ISABELLA BANK CORP
Form 10-Q
May 06, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended March 31, 2011

or

o **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 incorporation or organization)	(I.R.S. Employer 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.
þ Yes o 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).
o Yes o No

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock no par value, 7,561,641 as of April 18, 2011

ISABELLA BANK CORPORATION
QUARTERLY REPORT ON FORM 10-Q
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PART I FINANCIAL INFORMATION

Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	March 31 2011	December 31 2010
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	$ 18,341	$ 16,978
Interest bearing balances due from banks	4,991	1,131
Total cash and cash equivalents	**23,332**	**18,109**
Certificates of deposit held in other financial institutions	13,868	15,808
Trading securities	5,433	5,837
Available-for-sale securities (amortized cost of $358,918 in 2011 and $329,435 in 2010)	361,960	330,724
Mortgage loans available-for-sale	252	1,182
Loans		
Agricultural	69,993	71,446
Commercial	350,456	348,852
Installment	29,283	30,977
Residential real estate mortgage	288,245	284,029
Total loans	**737,977**	**735,304**
Less allowance for loan losses	12,381	12,373
Net loans	**725,596**	**722,931**
Premises and equipment	24,219	24,627
Corporate owned life insurance	17,608	17,466
Accrued interest receivable	6,258	5,456
Equity securities without readily determinable fair values	17,423	17,564
Goodwill and other intangible assets	47,015	47,091
Other assets	19,217	19,015
TOTAL ASSETS	**$ 1,262,181**	**$ 1,225,810**
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 108,720	$ 104,902
NOW accounts	152,784	142,259
Certificates of deposit under $100 and other savings	449,856	425,981
Certificates of deposit over $100	211,887	204,197
Total deposits	**923,247**	**877,339**
Borrowed funds ($10,343 in 2011 and $10,423 in 2010 at fair value)	183,263	194,917
Accrued interest payable and other liabilities	8,070	8,393

Total liabilities	**1,114,580**	**1,080,649**
Shareholders equity		
Common stock no par value 15,000,000 shares authorized; issued and outstanding 7,560,903 (including 29,720 shares to be issued) in 2011 and 7,550,074 (including 32,686 shares to be issued) in 2010	133,794	133,592
Shares to be issued for deferred compensation obligations	4,680	4,682
Retained earnings	9,478	8,596
Accumulated other comprehensive loss	(351)	(1,709)
Total shareholders equity	**147,601**	**145,161**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,262,181**	**$ 1,225,810**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

(Dollars in thousands except per share data)

	Common Stock Shares Outstanding	Common Stock	Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive Loss	Totals
Balance, January 1, 2010	**7,535,193**	**$ 133,443**	**$ 4,507**	**$ 4,972**	**$ (2,119)**	**$ 140,803**
Comprehensive income				2,023	815	2,838
Issuance of common stock	29,147	736				736
Common stock issued for deferred compensation obligations	13,331	247	(195)			52
Share based payment awards under equity compensation plan			181			181
Common stock purchased for deferred compensation obligations		(157)				(157)
Common stock repurchased pursuant to publicly announced repurchase plan	(34,165)	(629)				(629)
Cash dividends ($0.18 per share)				(1,354)		(1,354)
Balance, March 31, 2010	**7,543,506**	**$ 133,640**	**$ 4,493**	**$ 5,641**	**$ (1,304)**	**$ 142,470**
Balance, January 1, 2011	**7,550,074**	**$ 133,592**	**$ 4,682**	**$ 8,596**	**$ (1,709)**	**$ 145,161**
Comprehensive income				2,316	1,358	3,674
Issuance of common stock	30,531	728				728
Common stock issued for deferred compensation obligations	12,037	215	(182)			33
			180			180

Share based payment awards under equity compensation plan						
Common stock purchased for deferred compensation obligations		(164)				(164)
Common stock repurchased pursuant to publicly announced repurchase plan	(31,739)	(577)				(577)
Cash dividends ($0.19 per share)				(1,434)		(1,434)
Balance, March 31, 2011	**7,560,903**	**$ 133,794**	**$ 4,680**	**$ 9,478**	**$ (351)**	**$ 147,601**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(Dollars in thousands except per share data)

	Three Months Ended March 31	
	2011	2010
Interest income		
Loans, including fees	$ 11,361	$ 11,517
Investment securities		
Taxable	1,513	1,279
Nontaxable	1,179	1,094
Trading account securities	51	105
Federal funds sold and other	134	104
Total interest income	**14,238**	**14,099**
Interest expense		
Deposits	2,785	2,883
Borrowings	1,268	1,517
Total interest expense	**4,053**	**4,400**
Net interest income	**10,185**	**9,699**
Provision for loan losses	817	1,207
Net interest income after provision for loan losses	**9,368**	**8,492**
Noninterest income		
Service charges and fees	1,476	1,628
Gain on sale of mortgage loans	129	93
Net loss on trading securities	(19)	(1)
Net gain on borrowings measured at fair value	80	56
Gain on sale of available-for-sale investment securities		56
Other	282	335
Total noninterest income	**1,948**	**2,167**
Noninterest expenses		
Compensation and benefits	5,005	4,595
Occupancy	646	562
Furniture and equipment	1,106	1,031
FDIC insurance premiums	334	306
Other	1,496	1,860
Total noninterest expenses	**8,587**	**8,354**

Income before federal income tax expense	**2,729**	**2,305**
Federal income tax expense	413	282
NET INCOME	**$ 2,316**	**$ 2,023**
Earnings per share		
Basic	**$ 0.31**	**$ 0.27**
Diluted	**$ 0.30**	**$ 0.26**
Cash dividends per basic share	**$ 0.19**	**$ 0.18**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands)

	Three Months Ended March 31	
	2011	2010
Net income	**$ 2,316**	**$ 2,023**
Unrealized holding gains on available-for-sale securities:		
Unrealized holding gains arising during the period	1,753	1,360
Reclassification adjustment for net realized gains included in net income		(56)
Net unrealized gains	1,753	1,304
Tax effect	(395)	(489)
Other comprehensive income, net of tax	1,358	815
COMPREHENSIVE INCOME	**$ 3,674**	**$ 2,838**

See notes to interim condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	Three Months Ended March 31	
	2011	2010
OPERATING ACTIVITIES		
Net income	$ 2,316	$ 2,023
Reconciliation of net income to net cash provided by operations:		
Provision for loan losses	817	1,207
Impairment of foreclosed assets	10	77
Depreciation	647	598
Amortization and impairment of originated mortgage servicing rights	89	39
Amortization of acquisition intangibles	76	86
Net amortization of available-for-sale securities	362	203
Gain on sale of available-for-sale securities		(56)
Net unrealized losses on trading securities	19	1
Net gain on sale of mortgage loans	(129)	(93)
Net unrealized gains on borrowings measured at fair value	(80)	(56)
Increase in cash value of corporate owned life insurance	(142)	(148)
Realized gain on redemption of corporate owned life insurance		(21)
Share-based payment awards under equity compensation plan	180	181
Origination of loans held for sale	(8,830)	(11,311)
Proceeds from loan sales	9,889	13,203
Net changes in operating assets and liabilities which provided (used) cash:		
Trading securities	385	3,951
Accrued interest receivable	(802)	(506)
Other assets	(24)	(399)
Accrued interest payable and other liabilities	(323)	437
Net cash provided by operating activities	**4,460**	**9,416**
INVESTING ACTIVITIES		
Net change in certificates of deposit held in other financial institutions	1,940	576
Activity in available-for-sale securities		
Maturities, calls, and sales	15,597	20,051
Purchases	(45,442)	(36,922)
Loan principal originations and collections, net	(4,315)	(5,018)
Proceeds from sales of foreclosed assets	302	886
Purchases of premises and equipment	(239)	(962)
Proceeds from the redemption of corporate owned life insurance		111
Net cash used in investing activities	**(32,157)**	**(21,278)**

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CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(UNAUDITED)
(Dollars in thousands)

	Three Months Ended March 31	
	2011	2010
FINANCING ACTIVITIES		
Acceptances and withdrawals of deposits, net	45,908	16,884
Repayments of borrowed funds	(11,574)	(7,338)
Cash dividends paid on common stock	(1,434)	(1,354)
Proceeds from issuance of common stock	546	541
Common stock repurchased	(362)	(382)
Common stock purchased for deferred compensation obligations	(164)	(157)
Net cash provided by financing activities	**32,920**	**8,194**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**5,223**	**(3,668)**
Cash and cash equivalents at beginning of period	18,109	22,706
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 23,332**	**$ 19,038**
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	$ 4,025	$ 4,428
SUPPLEMENTAL NONCASH INFORMATION:		
Transfers of loans to foreclosed assets	$ 833	$ 970
Common stock issued for deferred compenstion obligations	182	195
Common stock repurchased from an associated grantor trust (Rabbi Trust)	(215)	(247)

See notes to interim condensed consolidated financial statements.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands except per share amounts)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 generally accepted accounting principles for complete financial statements. In management s opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation s annual report for the year ended December 31, 2010.

The accounting policies are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Corporation s annual report for the year ended December 31, 2010.

NOTE 2 ACCOUNTING STANDARDS UPDATES

Recently Adopted Accounting Standards Updates

Accounting Standards Update (ASU) No. 2010-06: *Improving Disclosures about Fair Value Measurement*

In January 2010, ASU No. 2010-06 amended Accounting Standards Codification (ASC) Topic 820 Fair Value Measurements and Disclosures to add new disclosures for: (1) Significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers and (2) Presenting separately information about purchases, sales, issuances and settlements for Level 3 fair value instruments (as opposed to reporting activity as net).

