

Edgar Filing: ISABELLA BANK Corp - Form 10-Q

ISABELLA BANK Corp
Form 10-Q
August 04, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2017

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: 0-18415

Isabella Bank Corporation
(Exact name of registrant as specified in its charter)

Michigan 38-2830092
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

401 N. Main St, Mt. Pleasant, MI 48858
(Address of principal executive offices) (Zip code)
(989) 772-9471
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

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The number of common shares outstanding of the registrant's Common Stock (no par value) was 7,884,003 as of August 2, 2017.

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ISABELLA BANK CORPORATION
QUARTERLY REPORT ON FORM 10-Q

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Forward Looking Statements

This report contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward looking statements to be covered by the safe harbor provisions for forward looking statements contained in the Private Securities Litigation Reform Act of 1995, and are included in this statement for purposes of these safe harbor provisions. Forward looking statements, which are based on certain assumptions and describe future plans, strategies and expectations, are generally identifiable by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” and similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects include, but are not limited to, changes in: interest rates, general economic conditions, monetary and fiscal policy, the quality or composition of the loan or investment portfolios, demand for loan products, fluctuation in the value of collateral securing our loan portfolio, deposit flows, competition, demand for financial services in our market area, and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward looking statements and undue reliance should not be placed on such statements. Further information concerning our business, including additional factors that could materially affect our financial results, is included in our filings with the SEC.

Glossary of Acronyms and Abbreviations

The acronyms and abbreviations identified below may be used throughout this Quarterly Report on Form 10-Q, or in our other SEC filings. You may find it helpful to refer back to this page while reading this report.

AFS: Available-for-sale	GAAP: U.S. generally accepted accounting principles
ALLL: Allowance for loan and lease losses	GLB Act: Gramm-Leach-Bliley Act of 1999
AOCI: Accumulated other comprehensive income	IFRS: International Financial Reporting Standards
ASC: FASB Accounting Standards Codification	IRR: Interest rate risk
ASU: FASB Accounting Standards Update	ISDA: International Swaps and Derivatives Association
ATM: Automated Teller Machine	JOBS Act: Jumpstart our Business Startups Act
BHC Act: Bank Holding Company Act of 1956	LIBOR: London Interbank Offered Rate
CFPB: Consumer Financial Protection Bureau	N/A: Not applicable
CIK: Central Index Key	N/M: Not meaningful
CRA: Community Reinvestment Act	NASDAQ: NASDAQ Stock Market Index
DIF: Deposit Insurance Fund	NASDAQ Banks: NASDAQ Bank Stock Index
DIFS: Department of Insurance and Financial Services	NAV: Net asset value
Directors Plan: Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors	NOW: Negotiable order of withdrawal
Dividend Reinvestment Plan: Isabella Bank Corporation Stockholder Dividend Reinvestment Plan and Employee Stock Purchase Plan	NSF: Non-sufficient funds
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	OCI: Other comprehensive income (loss)
ESOP: Employee Stock Ownership Plan	OMSR: Originated mortgage servicing rights
Exchange Act: Securities Exchange Act of 1934	OREO: Other real estate owned
FASB: Financial Accounting Standards Board	OTTI: Other-than-temporary impairment
FDI Act: Federal Deposit Insurance Act	PBO: Projected benefit obligation

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FDIC: Federal Deposit Insurance Corporation

FFIEC: Federal Financial Institutions Examinations Council

FRB: Federal Reserve Bank

FHLB: Federal Home Loan Bank

Freddie Mac: Federal Home Loan Mortgage Corporation

FTE: Fully taxable equivalent

PCAOB: Public Company Accounting Oversight Board

Rabbi Trust: A trust established to fund the Directors Plan

SEC: U.S. Securities & Exchange Commission

SOX: Sarbanes-Oxley Act of 2002

TDR: Troubled debt restructuring

XBRL: eXtensible Business Reporting Language

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands)

	June 30 2017	December 31 2016
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	\$21,485	\$ 20,167
Interest bearing balances due from banks	349	2,727
Total cash and cash equivalents	21,834	22,894
AFS securities (amortized cost of \$563,309 in 2017 and \$557,648 in 2016)	567,862	558,096
Mortgage loans AFS	1,482	1,816
Loans		
Commercial	600,584	575,664
Agricultural	130,954	126,492
Residential real estate	270,207	266,050
Consumer	46,752	42,409
Gross loans	1,048,497	1,010,615
Less allowance for loan and lease losses	7,600	7,400
Net loans	1,040,897	1,003,215
Premises and equipment	28,679	29,314
Corporate owned life insurance policies	26,663	26,300
Accrued interest receivable	5,686	6,580
Equity securities without readily determinable fair values	23,401	21,694
Goodwill and other intangible assets	48,604	48,666
Other assets	12,190	13,576
TOTAL ASSETS	\$ 1,777,298	\$ 1,732,151
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	\$210,122	\$ 205,071
NOW accounts	212,365	209,325
Certificates of deposit under \$250 and other savings	725,748	717,078
Certificates of deposit over \$250	61,917	63,566
Total deposits	1,210,152	1,195,040
Borrowed funds	360,940	337,694
Accrued interest payable and other liabilities	11,136	11,518
Total liabilities	1,582,228	1,544,252
Shareholders' equity		
Common stock — no par value 15,000,000 shares authorized; issued and outstanding 7,862,553 shares (including 23,925 shares held in the Rabbi Trust) in 2017 and 7,821,069 shares (including 26,042 shares held in the Rabbi Trust) in 2016	140,646	139,525
Shares to be issued for deferred compensation obligations	5,164	5,038
Retained earnings	49,174	46,114
Accumulated other comprehensive income (loss)	86	(2,778)
Total shareholders' equity	195,070	187,899
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,777,298	\$ 1,732,151

See notes to interim condensed consolidated financial statements (unaudited).

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in thousands except per share amounts)

	Three Months		Six Months	
	Ended		Ended	
	June 30		June 30	
	2017	2016	2017	2016
Interest income				
Loans, including fees	\$10,685	\$9,317	\$20,805	\$18,355
AFS securities				
Taxable	2,226	2,303	4,377	4,703
Nontaxable	1,413	1,441	2,828	2,926
Federal funds sold and other	174	157	349	315
Total interest income	14,498	13,218	28,359	26,299
Interest expense				
Deposits	1,615	1,418	3,155	2,817
Borrowings	1,413	1,260	2,704	2,475
Total interest expense	3,028	2,678	5,859	5,292
Net interest income	11,470	10,540	22,500	21,007
Provision for loan losses	9	12	36	168
Net interest income after provision for loan losses	11,461	10,528	22,464	20,839
Noninterest income				
Service charges and fees	1,405	1,163	2,935	2,376
Net gain on sale of mortgage loans	199	127	354	209
Earnings on corporate owned life insurance policies	183	195	363	383
Net gains on sale of AFS securities	142	245	142	245
Other	859	1,022	1,610	1,762
Total noninterest income	2,788	2,752	5,404	4,975
Noninterest expenses				
Compensation and benefits	4,833	4,684	10,509	9,472
Furniture and equipment	1,352	1,340	2,696	2,635
Occupancy	815	788	1,652	1,598
Other	2,507	2,406	4,601	4,593
Total noninterest expenses	9,507	9,218	19,458	18,298
Income before federal income tax expense	4,742	4,062	8,410	7,516
Federal income tax expense	898	655	1,430	1,092
NET INCOME	\$3,844	\$3,407	\$6,980	\$6,424
Earnings per common share				
Basic	\$0.49	\$0.44	\$0.89	\$0.82
Diluted	\$0.48	\$0.43	\$0.87	\$0.80
Cash dividends per common share	\$0.25	\$0.24	\$0.50	\$0.48

See notes to interim condensed consolidated financial statements (unaudited).

Table of ContentsINTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(Dollars in thousands)

	Three Months		Six Months	
	Ended		Ended	
	June 30		June 30	
	2017	2016	2017	2016
Net income	\$3,844	\$3,407	\$6,980	\$6,424
Unrealized gains (losses) on AFS securities				
Unrealized gains (losses) on AFS securities arising during the period	2,570	4,067	4,247	11,341
Reclassification adjustment for net realized (gains) losses included in net income	(142)	(245)	(142)	(245)
Tax effect (1)	(762)	(1,173)	(1,212)	(3,650)
Unrealized gains (losses) on AFS securities, net of tax	1,666	2,649	2,893	7,446
Unrealized gains (losses) on derivative instruments arising during the period	(61)	(152)	(44)	(152)
Tax effect (1)	21	52	15	52
Unrealized gains (losses) on derivative instruments, net of tax	(40)	(100)	(29)	(100)
Other comprehensive income, net of tax	1,626	2,549	2,864	7,346
Comprehensive income	\$5,470	\$5,956	\$9,844	\$13,770

(1) See "Note 12 – Accumulated Other Comprehensive Income" for tax effect reconciliation.

See notes to interim condensed consolidated financial statements (unaudited).

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(UNAUDITED)

(Dollars in thousands except per share amounts)

	Common Stock		Common Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Totals
	Common Shares Outstanding	Amount				
Balance, January 1, 2016	7,799,867	\$ 139,198	\$ 4,592	\$ 39,960	\$ 221	\$ 183,971
Comprehensive income (loss)	—	—	—	6,424	7,346	13,770
Issuance of common stock	88,486	2,489	—	—	—	2,489
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	127	(127)	—	—	—
Share-based payment awards under equity compensation plan	—	—	273	—	—	273
Common stock purchased for deferred compensation obligations	—	(164)	—	—	—	(164)
Common stock repurchased pursuant to publicly announced repurchase plan	(51,911)	(1,462)	—	—	—	(1,462)
Cash dividends paid (\$0.48 per common share)	—	—	—	(3,744)	—	(3,744)
Balance, June 30, 2016	7,836,442	\$ 140,188	\$ 4,738	\$ 42,640	\$ 7,567	\$ 195,133
Balance, January 1, 2017	7,821,069	\$ 139,525	\$ 5,038	\$ 46,114	\$ (2,778)	\$ 187,899
Comprehensive income (loss)	—	—	—	6,980	2,864	9,844
Issuance of common stock	135,516	3,764	—	—	—	3,764
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	176	(176)	—	—	—
Share-based payment awards under equity compensation plan	—	—	302	—	—	302
Common stock purchased for deferred compensation obligations	—	(197)	—	—	—	(197)
Common stock repurchased pursuant to publicly announced repurchase plan	(94,032)	(2,622)	—	—	—	(2,622)
Cash dividends paid (\$0.50 per common share)	—	—	—	(3,920)	—	(3,920)
Balance, June 30, 2017	7,862,553	\$ 140,646	\$ 5,164	\$ 49,174	\$ 86	\$ 195,070

See notes to interim condensed consolidated financial statements (unaudited).

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	Six Months Ended June 30	
	2017	2016
OPERATING ACTIVITIES		
Net income	\$6,980	\$6,424
Reconciliation of net income to net cash provided by operating activities:		
Provision for loan losses	36	168
Impairment of foreclosed assets	28	—
Depreciation	1,440	1,438
Amortization of OMSR	170	165
Amortization of acquisition intangibles	62	87
Net amortization of AFS securities	1,062	1,427
Net (gains) losses on sale of AFS securities	(142)	(245)
Net gain on sale of mortgage loans	(354)	(209)
Increase in cash value of corporate owned life insurance policies	(363)	(383)
Share-based payment awards under equity compensation plan	302	273
Origination of loans held-for-sale	(19,081)	(10,810)
Proceeds from loan sales	19,769	10,925
Net changes in operating assets and liabilities which provided (used) cash:		
Accrued interest receivable	894	478
Other assets	(1,734)	(667)
Accrued interest payable and other liabilities	(382)	(238)
Net cash provided by (used in) operating activities	8,687	8,833
INVESTING ACTIVITIES		
Activity in AFS securities		
Sales	12,827	35,664
Maturities, calls, and principal payments	45,021	58,145
Purchases	(64,429)	(26,222)
Net loan principal (originations) collections	(37,842)	(69,186)
Proceeds from sales of foreclosed assets	98	288
Purchases of premises and equipment	(805)	(1,351)
Proceeds from redemption of corporate owned life insurance policies	—	1,004
Net cash provided by (used in) investing activities	(45,130)	(1,658)

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Dollars in thousands)

	Six Months Ended	
	June 30	
	2017	2016
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	\$15,112	\$(7,693)
Net increase (decrease) in borrowed funds	23,246	8,864
Cash dividends paid on common stock	(3,920)	(3,744)
Proceeds from issuance of common stock	3,764	2,489
Common stock repurchased	(2,622)	(1,462)
Common stock purchased for deferred compensation obligations	(197)	(164)
Net cash provided by (used in) financing activities	35,383	(1,710)
Increase (decrease) in cash and cash equivalents	(1,060)	5,465
Cash and cash equivalents at beginning of period	22,894	21,569
Cash and cash equivalents at end of period	\$21,834	\$27,034
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	\$5,872	\$5,286
Income taxes paid	\$1,630	\$600
SUPPLEMENTAL NONCASH INFORMATION:		
Transfers of loans to foreclosed assets	\$124	\$116

See notes to interim condensed consolidated financial statements (unaudited).

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands except per share amounts)

Note 1 – Basis of Presentation

As used in these notes, as well as in Management's Discussion and Analysis of Financial Condition and Results of Operations, references to "Isabella," the "Corporation," "we," "our," "us," and similar terms refer to the consolidated entity consisting of Isabella Bank Corporation and its subsidiaries. Isabella Bank Corporation refers solely to the parent holding company, and Isabella Bank or the "Bank" refer to Isabella Bank Corporation's subsidiary, Isabella Bank. The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2016.

Our accounting policies are materially the same as those discussed in Note 1 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016.

Reclassifications: Certain amounts reported in the interim 2016 consolidated financial statements have been reclassified to conform with the 2017 presentation.

Note 2 – Computation of Earnings Per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate solely to outstanding shares in the Directors Plan.

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Average number of common shares outstanding for basic calculation	7,841,822	7,819,080	7,834,523	7,807,187
Average potential effect of common shares in the Directors Plan (1)	190,528	183,842	191,028	184,152
Average number of common shares outstanding used to calculate diluted earnings per common share	8,032,350	8,002,922	8,025,551	7,991,339
Net income	\$3,844	\$ 3,407	\$6,980	\$ 6,424
Earnings per common share				
Basic	\$0.49	\$ 0.44	\$0.89	\$ 0.82
Diluted	\$0.48	\$ 0.43	\$0.87	\$ 0.80

(1) Exclusive of shares held in the Rabbi Trust

Note 3 – Accounting Standards Updates

Pending Accounting Standards Updates

ASU No. 2017-09: "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting"

In May 2017, ASU No. 2017-09 provided guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting under Topic 718. The current disclosure requirements in Topic 718 apply regardless of whether an entity is required to apply modification accounting under the amendments in this updated. An entity should account for the effects of a modification unless all of the following are met:

1. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.

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2. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.

3. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017 and is not expected to have a significant impact on our operating results or financial statement disclosures.

Note 4 – AFS Securities

The amortized cost and fair value of AFS securities, with gross unrealized gains and losses, are as follows at:

June 30, 2017

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	\$280	\$ 1	\$ —	\$281
States and political subdivisions	215,999	6,121	27	222,093
Auction rate money market preferred	3,200	—	105	3,095
Preferred stocks	3,800	—	135	3,665
Mortgage-backed securities	223,225	701	1,969	221,957
Collateralized mortgage obligations	116,805	705	739	116,771
Total	\$563,309	\$ 7,528	\$ 2,975	\$567,862

December 31, 2016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	\$10,258	\$ 3	\$ 2	\$10,259
States and political subdivisions	208,977	4,262	320	212,919
Auction rate money market preferred	3,200	—	406	2,794
Preferred stocks	3,800	—	375	3,425
Mortgage-backed securities	229,593	581	2,918	227,256
Collateralized mortgage obligations	101,820	600	977	101,443
Total	\$557,648	\$ 5,446	\$ 4,998	\$558,096

The amortized cost and fair value of AFS securities by contractual maturity at June 30, 2017 are as follows:

Maturing

	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	Securities with Variable Monthly Payments or Noncontractual Maturities	Total
Government sponsored enterprises	\$32	\$ 248	\$—	\$ —	\$ —	\$280
States and political subdivisions	32,000	74,710	76,716	32,573	—	215,999
Auction rate money market preferred	—	—	—	—	3,200	3,200
Preferred stocks	—	—	—	—	3,800	3,800
Mortgage-backed securities	—	—	—	—	223,225	223,225
Collateralized mortgage obligations	—	—	—	—	116,805	116,805
Total amortized cost	\$32,032	\$ 74,958	\$76,716	\$ 32,573	\$ 347,030	\$563,309
Fair value	\$32,105	\$ 77,118	\$79,668	\$ 33,483	\$ 345,488	\$567,862

Expected maturities for government sponsored enterprises and states and political subdivisions may differ from contractual maturities because issuers may have the right to call or prepay obligations.

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As the auction rate money market preferred and preferred stocks have continual call dates, they are not reported by a specific maturity group. Because of their variable monthly payments, mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group.

