		$ 27,968		$ 25,250
Net Yield on Interest Earning Assets:						
Total Yield on Earning Assets		4.58%		4.62%		4.56%
Rate on Supporting Liabilities		0.64%		0.71%		0.86%
Average Interest Spread		3.94%		3.91%		3.70%
Net Interest Margin		4.03%		3.99%		3.80%

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 $666,000, $749,000, and $1,020,000 are included with interest income in Table 1 for the years 2015, 2014 and 2013, respectively.

TABLE 2: VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

(Dollars in thousands)	2015 Compared to 2014 Increase (Decrease) Due to Change In:			2014 Compared to 2013 Increase (Decrease) Due to Change In:		
Taxable Equivalent Basis	Volume	Rate	Net	Volume	Rate	Net
INTEREST INCOME:						
Interest Bearing Balances	$ (3)	$ 6	$ 3	$ (59)	$ (9)	$ (68)
Investment Securities:						
Taxable	125	(22)	103	(57)	941	884
Tax-Exempt	(200)	(72)	(272)	368	24	392
Total Investment Securities	(75)	(94)	(169)	311	965	1,276
Federal Funds Sold	-	2	2	(11)	-	(11)
Loans and Leases, Net	6,667	(611)	6,056	2,427	(1,639)	788
Restricted Investment Bank Stocks	28	98	126	4	99	103
Total Interest Income	6,617	(599)	6,018	2,672	(584)	2,088
INTEREST EXPENSE:						
Interest Bearing Deposits:						
NOW	77	(50)	27	125	(7)	118
Money Market	41	(7)	34	(6)	(100)	(106)
Savings	-	15	15	-	1	1
Time	422	(461)	(39)	(376)	(221)	(597)
Total Interest Bearing Deposits	540	(503)	37	(257)	(327)	(584)
Short-term Borrowings	(6)	(2)	(8)	11	18	29
Long-term Debt	343	(192)	151	535	(610)	(75)
Total Interest Expense	877	(697)	180	289	(919)	(630)
NET INTEREST INCOME	$ 5,740	$ 98	$ 5,838	$ 2,383	$ 335	$ 2,718

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 2015, taxable equivalent net interest income increased $5,838,000, or 20.9%, as compared to an increase of $2,718,000, or 10.8%, in 2014. The average balances, effective interest differential, and interest yields for the years ended December 31, 2015, 2014, and 2013 and the components of net interest income, are presented in Table 1. A comparative presentation of the changes in net interest income for 2015 compared to 2014, and 2014 compared to 2013, 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 decreased to 4.58% in 2015 from 4.62% in 2014. The yield on earning assets for 2013 was 4.56%. The decline in the yield on earning assets in 2015 was softened by the increase in loan volume. The increased volume helped mask the decline in the average rate, which decreased from 4.94% in 2014 to 4.85% in 2015. The average "prime rate" for 2015, 2014, and 2013 was 3.25%. The average rates on investment securities also declined from 2014 to 2015. Taxable investments decreased from 2.41% to 2.38% and tax-exempt investments decreased from 4.43% to 4.33%. This decline in rate was the result of matured and called municipal bonds being reinvested at current market rates.

Interest expense increased by $180,000, or 4.1%, in 2015 as compared to a decrease of $630,000, or 12.5%, in 2014. The cost of interest bearing liabilities decreased to 0.64% in 2015 from 0.71% in 2014. The cost of interest bearing liabilities for 2013 was 0.86%. While the continued low interest rate environment, the addition of Phoenix's low-cost deposit products, and Mid Penn's ability to replace higher-cost time deposits with lower-cost demand deposits aided in reducing the cost of interest bearing liabilities in 2015, the increase in the volume of interest bearing liabilities of $96,852,000 at December 31, 2015 compared to the same period in 2014 led to the increase in interest expense.

Included in the net interest income increase for the year ended December 31, 2015 is $558,000 in income from the successful resolution of six legacy Phoenix loans acquired with credit deterioration.

Net interest margin, on a tax equivalent basis was 4.03% in 2015 compared to 3.99% in 2014 and 3.80% in 2013. 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, 2014 to December 31, 2015. For the year ended December 31, 2015, the provision for loan and lease losses was $1,065,000, as compared to $1,617,000 for the year ended December 31, 2014. The allowance for loan and lease losses as a percentage of total loans was 0.83% at December 31, 2015, compared to 1.18% at December 31, 2014 and 1.16% at December 31, 2013. This ratio was impacted by the inclusion of the Phoenix loan portfolio in the calculation coupled with the elimination of Phoenix’s allowance for loan and lease losses in conformity with GAAP purchase accounting treatment in 2015.