ASU No. 2010-06 also clarified existing disclosures by requiring reporting entities to provide fair value measurement disclosures for each class of assets and liabilities and to provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The new authoritative guidance was effective for interim and annual periods beginning after December 15, 2009 except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements, which was effective for interim and annual periods beginning after December 15, 2010. The new guidance did not have a significant impact on the Corporation s consolidated financial statements.

Pending Accounting Standards Updates

ASU No. 2011-01: *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20.*

In January 2011, ASU No. 2011-01 amended ASC Topic 310, Receivables to temporarily delay the effective date of new disclosures related to troubled debt restructurings as required in ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* , which was effective for interim and annual periods ending after December 15, 2010. The effective date of the new disclosures about troubled debt restructurings has been delayed to coordinate with the issuance of the anticipated guidance for determining what constitutes a troubled debt restructuring. The new guidance, and related disclosures, related to troubled debt restructurings will be effective for interim and annual periods beginning on or after June 15, 2011.

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ASU No. 2011-02: *A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.*

In April 2011, ASU No. 2011-02 amended ASC Topic 310, Receivables to clarify authoritative guidance as to what loan modifications constitute concessions, and would therefore be considered a troubled debt restructuring. ASU No. 2011-02 clarifies that:

If a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the modified debt, the modification would be considered to be at a below-market rate, which may indicate that the creditor has granted a concession.

A modification that results in a temporary or permanent increase in the contractual interest rate can t be presumed to be at a rate that is at or above a market rate and therefore could still be considered a concession.

A creditor must consider whether a borrower s default is probable on any of its debt in the foreseeable future when assessing financial difficulty.

A modification that results in an insignificant delay in payments is not a concession.

In addition, ASU No. 2011-02 clarifies that a creditor is precluded from using the effective interest rate test in the debtor s guidance on modification of payables (ASC Topic 470, Debt) when evaluating whether a modification constitutes a troubled debt restructuring. The new authoritative guidance is effective for interim and annual periods beginning on or after June 15, 2011 and is likely to increase the amount of loans that the Corporation classifies as troubled debt restructurings. The Corporation is currently in the process of evaluating the extent of the impact that this standard may have on the Corporation s financial statements.

NOTE 3 COMPUTATION OF EARNINGS PER SHARE

Basic earnings per share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan).

Earnings per common share have been computed based on the following:

	Three Months Ended March 31	
	2011	2010
Average number of common shares outstanding for basic calculation	7,557,293	7,540,735
Average potential effect of shares in the Directors Plan (1)	193,128	182,386
Average number of common shares outstanding used to calculate diluted earnings per common share	7,750,421	7,723,121
Net income	$ 2,316	$ 2,023
Earnings per share		
Basic	**$ 0.31**	**$ 0.27**
Diluted	**$ 0.30**	**$ 0.26**

(1) Exclusive of shares held in the Rabbi Trust

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NOTE 4 TRADING SECURITIES

Trading securities, at fair value, consist of the following investments at:

	March 31 2011	December 31 2010
States and political subdivisions	**$ 5,433**	**$ 5,837**

Included in the net trading losses of $19 during the first three months of 2011 were $17 of net unrealized trading losses on securities that relate to the Corporation s trading portfolio as of March 31, 2011.

NOTE 5 AVAILABLE-FOR-SALE SECURITIES

The amortized cost and fair value of available-for-sale securities, with gross unrealized gains and losses, are as follows at:

	March 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$ 5,394	$ 2	$ 18	$ 5,378
States and political subdivisions	165,927	4,339	591	169,675
Auction rate money market preferred	3,200		397	2,803
Preferred stocks	7,800	64	271	7,593
Mortgage-backed	110,466	1,480	921	111,025
Collateralized mortgage obligations	66,131	313	958	65,486
Total	**$ 358,918**	**$ 6,198**	**$ 3,156**	**$ 361,960**

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$ 5,394	$ 10	$	$ 5,404
States and political subdivisions	167,328	3,349	960	169,717
Auction rate money market preferred	3,200		335	2,865
Preferred stocks	7,800		864	6,936
Mortgage-backed	101,096	1,633	514	102,215
Collateralized mortgage obligations	44,617	103	1,133	43,587
Total	**$ 329,435**	**$ 5,095**	**$ 3,806**	**$ 330,724**

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The amortized cost and fair value of available-for-sale securities by contractual maturity at March 31, 2011 are as follows:

	Maturing				Securities	
	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	With Variable Monthly Payments	Total
Government sponsored enterprises	$	$ 5,000	$ 394	$	$	$ 5,394
States and political subdivisions	8,974	33,373	86,531	37,049		165,927
Auction rate money market preferred					3,200	3,200
Preferred stocks					7,800	7,800
Mortgage-backed					110,466	110,466
Collateralized mortgage obligations					66,131	66,131
Total amortized cost	**$ 8,974**	**$ 38,373**	**$ 86,925**	**$ 37,049**	**$ 187,597**	**$ 358,918**
Fair value	**$ 8,993**	**$ 39,504**	**$ 89,398**	**$ 47,554**	**$ 176,511**	**$ 361,960**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, auction rate money market preferreds, preferred stocks, mortgage-backed securities, and collateralized mortgage obligations are not reported by a specific maturity group.

A summary of the activity related to sales of available-for-sale securities is as follows during the three month period ended March 31, 2010:

Proceeds from sales of securities	$ 3,632
Gross realized gains	$ 59
Gross realized losses	(3)
Net realized gains	$ 56
Applicable income tax expense	$ 19

There were no sales of available-for-sale securities in the first three months of 2011. The cost basis used to determine the realized gains or losses of securities sold was the amortized cost of the individual investment security as of the trade date.

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Information pertaining to available-for-sale securities with gross unrealized losses at March 31, 2011 and December 31, 2010 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	March 31, 2011				
	Less Than Twelve Months		Over Twelve Months		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Government sponsored enterprises	$ 18	$ 4,981	$	$	$ 18
States and political subdivisions	531	20,830	60	1,593	591
Auction rate money market preferred			397	2,803	397
Preferred stocks			271	3,529	271
Mortgage-backed	921	49,782			921
Collateralized mortgage obligations	958	45,661			958
Total	**$ 2,428**	**$ 121,254**	**$ 728**	**$ 7,925**	**$ 3,156**
Number of securities in an unrealized loss position:		**74**		**5**	**79**

	December 31, 2010				
	Less Than Twelve Months		Over Twelve Months		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
States and political subdivisions	$ 960	$ 29,409	$	$	$ 960
Auction rate money market preferred			335	2,865	335
Preferred stocks			864	2,936	864
Mortgage-backed	514	38,734			514
Collateralized mortgage obligations	1,133	33,880			1,133
Total	**$ 2,607**	**$ 102,023**	**$ 1,199**	**$ 5,801**	**$ 3,806**
Number of securities in an unrealized loss position:		**82**		**4**	**86**

The Corporation invested $11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, $7,800 converted to preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a discounted cash flow analysis as of March 31, 2011 and December 31, 2010. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, current market rates, and the current volume of trading activity. Specific assumptions underlying management s assumptions are continually evaluated and revised, when necessary, to reflect their ongoing relevance. Despite the limited trading of these securities, management has determined that any declines in the estimated fair values of these securities are the result of changes in interest rates and not risks related to the underlying credit quality of the issuer or specific security. Additionally, none of these securities are deemed to be below investment grade, management does not intend to sell the securities in an unrealized loss position, and it is more likely than not that the Corporation will not have to sell the securities before recovery of their cost basis. As a result, the Corporation has not recognized an other-than-temporary impairment loss related to these declines in fair value.

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As of March 31, 2011 and December 31, 2010, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including auction rate money market preferred securities and preferred stocks, should be considered other-than-temporarily-impaired (OTTI). 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 that the issuer will be unable to pay the amount when due?

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

Has the duration of the investment been extended?

Based on the Corporation s analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any such securities are other-than-temporarily impaired as of March 31, 2011 or December 31, 2010.

NOTE 6 LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of the major classifications of loans is as follows as of:

	March 31 2011	December 31 2010
Mortgage loans on real estate		
Residential 1-4 family	$ 214,311	$ 207,749
Commercial	242,360	239,810
Agricultural	43,269	44,246
Construction and land development	11,287	12,250
Second mortgages	24,971	26,712
Equity lines of credit	37,676	37,318
Total mortgage loans	573,874	568,085
Commercial and agricultural loans		
Commercial	108,096	109,042
Agricultural production	26,724	27,200
Total commercial and agricultural loans	134,820	136,242
Consumer installment loans	29,283	30,977
Total loans	737,977	735,304
Less: allowance for loan losses	12,381	12,373
Net loans	**$ 725,596**	**$ 722,931**

The Corporation grants commercial, agricultural, consumer and residential loans to customers situated primarily in Isabella, Gratiot, Mecosta, Midland, Western Saginaw, Montcalm and Southern Clare counties in Michigan. The ability of the borrowers to honor their repayment obligations is often dependent upon the real estate, agricultural, light manufacturing, retail, gaming and tourism, higher education, and general economic conditions of this region. Substantially all of the consumer and residential mortgage 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 management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loans losses, and any deferred fees or costs on originated loans. Interest income on loans 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 constant yield method.

The accrual of interest on mortgage and commercial 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. Credit card loans and other personal 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 or charged off at an earlier date if collection of principal or interest is considered doubtful.