A summary of the sales activity of AFS securities was as follows for the:

	Three Months		Six Months	
	Ended June 30 2017	2016	Ended June 30 2017	2016
Proceeds from sales of AFS securities	\$12,827	\$35,664	\$12,827	\$35,664
Gross realized gains (losses)	\$142	\$245	\$142	\$245
Applicable income tax expense (benefit)	\$48	\$83	\$48	\$83

The following information pertains to AFS securities with gross unrealized losses at June 30, 2017 and December 31, 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position.

	June 30, 2017				
	Less Than Twelve Months		Twelve Months or More		Total Unrealized Losses
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	
Government sponsored enterprises	\$—	\$—	\$—	\$—	\$—
States and political subdivisions	25	4,049	2	263	27
Auction rate money market preferred	—	—	105	3,095	105
Preferred stocks	—	—	135	3,665	135
Mortgage-backed securities	1,969	126,883	—	—	1,969
Collateralized mortgage obligations	444	36,057	295	10,413	739
Total	\$2,438	\$166,989	\$ 537	\$ 17,436	\$ 2,975
Number of securities in an unrealized loss position:		41		9	50

	December 31, 2016				
	Less Than Twelve Months		Twelve Months or More		Total Unrealized Losses
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	
Government sponsored enterprises	\$2	\$9,936	\$—	\$—	\$ 2
States and political subdivisions	311	21,800	9	355	320
Auction rate money market preferred	—	—	406	2,794	406
Preferred stocks	—	—	375	3,425	375
Mortgage-backed securities	2,918	175,212	—	—	2,918
Collateralized mortgage obligations	628	51,466	349	11,381	977
Total	\$3,859	\$258,414	\$ 1,139	\$ 17,955	\$ 4,998
Number of securities in an unrealized loss position:		104		9	113

As of June 30, 2017 and December 31, 2016, we conducted an analysis to determine whether any AFS securities currently in an unrealized loss position should be other-than-temporarily impaired. Such analyses considered, among other factors, the following criteria:

• Has the value of the investment declined more than what is deemed to be reasonable based on a risk and maturity adjusted discount rate?

• Is the investment credit rating below investment grade?

• Is it probable the issuer will be unable to pay the amount when due?

• Is it more likely than not that we will have to sell the security before recovery of its cost basis?

• Has the duration of the investment been extended?

During the fourth quarter of 2016, we identified one municipal bond as other-than-temporarily impaired. While management estimated the OTTI to be realized, we also engaged the services of an independent investment valuation firm to estimate the

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amount of impairment as of December 31, 2016. The valuation calculated the estimated market value utilizing two different approaches:

- 1) Market - Appraisal and Comparable Investments
- 2) Income - Discounted Cash Flow Method

The two methods were then weighted, with a higher weighting applied to the Market approach, to determine the estimated impairment. As a result of this analysis, we recognized an OTTI of \$770 in earnings for the year ended December 31, 2016. Based on analysis of this bond, there was no additional OTTI recognized as of June 30, 2017. Based on our analyses, the fact that we have asserted that we do not have the intent to sell AFS securities in an unrealized loss position, and considering it is unlikely that we will have to sell any AFS securities in an unrealized loss position before recovery of their cost basis, we do not believe that the values of any other AFS securities are other-than-temporarily impaired as of June 30, 2017 or December 31, 2016, with the exception of the one municipal bond discussed above.

Note 5 – Loans and ALLL

We grant commercial, agricultural, residential real estate, and consumer loans to customers situated primarily in Clare, Gratiot, Isabella, Mecosta, Midland, Montcalm, and Saginaw counties in Michigan. The ability of the borrowers to honor their repayment obligations is often dependent upon the real estate, agricultural, manufacturing, retail, gaming, tourism, higher education, and general economic conditions of this region. Substantially all of our consumer and residential real estate loans are secured by various items of property, while commercial loans are secured primarily by real estate, business assets, and personal guarantees. A portion of loans are unsecured.

Loans that we have the intent and ability to hold in our portfolio are reported at their outstanding principal balance adjusted for any charge-offs, the ALLL, and any deferred fees or costs. Interest income is accrued over the term of the loan based on the principal amount outstanding. Loan origination fees and certain direct loan origination costs are capitalized and recognized as a component of interest income over the term of the loan using the level yield method. The accrual of interest on commercial, agricultural, and residential real estate loans is discontinued at the time the loan is 90 days or more past due unless the credit is well-secured and in the process of collection. Upon transferring the loans to nonaccrual status, we perform an evaluation to determine the net realizable value of the underlying collateral. This evaluation is used to help determine if any charge-offs are necessary. Consumer loans are typically charged-off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. For loans that are placed on nonaccrual status or charged-off, all interest accrued in the current calendar year, but not collected, is reversed against interest income while interest accrued in prior calendar years, but not collected, is charged against the ALLL. Loans may be returned to accrual status after six months of continuous performance. Commercial and agricultural loans include loans for commercial real estate, commercial operating loans, advances to mortgage brokers, farmland and agricultural production, and states and political subdivisions. Repayment of these loans is dependent upon the successful operation and management of a business. We minimize our risk by limiting the amount of direct credit exposure to any one borrower to \$15,000. Borrowers with direct credit needs of more than \$15,000 are serviced through the use of loan participations with other commercial banks. Commercial and agricultural real estate loans commonly require loan-to-value limits of 80% or less. Depending upon the type of loan, past credit history, and current operating results, we may require the borrower to pledge accounts receivable, inventory, and property and equipment. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and sole proprietorships. In addition, we require annual financial statements, prepare cash flow analyses, and review credit reports.

We entered into a mortgage purchase program in 2016 with a financial institution where we participate in advances to mortgage brokers ("advances"). The mortgage brokers originate residential mortgage loans with the intent to sell them on the secondary market. We participate in the advance to the mortgage broker, which is secured by the underlying mortgage loan, until it is ultimately sold on the secondary market. As such, the average life of each participated advance is approximately 20-30 days. Funds from the sale of the loan are used to payoff our participation in the advance to the mortgage broker. We classify these advances as commercial loans and include the outstanding balance in commercial loans on our balance sheet. Under the participation agreement, we committed to a maximum

outstanding aggregate amount of \$30,000. The difference between our outstanding balances and the maximum outstanding aggregate amount is classified as “Unfunded commitments under lines of credit” in the “Contractual Obligations and Loan Commitments” section of the Management's Discussion and Analysis of Financial Condition and Results of Operations of this report.

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We offer adjustable rate mortgages, construction loans, and fixed rate residential real estate loans which have amortization periods up to a maximum of 30 years. We consider the anticipated direction of interest rates, balance sheet duration, the sensitivity of our balance sheet to changes in interest rates, and overall loan demand to determine whether or not to sell fixed rate loans to Freddie Mac.

Our lending policies generally limit the maximum loan-to-value ratio on residential real estate loans to 97% of the lower of the appraised value of the property or the purchase price, with the condition that private mortgage insurance is required on loans with loan-to-value ratios in excess of 80%.

Underwriting criteria for originated residential real estate loans include:

• Evaluation of the borrower's ability to make monthly payments.

• Evaluation of the value of the property securing the loan.

• Ensuring the payment of principal, interest, taxes, and hazard insurance does not exceed 28% of a borrower's gross income.

• Ensuring all debt servicing does not exceed 36% of income.

• Verification of acceptable credit reports.

• Verification of employment, income, and financial information.

Appraisals are performed by independent appraisers and reviewed for appropriateness. All originated mortgage loan requests are reviewed by our mortgage loan committee or through a secondary market underwriting system; loans in excess of \$500 require the approval of our Internal Loan Committee, the Executive Loan Committee, the Board of Directors' Loan Committee, or the Board of Directors.

Consumer loans include secured and unsecured personal loans. Loans are amortized for a period of up to 12 years based on the age and value of the underlying collateral. The underwriting emphasis is on a borrower's perceived intent and ability to pay rather than collateral value. No consumer loans are sold to the secondary market.

The ALLL is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the ALLL when we believe the uncollectability of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALLL.

The appropriateness of the ALLL is evaluated on a quarterly basis and is based upon a periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The primary factors behind the determination of the level of the ALLL are specific allocations for impaired loans, historical loss percentages, as well as unallocated components. Specific allocations for impaired loans are primarily determined based on the difference between the loan's outstanding balance and the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio, with the exception of advances to mortgage brokers, over the preceding five years. With no historical losses on advances to mortgage brokers, there is no allocation in the commercial segment displayed in the following tables based on historical loss factors. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A summary of changes in the ALLL and the recorded investment in loans by segments follows:

	Allowance for Loan Losses					
	Three Months Ended June 30, 2017					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
April 1, 2017	\$1,771	\$ 527	\$ 3,098	\$ 671	\$ 1,433	\$7,500
Charge-offs	(25)	—	—	(44)	—	(69)
Recoveries	55	—	63	42	—	160
Provision for loan losses	177	(52)	(563)	(86)	533	9

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June 30, 2017	\$1,978	\$ 475	\$ 2,598	\$ 583	\$ 1,966	\$7,600
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Allowance for Loan Losses						
Six Months Ended June 30, 2017						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2017	\$ 1,814	\$ 884	\$ 2,664	\$ 624	\$ 1,414	\$ 7,400
Charge-offs	(52)	—	(43)	(118)	—	(213)
Recoveries	188	—	99	90	—	377
Provision for loan losses	28	(409)	(122)	(13)	552	36
June 30, 2017	\$ 1,978	\$ 475	\$ 2,598	\$ 583	\$ 1,966	\$ 7,600
Allowance for Loan Losses and Recorded Investment in Loans						
June 30, 2017						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	\$ 783	\$ —	\$ 1,672	\$ —	\$ —	\$ 2,455
Collectively evaluated for impairment	1,195	475	926	583	1,966	5,145
Total	\$ 1,978	\$ 475	\$ 2,598	\$ 583	\$ 1,966	\$ 7,600
Loans						
Individually evaluated for impairment	\$ 7,362	\$ 11,125	\$ 8,628	\$ 20		\$ 27,135
Collectively evaluated for impairment	593,222	119,829	261,579	46,732		1,021,362
Total	\$ 600,584	\$ 130,954	\$ 270,207	\$ 46,752		\$ 1,048,497
Allowance for Loan Losses						
Three Months Ended June 30, 2016						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
April 1, 2016	\$ 2,421	\$ 336	\$ 3,130	\$ 540	\$ 1,073	\$ 7,500
Charge-offs	(32)	—	(128)	(48)	—	(208)
Recoveries	189	—	45	62	—	296
Provision for loan losses	(459)	198	83	(13)	203	12
June 30, 2016	\$ 2,119	\$ 534	\$ 3,130	\$ 541	\$ 1,276	\$ 7,600
Allowance for Loan Losses						
Six Months Ended June 30, 2016						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2016	\$ 2,171	\$ 329	\$ 3,330	\$ 522	\$ 1,048	\$ 7,400
Charge-offs	(48)	—	(369)	(132)	—	(549)
Recoveries	278	92	95	116	—	581
Provision for loan losses	(282)	113	74	35	228	168
June 30, 2016	\$ 2,119	\$ 534	\$ 3,130	\$ 541	\$ 1,276	\$ 7,600

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Allowance for Loan Losses and Recorded Investment in Loans
December 31, 2016

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	\$741	\$ 1	\$ 1,629	\$ —	\$ —	\$2,371
Collectively evaluated for impairment	1,073	883	1,035	624	1,414	5,029
Total	\$1,814	\$ 884	\$ 2,664	\$ 624	\$ 1,414	\$7,400
Loans						
Individually evaluated for impairment	\$7,859	\$ 5,545	\$ 8,638	\$ 26		\$22,068
Collectively evaluated for impairment	567,805	120,947	257,412	42,383		988,547
Total	\$575,664	\$ 126,492	\$ 266,050	\$ 42,409		\$1,010,615

The following table displays the credit quality indicators for commercial and agricultural credit exposures based on internally assigned credit risk ratings as of:

June 30, 2017

Rating	Commercial			Agricultural			Total
	Real Estate	Other	Advances to Mortgage Brokers	Real Estate	Other	Total	
1 - Excellent	\$26	\$232	\$ —	\$258	\$—	\$—	\$258
2 - High quality	7,479	15,878	—	23,357	3,088	1,006	27,451
3 - High satisfactory	103,672	45,853	19,914	169,439	21,435	9,306	200,180
4 - Low satisfactory	320,610	71,958	—	392,568	48,109	20,740	461,417
5 - Special mention	4,253	1,899	—	6,152	11,015	9,054	26,221
6 - Substandard	6,343	2,450	—	8,793	4,379	1,830	15,002
7 - Vulnerable	17	—	—	17	466	526	1,009
8 - Doubtful	—	—	—	—	—	—	—
Total	\$442,400	\$138,270	\$ 19,914	\$600,584	\$88,492	\$42,462	\$130,954

December 31, 2016

Rating	Commercial			Agricultural			Total
	Real Estate	Other	Advances to Mortgage Brokers	Real Estate	Other	Total	
1 - Excellent	\$28	\$438	\$ —	\$466	\$—	\$—	\$466
2 - High quality	11,821	12,091	19,688	43,600	3,566	1,426	48,592
3 - High satisfactory	103,529	41,982	—	145,511	21,657	11,388	178,556
4 - Low satisfactory	299,317	74,432	—	373,749	48,955	22,715	445,419
5 - Special mention	3,781	1,178	—	4,959	6,009	3,085	14,053
6 - Substandard	5,901	1,474	—	7,375	3,650	3,508	14,533
7 - Vulnerable	4	—	—	4	—	533	537
8 - Doubtful	—	—	—	—	—	—	—
Total	\$424,381	\$131,595	\$ 19,688	\$575,664	\$83,837	\$42,655	\$126,492

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Internally assigned credit risk ratings are reviewed, at a minimum, when loans are renewed or when management has knowledge of improvements or deterioration of the credit quality of individual credits. Descriptions of the internally assigned credit risk ratings for commercial and agricultural loans are as follows:

1. EXCELLENT – Substantially Risk Free

Credit has strong financial condition and solid earnings history, characterized by:

- High liquidity, strong cash flow, low leverage.
- Unquestioned ability to meet all obligations when due.

Experienced management, with management succession in place.

Secured by cash.

2. HIGH QUALITY – Limited Risk

Credit with sound financial condition and a positive trend in earnings supplemented by:

Favorable liquidity and leverage ratios.

Ability to meet all obligations when due.

Management with successful track record.

Steady and satisfactory earnings history.

If loan is secured, collateral is of high quality and readily marketable.

Access to alternative financing.

Well defined primary and secondary source of repayment.

If supported by guaranty, the financial strength and liquidity of the guarantor(s) are clearly evident.

3. HIGH SATISFACTORY – Reasonable Risk

Credit with satisfactory financial condition and further characterized by:

Working capital adequate to support operations.

Cash flow sufficient to pay debts as scheduled.

Management experience and depth appear favorable.

Loan performing according to terms.

If loan is secured, collateral is acceptable and loan is fully protected.

4. LOW SATISFACTORY – Acceptable Risk

Credit with bankable risks, although some signs of weaknesses are shown:

Would include most start-up businesses.

Occasional instances of trade slowness or repayment delinquency – may have been 10-30 days slow within the past year.

Management's abilities are apparent, yet unproven.

Weakness in primary source of repayment with adequate secondary source of repayment.

- Loan structure generally in accordance with policy.

If secured, loan collateral coverage is marginal.

Adequate cash flow to service debt, but coverage is low.

To be classified as less than satisfactory, only one of the following criteria must be met.

5. SPECIAL MENTION – Criticized

Credit constitutes an undue and unwarranted credit risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances surrounding a specific loan:

Downward trend in sales, profit levels, and margins.

Impaired working capital position.

Cash flow is strained in order to meet debt repayment.

Loan delinquency (30-60 days) and overdrafts may occur.

•

Shrinking equity
cushion.

Diminishing primary source of repayment and questionable secondary source.

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Management abilities are questionable.

Weak industry conditions.

Litigation pending against the borrower.

Collateral or guaranty offers limited protection.

Negative debt service coverage, however the credit is well collateralized and payments are current.

6. SUBSTANDARD – Classified

Credit where the borrower's current net worth, paying capacity, and value of the collateral pledged is inadequate. There is a distinct possibility that we will implement collection procedures if the loan deficiencies are not corrected. In addition, the following characteristics may apply:

Sustained losses have severely eroded the equity and cash flow.

Deteriorating liquidity.

Serious management problems or internal fraud.

Original repayment terms liberalized.

Likelihood of bankruptcy.

Inability to access other funding sources.

Reliance on secondary source of repayment.

Litigation filed against borrower.

Collateral provides little or no value.

Requires excessive attention of the loan officer.

Borrower is uncooperative with loan officer.

7. VULNERABLE – Classified

Credit is considered "Substandard" and warrants placing on nonaccrual status. Risk of loss is being evaluated and exit strategy options are under review. Other characteristics that may apply:

Insufficient cash flow to service debt.

Minimal or no payments being received.

Limited options available to avoid the collection process.

Transition status, expect action will take place to collect loan without immediate progress being made.

8. DOUBTFUL – Workout

Credit has all the weaknesses inherent in a "Substandard" loan with the added characteristic that collection and/or liquidation is pending. The possibility of a loss is extremely high, but its classification as a loss is deferred until liquidation procedures are completed, or reasonably estimable. Other characteristics that may apply:

Normal operations are severely diminished or have ceased.