For the year ended December 31, 2015, Mid Penn had net charge-offs of $1,613,000 compared to net charge-offs of $1,218,000 during the year ended December 31, 2014. Loans charged off during 2015 were comprised of seven commercial real estate loans among six relationships totaling $1,569,000. Two of these loans to unrelated borrowers comprised $1,461,000 of the total $1,568,000. In addition, there were charge-offs for five residential real estate loans to unrelated borrowers totaling $35,000, two commercial and industrial loans to one borrower totaling $130,000, and one home equity loan representing $36,000 of the total charged off during 2015. The remaining $14,000 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 of $552,000 in 2015 versus 2014. The first element was the general decline in criticized and classified assets during 2015. These categories of loans declined $4,221,000, or 20.6% from $20,507,000 at the end 2014 to $16,286,000 at December 31, 2015. The second element was a decrease in the special mention historical loss factor. This element of the allowance calculation declined to 2.2% at December 31, 2015 from 4.1% at the end of 2014. The decline was triggered by a more favorable loss history during the look-back period. Finally, the level of specific allocations required against impaired loans decreased from $1,634,000 at December 31, 2014 to $503,000 at the end of 2015 due to the resolution of several problem loan relationships.

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,				
	2015	2014	2013	2012	2011
Balance, beginning of year	$ 6,716	$ 6,317	$ 5,509	$ 6,772	$ 7,061
Loans and leases charged off:					
Commercial real estate, construction and land development	1,569	1,057	936	499	545
Commercial, industrial and agricultural	130	62	183	834	546
Real estate - residential	35	133	167	195	310
Consumer	50	76	187	860	142
Leases	-	-	-	-	44
Total loans and leases charged off	1,784	1,328	1,473	2,388	1,587
Recoveries on loans and leases previously charged off:					
Commercial real estate, construction and land development	75	13	286	15	26
Commercial, industrial and agricultural	12	13	193	31	10
Real estate - residential	44	20	23	-	19
Consumer	40	64	92	43	32
Leases	-	-	2	-	6
Total loans and leases recovered	171	110	596	89	93
Net charge-offs	1,613	1,218	877	2,299	1,494
Provision for loan and lease losses	1,065	1,617	1,685	1,036	1,205
Balance, end of year	$ 6,168	$ 6,716	$ 6,317	$ 5,509	$ 6,772

	Years ended December 31,				
	2015	2014	2013	2012	2011
Ratio of net charge-offs during the year to average loans and leases outstanding during					

the year, net of unearned discount	0.23%	0.22%	0.17%	0.48%	0.31%
Allowance for loan and lease losses as a percentage of total loans and leases at December 31	0.83%	1.18%	1.16%	1.14%	1.40%
Allowance for loan and lease losses as a percentage of non-performing assets at December 31	101.75%	58.36%	49.84%	42.05%	50.91%

Noninterest Income

2015 versus 2014

During the twelve months ended December 31, 2015, noninterest income, excluding securities gains of $325,000, increased $682,000, or 22.1%, versus the twelve months ended December 31, 2014, excluding security gains of $168,000. The twelve months ended December 31, 2015 was positively impacted by the addition of Phoenix to the income stream. Items of particular note are detailed below.

Income from fiduciary activities for 2015 was $466,000, an $86,000, or 15.6% decrease from $552,000 in 2014. This is primarily attributable to a change in the commission structure on 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 decreased from $46,859,000 at the end of 2014 to $42,891,000 at the end of 2015 and are not a component of Mid Penn's consolidated balance sheets.

Mid Penn recognized gains on sale of investment securities in 2015 of $325,000 as a result of efforts to better align the portfolio for a rising interest rate environment, up $157,000 from the $168,000 recorded in 2014.

Earnings on bank-owned life insurance increased $68,000, or 33.8%, to $269,000 during 2015 over earnings of $201,000 in 2014. This increase was from the addition of a pool of employee split-dollar policies acquired in the Phoenix acquisition.

Mortgage banking activity increased $143,000 or 45.7% to $456,000 during 2014 from $313,000 in 2014. Improved real estate activity throughout Mid Penn’s footprint and favorable interest rate conditions have contributed to increasing revenue from this business line.

Mid Penn has experienced significant activity in Small Business Administration (“SBA”) loans during 2015 as more qualified borrowers have taken advantage of Mid Penn’s Preferred Lender status with the SBA. During 2015, this business activity generated $252,000 in fee income, an increase of $133,000, or 111.8% versus the twelve months ended December 31, 2014.

An increase in Letter of Credit fees of $40,000 in 2015 aided in the increase in other income of $140,000, or 27.3% from 2014.

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 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.

TABLE 4: NONINTEREST INCOME

(Dollars in thousands)	Years ended December 31,		
	2015	2014	2013
Income from fiduciary activities	$ 466	$ 552	$ 492
Service charges on deposits	690	584	576
Net gain on sales of investment securities	325	168	220
Earnings from cash surrender value of life insurance	269	201	231
Mortgage banking income	456	313	348
ATM debit card interchange income	741	544	508
Merchant services income	235	254	330
Gain on sales of SBA loans	252	119	-
Other income	653	513	585
Total Noninterest Income	$ 4,087	$ 3,248	$ 3,290

Noninterest Expense

2015 versus 2014

Noninterest expenses increased $6,065,000, or 29.3%, during the twelve months ended December 31, 2015, versus the same period in 2014. Both periods were impacted by the addition of Phoenix to the expense stream or related merger expenses. Items of particular note are detailed below.