For loans that are placed on non-accrual 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 allowance for loan losses. The interest on these loans is accounted for on the cash-basis, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income continues to be accrued over the term of the loan based on the principal amount outstanding.

Commercial loans include loans for commercial real estate, farmland and agricultural production, state and political subdivisions, and commercial operating loans. The largest concentration of commercial loans is commercial real estate. Repayment of commercial loans is often dependent upon the successful operation and management of a business; thus, these loans generally involve greater risk than other types of lending. The Corporation minimizes its risk by limiting the amount of loans to any one borrower to $12,500. Borrowers with credit needs of more than $12,500 are serviced through the use of loan participations with other commercial banks. All commercial real estate loans require loan to value limits of less than 80%. Depending upon the type of loan, past credit history, and current operating results, the Corporation may require the borrower to pledge accounts receivable, inventory, and fixed assets. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and proprietorships. In addition, the Corporation requires annual financial statements, prepares cash flow analyses, and reviews credit reports as deemed necessary.

The Corporation offers adjustable rate mortgages, fixed rate balloon mortgages, and fixed rate mortgage loans which typically have amortization periods up to a maximum of 30 years. Fixed rate loans with an amortization of greater than 15 years are generally sold upon origination to the Federal Home Loan Mortgage Association. Fixed rate residential mortgage loans with an amortization of 15 years or less may be held in the Corporation s portfolio, held for future sale, or sold upon origination. Factors used in determining when to sell these mortgages include management s judgment about the direction of interest rates, the Corporation s need for fixed rate assets in the management of its interest rate sensitivity, and overall loan demand.

Construction and land development loans consist primarily of 1 to 4 family residential properties. These loans primarily have a 6 to 9 month maturity and are made using the same underwriting criteria as residential mortgages. Loan proceeds are disbursed in increments as construction progresses and inspections warrant. Construction loans are typically converted to permanent loans at the completion of construction.

Lending policies generally limit the maximum loan to value ratio on residential mortgages to 95% 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%. Substantially all loans upon origination have a loan to value ratio of less than 80%. Underwriting criteria for residential real estate loans include: evaluation of the borrower s ability to make monthly payments, 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, all debt servicing does not exceed 36% of income, acceptable credit reports, verification of employment, income, and financial information. Appraisals are performed by independent appraisers. All mortgage loan requests are reviewed by a mortgage loan committee or through a secondary market automated underwriting system; loans in excess of $400 require the approval of the Bank s Internal Loan Committee, Board of Directors, or its loan committee.

Consumer loans granted include automobile loans, secured and unsecured personal loans, credit cards, student loans, and overdraft protection related loans. Loans are amortized generally for a period of up to 6 years. The underwriting emphasis is on a borrower s ability to pay rather than collateral value. No consumer loans are sold to the secondary market.

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A summary of changes in the allowance for loan losses by loan segments follows:

Allowance for Credit Losses and Recorded Investment in Financing Receivables
For the Three Months Ended March 31, 2011

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
January 1, 2011	$ 6,048	$ 1,033	$ 3,198	$ 605	$ 1,489	$ 12,373
Loans charged off	(655)		(323)	(145)		(1,123)
Recoveries	137		74	103		314
Provision for loan losses	716	(257)	473	59	(174)	817
March 31, 2011	**$ 6,246**	**$ 776**	**$ 3,422**	**$ 622**	**$ 1,315**	**$ 12,381**
Allowance for loan losses as of March 31, 2011						
Individually evaluated for impairment	$ 91	$ 396	$ 834	$	$	$ 1,321
Collectively evaluated for impairment	6,155	380	2,588	622	1,315	11,060
Total	**$ 6,246**	**$ 776**	**$ 3,422**	**$ 622**	**$ 1,315**	**$ 12,381**
Loans as of March 31, 2011						
Individually evaluated for impairment	$ 6,476	$ 2,770	$ 5,402	$		$ 14,648
Collectively evaluated for impairment	343,980	67,223	282,843	29,283		723,329
Total	**$ 350,456**	**$ 69,993**	**$ 288,245**	**$ 29,283**		**$ 737,977**

Allowance for Credit Losses and Recorded Investment in Financing Receivables
As of December 31, 2010

Allowance for loan losses						
Individually evaluated for impairment	$ 490	$ 558	$ 732	$	$	$ 1,780
Collectively evaluated for impairment	5,558	475	2,466	605	1,489	10,593
Total	**$ 6,048**	**$ 1,033**	**$ 3,198**	**$ 605**	**$ 1,489**	**$ 12,373**

Loans					
Individually evaluated for impairment	$ 4,890	$ 2,629	$ 4,866	$	$ 12,385
Collectively evaluated for impairment	343,962	68,817	279,163	30,977	722,919
Total	**$ 348,852**	**$ 71,446**	**$ 284,029**	**$ 30,977**	**$ 735,304**

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Following is a summary of changes in the allowance for loan losses for the three months ended March 31, 2010:

January 1, 2010	$ 12,979
Loans charged off	(1,603)
Recoveries	404
Provision charged to income	1,207
March 31, 2010	**$ 12,987**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility 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 allowance for loan losses (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 net realizable value of the loan s underlying collateral or the net present value of the projected payment stream and its recorded investment. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio over the preceding three years. An unallocated component is maintained to cover uncertainties that management believes affect its estimate of probable losses based on qualitative 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.

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

	March 31, 2011					
	Commercial			Agricultural		
	Real Estate	Other	Total	Real Estate	Other	Total
Rating						
2 - High quality	$ 11,781	$ 14,482	$ 26,263	$ 3,773	$ 1,032	$ 4,805
3 - High satisfactory	74,983	24,786	99,769	10,450	2,616	13,066
4 - Low satisfactory	120,738	61,048	181,786	22,682	14,932	37,614
5 - Special mention	20,244	6,728	26,972	3,730	3,622	7,352
6 - Substandard	11,542	994	12,536	2,634	4,522	7,156
7 - Vulnerable	404	7	411			
8 - Doubtful	2,668	51	2,719			
Total	**$ 242,360**	**$ 108,096**	**$ 350,456**	**$ 43,269**	**$ 26,724**	**$ 69,993**

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	December 31, 2010					
	Commercial			Agricultural		
	Real Estate	Other	Total	Real Estate	Other	Total
Rating						
2 - High quality	$ 10,995	$ 13,525	$ 24,520	$ 3,792	$ 1,134	$ 4,926
3 - High satisfactory	74,912	30,322	105,234	11,247	3,235	14,482
4 - Low satisfactory	119,912	57,403	177,315	22,384	14,862	37,246
5 - Special mention	19,560	6,507	26,067	4,169	3,356	7,525
6 - Substandard	10,234	1,104	11,338	2,654	4,613	7,267
7 - Vulnerable	3,339	54	3,393			
8 - Doubtful	858	127	985			
Total	**$ 239,810**	**$ 109,042**	**$ 348,852**	**$ 44,246**	**$ 27,200**	**$ 71,446**

Internally assigned 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 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 has 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.

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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 abilities 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.

Management abilities are questionable.

Weak industry conditions.

Litigation pending against the borrower.

Loan may need to be restructured to improve collateral position or reduce payments.

Collateral / 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 the Corporation 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. 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.

9. **LOSS Charge off**

Credits are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification is for charged off loans but does not mean that the asset has absolutely no recovery or salvage value. These loans are further characterized by:

- Liquidation or reorganization under bankruptcy, with poor prospects of collection.
- Fraudulently overstated assets and/or earnings.
- Collateral has marginal or no value.
- Debtor cannot be located.
- Over 120 days delinquent.

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

	March 31, 2011					
	Accruing Interest and Past Due:			Total Past Due and		
	30-89 Days	90 Days or More	Nonaccrual	Nonaccrual	Current	Total
Commercial						
Commercial real estate	$ 1,739	$ 480	$ 3,108	$ 5,327	$ 237,033	$ 242,360
Commercial other	549		36	585	107,511	108,096
Total commercial	2,288	480	3,144	5,912	344,544	350,456
Agricultural						
Agricultural real estate	98	114	190	402	42,867	43,269
Agricultural other	8			8	26,716	26,724
Total agricultural	106	114	190	410	69,583	69,993
Residential mortgage						
Senior liens	3,507	167	1,602	5,276	220,323	225,599
Junior liens	162		21	183	24,787	24,970
Home equity lines of credit	534			534	37,142	37,676
Total residential mortgage	4,203	167	1,623	5,993	282,252	288,245
Consumer						
Secured	198			198	24,277	24,475
Unsecured	67			67	4,741	4,808
Total consumer	265			265	29,018	29,283
Total	**$ 6,862**	**$ 761**	**$ 4,957**	**$ 12,580**	**$ 725,397**	**$ 737,977**

	December 31, 2010					
	Accruing Interest and Past Due:			Total Past Due and		
	30-89 Days	90 Days or More	Nonaccrual	Nonaccrual	Current	Total
Commercial						
Commercial real estate	$ 4,814	$ 125	$ 4,001	$ 8,940	$ 230,870	$ 239,810
Commercial other	381		139	520	108,522	109,042

Total commercial	5,195	125	4,140	9,460	339,392	348,852
Agricultural						
Agricultural real estate	92			92	44,154	44,246
Agricultural other	4	50		54	27,146	27,200
Total agricultural	96	50		146	71,300	71,446
Residential mortgage						
Senior liens	5,265	310	1,421	6,996	213,003	219,999
Junior liens	476		49	525	26,187	26,712
Home equity lines of credit	598			598	36,720	37,318
Total residential mortgage	6,339	310	1,470	8,119	275,910	284,029
Consumer						
Secured	298			298	24,781	25,079
Unsecured	10	1		11	5,887	5,898
Total consumer	308	1		309	30,668	30,977
Total	**$ 11,938**	**$ 486**	**$ 5,610**	**$ 18,034**	**$ 717,270**	**$ 735,304**