Seriously impaired cash flow.

Original repayment terms materially altered.

Secondary source of repayment is inadequate.

Survivability as a "going concern" is impossible.

Collection process has begun.

Bankruptcy petition has been filed.

Judgments have been filed.

Portion of the loan balance has been charged-off.

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Our primary credit quality indicator for residential real estate and consumer loans is the individual loan's past due aging. The following tables summarize the past due and current loans as of:

	June 30, 2017				Total Past Due and Nonaccrual	Current	Total
	Accruing Interest and Past Due:						
	30-59 Days	60-89 Days	90 Days or More	Nonaccrual			
Commercial							
Commercial real estate	\$1,301	\$—	\$55	\$17	\$1,373	\$441,027	\$442,400
Commercial other	981	103	—	—	1,084	137,186	138,270
Advances to mortgage brokers	—	—	—	—	—	19,914	19,914
Total commercial	2,282	103	55	17	2,457	598,127	600,584
Agricultural							
Agricultural real estate	343	—	1,099	466	1,908	86,584	88,492
Agricultural other	29	—	—	526	555	41,907	42,462
Total agricultural	372	—	1,099	992	2,463	128,491	130,954
Residential real estate							
Senior liens	1,033	426	49	460	1,968	221,433	223,401
Junior liens	—	—	—	24	24	7,746	7,770
Home equity lines of credit	123	173	—	70	366	38,670	39,036
Total residential real estate	1,156	599	49	554	2,358	267,849	270,207
Consumer							
Secured	63	—	—	—	63	43,109	43,172
Unsecured	1	—	—	—	1	3,579	3,580
Total consumer	64	—	—	—	64	46,688	46,752
Total	\$3,874	\$702	\$1,203	\$1,563	\$7,342	\$1,041,155	\$1,048,497

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	December 31, 2016				Total Past Due and Nonaccrual	Current	Total
	Accruing Interest and Past Due:						
	30-59 Days	60-89 Days	90 Days or More	Nonaccrual			
Commercial							
Commercial real estate	\$ 1,580	\$ —	\$ 35	\$ 4	\$ 1,619	\$ 422,762	\$ 424,381
Commercial other	1,693	35	—	—	1,728	129,867	131,595
Advances to mortgage brokers	—	—	—	—	—	19,688	19,688
Total commercial	3,273	35	35	4	3,347	572,317	575,664
Agricultural							
Agricultural real estate	191	—	508	—	699	83,138	83,837
Agricultural other	19	—	—	533	552	42,103	42,655
Total agricultural	210	—	508	533	1,251	125,241	126,492
Residential real estate							
Senior liens	1,638	174	22	498	2,332	216,681	219,013
Junior liens	15	—	—	25	40	8,317	8,357
Home equity lines of credit	270	6	68	—	344	38,336	38,680
Total residential real estate	1,923	180	90	523	2,716	263,334	266,050
Consumer							
Secured	110	—	—	—	110	38,582	38,692
Unsecured	5	—	—	—	5	3,712	3,717
Total consumer	115	—	—	—	115	42,294	42,409
Total	\$ 5,521	\$ 215	\$ 633	\$ 1,060	\$ 7,429	\$ 1,003,186	\$ 1,010,615

Impaired Loans

Loans may be classified as impaired if they meet one or more of the following criteria:

1. There has been a charge-off of its principal balance (in whole or in part);
2. The loan has been classified as a TDR; or
3. The loan is in nonaccrual status.

Impairment is measured on a loan-by-loan basis for commercial and agricultural loans by comparing the loan's outstanding balance to the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell, if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Impairment is measured on a loan-by-loan basis for residential real estate and consumer loans by comparing the loan's unpaid principal balance to the present value of expected future cash flows discounted at the loan's effective interest rate.

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We do not recognize interest income on impaired loans in nonaccrual status. For impaired loans not classified as nonaccrual, interest income is recognized daily, as earned, according to the terms of the loan agreement and the principal amount outstanding. The following is a summary of information pertaining to impaired loans as of:

	June 30, 2017			December 31, 2016		
	Recorded Balance	Unpaid Principal Balance	Valuation Allowance	Recorded Balance	Unpaid Principal Balance	Valuation Allowance
Impaired loans with a valuation allowance						
Commercial real estate	\$5,063	\$ 5,183	\$ 733	\$5,811	\$ 5,992	\$ 716
Commercial other	1,099	1,099	50	1,358	1,358	25
Agricultural real estate	—	—	—	—	—	—
Agricultural other	—	—	—	134	134	1
Residential real estate senior liens	8,393	8,977	1,649	8,464	9,049	1,615
Residential real estate junior liens	76	76	15	72	82	14
Home equity lines of credit	70	70	8	—	—	—
Consumer secured	—	—	—	—	—	—
Total impaired loans with a valuation allowance	14,701	15,405	2,455	15,839	16,615	2,371
Impaired loans without a valuation allowance						
Commercial real estate	1,104	1,191		604	617	
Commercial other	96	96		86	97	
Agricultural real estate	7,826	7,826		4,037	4,037	
Agricultural other	3,299	3,299		1,374	1,374	
Home equity lines of credit	89	389		102	402	
Consumer secured	20	20		26	26	
Total impaired loans without a valuation allowance	12,434	12,821		6,229	6,553	
Impaired loans						
Commercial	7,362	7,569	783	7,859	8,064	741
Agricultural	11,125	11,125	—	5,545	5,545	1
Residential real estate	8,628	9,512	1,672	8,638	9,533	1,629
Consumer	20	20	—	26	26	—
Total impaired loans	\$27,135	\$ 28,226	\$ 2,455	\$22,068	\$ 23,168	\$ 2,371

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The following is a summary of information pertaining to impaired loans for the:

	Three Months Ended June 30			
	2017		2016	
	Average Interest	Average Interest	Average Interest	Average Interest
	Recorded Income	Recorded Income	Recorded Income	Recorded Income
	Balance	Recognized	Balance	Recognized
Impaired loans with a valuation allowance				
Commercial real estate	\$4,641	\$ 84	\$5,793	\$ 85
Commercial other	1,146	23	95	2
Agricultural real estate	—	—	91	2
Agricultural other	—	—	—	—
Residential real estate senior liens	8,385	83	9,508	93
Residential real estate junior liens	77	1	134	1
Home equity lines of credit	35	—	—	—
Consumer secured	—	—	—	—
Total impaired loans with a valuation allowance	14,284	191	15,621	183
Impaired loans without a valuation allowance				
Commercial real estate	1,576	19	814	28
Commercial other	119	2	77	2
Agricultural real estate	5,937	58	3,454	43
Agricultural other	2,401	33	603	10
Home equity lines of credit	126	5	118	4
Consumer secured	22	—	33	1
Total impaired loans without a valuation allowance	10,181	117	5,099	88
Impaired loans				
Commercial	7,482	128	6,779	117
Agricultural	8,338	91	4,148	55
Residential real estate	8,623	89	9,760	98
Consumer	22	—	33	1
Total impaired loans	\$24,465	\$ 308	\$20,720	\$ 271

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	Six Months Ended June 30			
	2017		2016	
	Average Interest RecordedIncome Balance	Recognized	Average Interest RecordedIncome Balance	Recognized
Impaired loans with a valuation allowance				
Commercial real estate	\$4,825	\$ 157	\$5,773	\$ 169
Commercial other	1,211	47	74	3
Agricultural real estate	—	—	46	2
Agricultural other	34	—	84	—
Residential real estate senior liens	8,403	166	9,711	193
Residential real estate junior liens	76	1	137	2
Home equity lines of credit	18	—	—	—
Consumer secured	—	—	—	—
Total impaired loans with a valuation allowance	14,567	371	15,825	369
Impaired loans without a valuation allowance				
Commercial real estate	1,451	52	1,139	47
Commercial other	117	4	104	4
Agricultural real estate	4,990	120	3,501	88
Agricultural other	1,920	46	477	16
Home equity lines of credit	129	10	121	8
Consumer secured	23	—	34	2
Total impaired loans without a valuation allowance	8,630	232	5,376	165
Impaired loans				
Commercial	7,604	260	7,090	223
Agricultural	6,944	166	4,108	106
Residential real estate	8,626	177	9,969	203
Consumer	23	—	34	2
Total impaired loans	\$23,197	\$ 603	\$21,201	\$ 534

We had committed to advance \$124 and \$117 in connection with impaired loans, which include TDRs, as of June 30, 2017 and December 31, 2016, respectively.

Troubled Debt Restructurings

Loan modifications are considered to be TDRs when the modification includes terms outside of normal lending practices to a borrower who is experiencing financial difficulties.

Typical concessions granted include, but are not limited to:

- Agreeing to interest rates below prevailing market rates for debt with similar risk characteristics.
- Extending the amortization period beyond typical lending guidelines for loans with similar risk characteristics.
- Forgiving principal.
- Forgiving accrued interest.

To determine if a borrower is experiencing financial difficulties, factors we consider include:

- ☐ The borrower is currently in default on any of their debt.
- ☐ The borrower would likely default on any of their debt if the concession was not granted.
- ☐ The borrower's cash flow was insufficient to service all of their debt if the concession was not granted.
- ☐ The borrower has declared, or is in the process of declaring, bankruptcy.
- ☐ The borrower is unlikely to continue as a going concern (if the entity is a business).

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The following is a summary of information pertaining to TDRs granted for the:

	Three Months Ended June 30			2016		
	2017			2016		
	Number	Post-Modification	Post-Modification	Number	Post-Modification	Post-Modification
	of Recorded	Recorded	Recorded	of Recorded	Recorded	Recorded
	Loans	Investment	Investment	Loans	Investment	Investment
Commercial other	1	\$ 86	\$ 86	—	\$ —	\$ —
Agricultural other	7	5,445	5,445	3	201	201
Residential real estate						
Senior liens	3	255	255	—	—	—
Junior liens	—	—	—	—	—	—
Total residential real estate	3	255	255	—	—	—
Consumer unsecured	—	—	—	—	—	—
Total	11	\$ 5,786	\$ 5,786	3	\$ 201	\$ 201

	Six Months Ended June 30			2016		
	2017			2016		
	Number	Post-Modification	Post-Modification	Number	Post-Modification	Post-Modification
	of Recorded	Recorded	Recorded	of Recorded	Recorded	Recorded
	Loans	Investment	Investment	Loans	Investment	Investment
Commercial other	3	\$ 313	\$ 313	—	\$ —	\$ —
Agricultural other	7	5,445	5,445	3	201	201
Residential real estate						
Senior liens	3	255	255	2	26	26
Junior liens	1	8	8	—	—	—
Total residential real estate	4	263	263	2	26	26
Consumer unsecured	—	—	—	1	2	2
Total	14	\$ 6,021	\$ 6,021	6	\$ 229	\$ 229

The following tables summarize concessions we granted to borrowers in financial difficulty for the:

	Three Months Ended June 30		2016	
	2017		2016	
	Below Market	Below Market	Below Market	Below Market
	Interest Rate	Interest Rate and	Interest Rate	Interest Rate and
		Extension of		Extension of
		Amortization Period		Amortization Period
	Number	Number	Number	Number
	of Recorded	of Recorded	of Recorded	of Recorded
	Loans	Loans	Loans	Loans
	Investment	Investment	Investment	Investment
Commercial other	—	\$ —	1	\$ 86
Agricultural other	4	1,349	3	4,096
Residential real estate				
Senior liens	—	—	3	255
Junior liens	—	—	—	—
Total residential real estate	—	—	3	255
Consumer unsecured	—	—	—	—
Total	4	\$ 1,349	7	\$ 4,437

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	Six Months Ended June 30 2017		2016	
	Below Market Interest Rate	Below Market Interest Rate and Extension of Amortization Period	Below Market Interest Rate	Below Market Interest Rate and Extension of Amortization Period
	Number of Recorded Loans Investment	Number of Recorded Loans Investment	Number of Recorded Loans Investment	Number of Recorded Loans Investment
Commercial other	— \$ —	3 \$ 313	— \$ —	— \$ —
Agricultural other	4 1,349	3 4,096	—	3 201
Residential real estate				
Senior liens	—	3 255	2 26	— —
Junior liens	1 8	— —	—	— —
Total residential real estate	1 8	3 255	2 26	— —
Consumer unsecured	—	— —	—	1 2
Total	5 \$ 1,357	9 \$ 4,664	2 \$ 26	4 \$ 203

We did not restructure any loans by forgiving principal or accrued interest in the three and six month periods ended June 30, 2017 or 2016.

Based on our historical loss experience, losses associated with TDRs are not significantly different than other impaired loans within the same loan segment. As such, TDRs, including TDRs that have been modified in the past 12 months that subsequently defaulted, are analyzed in the same manner as other impaired loans within their respective loan segment.

We had no loans that defaulted in the three and six month periods ended June 30, 2017 and June 30, 2016 which were modified within 12 months prior to the default date.

The following is a summary of TDR loan balances as of:

	June 30, 2017	December 31, 2016
TDRs	\$26,341	\$ 21,382

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Note 6 – Equity Securities Without Readily Determinable Fair Values

Included in equity securities without readily determinable fair values are restricted securities, which are carried at cost, and investments in unconsolidated entities accounted for under the equity method of accounting.

Equity securities without readily determinable fair values consist of the following as of:

	June 30	December 31
	2017	2016
FHLB Stock	\$13,700	\$ 11,900
Corporate Settlement Solutions, LLC	7,368	7,461
FRB Stock	1,999	1,999
Other	334	334
Total	\$23,401	\$ 21,694

Note 7 – Foreclosed Assets

Foreclosed assets are included in other assets in the consolidated balance sheets and consist of other real estate owned and repossessed assets. The following is a summary of foreclosed assets as of:

	June 30	December 31
	2017	2016
Consumer mortgage loans collateralized by residential real estate foreclosed as a result of obtaining physical possession	\$ 16	\$ 18
All other foreclosed assets	213	213
Total	\$ 229	\$ 231

There were \$411 and \$18 of consumer mortgage loans collateralized by residential real estate in the process of foreclosure as of June 30, 2017 and December 31, 2016.

Below is a summary of changes in foreclosed assets during the:

	Three Months Ended June 30	
	2017	2016
Balance, April 1	\$158	\$276
Properties transferred	98	27
Impairments	—	—
Proceeds from sale	(27)	(54)
Balance, June 30	\$229	\$249
	Six Months Ended June 30	
	2017	2016
Balance, January 1	\$231	\$421
Properties transferred	124	116
Impairments	(28)	—
Proceeds from sale	(98)	(288)
Balance, June 30	\$229	\$249

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Note 8 – Borrowed Funds

Borrowed funds consist of the following obligations as of:

	June 30, 2017		December 31, 2016	
	Amount	Rate	Amount	Rate
FHLB advances	\$310,000	1.81 %	\$270,000	1.82 %
Securities sold under agreements to repurchase without stated maturity dates	49,950	0.13 %	60,894	0.13 %
Federal funds purchased	990	1.39 %	6,800	1.00 %
Total	\$360,940	1.57 %	\$337,694	1.50 %

FHLB advances are collateralized by a blanket lien on all qualified 1-4 family residential real estate loans, specific AFS securities, and FHLB stock.

The following table lists the maturities and weighted average interest rates of FHLB advances as of:

	June 30, 2017		December 31, 2016	
	Amount	Rate	Amount	Rate
Fixed rate due 2017	\$65,000	1.28 %	\$70,000	1.39 %
Fixed rate due 2018	50,000	2.16 %	50,000	2.16 %
Fixed rate due 2019	70,000	1.93 %	60,000	1.99 %
Fixed rate due 2020	35,000	1.52 %	10,000	1.98 %
Fixed rate due 2021	50,000	1.91 %	50,000	1.91 %
Variable rate due 2021 ¹	10,000	1.48 %	10,000	1.21 %
Fixed rate due 2022	10,000	2.07 %	—	— %
Fixed rate due 2023	10,000	3.90 %	10,000	3.90 %
Fixed rate due 2026	10,000	1.17 %	10,000	1.17 %
Total	\$310,000	1.81 %	\$270,000	1.82 %

⁽¹⁾ Hedged advance (see "Derivative Instruments" section below)

Securities sold under agreements to repurchase are classified as secured borrowings and are reflected at the amount of cash received in connection with the transaction. The securities underlying the agreements have a carrying value and a fair value of \$49,969 and \$60,918 at June 30, 2017 and December 31, 2016, respectively. Such securities remain under our control. We may be required to provide additional collateral based on the fair value of underlying securities. Securities sold under repurchase agreements without stated maturity dates, federal funds purchased, and FRB Discount Window advances generally mature within one to four days from the transaction date. The following table provides a summary of securities sold under repurchase agreements without stated maturity dates, federal funds purchased, and FRB Discount Window advances.