Salaries and employee benefits increased during the year ended December 31, 2015 by $3,164,000, or 29.1%, versus 2014. The increase was driven by the addition of the Phoenix employees to Mid Penn's employee pool, an increase in staffing levels due to Mid Penn's entry into the Lancaster County and Mechanicsburg markets, and an increase in lending personnel and support staff to augment the expanding reach of Mid Penn.

Occupancy expense increased $634,000 to $1,947,000 in 2015. In addition to the occupancy expenses from the three leased and three owned properties acquired in the Phoenix transaction, this increase was impacted by the inclusion of rent for the new Corporate Administration offices on North Front Street in Harrisburg, and the new Elizabethtown and Simpson Ferry Road branch offices.

Legal and professional fees increased $72,000, or 14.0% , during the twelve months ended December 31, 2015 compared to the same period in 2014. This was due to the increase in consultant fees incurred for cyber penetration testing of Mid Penn's computer network, implementation of Mid Penn's mobile banking app, routine legal fees generated through the normal conduct of business, and the periodic examination of potential merger and acquisition opportunities as they became available.

Marketing and advertising expense increased $225,000 in 2015 to $533,000 from $308,000 in 2014. This increase is primarily the result of rebranding efforts in the Phoenix footprint to bring Mid Penn's style of community banking to the new region.

Equipment, Pennsylvania Bank Shares tax, software licensing, telephone, and other expenses all saw increases related to the inclusion of Phoenix's normal operating expenses to Mid Penn's expense stream year-to-date.

Merger and acquisition expenses in connection with the acquisition of Phoenix increased $189,000 to $762,000 in 2015 versus 2014. All expenses in connection with the merger have been recognized.

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.

TABLE 5: NONINTEREST EXPENSE

(Dollars in thousands)	Years ended December 31,		
	2015	2014	2013
Salaries and employee benefits	$ 14,043	$ 10,879	$ 10,788
Occupancy expense, net	1,947	1,313	1,128
Equipment expense	1,477	1,205	1,299
Pennsylvania Bank Shares tax expense	408	365	464
FDIC Assessment	613	542	486
Legal and professional fees	588	516	705
Director fees and benefits expense	363	377	319
Marketing and advertising expense	533	308	253
Software licensing	1,472	965	947
Telephone expense	569	467	436
Loss (gain) on sale/write-down of foreclosed assets	111	204	(302)
Intangible amortization	88	27	29
Loan collection costs	306	288	214
Merger and acquisition expense	762	573	-
ATM debit card processing expense	334	310	202
Internet banking expense	429	319	252
Meals, travel, and lodging expense	399	273	271
Data processing	346	251	130
Insurance	186	141	129
OREO expense	255	172	290
Investor services	96	72	68
Other expenses	1,408	1,101	1,283
Total Noninterest Expense	$ 26,733	$ 20,668	$ 19,391

Investments

Mid Penn's investment portfolio is utilized to provide liquidity, collateral, 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. The 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.

At December 31, 2015, the unrealized gain on investment securities resulted in an increase in shareholders' equity of $1,565,000 (unrealized gain on securities of $2,371,000 less deferred income taxes of $806,000). At 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). 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,		
	2015	2014	2013
U.S. Treasury and U.S. government agencies	$ 26,990	$ 27,066	$ 12,834
Mortgage-backed U.S. government agencies	38,804	33,776	39,392
State and political subdivision obligations	66,617	79,171	69,038
Equity securities	3,310	1,621	1,539
	$ 135,721	$ 141,634	$ 122,803

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, 2015	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	$ 1,032	$ 8,779	$ 17,179	$ -	$ 26,990
Mortgage-backed U.S. government agencies	1,786	31,951	5,067	-	38,804
State and political subdivision obligations	4,319	23,740	35,321	3,237	66,617
Equity securities	-	1,080	990	1,240	3,310
	$ 7,137	$ 65,550	$ 58,557	$ 4,477	$ 135,721

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	5.17%	3.31%	2.51%	-	2.87%
Mortgage-backed U.S. government agencies	4.32%	3.67%	2.41%	-	3.54%
State and political subdivision obligations	4.56%	5.18%	4.63%	4.69%	4.80%
Equity securities	-	6.38%	4.75%	2.84%	4.57%
	4.59%	4.04%	3.71%	4.18%	3.94%

Loans

At December 31, 2015, loans and leases totaled $739,191,000, a $167,658,000, or 29.3% increase from December 31, 2014. Along with the addition of $110,363,000 from Phoenix's loan portfolio, the other main driver of Mid Penn's loan growth was in the commercial loan area, specifically in commercial and industrial and commercial real estate loans. Mid Penn has made enhancements to its commercial lending team over the past few years and now has professional lenders who focus their efforts on developing and maintaining complete business relationships.

At December 31, 2015, loans, net of unearned income, represented 83.6% of earning assets as compared to 79.0% on December 31, 2014, and 80.2% on December 31, 2013.

The Bank's loan portfolio is diversified among individuals and small and medium-sized businesses generally located within the Bank's primary market 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