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

	March 31, 2011			December 31, 2010		
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance
Impaired loans with a valuation allowance						
Commercial real estate	$ 1,171	$ 1,403	$ 91	$ 3,010	$ 4,110	$ 472
Commercial other				18	18	18
Agricultural other	2,196	2,196	396	2,196	2,196	558
Residential mortgage senior liens	4,561	5,560	802	4,292	5,236	698
Residential mortgage junior liens	167	258	32	172	250	34
Total impaired loans with a valuation allowance	**$ 8,095**	**$ 9,417**	**$ 1,321**	**$ 9,688**	**$ 11,810**	**$ 1,780**
Impaired loans without a valuation allowance						
Commercial real estate	$ 3,609	$ 5,689		$ 1,742	$ 2,669	
Commercial other	1,793	1,834		169	269	
Agricultural real estate	190	190				
Residential mortgage senior liens	673	773		401	501	
Residential mortgage junior liens	1	7				
Consumer secured	45	82		48	85	
Total impaired loans without a valuation allowance	**$ 6,311**	**$ 8,575**		**$ 2,360**	**$ 3,524**	
Impaired loans						
Commercial	$ 6,573	$ 8,926	$ 91	$ 4,939	$ 7,066	$ 490
Agricultural	2,386	2,386	396	2,196	2,196	558
Residential mortgage	5,402	6,598	834	4,865	5,987	732
Consumer	45	82		48	85	
Total impaired loans	**$ 14,406**	**$ 17,992**	**$ 1,321**	**$ 12,048**	**$ 15,334**	**$ 1,780**

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

	March 31, 2011	
	Average Outstanding Balance	Interest Income Recognized
Impaired loans with a valuation allowance		
Commercial real estate	$ 2,091	$ 24
Commercial other	9	
Agricultural other	2,196	33
Residential mortgage senior liens	4,427	36
Residential mortgage junior liens	170	1
Total impaired loans with a valuation allowance	**$ 8,893**	**$ 94**
Impaired loans without a valuation allowance		
Commercial real estate	$ 2,676	$ 33
Commercial other	981	60
Agricultural real estate	95	(1)
Residential mortgage senior liens	537	6
Residential mortgage junior liens	1	
Consumer secured	47	2
Total impaired loans without a valuation allowance	**$ 4,337**	**$ 100**
Impaired loans		
Commercial	$ 5,757	$ 117
Agricultural	2,291	32
Residential mortgage	5,135	43
Consumer	47	2
Total impaired loans	**$ 13,230**	**$ 194**
Total impaired loans March 31, 2010	**$ 12,839**	**$ 70**

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

1. There has been a chargeoff of its principal balance;
2. The loan has been classified as a troubled debt restructuring; or
3. The loan is in nonaccrual status.

Impairment is measured on a loan by loan basis for commercial and commercial real estate loans by either 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. Accordingly, the Corporation does not separately identify individual consumer loans for impairment allocations and related disclosures.

Interest income is recognized on impaired loans in nonaccrual status on the cash basis, but only after all principal has been collected. For impaired loans not in nonaccrual status, interest income is recognized daily as it s earned according to the terms of the loan agreement.

No additional funds are committed to be advanced in connection with impaired loans, which include troubled debt restructurings.

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The following is a summary of troubled debt restructurings as of:

	March 31 2011	December 31 2010
Troubled debt restructurings	$ 8,561	$ 5,763

NOTE 7 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 nonconsolidated entities accounted for under the equity method of accounting.

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

	March 31 2011	December 31 2010
Federal Home Loan Bank Stock	$ 7,596	$ 7,596
Investment in Corporate Settlement Solutions	6,655	6,793
Federal Reserve Bank Stock	1,879	1,879
Investment in Valley Financial Corporation	1,000	1,000
Other	293	296
Total	**$ 17,423**	**$ 17,564**

NOTE 8 BORROWED FUNDS

Borrowed funds consist of the following obligations as of:

	March 31, 2011		December 31, 2010	
	Amount	Rate	Amount	Rate
Federal Home Loan Bank advances	$ 122,343	3.56%	$ 113,423	3.64%
Securities sold under agreements to repurchase without stated maturity dates	41,406	0.25%	45,871	0.25%
Securities sold under agreements to repurchase with stated maturity dates	19,514	3.03%	19,623	3.01%
Federal funds purchased			16,000	0.60%
Total	**$ 183,263**	**2.76%**	**$ 194,917**	**2.53%**

The Federal Home Loan Bank borrowings are collateralized by a blanket lien on all qualified 1-to-4 family mortgage loans and U.S. government and federal agency securities. Advances are also secured by FHLB stock owned by the Corporation. The Corporation had the ability to borrow up to an additional $128,711 based on the assets pledged as collateral as of March 31, 2011.

Securities sold under agreements to repurchase are classified as secured borrowings. Securities sold under agreements to repurchase without stated maturity dates generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase 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 $83,496 and $86,381 at March 31, 2011 and December 31, 2010, respectively. Such securities remain under the control of the Corporation. The Corporation may be required to provide additional collateral based on the fair value of underlying securities.

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Securities sold under repurchase agreements without stated maturity dates and federal funds purchased generally mature within one to four days from the transaction date. The following table provides a summary of short term borrowings for the three month periods ended March 31:

	2011			2010		
	Maximum Month-End Balance	QTD Average Balance	Weighted Average Interest Rate During the Period	Maximum Month-End Balance	QTD Average Balance	Weighted Average Interest Rate During the Period
Securities sold under agreements to repurchase witout stated maturity dates	$ 41,406	$ 41,036	0.25%	$ 38,409	$ 36,566	0.30%
Federal funds purchased	3,600	1,206	0.50%		336	0.50%

The Corporation had pledged certificates of deposit held in other financial institutions, trading securities, available-for-sale securities, and 1-4 family mortgage loans in the following amounts at:

	March 31 2011	December 31 2010
Pledged to secure borrowed funds	$ 299,488	$ 297,297
Pledged to secure repurchase agreements	83,496	86,381
Pledged for public deposits and for other purposes necessary or required by law	15,044	14,626
Total	**$ 398,028**	**$ 398,304**

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

NOTE 9 OTHER NONINTEREST EXPENSES

A summary of expenses included in other noninterest expenses are as follows for the three month periods ended March 31:

	2011	2010
Marketing and community relations	$ 223	$ 388
Foreclosed asset and collection	100	199
Directors fees	211	209
Audit and SOX compliance fees	156	245
Education and travel	105	114
Printing and supplies	100	96
Postage and freight	100	83
Legal fees	62	83
Amortization of deposit premium	76	86
Consulting fees	33	46
All other	330	311
Total other	**$ 1,496**	**$ 1,860**

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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 month periods ended March 31:

	2011	2010
Income taxes at 34% statutory rate	$ 928	$ 784
Effect of nontaxable income		
Interest income on tax exempt municipal bonds	(383)	(352)
Earnings on corporate owned life insurance	(48)	(57)
Other	(94)	(97)
Total effect of nontaxable income	(525)	(506)
Effect of nondeductible expenses	10	4
Federal income tax expense	**$ 413**	**$ 282**

Included in other comprehensive income for the three month periods ended March 31, 2011 and 2010 are changes in unrealized holding gains of $595 and losses of $133, respectively, related to auction rate money market preferred stock securities 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.

NOTE 11 DEFINED BENEFIT PENSION PLAN

The Corporation has a non contributory defined benefit pension plan, which was curtailed effective March 1, 2007. As a result of the curtailment, future salary increases are no longer considered and plan benefits are based on years of service and the employees five highest consecutive years of compensation out of the last ten years of service through March 1, 2007. The Corporation made no contributions to the pension plan during three month periods ended March 31, 2011 or 2010. The Corporation does not anticipate any contributions to the plan in 2011.

Following are the components of net periodic benefit cost for the three month periods ended March 31:

	2011	2010
Interest cost on projected benefit obligation	$ 127	$ 133
Expected return on plan assets	(131)	(123)
Amortization of unrecognized actuarial net loss	38	38
Net periodic benefit cost	**$ 34**	**$ 48**

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NOTE 12 FAIR VALUE

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, the Corporation uses present value techniques and other valuation methods to estimate the fair values of its 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 on the Corporation s consolidated balance sheets are as follows:

	March 31, 2011		December 31, 2010	
	Estimated Fair Value	Carrying Value	Estimated Fair Value	Carrying Value
ASSETS				
Cash and demand deposits due from banks	$ 23,332	$ 23,332	$ 18,109	$ 18,109
Certicates of deposit held in other financial institutions	13,956	13,868	15,908	15,808
Mortgage loans available-for-sale	252	252	1,182	1,182
Net loans	730,237	725,596	734,634	722,931
Accrued interest receivable	6,258	6,258	5,456	5,456
Equity securities without readily determinable fair values	17,423	17,423	17,564	17,564
Originated mortgage servicing rights	2,653	2,653	2,673	2,667
LIABILITIES				
Deposits with no stated maturities	462,458	462,458	424,978	424,978
Deposits with stated maturities	459,013	460,789	454,332	452,361
Borrowed funds	177,768	172,920	190,180	184,494
Accrued interest payable	1,031	1,031	1,003	1,003

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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:

	March 31, 2011			December 31, 2010		
Description	Total	Level 2	Level 3	Total	Level 2	Level 3
Recurring items						
Trading securities						
States and political subdivisions	$ 5,433	$ 5,433	$	$ 5,837	$ 5,837	$
Total trading securities	5,433	5,433		5,837	5,837	
Available-for-sale investment securities						
Government sponsored enterprises	5,378	5,378		5,404	5,404	
States and political subdivisions	169,675	169,675		169,717	169,717	
Auction rate money market preferred	2,803		2,803	2,865		2,865
Preferred stock	7,593		7,593	6,936		6,936
Mortgage-backed	111,025	111,025		102,215	102,215	
Collateralized mortgage obligations	65,486	65,486		43,587	43,587	
Total available-for-sale investment securities	361,960	351,564	10,396	330,724	320,923	9,801
Borrowed funds	10,343	10,343		10,423	10,423	
Nonrecurring items						
Impaired loans	14,406		14,406	12,048		12,048
Originated mortgage servicing rights	2,653	2,653		2,667	2,667	
Foreclosed assets	2,588	2,588		2,067	2,067	
	$ 397,383	$ 372,581	$ 24,802	$ 363,766	$ 341,917	$ 21,849
Percent of assets and liabilities measured at fair value		93.76%	6.24%		93.99%	6.01%

As of March 31, 2011 and December 31, 2010, the Corporation had no assets or liabilities measured utilizing Level 1 valuation techniques.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, as well as a description of the methods and significant assumptions used to estimate fair value disclosures for financial instruments not recorded at fair value in their entirety on a recurring basis. For financial assets and liabilities recorded at fair value, the description includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Cash and demand deposits due from banks: The carrying amounts of cash and short term investments, including Federal funds sold, approximate fair values.

Certificates of deposit held in other financial institutions: Interest bearing balances held in unaffiliated financial institutions include certificates of deposit and other short term interest bearing balances that mature within 3 years. Fair value is determined using prices for similar assets with similar characteristics.

Investment securities: Investment securities are recorded at fair value on a recurring basis. Level 2 fair value measurement is based upon quoted prices, if available. 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. Level 2 securities include bonds issued by government sponsored enterprises, states and political subdivisions, mortgage-backed securities, and collateralized mortgage obligations issued by government sponsored enterprises.

Securities classified as Level 3 include securities in less liquid markets and include auction rate money market preferred securities and preferred stocks. Due to the limited trading activity of these securities, the fair values were estimated utilizing a hybrid of market value and discounted cash flow analysis as of March 31, 2011 and a discounted cash flow analysis as of December 31, 2010. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, the current volume of trading activity, and recent trade prices. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The Corporation calculated the present value assuming a 3 year nonamortizing balloon using weighted average discount rates between approximately 5.50% and 7.25% as of March 31, 2011.

Mortgage loans available-for-sale: Mortgage loans available-for-sale are carried at the lower of cost or fair value. The fair value of mortgage loans available-for-sale are based on what price secondary markets are currently offering for portfolios with similar characteristics. As such, the Corporation classifies loans subjected 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.

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered 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, management measures the estimated impairment. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value, or discounted cash flows. 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.

The Corporation reviews 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, management utilizes independent appraisals, broker price opinions, or internal evaluations. These valuations are reviewed 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 carry and sell an asset if it is determined that the collateral will be liquidated in connection with the ultimate settlement of the loan. The Corporation uses this valuation to determine if any charge offs or specific reserves are necessary. The Corporation 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.

Impaired loans where an allowance is established based on the net realizable value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraisal value, the Corporation records the loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value collateral is further impaired below the appraised value, the Corporation records the impaired loans as nonrecurring Level 3.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Goodwill and other intangible assets: Acquisition intangibles and goodwill are subject to impairment testing. A projected cash flow valuation method is used in the completion of impairment testing. This valuation method requires a significant degree of management judgment. In the event the projected undiscounted net operating cash flows are less than the carrying value, the asset is recorded at fair value as determined by the valuation model. If the testing resulted in impairment, the Corporation would classify goodwill and other acquisition intangibles subjected to nonrecurring fair value adjustments as Level 3. During 2011 and 2010, there were no impairments recorded on goodwill and other acquisition intangibles.

Equity securities without readily determinable fair values: The Corporation has investments in equity securities without readily determinable fair values as well as investments in joint ventures. The assets are individually reviewed for impairment on an annual basis, or more frequently if an indication of impairment exists, by comparing the carrying value to the estimated fair value. The lack of an independent source to validate fair value estimates, including the impact of future capital calls and transfer restrictions, is an inherent limitation in the valuation process. The

Corporation classifies nonmarketable equity securities and its investments in joint ventures subjected to nonrecurring fair value adjustments as Level 3. During 2011 and 2010, there were no impairments recorded on equity securities without readily determinable fair values.

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Foreclosed assets: Upon transfer from the loan portfolio, foreclosed 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 and as such, the Corporation classifies foreclosed assets as a nonrecurring Level 2. When management determines that the net realizable value of the collateral is further impaired below the appraised value but there is no observable market price, the Corporation records the foreclosed asset as nonrecurring Level 3.

Originated mortgage servicing rights: Originated mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, originated mortgage servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies loan servicing rights subject to nonrecurring fair value adjustments as Level 2.

Deposits: Demand, savings, and money market deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for variable rate certificates of deposit approximate their recorded 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.

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 the Corporation s other borrowed funds are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing arrangements.

The Corporation has elected to measure a portion of borrowed funds at fair value. These borrowings are recorded at fair value on a recurring basis, with the fair value measurement estimated using discounted cash flow analysis based on the Corporation s current incremental borrowings rates for similar types of borrowing arrangements. Changes in the fair value of these borrowings are included in noninterest income. As such, the Corporation classifies other borrowed funds as Level 2.

Commitments to extend credit, standby letters of credit and undisbursed loans: Fair values for off balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the counterparties credit standings. The Corporation does not charge fees for lending commitments; thus it is not practicable to estimate the fair value of these instruments.

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. Furthermore, although the Corporation believes its 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.

The table below represents the activity in available-for-sale investment securities measured with Level 3 inputs on a recurring basis for the three month periods ended March 31:

	2011	2010
Level 3 inputs at beginning of period	$ 9,801	$ 10,027
Net unrealized gains (losses)	595	(133)
Level 3 inputs March 31	$ 10,396	$ 9,894

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The changes in fair value of assets and liabilities recorded at fair value through earnings on a recurring basis and changes in assets and liabilities recorded at fair value on a nonrecurring basis, for which an impairment, or reduction of an impairment, was recognized in the three month periods ended March 31, 2011 and 2010, are summarized as follows:

	2011			2010		
Description	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
Recurring items						
Trading securities	$ (19)	$	$ (19)	$ (1)	$	$ (1)
Borrowed funds		80	80		56	56
Nonrecurring items						
Foreclosed assets		(10)	(10)		(77)	(77)
Originated mortgage servicing rights		7	7		36	36
Total	**$ (19)**	**$ 77**	**$ 58**	**$ (1)**	**$ 15**	**$ 14**

The activity in borrowings which the Corporation has elected to carry at fair value was as follows for the three month periods ended March 31:

	2011	2010
Borrowings carried at fair value January 1	$ 10,423	$ 17,804
Net change in fair value	(80)	(56)
Borrowings carried at fair value March 31	**$ 10,343**	**$ 17,748**
Unpaid principal balance March 31	**$ 10,000**	**$ 17,154**

NOTE 13 OPERATING SEGMENTS

The Corporation s reportable segments are based on legal entities that account for at least 10% of net operating results. Retail banking operations as of March 31, 2011 and 2010 and each of the three month periods then ended, represented 90% or more of the Corporation s 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

(All dollars in thousands)

The following is management s discussion and analysis of the financial condition and results of operations for Isabella Bank Corporation. This discussion and analysis is intended to provide a better understanding of the unaudited interim condensed consolidated financial statements and statistical data included elsewhere in this Form 10-Q. This analysis should be read in conjunction with the Corporation s 2010 annual report and with the unaudited interim condensed consolidated financial statements and notes, beginning on page 3 of this report.

Executive Summary

Isabella Bank Corporation, as well as all other financial institutions in Michigan and across the entire country, continues to experience the negative impacts on its operations from the recent economic recession. This recession, which began in the fourth quarter of 2008, has resulted in historically high levels of loan delinquencies and nonaccrual loans, which have translated into increases in net loans charged off and foreclosed asset and collection expenses. Despite the current economic downturn, the Corporation continues to be profitable, with net income of $2,316 for the three month period ended March 31, 2011. The Corporation s nonperforming loans represented 0.77% of total loans as of March 31, 2011 which declined from 0.83% as of December 31, 2010. The ratio of nonperforming loans to total loans for all banks in the Corporation s peer group was 3.57% as of December 31, 2010 (March 31, 2011 peer group ratios are not yet available). The Corporation s interest margins also continue to be strong, as the net yield on interest earning assets (on a fully tax equivalent basis) was 3.92% for the three month period ended March 31, 2011.

Recent Legislation

The Health Care and Education Act of 2010 and the Patient Protection and Affordable Care Act could have a significant impact on the Corporation s operating results in future periods. Aside from the potential increases in the Corporation s health care costs, the implementation of the new rules and requirements is likely to require a substantial commitment from the Corporation s management.