	Three Months Ended June 30							
	2017				2016			
	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period		Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period	
Securities sold under agreements to repurchase without stated maturity dates	\$55,731	\$53,841	0.13 %		\$57,032	\$56,010	0.13 %	
Federal funds purchased	5,965	7,496	1.13 %		11,800	12,294	0.69 %	
FRB Discount Window	—	88	1.48 %		—	—	— %	

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	Six Months Ended June 30							
	2017				2016			
	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period		Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period	
Securities sold under agreements to repurchase without stated maturity dates	\$61,131	\$55,663	0.13 %		\$61,783	\$58,531	0.13 %	
Federal funds purchased	27,300	4,197	1.11 %		11,800	8,495	0.69 %	
FRB Discount Window	—	44	1.48 %		—	—	— %	

We had pledged AFS securities and 1-4 family residential real estate loans in the following amounts at:

	June 30		December 31	
	2017		2016	
Pledged to secure borrowed funds	\$418,917		\$363,427	
Pledged to secure repurchase agreements	49,969		60,918	
Pledged for public deposits and for other purposes necessary or required by law	31,429		33,916	
Total	\$500,315		\$458,261	

AFS securities pledged to repurchase agreements without stated maturity dates consisted of the following at:

	June 30		December 31	
	2017		2016	
States and political subdivisions	\$2,784		\$5,676	
Mortgage-backed securities	14,813		11,383	
Collateralized mortgage obligations	32,372		43,859	
Total	\$49,969		\$60,918	

AFS securities pledged to repurchase agreements are monitored to ensure the appropriate level is collateralized. In the event of maturities, calls, significant principal repayments, or significant decline in market values, we have adequate levels of AFS securities to pledge to satisfy required collateral.

As of June 30, 2017, we had the ability to borrow up to an additional \$119,462, based on assets pledged as collateral.

We had no investment securities that are restricted to be pledged for specific purposes.

Derivative Instruments

We enter into interest rate swaps to manage exposure to interest rate risk and variability in cash flows. The interest rate swaps, associated with our variable rate borrowings, are designated upon inception as cash flow hedges of forecasted interest payments. We enter into LIBOR-based interest rate swaps that involve the receipt of variable amounts in exchange for fixed rate payments, in effect converting variable rate debt to fixed rate debt.

Cash flow hedges are assessed for effectiveness using regression analysis. The effective portion of changes in fair value are recorded in OCI and subsequently reclassified into interest expense in the same period in which the related interest on the variable rate borrowings affects earnings. In the event that a portion of the changes in fair value were determined to be ineffective, the ineffective amount would be recorded in earnings.

The following tables provide information on derivatives related to variable rate borrowings as of:

	June 30, 2017		Remaining Life (Years)	Notional Amount	Balance Sheet Location	Fair Value
	Pay Rate	Receive Rate				
Derivatives designated as hedging instruments						
Cash Flow Hedges:						
Interest rate swaps	1.56 %	3-Month LIBOR	3.8	\$10,000	Other Assets	\$204

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	December 31, 2016		Remaining Life (Years)	Notional Amount	Balance Sheet Location	Fair Value
	Pay Rate	Receive Rate				
Derivatives designated as hedging instruments						
Cash Flow Hedges:						
Interest rate swaps	1.56%	3-Month LIBOR	4.3	\$ 10,000	Other Assets	\$ 248

Derivatives contain an element of credit risk which arises from the possibility that we will incur a loss as a result of a counterparty failing to meet its contractual obligations. Credit risk is minimized through counterparty collateral, transaction limits and monitoring procedures. We also manage dealer credit risk by entering into interest rate derivatives only with primary and highly rated counterparties, the use of ISDA master agreements and counterparties limits. We do not anticipate any losses from failure of interest rate derivative counterparties to honor their obligations.

Note 9 – Other Noninterest Expenses

A summary of expenses included in other noninterest expenses is as follows for the:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
ATM and debit card fees	\$404	\$228	\$620	\$417
Audit and related fees	237	186	435	345
Director fees	213	214	422	423
Consulting fees	208	196	413	369
Loan underwriting fees	192	127	309	235
FDIC insurance premiums	155	217	308	422
Donations and community relations	168	146	298	265
Postage and freight	110	91	219	197
Printing and supplies	103	129	210	220
Marketing costs	100	103	189	258
Education and travel	93	125	189	236
All other	524	644	989	1,206
Total other	\$2,507	\$2,406	\$4,601	\$4,593

Note 10 – Federal Income Taxes

The reconciliation of the provision for federal income taxes and the amount computed at the federal statutory tax rate of 34% of income before federal income tax expense is as follows for the:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Income taxes at 34% statutory rate	\$1,612	\$1,381	\$2,859	\$2,555
Effect of nontaxable income				
Interest income on tax exempt municipal securities	(454)	(465)	(909)	(943)
Earnings on corporate owned life insurance policies	(62)	(66)	(123)	(130)
Effect of tax credits	(191)	(193)	(380)	(387)
Other	(18)	(18)	(36)	(36)
Total effect of nontaxable income	(725)	(742)	(1,448)	(1,496)
Effect of nondeductible expenses	11	16	19	33
Federal income tax expense	\$898	\$655	\$1,430	\$1,092

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Note 11 – Fair Value

Following is a description of the valuation methodologies, key inputs, and an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Cash and cash equivalents: The carrying amounts of cash and demand deposits due from banks and interest bearing balances due from banks approximate fair values. As such, we classify cash and cash equivalents as Level 1.

AFS securities: AFS securities are recorded at fair value on a recurring basis. Level 1 fair value measurement is based upon quoted prices for identical instruments. Level 2 fair value measurement is based upon quoted prices for similar instruments. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. The values for Level 1 and Level 2 investment securities are generally obtained from an independent third party. On a quarterly basis, we compare the values provided to alternative pricing sources.

Mortgage loans AFS: Mortgage loans AFS are carried at the lower of cost or fair value. The fair value of mortgage loans AFS are based on the price secondary markets are currently offering for portfolios with similar characteristics. As such, we classify mortgage loans AFS subject to nonrecurring fair value adjustments as Level 2.

Loans: For variable rate loans with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The resulting amounts are adjusted to estimate the effect of changes in the credit quality of borrowers since the loans were originated. As such, we classify loans as Level 3 assets.

We do not record loans at fair value on a recurring basis. However, from time-to-time, loans are classified as impaired and a specific allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will be significantly different than the contractual terms of the original loan agreement are considered impaired. Once a loan is identified as impaired, we measure the estimated impairment. The fair value of impaired loans is estimated using one of several methods, including the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell, if the loan is collateral dependent. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

We review the net realizable values of the underlying collateral for collateral dependent impaired loans on at least a quarterly basis for all loan types. To determine the collateral value, we utilize independent appraisals, broker price opinions, or internal evaluations. We review these valuations to determine whether an additional discount should be applied given the age of market information that may have been considered as well as other factors such as costs to sell an asset if it is determined that the collateral will be liquidated in connection with the ultimate settlement of the loan. We use these valuations to determine if any specific reserves or charge-offs are necessary. We may obtain new valuations in certain circumstances, including when there has been significant deterioration in the condition of the collateral, if the foreclosure process has begun, or if the existing valuation is deemed to be outdated.

The following tables list the quantitative fair value information about impaired loans as of:

June 30, 2017

Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
		Real Estate	20% - 30%
		Equipment	20% - 45%
Discounted value	\$15,117	Cash crop inventory	30% - 40%
		Liquor license	75%
		Furniture, fixtures & equipment	40% - 45%

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December 31, 2016

Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
		Real Estate	20% - 30%
		Equipment	20% - 45%
Discounted value	\$9,166	Cash crop inventory	30% - 40%
		Liquor license	75%
		Furniture, fixtures & equipment	45%

Discount factors with ranges are based on the age of the independent appraisal, broker price opinion, or internal evaluation.

Accrued interest receivable: The carrying amounts of accrued interest receivable approximate fair value. As such, we classify accrued interest receivable as Level 1.

Equity securities without readily determinable fair values: Included in equity securities without readily determinable fair values are FHLB stock and FRB stock as well as our minority ownership interest in Corporate Settlement Solutions, LLC. The investment in Corporate Settlement Solutions, LLC, a title insurance agency, was made in the first quarter 2008 and we account for our investment under the equity method of accounting.

The lack of an active market, or other independent sources to validate fair value estimates coupled with the impact of future capital calls and transfer restrictions, is an inherent limitation in the valuation process. As the fair values of these investments are not readily determinable, they are not disclosed under a specific fair value hierarchy; however, they are reviewed quarterly for impairment. If we were to record an impairment adjustment related to these securities, it would be classified as a nonrecurring Level 3 fair value adjustment. During 2017 and 2016, there were no impairments recorded on equity securities without readily determinable fair values.

Foreclosed assets: Upon transfer from the loan portfolio, foreclosed assets (which are included in other assets) are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Net realizable value is based upon independent market prices, appraised values of the collateral, or management's estimation of the value of the collateral. Due to the inherent level of estimation in the valuation process, we classify foreclosed assets as nonrecurring Level 3.

The table below lists the quantitative fair value information related to foreclosed assets as of:

June 30, 2017

Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
Discounted value	\$229	Real Estate	20% - 30%

December 31, 2016

Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
Discounted value	\$231	Real Estate	20% - 30%

Discount factors with ranges are based on the age of the independent appraisal, broker price opinion, or internal evaluations.

Goodwill and other intangible assets: Acquisition intangibles and goodwill are evaluated for potential impairment on at least an annual basis. Acquisition intangibles and goodwill are typically qualitatively evaluated to determine if it is more likely than not that the carrying balance is impaired. If it is determined that the carrying balance of acquisition intangibles or goodwill is more likely than not to be impaired, we perform a cash flow valuation to determine the extent of the potential impairment. If the testing resulted in impairment, we would classify goodwill and other acquisition intangibles subjected to nonrecurring fair value adjustments as Level 3. During 2017 and 2016, there were no impairments recorded on goodwill and other acquisition intangibles.

OMSR: OMSR (which are included in other assets) are subject to impairment testing. To test for impairment, we utilize a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for

comparable instruments and discount rates. If the valuation model reflects a value less than the carrying value, OMSR are adjusted to fair

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value through a valuation allowance as determined by the model. As such, we classify OMSR subject to nonrecurring fair value adjustments as Level 2.

Deposits: The fair value of demand, savings, and money market deposits are equal to their carrying amounts and are classified as Level 1. Fair values for variable rate certificates of deposit approximate their carrying value. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. As such, fixed rate certificates of deposit are classified as Level 2.

Borrowed funds: The carrying amounts of federal funds purchased, borrowings under overnight repurchase agreements, and other short-term borrowings maturing within ninety days approximate their fair values. The fair values of other borrowed funds are estimated using discounted cash flow analyses based on current incremental borrowing arrangements. As such, borrowed funds are classified as Level 2.

Accrued interest payable: The carrying amounts of accrued interest payable approximate fair value. As such, we classify accrued interest payable as Level 1.

Derivative instruments: Derivative instruments, consisting solely of interest rate swaps, are recorded at fair value on a recurring basis. Derivatives qualifying as cash flow hedges, when highly effective, are reported at fair value in other assets or other liabilities on our Consolidated Balance Sheets with changes in value recorded in OCI. Should the hedge no longer be considered effective, the ineffective portion of the change in fair value is recorded directly in earnings in the period in which the change occurs. The fair value of a derivative is determined by quoted market prices and model based valuation techniques. As such, we classify derivative instruments as Level 2.

Commitments to extend credit, standby letters of credit, and undisbursed loans: Our commitments to extend credit, standby letters of credit, and undisbursed funds have no carrying amount and are estimated to have no realizable fair value. Historically, a majority of the unused commitments to extend credit have not been drawn upon and, generally, we do not receive fees in connection with these commitments other than standby letter of credit fees, which are not significant.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Although we believe our valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement.

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Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis
Disclosure of the estimated fair values of financial instruments, which differ from carrying values, often requires the use of estimates. In cases where quoted market values in an active market are not available, we use present value techniques and other valuation methods to estimate the fair values of our financial instruments. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used.

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis were as follows as of:

	June 30, 2017				
	Carrying Value	Estimated Fair Value	(Level 1)	(Level 2)	(Level 3)
ASSETS					
Cash and cash equivalents	\$21,834	\$ 21,834	\$21,834	\$ —	—
Mortgage loans AFS	1,482	1,493	—	1,493	—
Gross loans	1,048,497	1,029,290	—	—	1,029,290
Less allowance for loan and lease losses	7,600	7,600	—	—	7,600
Net loans	1,040,897	1,021,690	—	—	1,021,690
Accrued interest receivable	5,686	5,686	5,686	—	—
Equity securities without readily determinable fair values (1)	23,401	N/A	—	—	—
OMSR	2,490	2,499	—	2,499	—
LIABILITIES					
Deposits without stated maturities	780,243	780,243	780,243	—	—
Deposits with stated maturities	429,909	427,877	—	427,877	—
Borrowed funds	360,940	361,076	—	361,076	—
Accrued interest payable	561	561	561	—	—
	December 31, 2016				
	Carrying Value	Estimated Fair Value	(Level 1)	(Level 2)	(Level 3)
ASSETS					
Cash and cash equivalents	\$22,894	\$ 22,894	\$22,894	\$ —	—
Mortgage loans AFS	1,816	1,836	—	1,836	—
Gross loans	1,010,619	991,009	—	—	991,009
Less allowance for loan and lease losses	7,400	7,400	—	—	7,400
Net loans	1,003,219	983,609	—	—	983,609
Accrued interest receivable	6,580	6,580	6,580	—	—
Equity securities without readily determinable fair values (1)	21,694	N/A	—	—	—
OMSR	2,306	2,306	—	2,306	—
LIABILITIES					
Deposits without stated maturities	761,626	761,626	761,626	—	—
Deposits with stated maturities	433,414	430,088	—	430,088	—
Borrowed funds	337,694	336,975	—	336,975	—
Accrued interest payable	574	574	574	—	—

Due to the characteristics of equity securities without readily determinable fair values, they are not disclosed under (1) a specific fair value hierarchy. If we were to record an impairment adjustment related to these securities, such amount would be classified as a nonrecurring Level 3 fair value adjustment.

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Financial Instruments Recorded at Fair Value

The table below presents the recorded amount of assets and liabilities measured at fair value on:

	June 30, 2017				December 31, 2016			
	Total	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)
Recurring items								
AFS securities								
Government-sponsored enterprises	\$281	\$—	\$281	\$—	\$10,259	\$—	\$10,259	\$—
States and political subdivisions	222,093	—	222,093	—	212,919	—	212,919	—
Auction rate money market preferred	3,095	—	3,095	—	2,794	—	2,794	—
Preferred stocks	3,665	3,665	—	—	3,425	3,425	—	—
Mortgage-backed securities	221,957	—	221,957	—	227,256	—	227,256	—
Collateralized mortgage obligations	116,771	—	116,771	—	101,443	—	101,443	—
Total AFS securities	567,862	3,665	564,197	—	558,096	3,425	554,671	—
Derivative instruments	204	—	204	—	248	—	248	—
Nonrecurring items								
Impaired loans (net of the ALLL)	15,117	—	—	15,117	9,166	—	—	9,166
Foreclosed assets	229	—	—	229	231	—	—	231
Total	\$583,412	\$3,665	\$564,401	\$15,346	\$567,741	\$3,425	\$554,919	\$9,397
Percent of assets and liabilities measured at fair value		0.63 %	96.74 %	2.63 %		0.60 %	97.74 %	1.66 %

We had no assets or liabilities recorded at fair value with changes in fair value recognized through earnings, on a recurring basis, as of June 30, 2017. Foreclosed assets, which are recorded at fair value with changes in fair value recognized through earnings on a nonrecurring basis, were written down to \$229 as of June 30, 2017 which resulted in an impairment recorded through earnings in the amount of \$28 for the six month period ended June 30, 2017. We had no other assets or liabilities recorded at fair value with changes in fair value recognized through earnings, on a nonrecurring basis, as of June 30, 2017.

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Note 12 – Accumulated Other Comprehensive Income

The following table summarizes the changes in AOCI by component for the:

	Three Months Ended June 30				2016			
	2017		2016		2016		2016	
	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Holding Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Holding Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total
Balance, April 1	\$1,257	\$ 175	\$ (2,972)	\$(1,540)	\$8,333	\$ —	\$ (3,315)	\$5,018
OCI before reclassifications	2,570	(61)	—	2,509	4,067	(152)	—	3,915
Amounts reclassified from AOCI	(142)	—	—	(142)	(245)	—	—	(245)
Subtotal	2,428	(61)	—	2,367	3,822	(152)	—	3,670
Tax effect	(762)	21	—	(741)	(1,173)	52	—	(1,121)
OCI, net of tax	1,666	(40)	—	1,626	2,649	(100)	—	2,549
Balance, June 30	\$2,923	\$ 135	\$ (2,972)	\$86	\$10,982	\$ (100)	\$ (3,315)	\$7,567
	Six Months Ended June 30				2016			
	2017		2016		2016		2016	
	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Holding Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Holding Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total
Balance, January 1	\$30	\$ 164	\$ (2,972)	\$(2,778)	\$3,536	\$ —	\$ (3,315)	\$221
OCI before reclassifications	4,247	(44)	—	4,203	11,341	(152)	—	11,189
Amounts reclassified from AOCI	(142)	—	—	(142)	(245)	—	—	(245)
Subtotal	4,105	(44)	—	4,061	11,096	(152)	—	10,944
Tax effect	(1,212)	15	—	(1,197)	(3,650)	52	—	(3,598)
OCI, net of tax	2,893	(29)	—	2,864	7,446	(100)	—	7,346
Balance, June 30	\$2,923	\$ 135	\$ (2,972)	\$86	\$10,982	\$ (100)	\$ (3,315)	\$7,567

Included in OCI for the three and six month periods ended June 30, 2017 and 2016 are changes in unrealized holding gains and losses related to auction rate money market preferred and preferred stocks. For federal income tax purposes, these securities are considered equity investments. As such, no deferred federal income taxes related to unrealized holding gains or losses are expected or recorded.

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A summary of the components of unrealized holding gains on AFS securities included in OCI follows for the:

	Three Months Ended June 30					
	2017			2016		
	Auction			Auction		
	Rate			Rate		
	Money	All Other	Total	Money	All Other	Total
	Market	AFS		Market	AFS	
	Preferred	Securities		Preferred	Securities	
	and			and		
	Preferred			Preferred		
	Stocks			Stocks		
Unrealized gains (losses) arising during the period	\$186	\$ 2,384	\$2,570	\$372	\$ 3,695	\$4,067
Reclassification adjustment for net realized (gains) losses included in net income	—	(142)	(142)	—	(245)	(245)
Net unrealized gains (losses)	186	2,242	2,428	372	3,450	3,822
Tax effect	—	(762)	(762)	—	(1,173)	(1,173)
Unrealized gains (losses), net of tax	\$186	\$ 1,480	\$1,666	\$372	\$ 2,277	\$2,649
	Six Months Ended June 30					
	2017			2016		
	Auction			Auction		
	Rate			Rate		
	Money	All Other	Total	Money	All Other	Total
	Market	AFS		Market	AFS	
	Preferred	Securities		Preferred	Securities	
	and			and		
	Preferred			Preferred		
	Stocks			Stocks		
Unrealized gains (losses) arising during the period	\$541	\$ 3,706	\$4,247	\$360	\$ 10,981	\$11,341
Reclassification adjustment for net realized (gains) losses included in net income	—	(142)	(142)	—	(245)	(245)
Net unrealized gains (losses)	541	3,564	4,105	360	10,736	11,096
Tax effect	—	(1,212)	(1,212)	—	(3,650)	(3,650)
Unrealized gains (losses), net of tax	\$541	\$ 2,352	\$2,893	\$360	\$ 7,086	\$7,446

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Interim Condensed Balance Sheets

	June 30 2017	December 31 2016
ASSETS		
Cash on deposit at the Bank	\$1,144	\$ 1,297
AFS securities	—	251
Investments in subsidiaries	145,128	138,549
Premises and equipment	1,940	1,991
Other assets	52,673	52,846
TOTAL ASSETS	\$200,885	\$ 194,934
LIABILITIES AND SHAREHOLDERS' EQUITY		
Other liabilities	\$5,815	\$ 7,035
Shareholders' equity	195,070	187,899
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$200,885	\$ 194,934

Interim Condensed Statements of Income

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Income				
Dividends from subsidiaries	\$2,600	\$2,000	\$4,300	\$3,600
Interest income	—	4	2	8
Management fee and other	1,691	1,758	3,241	3,282
Total income	4,291	3,762	7,543	6,890
Expenses				
Compensation and benefits	1,118	1,184	2,490	2,384
Occupancy and equipment	432	413	876	843
Audit and related fees	140	100	264	196
Other	634	588	1,175	1,134
Total expenses	2,324	2,285	4,805	4,557
Income before income tax benefit and equity in undistributed earnings of subsidiaries	1,967	1,477	2,738	2,333
Federal income tax benefit	212	171	528	417
Income before equity in undistributed earnings of subsidiaries	2,179	1,648	3,266	2,750
Undistributed earnings of subsidiaries	1,665	1,759	3,714	3,674
Net income	\$3,844	\$3,407	\$6,980	\$6,424

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Interim Condensed Statements of Cash Flows

	Six Months Ended June 30	
	2017	2016
Operating activities		
Net income	\$6,980	\$6,424
Adjustments to reconcile net income to cash provided by operations		
Undistributed earnings of subsidiaries	(3,714)	(3,674)
Undistributed earnings of equity securities without readily determinable fair values	93	(141)
Share-based payment awards under equity compensation plan	302	273
Depreciation	77	81
Changes in operating assets and liabilities which provided (used) cash		
Other assets	80	108
Accrued interest and other liabilities	(1,219)	(1,692)
Net cash provided by (used in) operating activities	2,599	1,379
Investing activities		
Maturities, calls, principal payments, and sales of AFS securities	249	—
Purchases of premises and equipment	(26)	(69)
Net cash provided by (used in) investing activities	223	(69)
Financing activities		
Cash dividends paid on common stock	(3,920)	(3,744)
Proceeds from the issuance of common stock	3,764	2,489
Common stock repurchased	(2,622)	(1,462)
Common stock purchased for deferred compensation obligations	(197)	(164)
Net cash provided by (used in) financing activities	(2,975)	(2,881)
Increase (decrease) in cash and cash equivalents	(153)	(1,571)
Cash and cash equivalents at beginning of period	1,297	4,125
Cash and cash equivalents at end of period	\$1,144	\$2,554

Note 14 – Operating Segments

Our reportable segments are based on legal entities that account for at least 10% of net operating results. The operations of the Bank as of June 30, 2017 and 2016 and each of the three and six month periods then ended, represent approximately 90% or more of our consolidated total assets and operating results. As such, no additional segment reporting is presented.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

ISABELLA BANK CORPORATION FINANCIAL REVIEW

(Dollars in thousands except per share amounts)

This section reviews our financial condition and results of our operations for the unaudited three and six month periods ended June 30, 2017 and 2016. This analysis should be read in conjunction with our 2016 Annual Report on Form 10-K and with the unaudited interim condensed consolidated financial statements and notes, beginning on page 4 of this report.

Executive Summary

During the three and six months ended June 30, 2017, we reported net income of \$3,844 and \$6,980 and earnings per common share of \$0.49 and \$0.89, respectively. Net income and earnings per common share for the same periods of 2016 were \$3,407 and \$6,424 and \$0.44 and \$0.82, respectively. The increase in earnings was primarily driven by interest income which increased \$2,060 for the first six months of 2017 in comparison to the same period in 2016. Increased interest income is the result of strong loan growth during the past year.

During the six month period ended June 30, 2017, total assets grew by 2.61% to \$1,777,298, and assets under management increased to \$2,501,187 which includes loans sold and serviced, and assets managed by our Investment and Trust Services Department of \$723,889. Total loans increased by \$37,882 from December 31, 2016 which was largely driven by growth of \$24,920 in the commercial loan portfolio. The growth in the loan portfolio was funded by an increase of \$15,112 in deposits since December 31, 2016, with the remainder being funded through additional borrowed funds.

Our net yield on interest earning assets remains historically low at 3.01% for the six month period ended June 30, 2017. The growth in net interest income will increase only through continued growth in a strategic mix of loans, investments, and other income earning assets. We do not anticipate that the Federal Reserve Bank will increase short term interest rates significantly in the remainder of 2017; therefore, we anticipate marginal improvements in our net yield on interest earning assets in the short term. We are committed to increasing earnings and shareholder value through growth in our loan portfolio, investment and trust services, and in deposits while managing operating costs. Reclassifications: Certain amounts reported in the 2016 consolidated financial statements have been reclassified to conform with the 2017 presentation.

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Results of Operations

The following table outlines our results of operations and provides certain performance measures as of, and for the three month periods ended:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016	
INCOME STATEMENT DATA						
Interest income	\$ 14,498	\$ 13,861	\$ 13,760	\$ 13,607	\$ 13,218	
Interest expense	3,028	2,831	2,826	2,747	2,678	
Net interest income	11,470	11,030	10,934	10,860	10,540	
Provision for loan losses	9	27	(320)	17	12	
Noninterest income	2,788	2,616	3,187	2,946	2,752	
Noninterest expenses	9,507	9,951	10,166	9,433	9,218	
Federal income tax expense	898	532	493	763	655	
Net Income	\$ 3,844	\$ 3,136	\$ 3,782	\$ 3,593	\$ 3,407	
PER SHARE						
Basic earnings	\$ 0.49	\$ 0.40	\$ 0.48	\$ 0.46	\$ 0.44	
Diluted earnings	\$ 0.48	\$ 0.39	\$ 0.47	\$ 0.45	\$ 0.43	
Dividends	\$ 0.25	\$ 0.25	\$ 0.25	\$ 0.25	\$ 0.24	
Tangible book value*	\$ 18.62	\$ 18.34	\$ 18.16	\$ 17.93	\$ 17.72	
Quoted market value						
High	\$ 28.45	\$ 29.00	\$ 28.35	\$ 28.08	\$ 28.25	
Low	\$ 27.60	\$ 27.60	\$ 27.60	\$ 27.60	\$ 27.63	
Close*	\$ 28.00	\$ 27.60	\$ 27.85	\$ 27.70	\$ 27.90	
Common shares outstanding*	7,862,553	7,843,120	7,821,069	7,833,481	7,836,442	
PERFORMANCE RATIOS						
Return on average total assets	0.87	% 0.72	% 0.88	% 0.85	% 0.81	%
Return on average shareholders' equity	7.85	% 6.56	% 7.77	% 7.27	% 7.05	%
Return on average tangible shareholders' equity	10.59	% 8.77	% 10.70	% 10.28	% 9.89	%
Net interest margin yield (FTE)	3.03	% 2.99	% 3.01	% 3.05	% 2.97	%
BALANCE SHEET DATA*						
Gross loans	\$ 1,048,497	\$ 1,012,920	\$ 1,010,615	\$ 989,366	\$ 919,594	
AFS securities	\$ 567,862	\$ 590,114	\$ 558,096	\$ 564,229	\$ 602,463	
Total assets	\$ 1,777,298	\$ 1,760,860	\$ 1,732,151	\$ 1,706,498	\$ 1,680,359	
Deposits	\$ 1,210,152	\$ 1,231,061	\$ 1,195,040	\$ 1,175,833	\$ 1,156,870	
Borrowed funds	\$ 360,940	\$ 327,375	\$ 337,694	\$ 325,409	\$ 318,596	
Shareholders' equity	\$ 195,070	\$ 190,976	\$ 187,899	\$ 195,184	\$ 195,133	
Gross loans to deposits	86.64	% 82.28	% 84.57	% 84.14	% 79.49	%
ASSETS UNDER MANAGEMENT*						
Loans sold with servicing retained	\$ 269,595	\$ 270,217	\$ 272,882	\$ 275,037	\$ 275,958	
Assets managed by our Investment and Trust Services Department	\$ 454,294	\$ 444,749	\$ 427,693	\$ 424,573	\$ 415,762	
Total assets under management	\$ 2,501,187	\$ 2,475,826	\$ 2,432,726	\$ 2,406,108	\$ 2,372,079	
ASSET QUALITY*						
Nonperforming loans to gross loans	0.26	% 0.24	% 0.17	% 0.16	% 0.13	%
Nonperforming assets to total assets	0.17	% 0.15	% 0.11	% 0.11	% 0.09	%
ALLL to gross loans	0.72	% 0.74	% 0.73	% 0.79	% 0.83	%
CAPITAL RATIOS*						

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Shareholders' equity to assets	10.98	% 10.85	% 10.85	% 11.44	% 11.61	%
Tier 1 leverage	8.50	% 8.54	% 8.56	% 8.59	% 8.50	%
Common equity tier 1 capital	12.43	% 12.49	% 12.39	% 12.41	% 13.08	%
Tier 1 risk-based capital	12.43	% 12.49	% 12.39	% 12.41	% 13.08	%
Total risk-based capital	13.07	% 13.14	% 13.04	% 13.10	% 13.80	%
* At end of period						

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The following table outlines our results of operations and provides certain performance measures as of, and for the six month periods ended:

	June 30 2017	June 30 2016	June 30 2015	June 30 2014	June 30 2013	
INCOME STATEMENT DATA						
Interest income	\$28,359	\$26,299	\$25,512	\$25,318	\$25,054	
Interest expense	5,859	5,292	5,006	4,968	5,602	
Net interest income	22,500	21,007	20,506	20,350	19,452	
Provision for loan losses	36	168	(1,261)	(442)	515	
Noninterest income	5,404	4,975	4,757	4,683	5,183	
Noninterest expenses	19,458	18,298	17,005	17,349	16,601	
Federal income tax expense	1,430	1,092	1,748	1,252	1,219	
Net Income	\$6,980	\$6,424	\$7,771	\$6,874	\$6,300	
PER SHARE						
Basic earnings	\$0.89	\$0.82	\$1.00	\$0.89	\$0.82	
Diluted earnings	\$0.87	\$0.80	\$0.98	\$0.87	\$0.80	
Dividends	\$0.50	\$0.48	\$0.46	\$0.44	\$0.42	
Tangible book value*	\$18.62	\$17.72	\$17.17	\$16.08	\$15.19	
Quoted market value						
High	\$29.00	\$29.90	\$23.80	\$23.94	\$26.00	
Low	\$27.60	\$27.25	\$22.00	\$22.52	\$21.60	
Close*	\$28.00	\$27.90	\$23.75	\$22.95	\$24.75	
Common shares outstanding*	7,862,553	7,836,442	7,797,188	7,735,156	7,703,589	
PERFORMANCE RATIOS						
Return on average total assets	0.80	% 0.77	% 1.00	% 0.91	% 0.88	%
Return on average shareholders' equity	7.21	% 6.71	% 8.69	% 8.24	% 7.63	%
Return on average tangible shareholders' equity	9.67	% 9.37	% 11.71	% 11.17	% 10.98	%
Net interest margin yield (FTE)	3.01	% 2.97	% 3.15	% 3.21	% 3.22	%
BALANCE SHEET DATA*						
Gross loans	\$1,048,497	\$919,594	\$831,831	\$819,253	\$805,733	
AFS securities	\$567,862	\$602,463	\$595,318	\$550,518	\$499,424	
Total assets	\$1,777,298	\$1,680,359	\$1,586,975	\$1,522,135	\$1,451,415	
Deposits	\$1,210,152	\$1,156,870	\$1,090,469	\$1,060,928	\$1,021,424	
Borrowed funds	\$360,940	\$318,596	\$307,599	\$279,457	\$262,460	
Shareholders' equity	\$195,070	\$195,133	\$178,025	\$171,099	\$159,288	
Gross loans to deposits	86.64	% 79.49	% 76.28	% 77.22	% 78.88	%
ASSETS UNDER MANAGEMENT*						
Loans sold with servicing retained	\$269,595	\$275,958	\$289,089	\$290,590	\$295,047	
Assets managed by our Investment and Trust Services Department	\$454,294	\$415,762	\$400,827	\$374,092	\$336,132	
Total assets under management	\$2,501,187	\$2,372,079	\$2,276,891	\$2,186,817	\$2,082,594	
ASSET QUALITY*						
Nonperforming loans to gross loans	0.26	% 0.13	% 0.19	% 0.57	% 0.52	%
Nonperforming assets to total assets	0.17	% 0.09	% 0.15	% 0.38	% 0.36	%
ALLL to gross loans	0.72	% 0.83	% 1.08	% 1.31	% 1.45	%
CAPITAL RATIOS*						
Shareholders' equity to assets	10.98	% 11.61	% 11.22	% 11.24	% 10.97	%
Tier 1 leverage	8.50	% 8.50	% 8.77	% 8.50	% 8.38	%

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Common equity tier 1 capital	12.43	% 13.08	% 13.94	% N/A	N/A	
Tier 1 risk-based capital	12.43	% 13.08	% 13.94	% 13.86	% 13.60	%
Total risk-based capital	13.07	% 13.80	% 14.88	% 15.11	% 14.85	%

* At end of period

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Average Balances, Interest Rate, and Net Interest Income

The following schedules present the daily average amount outstanding for each major category of interest earning assets, non-earning assets, interest bearing liabilities, and noninterest bearing liabilities. These schedules also present an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a FTE basis using a 34% federal income tax rate. Loans in nonaccrual status, for the purpose of the following computations, are included in the average loan balances. FRB and FHLB restricted equity holdings are included in accrued income and other assets.