In 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act makes sweeping changes in the regulation of financial institutions aimed at strengthening the sound operation of the financial services sector. Many of the provisions in the Dodd-Frank Act will not become effective until future years. The Dodd-Frank Act includes the following provisions, among other things:

- Directs the Federal Reserve to issue rules which are expected to limit debit-card interchange fees for financial institutions with assets in excess of $10,000,000;

- Creates a new Consumer Financial Protection Bureau that will have rulemaking and enforcement authority for a wide range of consumer protection laws affecting financial institutions;

- Increases leverage and risk-based capital requirements, FDIC premiums and examination fees;

- Provides for new disclosure, say-on-pay, and other rules relating to executive compensation and corporate governance for public companies, including public financial institutions;

- Permanently increases the federal deposit insurance coverage limit to $250;

- Provides for mortgage reform addressing a customer s ability to repay, restricts variable-rate lending, and makes more loans subject to disclosure requirements and other restrictions; and

- Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

Uncertainty remains as to the ultimate impact of the Dodd-Frank Act on the financial services industry as a whole and on the Corporation. In particular, many provisions of the Dodd-Frank Act are subject to rulemaking, which make it difficult to predict the impact of the Dodd-Frank Act on the Corporation, its customers and the financial services industry as a whole. The Dodd-Frank Act will likely result in increases in the Corporation s expenses, decreases to its revenues, and changes in the activities in which the Corporation engages, which could have a material adverse impact on the Corporation s financial performance and results of operations that cannot be foreseen. Management anticipates that the impact will be substantial.

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CRITICAL ACCOUNTING POLICIES

A summary of the Corporation s significant accounting policies is set forth in Note 1 of the Consolidated Financial Statements included in the Corporation s Annual Report for the year ended December 31, 2010. Of these significant accounting policies, the Corporation considers its policies regarding the allowance for loan losses, acquisition intangibles, and the determination of the fair value of investment securities to be its most critical accounting policies. The allowance for loan losses requires management s most subjective and complex judgment. Changes in economic conditions can have a significant impact on the allowance for loan losses and, therefore, the provision for loan losses and results of operations. The Corporation has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation s assessments may be impacted in future periods by changes in economic conditions, and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation s allowance for loan losses and related matters, see the detailed discussion to follow under the heading Allowance for Loan Losses .

United States generally accepted accounting principles require that the Corporation determine the fair value of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. The Corporation employs a variety of measures in the determination of the fair value, including the use of discounted cash flow analysis, market appraisals, and projected future revenue streams. For certain items that management believes it has the appropriate expertise to determine the fair value, management may choose to use its own calculations of the value. In other cases, where the value is not easily determined, the Corporation consults with outside parties to determine the fair value of the identified asset or liability. Once valuations have been adjusted, the net difference between the price paid for the acquired entity and the value of its balance sheet, including identifiable intangibles, is recorded as goodwill. This goodwill is not amortized, but is tested for impairment on at least an annual basis.

The Corporation currently has both available-for-sale and trading investment securities that are carried at fair value. Changes in the fair value of available-for-sale investment securities are included as a component of other comprehensive income, while declines in the fair value of these securities below their cost that are other-than-temporary are reflected as realized losses in the consolidated statements of income. The change in value of trading investment securities is included in current earnings. Management evaluates securities for indications of losses that are considered other-than-temporary, if any, on a regular basis. The market values for available-for-sale and trading investment securities are typically obtained from outside sources and applied to individual securities within the portfolio.

The Corporation invested $11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, $7,800 converted to preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a hybrid of market value and discounted cash flow analysis as of March 31, 2011 and a discounted cash flow analysis as of December 31, 2010. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, the current volume of trading activity, and recent trade prices. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The Corporation calculated the present value assuming a 3 year nonamortizing balloon using weighted average discount rates between approximately 5.50% and 7.25% as of March 31, 2011.

As of March 31, 2011, the Corporation held an auction rate money market preferred security and preferred stocks which declined in fair value as a result of the securities interest rates, as they are currently lower than the offering rates of securities with similar characteristics. Despite the limited trading of these securities, management has determined that any declines in the fair value of these securities are the result of changes in interest rates and not risks related to the underlying credit quality of the security. Additionally, none of these securities are deemed to be below investment grade, and management does not intend to sell the securities in an unrealized loss position, and it is more likely than not that the Corporation will not have to sell the securities before recovery of their cost basis. As a result, the Corporation has not recognized an other-than-temporary impairment related to these declines in fair value.

RESULTS OF OPERATIONS

Selected Financial Data

The following table outlines the results of operations for the three month periods ended March 31, 2011 and 2010.

	2011	2010
INCOME STATEMENT DATA		
Net interest income	$ 10,185	$ 9,699
Provision for loan losses	817	1,207
Net income	2,316	2,023
PER SHARE DATA		
Earnings per share		
Basic	$ 0.31	$ 0.27
Diluted	0.30	0.26
Cash dividends per common share	0.19	0.18
Book value (at end of period)	19.52	18.89
RATIOS		
Average primary capital to average assets	12.63%	13.42%
Net income to average assets (annualized)	0.74	0.71
Net income to average equity (annualized)	6.34	5.68
Net income to average tangible equity (annualized)	9.56	8.66

Net Interest Income

Net interest income equals interest income less interest expense and is the primary source of income for the Corporation. Interest income includes loan fees of $566 and $403 for the three month periods ended March 31, 2011 and 2010, respectively. For analytical purposes, net interest income is adjusted to a taxable equivalent basis by adding the income tax savings from interest on tax exempt loans and securities, thus making year to year comparisons more meaningful.

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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, nonearning assets, interest bearing liabilities, and noninterest bearing liabilities. This schedule also presents an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a fully taxable equivalent (FTE) basis using a 34% tax rate. Non accruing loans, for the purpose of the following computations, are included in the average loan amounts outstanding. Federal Reserve and Federal Home Loan Bank restricted equity holdings are included in other.

The following table displays the results for the three month periods ended March 31:

	2011			2010		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS						
Loans	$ 734,630	$ 11,361	6.19%	$ 724,194	$ 11,517	6.36%
Taxable investment securities	201,508	1,513	3.00%	142,075	1,279	3.60%
Nontaxable investment securities	134,514	1,927	5.73%	118,767	1,756	5.91%
Trading account securities	5,527	77	5.57%	11,022	141	5.12%
Other	43,279	134	1.24%	33,739	104	1.23%
Total earning assets	1,119,458	15,012	5.36%	1,029,797	14,797	5.75%
NON EARNING ASSETS						
Allowance for loan losses	(12,585)			(13,395)		
Cash and demand deposits due from banks	20,512			16,110		
Premises and equipment	24,510			24,323		
Accrued income and other assets	92,607			90,423		
Total assets	$ 1,244,502			$ 1,147,258		
INTEREST BEARING LIABILITIES						
Interest bearing demand deposits	$ 151,228	46	0.12%	$ 133,839	35	0.10%
Savings deposits	190,147	124	0.26%	165,901	89	0.21%
Time deposits	457,374	2,615	2.29%	417,030	2,759	2.65%
Borrowed funds	182,943	1,268	2.77%	186,079	1,517	3.26%
Total interest bearing liabilities	981,692	4,053	1.65%	902,849	4,400	1.95%
NONINTEREST BEARING LIABILITIES						
Demand deposits	107,402			93,560		

Other	9,260			8,444		
Shareholders equity	146,148			142,405		
Total liabilities and shareholders equity	$ 1,244,502			$ 1,147,258		
Net interest income (FTE)		$ 10,959			$ 10,397	
Net yield on interest earning assets (FTE)			3.92%			4.04%

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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 Variance change in volume multiplied by the previous year s rate.

Rate Variance change in the fully taxable equivalent (FTE) rate multiplied by the prior year s volume.

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 March 31, 2011 Compared to March 31, 2010 Increase (Decrease) Due to		
	Volume	Rate	Net
CHANGES IN INTEREST INCOME			
Loans	$ 164	$ (320)	$ (156)
Taxable investment securities	471	(237)	234
Nontaxable investment securities	227	(56)	171
Trading account securities	(76)	12	(64)
Other	30		30
Total changes in interest income	816	(601)	215
CHANGES IN INTEREST EXPENSE			
Interest bearing demand deposits	5	6	11
Savings deposits	14	21	35
Time deposits	252	(396)	(144)
Borrowed funds	(25)	(224)	(249)
Total changes in interest expense	246	(593)	(347)
Net change in interest margin (FTE)	$ 570	$ (8)	$ 562

Despite the declines in interest rates over the last year (for both interest earning assets and interest bearing liabilities), the Corporation has been able to maintain adequate interest margins.

The Corporation anticipates that net interest margin yield will decline slightly during the remainder 2011 due to the following factors:

Based on the current economic conditions, management does not anticipate any changes in the target Fed Funds rate in the reasonably foreseeable future. As such, the Corporation does not anticipate significant, if any, changes in market rates. However, there is the potential for declines in rates earned on interest earning assets. Most of the potential declines would arise out of the Corporation s investment portfolio, as securities, which are either called or matured during 2011, will likely be reinvested at significantly lower rates of return.

Average loans to assets were 59.0% in the first three months of 2011 as compared to 63.1% in 2010. The decline represents a shift of assets from higher yielding loans into investments, which negatively impacts net interest margin yield.

The interest rates on many types of loans including home equity lines of credit and investment securities with acceptable credit and interest rate risks are currently priced at or below the Corporation s quarter to date net yield on interest earning assets of 3.92%. In order to earn additional net interest income, the Corporation is continuing to extend loans and purchase investments that will increase net income but decrease net interest margin yield.