	Three Months Ended								
	June 30, 2017			March 31, 2017			June 30, 2016		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS									
Loans	\$1,028,875	\$ 10,685	4.15 %	\$997,443	\$ 10,120	4.06 %	\$893,282	\$ 9,316	4.17 %
Taxable investment securities	374,156	2,226	2.38 %	364,251	2,151	2.36 %	419,252	2,303	2.20 %
Nontaxable investment securities	206,668	2,314	4.48 %	205,372	2,316	4.51 %	208,425	2,356	4.52 %
Fed Funds Sold	95	—	— %	2,397	4	0.67 %	—	—	— %
Other	23,299	174	2.99 %	26,929	171	2.54 %	23,564	157	2.67 %
Total earning assets	1,633,093	15,399	3.77 %	1,596,392	14,762	3.70 %	1,544,523	14,132	3.66 %
NONEARNING ASSETS									
Allowance for loan losses	(7,554)			(7,480)			(7,557)		
Cash and demand deposits due from banks	18,425			18,736			17,942		
Premises and equipment	28,895			29,238			28,363		
Accrued income and other assets	99,468			97,692			101,341		
Total assets	\$1,772,327			\$1,734,578			\$1,684,612		
INTEREST BEARING LIABILITIES									
Interest bearing demand deposits	\$209,638	\$ 55	0.10 %	\$213,617	\$ 53	0.10 %	\$204,044	\$ 40	0.08 %
Savings deposits	360,870	259	0.29 %	354,006	222	0.25 %	340,251	144	0.17 %
Time deposits	436,716	1,301	1.19 %	436,003	1,265	1.16 %	427,753	1,234	1.15 %
Borrowed funds	356,096	1,413	1.59 %	328,368	1,291	1.57 %	320,337	1,260	1.57 %
Total interest bearing liabilities	1,363,320	3,028	0.89 %	1,331,994	2,831	0.85 %	1,292,385	2,678	0.83 %
NONINTEREST BEARING LIABILITIES									
Demand deposits	202,597			200,598			189,520		
Other	10,579			10,841			9,360		

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Shareholders' equity	195,831	191,145	193,347
Total liabilities and shareholders' equity	\$1,772,327	\$1,734,578	\$1,684,612
Net interest income (FTE)	\$ 12,371	\$ 11,931	\$ 11,454
Net yield on interest earning assets (FTE)	3.03 %	2.99 %	2.97 %

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	Six Months Ended					
	June 30, 2017			June 30, 2016		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS						
Loans	\$ 1,013,248	\$ 20,805	4.11 %	\$ 875,533	\$ 18,355	4.19 %
Taxable investment securities	369,231	4,377	2.37 %	425,999	4,703	2.21 %
Nontaxable investment securities	206,023	4,627	4.49 %	210,060	4,779	4.55 %
Fed Funds Sold	1,240	4	0.65 %	—	—	— %
Other	25,128	345	2.75 %	25,246	315	2.50 %
Total earning assets	1,614,870	30,158	3.74 %	1,536,838	28,152	3.66 %
NONEARNING ASSETS						
Allowance for loan losses	(7,517)			(7,498)		
Cash and demand deposits due from banks	18,551			17,857		
Premises and equipment	29,068			28,308		
Accrued income and other assets	98,588			101,039		
Total assets	\$ 1,753,560			\$ 1,676,544		
INTEREST BEARING LIABILITIES						
Interest bearing demand deposits	\$ 211,616	\$ 108	0.10 %	\$ 206,177	\$ 82	0.08 %
Savings deposits	357,456	481	0.27 %	341,396	288	0.17 %
Time deposits	436,362	2,566	1.18 %	424,333	2,447	1.15 %
Borrowed funds	342,307	2,704	1.58 %	315,488	2,475	1.57 %
Total interest bearing liabilities	1,347,741	5,859	0.87 %	1,287,394	5,292	0.82 %
NONINTEREST BEARING LIABILITIES						
Demand deposits	201,613			188,242		
Other	10,707			9,501		
Shareholders' equity	193,499			191,407		
Total liabilities and shareholders' equity	\$ 1,753,560			\$ 1,676,544		
Net interest income (FTE)		\$ 24,299			\$ 22,860	
Net yield on interest earning assets (FTE)			3.01 %			2.97 %

Net Interest Income

Net interest income is the amount by which interest income on earning assets exceeds the interest expenses on interest bearing liabilities. Net interest income, which includes loan fees, is influenced by changes in the balance and mix of assets and liabilities and market interest rates. We exert some control over these factors; however, FRB monetary policy and competition have a significant impact. For analytical purposes, net interest income is adjusted to an FTE basis by adding the income tax savings from interest on tax exempt loans, and nontaxable investment securities, thus making year to year comparisons more meaningful.

Volume and Rate Variance Analysis

The following table sets forth the effect of volume and rate changes on interest income and expense for the periods indicated. For the purpose of this table, changes in interest due to volume and rate were determined as follows:

Volume—change in volume multiplied by the previous period's rate.

Rate—change in the FTE rate multiplied by the previous period's volume.

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The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	Three Months Ended June 30, 2017 Compared to March 31, 2017 Increase (Decrease) Due to			Three Months Ended June 30, 2017 Compared to June 30, 2016 Increase (Decrease) Due to			Six Months Ended June 30, 2017 Compared to June 30, 2016 Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net	Volume	Rate	Net
Changes in interest income									
Loans	\$323	\$242	\$565	\$1,408	\$(39)	\$1,369	\$2,835	\$(385)	\$2,450
Taxable investment securities	59	16	75	(259)	182	(77)	(656)	330	(326)
Nontaxable investment securities	15	(17)	(2)	(20)	(22)	(42)	(91)	(61)	(152)
Fed Funds Sold	—	(4)	(4)	—	—	—	4	—	4
Other	(25)	28	3	(2)	19	17	(1)	31	30
Total changes in interest income	372	265	637	1,127	140	1,267	2,091	(85)	2,006
Changes in interest expense									
Interest bearing demand deposits	(1)	3	2	1	14	15	2	24	26
Savings deposits	4	33	37	9	106	115	14	179	193
Time deposits	2	34	36	26	41	67	70	49	119
Borrowed funds	110	12	122	142	11	153	212	17	229
Total changes in interest expense	115	82	197	178	172	350	298	269	567
Net change in interest margin (FTE)	\$257	\$183	\$440	\$949	\$(32)	\$917	\$1,793	\$(354)	\$1,439

Our net yield on interest earning assets remains at historically low levels. The persistent low interest rate environment coupled with a high concentration of AFS securities as a percentage of earning assets has also placed downward pressure on net interest margin. While we do not anticipate significant improvement in our net yield on interest earning assets, we do expect marginal improvement as a result of loan growth throughout 2017.

Average Yield / Rate for the Three Month Periods Ended:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Total earning assets	3.77%	3.70%	3.73%	3.76%	3.66%
Total interest bearing liabilities	0.89%	0.85%	0.87%	0.86%	0.83%
Net yield on interest earning assets (FTE)	3.03%	2.99%	3.01%	3.05%	2.97%

Quarter to Date Net Interest Income (FTE)

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Total interest income (FTE)	\$15,399	\$14,762	\$14,642	\$14,508	\$14,132
Total interest expense	3,028	2,831	2,826	2,747	2,678
Net interest income (FTE)	\$12,371	\$11,931	\$11,816	\$11,761	\$11,454

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Allowance for Loan and Lease Losses

The viability of any financial institution is ultimately determined by its management of credit risk. Loans represent our single largest concentration of risk. The ALLL is our estimation of incurred losses within the existing loan portfolio. We allocate the ALLL throughout the loan portfolio based on our assessment of the underlying risks associated with each loan segment. Our assessments include allocations based on specific impairment valuation allowances, historical charge-offs, internally assigned credit risk ratings, and past due and nonaccrual balances. A portion of the ALLL is not allocated to any one loan segment, but is instead a reflection of other qualitative risks that reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The following table summarizes our charge-offs, recoveries, provisions for loan losses, and ALLL balances as of, and for the:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
ALLL at beginning of period	\$7,500	\$7,500	\$7,400	\$7,400
Charge-offs				
Commercial and agricultural	25	32	52	48
Residential real estate	—	128	43	369
Consumer	44	48	118	132
Total charge-offs	69	208	213	549
Recoveries				
Commercial and agricultural	55	189	188	370
Residential real estate	63	45	99	95
Consumer	42	62	90	116
Total recoveries	160	296	377	581
Net loan charge-offs (recoveries)	(91)	(88)	(164)	(32)
Provision for loan losses	9	12	36	168
ALLL at end of period	\$7,600	\$7,600	\$7,600	\$7,600
Net loan charge-offs (recoveries) to average loans outstanding	(0.01)%	(0.01)%	(0.02)%	— %

The following table summarizes our charge-offs, recoveries, provisions for loan losses, and ALLL balances as of, and for the three month periods ended:

	June 30	March 31	December 31	September 30	June 30
	2017	2017	2016	2016	2016
Total charge-offs	\$69	\$144	\$ 236	\$ 131	\$208
Total recoveries	160	217	156	314	296
Net loan charge-offs (recoveries)	(91)	(73)	80	(183)	(88)
Net loan charge-offs (recoveries) to average loans outstanding	(0.01)%	(0.01)%	0.01 %	(0.02)%	(0.01)%
Provision for loan losses	\$9	\$27	\$ (320)	\$ 17	\$12
Provision for loan losses to average loans outstanding	— %	— %	(0.03)%	— %	— %
ALLL	\$7,600	\$7,500	\$ 7,400	\$ 7,800	\$7,600
ALLL as a % of loans at end of period	0.72 %	0.74 %	0.73 %	0.79 %	0.83 %

Net loan recoveries and improvement in credit quality indicators have resulted in a reduction of the required ALLL as a percentage of loans over the past year. During this time, credit quality indicators, specifically historical loss factors, remain strong and have led to lower levels of required reserves. While they can be more volatile, loans individually evaluated for impairment have been steadily declining. The addition of advances to mortgage brokers contributed to the overall decline in the level of ALLL to gross loans as there are no historical losses requiring reserves. While these advances contribute to other qualitative factors, the impact is not significant on the required level of the ALLL.

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The following table illustrates our changes within the two main components of the ALLL as of:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
ALLL					
Individually evaluated for impairment	\$2,455	\$2,381	\$ 2,371	\$ 2,523	\$2,602
Collectively evaluated for impairment	5,145	5,119	5,029	5,277	4,998
Total	\$7,600	\$7,500	\$ 7,400	\$ 7,800	\$7,600
ALLL to gross loans					
Individually evaluated for impairment	0.23 %	0.24 %	0.23 %	0.26 %	0.28 %
Collectively evaluated for impairment	0.49 %	0.50 %	0.50 %	0.53 %	0.55 %
Total	0.72 %	0.74 %	0.73 %	0.79 %	0.83 %

For further discussion of the allocation of the ALLL, see “Note 5 – Loans and ALLL” of our interim condensed consolidated financial statements.

Loans Past Due and Loans in Nonaccrual Status

Fluctuations in past due and nonaccrual status loans can have a significant impact on the ALLL. To determine the potential impact, and corresponding estimated losses, we analyze our historical loss trends on loans past due greater than 30 days and nonaccrual status loans. We monitor all loans that are past due and in nonaccrual status for indications of additional deterioration.

	Total Past Due and Nonaccrual Loans				
	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Commercial and agricultural	\$4,920	\$5,758	\$ 4,598	\$ 3,148	\$2,247
Residential real estate	2,358	3,168	2,716	2,436	2,755
Consumer	64	35	115	51	23
Total	\$7,342	\$8,961	\$ 7,429	\$ 5,635	\$5,025
Total past due and nonaccrual loans to gross loans	0.70 %	0.88 %	0.74 %	0.57 %	0.55 %

While past due and nonaccrual status loans have increased over the last year, they continue to be below historical norms and are the result of strong loan performance. A summary of loans past due and in nonaccrual status, including the composition of the ending balance of nonaccrual status loans by type, is included in “Note 5 – Loans and ALLL” of our interim condensed consolidated financial statements.

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Troubled Debt Restructurings

We have taken a proactive approach to avoid foreclosures on borrowers who are willing to work with us in modifying their loans, thus making them more affordable. While this approach has permitted certain borrowers to develop a payment structure that will allow them to continue making payments in lieu of foreclosure, it has contributed to a significant level of loans classified as TDR. The modifications have been successful for us and our customers as very few of the modified loans have resulted in foreclosures. At the time of the TDR, the loan is reviewed to determine whether or not to classify the loan as accrual or nonaccrual status. The majority of new modifications result in terms that satisfy our criteria for continued interest accrual. TDRs that have been placed on nonaccrual status may be placed back on accrual status after six months of continued performance.

We restructure debt with borrowers who, due to financial difficulties, are unable to service their debt under the original terms. We may extend the amortization period, reduce interest rates, forgive principal, forgive interest, or a combination of these modifications. Typically, the modifications are for a period of five years or less. There were no TDRs that were government sponsored as of June 30, 2017 or December 31, 2016.

Losses associated with TDRs, if any, are included in the estimation of the ALLL in the quarter in which a loan is identified as a TDR, and we review the analysis of the ALLL estimation each reporting period to ensure its continued appropriateness.

The following tables provide a roll-forward of TDRs for the:

	Three Months Ended June 30, 2017					
	Accruing Interest		Nonaccrual		Total	
	Number	Balance	Number	Balance	Number	Balance
	of Loans	of Loans	of Loans	of Loans	of Loans	of Loans
April 1, 2017	150	\$20,251	6	\$800	156	\$21,051
New modifications	10	5,320	1	466	11	5,786
Principal advances (payments)	—	(113)	—	(16)	—	(129)
Loans paid-off	(5)	(276)	—	—	(5)	(276)
Partial charge-offs	—	—	—	—	—	—
Balances charged-off	—	—	—	—	—	—
Transfers to OREO	—	—	(2)	(91)	(2)	(91)
Transfers to accrual status	—	—	—	—	—	—
Transfers to nonaccrual status	—	—	—	—	—	—
June 30, 2017	155	\$25,182	5	\$1,159	160	\$26,341
	Six Months Ended June 30, 2017					
	Accruing Interest		Nonaccrual		Total	
	Number	Balance	Number	Balance	Number	Balance
	of Loans	of Loans	of Loans	of Loans	of Loans	of Loans
January 1, 2017	153	\$20,593	5	\$789	158	\$21,382
New modifications	13	5,555	1	466	14	6,021
Principal advances (payments)	—	(422)	—	(22)	—	(444)
Loans paid-off	(10)	(527)	—	—	(10)	(527)
Partial charge-offs	—	—	—	—	—	—
Balances charged-off	—	—	—	—	—	—
Transfers to OREO	—	—	(2)	(91)	(2)	(91)
Transfers to accrual status	1	75	(1)	(75)	—	—
Transfers to nonaccrual status	(2)	(92)	2	92	—	—
June 30, 2017	155	\$25,182	5	\$1,159	160	\$26,341

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	Three Months Ended June 30, 2016					
	Accruing Interest		Nonaccrual		Total	
	Number	of Balance	Number	of Balance	Number	of Balance
	Loans	Loans	Loans	Loans	Loans	Loans
April 1, 2016	151	\$ 19,411	6	\$ 577	157	\$ 19,988
New modifications	3	201	—	—	3	201
Principal advances (payments)	—	(350)	—	(9)	—	(359)
Loans paid-off	(2)	(98)	(1)	(221)	(3)	(319)
Partial charge-offs	—	—	—	(81)	—	(81)
Balances charged-off	—	—	—	—	—	—
Transfers to OREO	—	—	—	—	—	—
Transfers to accrual status	—	—	—	—	—	—
Transfers to nonaccrual status	(1)	(321)	1	321	—	—
June 30, 2016	151	\$ 18,843	6	\$ 587	157	\$ 19,430
	Six Months Ended June 30, 2016					
	Accruing Interest		Nonaccrual		Total	
	Number	of Balance	Number	of Balance	Number	of Balance
	Loans	Loans	Loans	Loans	Loans	Loans
January 1, 2016	155	\$ 20,931	5	\$ 394	160	\$ 21,325
New modifications	6	229	—	—	6	229
Principal advances (payments)	—	(627)	—	(17)	—	(644)
Loans paid-off	(6)	(1,076)	(1)	(221)	(7)	(1,297)
Partial charge-offs	—	—	—	(133)	—	(133)
Balances charged-off	(1)	(15)	—	—	(1)	(15)
Transfers to OREO	—	—	(1)	(35)	(1)	(35)
Transfers to accrual status	—	—	—	—	—	—
Transfers to nonaccrual status	(3)	(599)	3	599	—	—
June 30, 2016	151	\$ 18,843	6	\$ 587	157	\$ 19,430

The following table summarizes our TDRs as of:

	June 30, 2017			December 31, 2016			
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total	Total Change
Current	\$ 23,328	\$ 295	\$ 23,623	\$ 17,557	\$ 559	\$ 18,116	\$ 5,507
Past due 30-59 days	1,631	466	2,097	2,898	230	3,128	(1,031)
Past due 60-89 days	—	—	—	138	—	138	(138)
Past due 90 days or more	223	398	621	—	—	—	621
Total	\$ 25,182	\$ 1,159	\$ 26,341	\$ 20,593	\$ 789	\$ 21,382	\$ 4,959

Additional disclosures about TDRs are included in “Note 5 – Loans and ALLL” of our interim condensed consolidated financial statements.

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Impaired Loans

The following is a summary of information pertaining to impaired loans as of:

	June 30, 2017			December 31, 2016		
	Recorded Balance	Unpaid Principal Balance	Valuation Allowance	Recorded Balance	Unpaid Principal Balance	Valuation Allowance
TDRs						
Commercial real estate	\$6,008	\$6,129	\$ 733	\$6,264	\$6,383	\$ 713
Commercial other	1,195	1,195	50	1,444	1,455	25
Agricultural real estate	7,826	7,826	—	4,037	4,037	—
Agricultural other	3,171	3,171	—	1,380	1,380	1
Residential real estate senior liens	7,956	8,333	1,563	8,058	8,437	1,539
Residential real estate junior liens	76	76	15	71	71	13
Home equity lines of credit	89	389	—	102	402	—
Consumer secured	20	20	—	26	26	—
Total TDRs	26,341	27,139	2,361	21,382	22,191	2,291
Other impaired loans						
Commercial real estate	159	245	—	151	226	3
Commercial other	—	—	—	—	—	—
Agricultural real estate	—	—	—	—	—	—
Agricultural other	128	128	—	128	128	—
Residential real estate senior liens	437	644	86	406	612	76
Residential real estate junior liens	—	—	—	1	11	1
Home equity lines of credit	70	70	8	—	—	—
Consumer secured	—	—	—	—	—	—
Total other impaired loans	794	1,087	94	686	977	80
Total impaired loans	\$27,135	\$28,226	\$ 2,455	\$22,068	\$23,168	\$ 2,371

Additional disclosure related to impaired loans is included in “Note 5 – Loans and ALLL” of our interim condensed consolidated financial statements.

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Nonperforming Assets

The following table summarizes our nonperforming assets as of:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Nonaccrual status loans	\$1,563	\$1,138	\$ 1,060	\$ 690	\$974
Accruing loans past due 90 days or more	1,203	1,339	633	847	208
Total nonperforming loans	2,766	2,477	1,693	1,537	1,182
Foreclosed assets	229	158	231	284	249
Total nonperforming assets	\$2,995	\$2,635	\$ 1,924	\$ 1,821	\$1,431
Nonperforming loans as a % of total loans	0.26 %	0.24 %	0.17 %	0.16 %	0.13 %
Nonperforming assets as a % of total assets	0.17 %	0.15 %	0.11 %	0.11 %	0.09 %

Typically after a loan is 90 days past due, it is placed on nonaccrual status unless it is well secured and in the process of collection. Upon transferring the loans to nonaccrual status, we perform an evaluation to determine the net realizable value of the underlying collateral. This evaluation is used to help determine if any charge-offs are necessary. Loans may be placed back on accrual status after six months of continued performance. While nonperforming loans have increased in recent periods, current levels of nonperforming loans continue to reflect historically low levels.

Included in the nonaccrual loan balances above were loans currently classified as TDR as of:

	June 30 2017	December 31 2016
Commercial and agricultural	\$864	\$ 405
Residential real estate	295	384
Total	\$1,159	\$ 789

Additional disclosures about nonaccrual status loans are included in “Note 5 – Loans and ALLL” of our interim condensed consolidated financial statements.

We continue to devote considerable attention to identifying impaired loans and adjusting the net carrying value of these loans to their current net realizable values through the establishment of a specific reserve or the recording of a charge-off. We believe that we have identified all impaired loans as of June 30, 2017.

We believe that the level of the ALLL is appropriate as of June 30, 2017. We will continue to closely monitor overall credit quality indicators and our policies and procedures related to the analysis of the ALLL to ensure that the ALLL remains at the appropriate level.

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Noninterest Income and Noninterest Expenses

Significant noninterest account balances are highlighted in the following table with additional descriptions of significant fluctuations:

	Three Months Ended June 30			
	2017	2016	Change	
			\$	%
Service charges and fees				
ATM and debit card fees	\$675	\$637	\$38	5.97 %
NSF and overdraft fees	461	462	(1)	(0.22)%
Freddie Mac servicing fee	170	174	(4)	(2.30)%
Net OMSR income (loss)	(17)	(227)	210	N/M
Service charges on deposit accounts	86	86	—	— %
All other	30	31	(1)	(3.23)%
Total service charges and fees	1,405	1,163	242	20.81 %
Net gain on sale of mortgage loans	199	127	72	56.69 %
Earnings on corporate owned life insurance policies	183	195	(12)	(6.15)%
Net gains (losses) on sale of AFS securities	142	245	(103)	(42.04)%
Other				
Trust and brokerage advisory fees	666	609	57	9.36 %
Corporate Settlement Solutions joint venture	105	224	(119)	(53.13)%
Other	88	189	(101)	(53.44)%
Total other	859	1,022	(163)	(15.95)%
Total noninterest income	\$2,788	\$2,752	\$36	1.31 %
	Six Months Ended June 30			
	2017	2016	Change	
			\$	%
Service charges and fees				
ATM and debit card fees	\$1,278	\$1,234	\$44	3.57 %
NSF and overdraft fees	902	880	22	2.50 %
Freddie Mac servicing fee	339	357	(18)	(5.04)%
Net OMSR income (loss)	184	(329)	513	N/M
Service charges on deposit accounts	171	171	—	— %
All other	61	63	(2)	(3.17)%
Total service charges and fees	2,935	2,376	559	23.53 %
Net gain on sale of mortgage loans	354	209	145	69.38 %
Earnings on corporate owned life insurance policies	363	383	(20)	(5.22)%
Net gains (losses) on sale of AFS securities	142	245	(103)	(42.04)%
Other				
Trust and brokerage advisory fees	1,237	1,135	102	8.99 %
Corporate Settlement Solutions joint venture	87	217	(130)	(59.91)%
Other	286	410	(124)	(30.24)%
Total other	1,610	1,762	(152)	(8.63)%
Total noninterest income	\$5,404	\$4,975	\$429	8.62 %

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Significant changes in noninterest income are detailed below:

Offering rates on residential mortgage loans and prepayment speeds have been the most significant drivers behind fluctuations in net OMSR income (loss). We anticipate increases in mortgage rates and decreased prepayment speeds; therefore, we anticipate net OMSR income to remain positive during the remainder of 2017.

We anticipate increases in our originations in purchase money mortgage activity as a result of our various initiatives to drive growth. As a result, we expect net gains on the sale of mortgage loans to increase during the remainder of 2017.

We continue to invest considerable efforts to increase our market share in trust and brokerage advisory services.

These efforts have translated into increases in such fees. We anticipate that these fees will continue to increase during the remainder of 2017.

Corporate Settlement Solutions income is down in the second quarter of 2017 due to the sales cycle on a couple of substantial new customers taking longer than anticipated. It is anticipated that income will increase during the remainder of 2017.

The fluctuations in all other income is spread throughout various categories, none of which are individually significant.

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Significant noninterest expense account balances are highlighted in the following table with additional descriptions of significant fluctuations:

	Three Months Ended June 30			
	2017	2016	Change	
			\$	%
Compensation and benefits				
Employee salaries	\$3,961	\$3,381	\$580	17.15 %
Employee benefits	872	1,303	(431)	(33.08)%
Total compensation and benefits	4,833	4,684	149	3.18 %
Furniture and equipment				
Service contracts	784	774	10	1.29 %
Depreciation	508	517	(9)	(1.74)%
All other	60	49	11	22.45 %
Total furniture and equipment	1,352	1,340	12	0.90 %
Occupancy				
Depreciation	210	194	16	8.25 %
Outside services	200	191	9	4.71 %
Property taxes	146	143	3	2.10 %
Utilities	115	120	(5)	(4.17)%
All other	144	140	4	2.86 %
Total occupancy	815	788	27	3.43 %
Other				
ATM and debit card fees	404	228	176	77.19 %
Audit and related fees	237	186	51	27.42 %
Director fees	213	214	(1)	(0.47)%
Consulting fees	208	196	12	6.12 %
Loan underwriting fees	192	127	65	51.18 %
FDIC insurance premiums	155	217	(62)	(28.57)%
Donations and community relations	168	146	22	15.07 %
Postage and freight	110	91	19	20.88 %
Printing and supplies	103	129	(26)	(20.16)%
Marketing costs	100	103	(3)	(2.91)%
Education and travel	93	125	(32)	(25.60)%
All other	524	644	(120)	(18.63)%
Total other	2,507	2,406	101	4.20 %
Total noninterest expenses	\$9,507	\$9,218	\$289	3.14 %

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	Six Months Ended June 30			
	2017	2016	Change	
			\$	%
Compensation and benefits				
Employee salaries	\$8,122	\$6,777	\$1,345	19.85 %
Employee benefits	2,387	2,695	(308)	(11.43)%
Total compensation and benefits	10,509	9,472	1,037	10.95 %
Furniture and equipment				
Service contracts	1,572	1,498	74	4.94 %
Depreciation	1,020	1,050	(30)	(2.86)%
All other	104	87	17	19.54 %
Total furniture and equipment	2,696	2,635	61	2.31 %
Occupancy				
Depreciation	420	388	32	8.25 %
Outside services	399	384	15	3.91 %
Property taxes	292	288	4	1.39 %
Utilities	258	261	(3)	(1.15)%
All other	283	277	6	2.17 %
Total occupancy	1,652	1,598	54	3.38 %
Other				
ATM and debit card fees	620	417	203	48.68 %
Audit and related fees	435	345	90	26.09 %
Director fees	422	423	(1)	(0.24)%
Consulting fees	413	369	44	11.92 %
Loan underwriting fees	309	235	74	31.49 %
FDIC insurance premiums	308	422	(114)	(27.01)%
Donations and community relations	298	265	33	12.45 %
Postage and freight	219	197	22	11.17 %
Printing and supplies	210	220	(10)	(4.55)%
Marketing costs	189	258	(69)	(26.74)%
Education and travel	189	236	(47)	(19.92)%
All other	989	1,206	(217)	(17.99)%
Total other	4,601	4,593	8	0.17 %
Total noninterest expenses	\$19,458	\$18,298	\$1,160	6.34 %

Significant changes in noninterest expenses are detailed below:

Employee salaries have increased in 2017 as a result of new positions required for future growth within our new markets, normal merit increases and increased incentive compensation. As such, we anticipate employee salaries expense to continue to trend higher for the remainder of 2017 compared to the expense levels of 2016.

Employee benefits have declined in 2017 due to a settlement with an insurance claim administrator in favor of Isabella Bank.

ATM and debit card fees increased in the second quarter of 2017 due to an early contract termination fee.

FDIC insurance premiums have declined in 2017 as a result of changes to the premium calculation; therefore, 2017 expenses are expected to be lower than 2016.

Marketing costs fluctuate from period-to-period based on the timing of campaigns. For the remainder of 2017, expenses are expected to slightly exceed 2016 levels as a result of marketing initiatives planned for 2017.

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The fluctuations in all other expenses are spread throughout various categories, none of which are individually significant.

Analysis of Changes in Financial Condition

	June 30 2017	December 31 2016	\$ Change	% Change (unannualized)	
ASSETS					
Cash and cash equivalents	\$21,834	\$ 22,894	\$(1,060)	(4.63)	%
AFS securities					
Amortized cost of AFS securities	563,309	557,648	5,661	1.02	%
Unrealized gains (losses) on AFS securities	4,553	448	4,105	N/M	
AFS securities	567,862	558,096	9,766	1.75	%
Mortgage loans AFS	1,482	1,816	(334)	(18.39)	%
Loans					
Gross loans	1,048,497	1,010,615	37,882	3.75	%
Less allowance for loan and lease losses	7,600	7,400	200	2.70	%
Net loans	1,040,897	1,003,215	37,682	3.76	%
Premises and equipment	28,679	29,314	(635)	(2.17)	%
Corporate owned life insurance policies	26,663	26,300	363	1.38	%
Accrued interest receivable	5,686	6,580	(894)	(13.59)	%
Equity securities without readily determinable fair values	23,401	21,694	1,707	7.87	%
Goodwill and other intangible assets	48,604	48,666	(62)	(0.13)	%
Other assets	12,190	13,576	(1,386)	(10.21)	%
TOTAL ASSETS	\$1,777,298	\$ 1,732,151	\$45,147	2.61	%
LIABILITIES AND SHAREHOLDERS' EQUITY					
Liabilities					
Deposits	\$1,210,152	\$ 1,195,040	\$15,112	1.26	%
Borrowed funds	360,940	337,694	23,246	6.88	%
Accrued interest payable and other liabilities	11,136	11,518	(382)	(3.32)	%
Total liabilities	1,582,228	1,544,252	37,976	2.46	%
Shareholders' equity	195,070	187,899	7,171	3.82	%
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,777,298	\$ 1,732,151	\$45,147	2.61	%

As shown above, total assets have increased \$45,147 since December 31, 2016 which was primarily driven by loan growth of \$37,882. This growth was funded by an increase in deposits and in borrowed funds of \$15,112 and \$23,246 respectively since December 31, 2016. While generating quality loans will continue to be competitive, we expect that loans will continue to grow in 2017.

The following table outlines the changes in loans:

	June 30 2017	December 31 2016	\$ Change	% Change (unannualized)	
Commercial	\$600,584	\$ 575,664	\$24,920	4.33	%
Agricultural	130,954	126,492	4,462	3.53	%
Residential real estate	270,207	266,050	4,157	1.56	%
Consumer	46,752	42,409	4,343	10.24	%
Total	\$1,048,497	\$ 1,010,615	\$37,882	3.75	%

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The following table displays loan balances as of:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Commercial	\$600,584	\$576,822	\$575,664	\$554,847	\$500,374
Agricultural	130,954	126,049	126,492	133,637	126,517
Residential real estate	270,207	267,141	266,050	260,122	255,116
Consumer	46,752	42,908	42,409	40,760	37,587
Total	\$1,048,497	\$1,012,920	\$1,010,615	\$989,366	\$919,594

While competition for commercial and agricultural loans continues to be strong, we experienced growth in these segments of the portfolio during 2016 and anticipate continued growth in 2017. Residential real estate and consumer loans have experienced growth over the last year and are both expected to increase for the remainder of 2017.

The following table outlines the changes in deposits:

	June 30 2017	December 31 2016	\$ Change	% Change (unannualized)
Noninterest bearing demand deposits	\$210,122	\$205,071	\$5,051	2.46 %
Interest bearing demand deposits	212,365	209,325	3,040	1.45 %
Savings deposits	357,756	347,230	10,526	3.03 %
Certificates of deposit	314,482	321,914	(7,432)	(2.31) %
Brokered certificates of deposit	94,948	88,632	6,316	7.13 %
Internet certificates of deposit	20,479	22,868	(2,389)	(10.45) %
Total	\$1,210,152	\$1,195,040	\$15,112	1.26 %

The following table displays deposit balances as of:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Noninterest bearing demand deposits	\$210,122	\$207,448	\$205,071	\$201,804	\$192,194
Interest bearing demand deposits	212,365	216,975	209,325	205,817	197,590
Savings deposits	357,756	365,287	347,230	331,414	331,144
Certificates of deposit	314,482	320,345	321,914	324,910	328,771
Brokered certificates of deposit	94,948	98,442	88,632	87,583	83,677
Internet certificates of deposit	20,479	22,564	22,868	24,305	23,494
Total	\$1,210,152	\$1,231,061	\$1,195,040	\$1,175,833	\$1,156,870

Deposit demand continues to be driven by non-contractual deposits, such as demand and savings deposits, while certificates of deposit and Internet certificates of deposit have gradually declined. Brokered certificates of deposit offer another source of funding and fluctuate from period-to-period based on our funding needs, including changes in assets such as loans and investments.

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The balance of AFS securities fluctuate from period-to-period based on changes in loans and deposits. While loan growth has been strong over the last year, we purchased AFS securities in periods when deposit growth outpaced loan demand. Conversely, we have sold AFS securities in periods when loan demand has outpaced deposit growth. We remain active in investments with our local schools and municipalities. Potential future growth is anticipated in state and political subdivisions AFS securities and purchases of mortgage-backed securities and collateralized mortgage obligations. The following table displays fair values of AFS securities as of:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
Government sponsored enterprises	\$281	\$10,264	\$ 10,259	\$ 344	\$10,371
States and political subdivisions	222,093	222,777	212,919	219,689	226,047
Auction rate money market preferred	3,095	2,977	2,794	3,145	3,119
Preferred stocks	3,665	3,597	3,425	3,588	3,406
Mortgage-backed securities	221,957	229,774	227,256	226,649	240,195
Collateralized mortgage obligations	116,771	120,725	101,443	110,814	119,325
Total	\$567,862	\$590,114	\$ 558,096	\$ 564,229	\$602,463

Borrowed funds include FHLB advances and securities sold under agreements to repurchase. The balance of borrowed funds fluctuates from period-to-period based on our funding needs including changes in loans, investments, and deposits. To provide balance sheet growth, we utilize borrowings and brokered deposits to fund earning assets. The following table displays borrowed funds balances as of:

	June 30 2017	March 31 2017	December 31 2016	September 30 2016	June 30 2016
FHLB advances	\$310,000	\$270,000	\$ 270,000	\$ 250,000	\$265,000
Securities sold under agreements to repurchase without stated maturity dates	49,950	57,375	60,894	54,809	53,596
Federal funds purchased	990	—	6,800	20,600	—
Total	\$360,940	\$327,375	\$ 337,694	\$ 325,409	\$318,596

Capital

Capital consists solely of common stock, retained earnings, and accumulated other comprehensive income (loss). We are authorized to raise capital through dividend reinvestment, employee and director stock purchases, and shareholder stock purchases. Pursuant to these authorizations, we issued 135,516 shares or \$3,764 of common stock during the first six months of 2017, as compared to 88,486 shares or \$2,489 of common stock during the same period in 2016. We also offer the Directors Plan in which participants either directly purchase stock or purchase stock units through deferred fees, in lieu of cash payments. Pursuant to this plan, we increased shareholders' equity by \$302 and \$273 during the six month periods ended June 30, 2017 and 2016, respectively.

We have a publicly announced common stock repurchase plan. Pursuant to this plan, we repurchased 94,032 shares or \$2,622 of common stock during the first six months of 2017 and 51,911 shares or \$1,462 during the first six months of 2016. As of June 30, 2017, we were authorized to repurchase up to an additional 105,875 shares of common stock.