While the Corporation s liability sensitive balance sheet has allowed it to benefit from decreases in interest rates, it also makes the Corporation sensitive to increases in deposit and borrowing rates. As part of the Corporation s goal to minimize the potential negative impacts of possible increases in future interest rates, management is actively working to lengthen the terms of its interest bearing liabilities. This lengthening has increased the Corporation s cost of funding, reducing net interest income in the short term.

Allowance for Loan Losses

The viability of any financial institution is ultimately determined by its management of credit risk. Loans outstanding represent the Corporation s single largest concentration of risk. The allowance for loan losses is management s estimation of probable losses inherent in the existing loan portfolio. Factors used to evaluate the loan portfolio, and thus to determine the current charge to expense, include recent loan loss history, financial condition of borrowers, amount of nonperforming and impaired loans, overall economic conditions and other factors. The following table summarizes the Corporation s charge off and recovery activity for the three month periods ended March 31:

	2011	2010	Variance
Allowance for loan losses January 1	$ 12,373	$ 12,979	$ (606)
Loans charged off			
Commercial and agricultural	(655)	(506)	(149)
Real estate mortgage	(323)	(983)	660
Consumer	(145)	(114)	(31)
Total loans charged off	**(1,123)**	**(1,603)**	**480**
Recoveries			
Commercial and agricultural	137	158	(21)
Real estate mortgage	74	152	(78)
Consumer	103	94	9
Total recoveries	**314**	**404**	**(90)**
Provision for loan losses	817	1,207	(390)
Allowance for loan losses March 31	**$ 12,381**	**$ 12,987**	**$ (606)**
Net loans charged off	$ 809	$ 1,199	$ (390)
Year to date average loans outstanding	734,630	724,194	10,436
Net loans charged off to average loans outstanding	**0.11%**	**0.17%**	**-0.06%**
Total amount of loans outstanding	**$ 737,977**	**$ 726,165**	**$ 11,812**
Allowance for loan losses as a % of loans	**1.68%**	**1.79%**	**-0.11%**

Increases in the inventory of unsold homes have led to significant declines in residential real estate values in the Corporation s market areas. This increased inventory is partially the result of the inability of potential home buyers to obtain financing due to the tightening of loan underwriting criteria by many financial institutions, brokers and government sponsored agencies. While the Corporation has maintained traditional lending standards, the decline in real estate values has had an adverse impact on customers who are experiencing financial difficulties. Historically, customers who experienced difficulties were able to sell their properties for more than the loan balance owed. The steep decline in real estate values has diminished homeowner equity and led borrowers who are experiencing financial difficulties to default on their mortgage loans.

The Corporation originates and sells fixed rate residential real estate mortgages to the Federal Home Loan Mortgage Corporation (Freddie Mac). The Corporation has not originated loans for either trading or its own portfolio that would be classified as subprime, nor has it originated adjustable rate mortgages or financed loans for more than 80% of market value unless insured by private third party insurance.

As shown in the preceding table, when comparing the first three months of 2011 to the same period in 2010, net loans charged off decreased by $390. This improvement allowed the Corporation to reduce its provision for loan losses in 2011 as compared to 2010. While there have been marked improvements in the level of net loans charged off and nonperforming assets, which has contributed to the Corporation s ability to reduce its provision for loan losses, the overall local, regional and national economies have yet to show consistent improvement.

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The Corporation allocates the allowance throughout its loan portfolio based on management s assessment of the underlying risks associated with each loan segment. Management s assessments include allocations based on specific impairment allocations, historical loss histories, internally assigned credit ratings, and past due and nonaccrual balances. A portion of the allowance for loan losses is not allocated to any one loan segment, but is instead a reflection of other qualitative risks within the Corporation s loan portfolio.

For further discussion on the allocation of the allowance for loan losses, see Note 6 Loans and Allowance for Loan Losses to the Corporation s interim condensed consolidated financial statements.

Loans Past Due and Loans in Nonaccrual Status

Increases in past due and nonaccrual loans can have a significant impact on the allowance for loan losses. To determine the potential impact, and corresponding estimated losses, management analyzes its historical loss trends on loans past due 30-89 days, 90 days or more, and nonaccrual loans.

The following tables summarize the Corporation s past due and nonaccrual loans as of:

	March 31, 2011			
	Accruing Loans Past Due			
	30-89 Days	Greater Than 90 Days	Nonaccrual	Total Past Due and Nonaccrual
Commercial and agricultural	$ 2,395	$ 594	$ 3,334	$ 6,323
Residential mortgage	4,203	167	1,623	5,993
Consumer installment	265			265
	$ 6,863	$ 761	$ 4,957	$ 12,581

	December 31, 2010			
	Accruing Loans Past Due			
	30-89 Days	Greater Than 90 Days	Nonaccrual	Total Past Due and Nonaccrual
Commercial and agricultural	$ 5,291	$ 175	$ 4,140	$ 9,606
Residential mortgage	6,339	310	1,470	8,119
Consumer installment	308	1		309
	$ 11,938	$ 486	$ 5,610	$ 18,034

Troubled Debt Restructurings

The following table summarizes the Corporation s troubled debt restructurings as of:

	March 31 2011			December 31 2010			
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total	Total Change
Current	$ 7,849	$ 459	$ 8,308	$ 4,798	$ 499	$ 5,297	$ 3,011
Past due 30-89 days	177		177	277	26	303	(126)
Past due 90 days or more		76	76		163	163	(87)
Total troubled debt restructurings	**$ 8,026**	**$ 535**	**$ 8,561**	**$ 5,075**	**$ 688**	**$ 5,763**	**$ 2,798**

Since December 31, 2008 the Corporation has taken aggressive actions to avoid foreclosures on borrowers who are willing to work with the Corporation in modifying their loans, thus making them more affordable. These loan modifications have allowed borrowers to develop a payment structure that will allow them to continue making payments in lieu of foreclosure. Troubled debt restructurings that have been placed in nonaccrual status may be placed back on accrual status after six months of continuous performance.

To be classified as a troubled debt restructuring, the concessions granted to a customer who is experiencing financial difficulty must meet one of the following criteria:

1. Reduction of the stated interest rate related to the sole purpose of providing payment relief for the remaining original life of the debt.

2. Extension of the amortization period beyond typical lending guidelines.

3. Forbearance of principal.

4. Forbearance of accrued interest.

The following table displays the results of the Corporation s efforts related to troubled debt restructurings modified since December 31, 2008:

	Successful		Unsuccessful		Total	
	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans
Reduction in interest rate	2	$ 275	1	$ 132	3	$ 407
Extension of amortization	32	7,152	3	114	35	7,266
Reduction in interest rate and extension of amortization	34	6,001	1	93	35	6,094
	68	$ 13,428	5	$ 339	73	$ 13,767

Since December 31, 2008 the Corporation has not restructured any loans as a result of a forbearance of principal or accrued interest. As shown the preceding table, the Corporation has been successful in its efforts to modify loans to prevent foreclosures.

Nonperforming Assets

The following table summarizes the Corporation s nonperforming assets as of:

	March 31 2011	December 31 2010	Change
Nonaccrual loans	$ 4,957	$ 5,610	$ (653)
Accruing loans past due 90 days or more	761	486	275
Total nonperforming loans	**5,718**	**6,096**	**(378)**
Other real estate owned (OREO)	2,575	2,039	536
Repossessed assets	13	28	(15)
Total nonperforming assets	**$ 8,306**	**$ 8,163**	**$ 143**
Nonperforming loans as a % of total loans	**0.77%**	**0.83%**	**-0.05%**
Nonperforming assets as a % of total assets	**0.66%**	**0.67%**	**-0.01%**

Loans are placed in nonaccrual status when the foreclosure process has begun, generally after a loan is 90 days past due, unless they are well secured and in the process of collection. Upon transferring the loans to nonaccrual status, an evaluation to determine the net realizable value of the underlying collateral is performed. This evaluation is used to help determine if any charge downs are necessary. Loans may be placed back on accrual status after six months of continued performance.

The following table summarizes the Corporation s nonaccrual loan balances by type as of:

	March 31 2011	December 31 2010	Change
Commercial and agricultural	$ 3,334	$ 4,140	$ (806)
Residential mortgage	1,623	1,470	153
	$ 4,957	$ 5,610	$ (653)

Included in nonaccrual commercial and agricultural loans was one credit with a balance of $2,329 as of March 31, 2011 and $2,679 as of December 31, 2010. This credit is secured by undeveloped commercial real estate for which there has been a specific allocation established in the amount of $345 as of December 31, 2010. As of March 31, 2011, there was no specific allocation established for this credit as it was charged down to reflect the current market value of the real estate. There were no other individually significant credits included in nonaccrual loans as of March 31, 2011 and December 31, 2010.

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

	March 31 2011	December 31 2010	Change
Commercial and agricultural	$	$ 115	$ (115)
Residential mortgage	535	573	(38)

$	535	$	688	$	(153)

The Corporation has devoted 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. To management s knowledge, there are no other loans which cause management to have serious doubts as to the ability of a borrower to comply with their loan repayment terms. A continued decline in real estate values may require further write downs of loans in foreclosure and other real estate owned and could potentially have an adverse impact on the Corporation s financial performance.

Based on management s analysis, the allowance for loan losses is considered appropriate as of March 31, 2011. Management will continue to closely monitor its overall credit quality during 2011 to ensure that the allowance for loan losses remains appropriate.