The FRB has established minimum risk based capital guidelines. Pursuant to these guidelines, a framework has been established that assigns risk weights to each category of on and off-balance-sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum standard to determine whether a corporation has adequate capital. On July 2, 2013, the FRB published revised BASEL III Capital standards for banks. The final rules redefine what is included or deducted from equity capital, changes risk weighting for certain on and off-balance sheet assets, increases the minimum required equity capital to be considered well capitalized, and introduces a capital conservation buffer. The rules, which are being gradually phased in between 2015 and 2019, are not expected to have a material impact on the Corporation but will require us to hold more capital than has historically been required.

There are no significant regulatory constraints placed on our capital. The FRB's current recommended minimum primary capital to assets requirement is 6.00%. Our primary capital to adjusted average assets, or tier 1 leverage ratio, was 8.50% as of June 30, 2017.

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Effective January 1, 2015, the minimum standard for primary, or Tier 1 capital, increased from 4.00% to 6.00%. The minimum standard for total capital is 8.00%. Also effective January 1, 2015 was the new common equity tier 1 capital ratio which had a minimum requirement of 4.50%. Beginning on January 1, 2016 the capital conservation buffer went into effect which will further increase the required levels each year through 2019. The following table sets forth the percentages required under the Risk Based Capital guidelines and our ratios as of:

	June 30 2017		December 31 2016	
	Actual	Minimum Required	Actual	Minimum Required
Common equity tier 1 capital	12.430%	5.750 %	12.390%	5.125 %
Tier 1 capital	12.430%	7.250 %	12.390%	6.625 %
Tier 2 capital	0.640 %	2.000 %	0.650 %	2.000 %
Total Capital	13.070%	9.250 %	13.040%	8.625 %

Tier 2 capital, or secondary capital, includes only the ALLL. The percentage for the secondary capital under the required column is the maximum amount allowed from all sources.

The FRB and FDIC also prescribe minimum capital requirements for Isabella Bank. At June 30, 2017, the Bank exceeded these minimum capital requirements.

Contractual Obligations and Loan Commitments

We are party to credit related financial instruments with off-balance-sheet risk. These financial instruments are entered into in the normal course of business to meet the financing needs of our customers. These financial instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of these instruments reflect the extent of involvement we have in a particular class of financial instrument.

The following table summarizes our credit related financial instruments with off-balance-sheet risk as of:

	June 30 2017	December 31 2016
Unfunded commitments under lines of credit	\$ 160,407	\$ 168,840
Commitments to grant loans	36,746	29,339
Commercial and standby letters of credit	1,493	1,223
Total	\$ 198,646	\$ 199,402

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. These commitments may expire without being drawn upon and do not necessarily represent future cash requirements. Advances to mortgage brokers are also included in unfunded commitments under lines of credit. The unfunded commitment amount is the difference between our outstanding balances and the maximum outstanding aggregate amount.

Commitments to grant loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The amount of collateral obtained, if it is deemed necessary, is based on management's credit evaluation of the customer. Commitments to grant loans include residential mortgage loans with the majority being loans committed to be sold to the secondary market.

Commercial and standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements, including commercial paper, bond financing, and similar transactions. These commitments to extend credit and letters of credit generally mature within one year. The credit risk involved in these transactions is essentially the same as that involved in extending loans to customers. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon the extension of credit, is based on a credit evaluation of the borrower. While we consider standby letters of credit to be guarantees, the amount of the liability related to such guarantees on the commitment date is not significant and a liability related to such guarantees is not recorded on the

consolidated balance sheets.

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Our exposure to credit-related loss in the event of nonperformance by the counter parties to the financial instruments for commitments to extend credit and standby letters of credit could be up to the contractual notional amount of those instruments. We use the same credit policies as we do for extending loans to customers. No significant losses are anticipated as a result of these commitments.

Fair Value

We utilize fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. AFS securities, cash flow hedge derivative instruments and certain liabilities are recorded at fair value on a recurring basis. Additionally, from time-to-time, we may be required to record at fair value other assets on a nonrecurring basis, such as mortgage loans AFS, impaired loans, goodwill, foreclosed assets, OMSR, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

For further information regarding fair value measurements see “Note 11 – Fair Value” of our notes to the interim condensed consolidated financial statements.

Liquidity

Liquidity is monitored regularly by our Market Risk Committee, which consists of members of senior management. The committee reviews projected cash flows, key ratios, and liquidity available from both primary and secondary sources.

Our primary sources of liquidity are cash and cash equivalents and unencumbered AFS securities. These categories totaled \$276,489 or 15.56% of assets as of June 30, 2017, compared to \$307,112 or 17.73% as of December 31, 2016. The decrease in primary liquidity is a direct result of our unencumbered AFS securities activity during 2017. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests, and various other commitments including expansion of operations, investment opportunities, and payment of cash dividends. Liquidity varies significantly daily, based on customer activity.

Our primary source of funds is through deposit accounts. We also have the ability to borrow from the FHLB, the FRB, and through various correspondent banks in the form of federal funds purchased and a line of credit. These funding methods typically carry a higher interest rate than traditional market deposit accounts. Some borrowed funds, including FHLB advances, FRB Discount Window advances, and repurchase agreements, require us to pledge assets, typically in the form of AFS securities or loans, as collateral. As of June 30, 2017, we had available lines of credit of \$119,462.

The following table summarizes our sources and uses of cash for the six month period ended June 30:

	2017	2016	\$ Variance
Net cash provided by (used in) operating activities	\$8,687	\$8,833	\$(146)
Net cash provided by (used in) investing activities	(45,130)	(1,658)	(43,472)
Net cash provided by (used in) financing activities	35,383	(1,710)	37,093
Increase (decrease) in cash and cash equivalents	(1,060)	5,465	(6,525)
Cash and cash equivalents January 1	22,894	21,569	1,325
Cash and cash equivalents June 30	\$21,834	\$27,034	\$(5,200)

Market Risk

Our primary market risks are interest rate risk and liquidity risk. We have no significant foreign exchange risk in the management of IRR. Any changes in foreign exchange rates or commodity prices would have an insignificant impact on our interest income and cash flows.

IRR is the exposure of our net interest income to changes in interest rates. IRR results from the difference in the maturity or repricing frequency of a financial institution's interest earning assets and its interest bearing liabilities. IRR is the fundamental method by which financial institutions earn income and create shareholder value. Excessive exposure to IRR could pose a significant risk to our earnings and capital.

The FRB has adopted a policy requiring us to effectively manage the various risks that can have a material impact on our safety and soundness. The risks include credit, interest rate, liquidity, operational, and reputational. We have policies, procedures, and internal controls for measuring and managing these risks. Specifically, our Funds

Management policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long

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term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to our Board.

The primary technique to measure IRR is simulation analysis. Simulation analysis forecasts the effects on the balance sheet structure and net interest income under a variety of scenarios that incorporate changes in interest rates, the shape of yield curves, interest rate relationships, loan prepayments, and changes in funding sources. These forecasts are compared against net interest income projected in a stable interest rate environment. While many assets and liabilities reprice either at maturity or in accordance with their contractual terms, several balance sheet components demonstrate characteristics that require an evaluation to more accurately reflect their repricing behavior. Key assumptions in the simulation analysis include prepayments on loans, probable calls of investment securities, changes in market conditions, loan volumes and loan pricing, deposit sensitivity, and customer preferences. These assumptions are inherently uncertain as they are subject to fluctuation and revision in a dynamic environment. As a result, the simulation analysis cannot precisely forecast the impact of rising and falling interest rates on net interest income. Actual results will differ from simulated results due to many other factors, including changes in balance sheet components, interest rate changes, changes in market conditions, and management strategies.

Our interest rate sensitivity is estimated by first forecasting the next 12 and 24 months of net interest income under an assumed environment of a constant balance sheet and constant market interest rates (base case). We then compare the results of various simulation analyses to the base case. At June 30, 2017, we projected the change in net interest income during the next 12 and 24 months assuming market interest rates were to immediately decrease by 100 basis points and increase by 100, 200, 300, and 400 basis points in a parallel fashion over the entire yield curve during the same time period. We did not project scenarios showing decreases in interest rates beyond 100 basis points as this is considered extremely unlikely given current interest rate levels. These projections were based on our assets and liabilities remaining static over the next 12 and 24 months, while factoring in probable calls and prepayments of certain investment securities and residential real estate and consumer loans. While it is extremely unlikely that interest rates would immediately increase to these levels, we feel that these extreme scenarios help us identify potential gaps and mismatches in the repricing characteristics of assets and liabilities. We regularly monitor our projected net interest income sensitivity to ensure that it remains within established limits. As of June 30, 2017, our interest rate sensitivity results were within Board approved limits.

The following tables summarize our interest rate sensitivity for the next 12 and 24 months as of:

	June 30, 2017									
	12 Months					24 Months				
Immediate basis point change assumption (short-term)	-100	+100	+200	+300	+400	-100	+100	+200	+300	+400
Percent change in net interest income vs. constant rates	(2.23)%	2.36%	4.67%	6.60%	8.68%	(2.27)%	2.79%	5.31%	7.14%	8.68%
	December 31, 2016									
	12 Months					24 Months				
Immediate basis point change assumption (short-term)	-100	+100	+200	+300	+400	-100	+100	+200	+300	+400
Percent change in net interest income vs. constant rates	(4.49)%	2.19%	4.31%	5.68%	6.67%	(5.32)%	2.64%	5.01%	6.33%	6.75%

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The following tables provide information about assets and liabilities that are sensitive to changes in interest rates as of June 30, 2017 and December 31, 2016. The principal amounts of investments, loans, other interest earning assets, borrowings, and time deposits maturing were calculated based on the contractual maturity dates. Estimated cash flows for savings and NOW accounts are based on our estimated deposit decay rates.

	June 30, 2017						Total	Fair Value
	2018	2019	2020	2021	2022	Thereafter		
Rate sensitive assets								
Other interest bearing assets	\$249	\$—	\$100	\$—	\$—	\$—	\$349	\$344
Average interest rates	0.98	% —	% 0.35	% —	% —	% —	% 0.80	%
AFS securities	\$109,667	\$79,419	\$76,855	\$62,941	\$51,836	\$187,144	\$567,862	\$567,862
Average interest rates	2.24	% 2.41	% 2.56	% 2.54	% 2.40	% 2.48	% 2.43	%
Fixed interest rate loans (1)	\$168,142	\$109,706	\$112,363	\$110,146	\$116,292	\$205,396	\$822,045	\$802,838
Average interest rates	4.04	% 4.31	% 4.26	% 4.22	% 4.22	% 4.02	% 4.15	%
Variable interest rate loans (1)	\$76,147	\$33,166	\$29,606	\$15,998	\$28,272	\$43,263	\$226,452	\$226,452
Average interest rates	5.09	% 4.57	% 4.59	% 4.14	% 4.22	% 3.94	% 4.55	%
Rate sensitive liabilities								
Fixed rate borrowed funds	\$145,940	\$70,000	\$40,000	\$25,000	\$50,000	\$20,000	\$350,940	\$351,076
Average interest rates	1.13	% 1.95	% 1.72	% 1.54	% 2.07	% 2.54	% 1.60	%
Variable rate borrowed funds	\$—	\$—	\$—	\$10,000	\$—	\$—	\$10,000	\$10,000
Average interest rates	—	% —	% —	% 1.34	% —	% —	% 1.34	%
Savings and NOW accounts	\$135,834	\$42,252	\$37,787	\$33,822	\$30,293	\$290,133	\$570,121	\$570,121
Average interest rates	0.48	% 0.15	% 0.15	% 0.15	% 0.15	% 0.13	% 0.22	%
Fixed interest rate certificates of deposit	\$205,035	\$71,509	\$40,849	\$46,190	\$42,356	\$19,126	\$425,065	\$423,033
Average interest rates	0.90	% 1.27	% 1.48	% 1.69	% 1.77	% 1.98	% 1.24	%
Variable interest rate certificates of deposit	\$2,490	\$2,354	\$—	\$—	\$—	\$—	\$4,844	\$4,844
Average interest rates	1.00	% 1.21	% —	% —	% —	% —	% 1.10	%

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	December 31, 2016							Fair Value
	2017	2018	2019	2020	2021	Thereafter	Total	
Rate sensitive assets								
Other interest bearing assets	\$2,727	\$—	\$—	\$—	\$—	\$—	\$2,727	\$2,727
Average interest rates	0.34	% —	% —	% —	% —	% —	% 0.34	%
AFS securities	\$114,247	\$71,220	\$64,931	\$63,150	\$66,976	\$177,572	\$558,096	\$558,096
Average interest rates	2.35	% 2.38	% 2.45	% 2.64	% 2.57	% 2.50	% 2.47	%
Fixed interest rate loans (1)	\$159,964	\$115,741	\$103,514	\$107,185	\$112,811	\$199,160	\$798,375	\$778,769
Average interest rates	4.15	% 4.25	% 4.34	% 4.16	% 4.15	% 4.10	% 4.18	%
Variable interest rate loans (1)	\$69,024	\$29,179	\$38,248	\$16,179	\$23,632	\$35,978	\$212,240	\$212,240
Average interest rates	4.83	% 4.32	% 4.16	% 3.62	% 3.74	% 3.86	% 4.26	%
Rate sensitive liabilities								
Fixed rate borrowed funds	\$137,694	\$50,000	\$60,000	\$10,000	\$50,000	\$20,000	\$327,694	\$326,975
Average interest rates	0.83	% 2.16	% 1.99	% 1.98	% 1.91	% 2.54	% 1.55	%
Variable rate borrowed funds	\$—	\$—	\$—	\$—	\$10,000	\$—	\$10,000	\$10,000
Average interest rates	—	% —	% —	% —	% 1.21	% —	% 1.21	%
Savings and NOW accounts	\$84,972	\$42,596	\$38,220	\$34,326	\$30,858	\$325,583	\$556,555	\$556,555
Average interest rates	0.57	% 0.12	% 0.11	% 0.11	% 0.11	% 0.11	% 0.18	%
Fixed interest rate certificates of deposit	\$195,389	\$80,139	\$45,110	\$33,929	\$50,978	\$24,881	\$430,426	\$427,100
Average interest rates	0.86	% 1.18	% 1.35	% 1.58	% 1.68	% 1.84	% 1.18	%
Variable interest rate certificates of deposit	\$1,078	\$1,910	\$—	\$—	\$—	\$—	\$2,988	\$2,988
Average interest rates	0.62	% 0.99	% —	% —	% —	% —	% 0.85	%

(1) The fair value reported is exclusive of the allocation of the ALLL.

We do not believe that there has been a material change in the nature or categories of our primary market risk exposure, or the particular markets that present the primary risk of loss. As of the date of this report, we do not know of or expect there to be any material change in the general nature of our primary market risk exposure in the near term and we do not expect to make material changes in those methods in the near term. We may change those methods in

the future to adapt to changes in circumstances or to implement new techniques.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The information presented in the section captioned “Market Risk” in Management's Discussion and Analysis of Financial Condition and Results of Operations is incorporated herein by reference.

Item 4. Controls and Procedures.

DISCLOSURE CONTROLS AND PROCEDURES

We carried out an evaluation, under the supervision and with the participation of the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15(d)-15(e) under the Exchange Act) as of June 30, 2017, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures as of June 30, 2017, were effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the most recent fiscal quarter, no change occurred in our internal control over financial reporting that materially affected, or is likely to materially effect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

We are not involved in any material legal proceedings. We are involved in ordinary, routine litigation incidental to our business; however, no such routine proceedings are expected to result in any material adverse effect on operations, earnings, financial condition, or cash flows.

Item 1A. Risk Factors.

There have been no material changes to the risk factors disclosed in Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(A) None

(B) None

(C) Repurchases of Common Stock

We have adopted and publicly announced a common stock repurchase plan. The plan was last amended on December 21, 2016, to allow for the repurchase of an additional 200,000 shares of common stock after that date. These authorizations do not have expiration dates. As common shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued common shares.

The following table provides information for the three month period ended June 30, 2017, with respect to this plan:

	Common Shares Repurchased	Average Price Number Per Common Share	Total Number of Common Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Common Shares That May Yet Be Purchased Under the Plans or Programs
Balance, March 31				158,142
April 1 - 30	19,935	\$ 27.89	19,935	138,207
May 1 - 31	16,147	27.68	16,147	122,060
June 1 - 30	16,185	27.87	16,185	105,875
Balance, June 30	52,267	\$ 27.82	52,267	105,875

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

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Item 6. Exhibits.

(a) Exhibits

Exhibit Number	Exhibits
31(a)	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Executive Officer
31(b)	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Financial Officer
32	Section 1350 Certification of Principal Executive Officer and Principal Financial Officer
101.1*	101.INS (XBRL Instance Document)
	101.SCH (XBRL Taxonomy Extension Schema Document)
	101.CAL (XBRL Calculation Linkbase Document)
	101.LAB (XBRL Taxonomy Label Linkbase Document)
	101.DEF (XBRL Taxonomy Linkbase Document)
	101.PRE (XBRL Taxonomy Presentation Linkbase Document)

In accordance with Rule 406T of Regulations S-T, the XBRL related information shall not be deemed to be “filed” for *purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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SIGNATURES

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

Isabella Bank Corporation

Date: August 4, 2017 /s/ Jae A. Evans
Jae A. Evans
President, Chief Executive Officer
(Principal Executive Officer)

Date: August 4, 2017 /s/ Rhonda S. Tudor
Rhonda S. Tudor
Interim Chief Financial Officer
(Principal Accounting Officer)