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NONINTEREST INCOME AND EXPENSES

Noninterest Income

Noninterest income consists of service charges and fee income, gains from the sale of mortgage loans, gains and losses on trading securities and borrowings measured at fair value, gains from the sale of investment securities, and other. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations:

	Three Months Ended March 31			
			Change	
	2011	2010	$	%
Service charges and fees				
NSF and overdraft fees	$ 571	$ 710	$ (139)	-19.6%
ATM and debit card fees	403	345	58	16.8%
Trust fees	221	194	27	13.9%
Freddie Mac servicing fee	182	188	(6)	-3.2%
Service charges on deposit accounts	75	80	(5)	-6.3%
Net originated mortgage servicing rights (loss) income	(14)	75	(89)	N/M
All other	38	36	2	5.6%
Total service charges and fees	**1,476**	**1,628**	**(152)**	**-9.3%**
Gain on sale of mortgage loans	**129**	**93**	**36**	**38.7%**
Net loss on trading securities	**(19)**	**(1)**	**(18)**	**N/M**
Net gain on borrowings measured at fair value	**80**	**56**	**24**	**42.9%**
Gain on sale of available-for-sale investment securities		**56**	**(56)**	**-100.0%**
Other				
Earnings on corporate owned life insurance policies	142	169	(27)	-16.0%
Brokerage and advisory fees	139	143	(4)	-2.8%
All other	1	23	(22)	-95.7%
Total other	**282**	**335**	**(53)**	**-15.8%**
Total noninterest income	**$ 1,948**	**$ 2,167**	**$ (219)**	**-10.1%**

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Significant changes in noninterest income are detailed below:

Management continuously analyzes various fees related to deposit accounts including service charges and NSF and overdraft fees. Based on these analyses, the Corporation makes any necessary adjustments to ensure that its fee structure is within the range of its competitors, while at the same time making sure that the fees remain fair to deposit customers. NSF and overdraft fees have been steadily declining over the past two years, with the decline accelerating in the third quarter of 2010 as a result of new regulatory guidance issued by the Federal Reserve Bank being implemented related to NSF and overdraft fees. The Corporation anticipates that NSF and overdraft fees will approximate current levels for the remainder of 2011.

The increases in ATM and debit card fees are primarily the result of the increased usage of debit cards by customers. As management does not anticipate any significant changes to the ATM and debit card fee structures, income is expected to continue to increase as the usage of debit cards increases.

Fluctuations in the gains and losses related to trading securities and borrowings carried at fair value are caused by interest rate variances. Management does not anticipate any significant fluctuations in net trading activities for the remainder of the year as significant interest rate changes are not expected.

The Corporation is continuously analyzing its available-for-sale investment portfolio to take advantage of selling opportunities that would generate gains. Currently, management does not anticipate any significant sales throughout the remainder of 2011.

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

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Noninterest Expenses

Noninterest expenses include compensation and benefits, occupancy, furniture and equipment, FDIC insurance premiums, and other expenses. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations:

	Three Months Ended March 31			
			Change	
	2011	2010	$	%
Compensation and benefits				
Leased employee salaries	$ 3,556	$ 3,377	$ 179	5.3%
Leased employee benefits	1,443	1,213	230	19.0%
All other	6	5	1	20.0%
Total compensation and benefits	**5,005**	**4,595**	**410**	**8.9%**
Occupancy				
Depreciation	148	145	3	2.1%
Outside services	162	124	38	30.6%
Property taxes	128	114	14	12.3%
Utilities	127	123	4	3.3%
Building repairs	60	39	21	53.8%
All other	21	17	4	23.5%
Total occupancy	**646**	**562**	**84**	**14.9%**
Furniture and equipment				
Depreciation	499	453	46	10.2%
Computer / service contracts	460	429	31	7.2%
ATM and debit card fees	139	142	(3)	-2.1%
All other	8	7	1	14.3%
Total furniture and equipment	**1,106**	**1,031**	**75**	**7.3%**
FDIC insurance premiums	**334**	**306**	**28**	**9.2%**
Other				
Marketing and community relations	223	388	(165)	-42.5%
Foreclosed asset and collection	100	199	(99)	-49.7%
Directors fees	211	209	2	1.0%
Audit and SOX compliance fees	156	245	(89)	-36.3%
Education and travel	105	114	(9)	-7.9%
Printing and supplies	100	96	4	4.2%
Postage and freight	100	83	17	20.5%
Legal fees	62	83	(21)	-25.3%
Amortization of deposit premium	76	86	(10)	-11.6%
Consulting fees	33	46	(13)	-28.3%
All other	330	311	19	6.1%
Total other	**1,496**	**1,860**	**(364)**	**-19.6%**

Total noninterest expenses	**$ 8,587**	**$ 8,354**	**$ 233**	**2.8%**

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Significant changes in noninterest expenses are detailed below:

Leased employee salaries have increased due to annual merit increases and the continued growth of the Corporation.

Leased employee benefits returned to more normal levels when the first three months of 2011 is compared to the same period in 2010. Expenses during the first quarter of 2010 were abnormally low due to reduced health care related expenses, which tend to fluctuate from period to period. The Corporation expects leased employee benefits to remain at current levels for the remainder of 2011.

Marketing and community relations returned to normal levels in the first three months of 2011 when compared to the same period in 2010 as a result of nonrecurring charitable contributions made in the first quarter of 2010. The Corporation anticipates marketing and community relations to approximate current levels throughout the remainder of 2011.

While foreclosed asset and collection expenses have declined from 2010, they continue to be at historically high levels. Management anticipates that these expenses will approximate current levels throughout the remainder of 2011.

The decline in Audit and Sox compliance fees is primarily due to the timing of performance of recurring audit procedures. Management does not anticipate any significant changes for the remainder of 2011.

The Corporation s legal expenses can fluctuate from period to period based on the volume of foreclosures as well as expenses related to the Corporation s ongoing operations. At this time, the Corporation is not aware of any significant legal matters for 2011.

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

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ANALYSIS OF CHANGES IN FINANCIAL CONDITION

	March 31 2011	December 31% 2010	$ Change	Change (unannualized)
ASSETS				
Cash and cash equivalents	$ 23,332	$ 18,109	$ 5,223	28.84%
Certificates of deposit held in other financial institutions	13,868	15,808	(1,940)	-12.27%
Trading securities	5,433	5,837	(404)	-6.92%
Available-for-sale securities	361,960	330,724	31,236	9.44%
Mortgage loans available-for-sale	252	1,182	(930)	-78.68%
Loans	737,977	735,304	2,673	0.36%
Allowance for loan losses	(12,381)	(12,373)	(8)	0.06%
Premises and equipment	24,219	24,627	(408)	-1.66%
Goodwill and other intangible assets	47,015	47,091	(76)	-0.16%
Equity securities without readily determinable fair values	17,423	17,564	(141)	-0.80%
Other assets	43,083	41,937	1,146	2.73%
TOTAL ASSETS	**$ 1,262,181**	**$ 1,225,810**	**$ 36,371**	**2.97%**
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities				
Deposits	$ 923,247	$ 877,339	$ 45,908	5.23%
Borrowed funds	183,263	194,917	(11,654)	-5.98%
Accrued interest payable and other liabilities	8,070	8,393	(323)	-3.85%
Total liabilities	**1,114,580**	**1,080,649**	**33,931**	**3.14%**
Shareholders equity	**147,601**	**145,161**	**2,440**	**1.68%**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,262,181**	**$ 1,225,810**	**$ 36,371**	**2.97%**

As shown above, the Corporation has had significant deposit growth since year end. However, as loans have remained essentially unchanged, the Corporation increased cash and cash equivalents (which includes interest bearing balances due from banks) and available-for-sale investment securities. As deposits are anticipated to continue to grow throughout the remainder of 2011, the Corporation s holdings of available-for-sale investment securities are expected to increase as well.

The following table outlines the changes in the loan portfolio:

	March 31 2011	December 31% 2010	$ Change	Change (unannualized)
Commercial	$ 350,456	$ 348,852	$ 1,604	0.46%
Agricultural	69,993	71,446	(1,453)	-2.03%

Residential real estate mortgage	288,245	284,029	4,216	1.48%
Installment	29,283	30,977	(1,694)	-5.47%
	$ 737,977	$ 735,304	$ 2,673	0.36%

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The following table outlines the changes in the deposit portfolio:

	March 31 2011	December 31% 2010	$ Change	Change (unannualized)
Noninterest bearing demand deposits	$ 108,720	$ 104,902	$ 3,818	3.64%
Interest bearing demand deposits	152,784	142,259	10,525	7.40%
Savings deposits	200,954	177,817	23,137	13.01%
Certificates of deposit	393,200	386,435	6,765	1.75%
Brokered certificates of deposit	52,147	53,748	(1,601)	-2.98%
Internet certificates of deposit	15,442	12,178	3,264	26.80%
Total	**$ 923,247**	**$ 877,339**	**$ 45,908**	**5.23%**

As shown in the preceding table, the growth in deposits since December 31, 2010 has primarily been in the savings category. This growth was the result of focused marketing efforts to increase deposit market share in the communities served. Management anticipates that deposits will continue to grow in 2011.
Borrowed funds consist of the following obligations as of:

	March 31, 2011		December 31, 2010	
	Amount	Rate	Amount	Rate
Federal Home Loan Bank advances	$ 122,343	3.56%	$ 113,423	3.64%
Securities sold under agreements to repurchase without stated maturity dates	41,406	0.25%	45,871	0.25%
Securities sold under agreements to repurchase with stated maturity dates	19,514	3.03%	19,623	3.01%
Federal funds purchased			16,000	0.60%
Total	**$ 183,263**	**2.76%**	**$ 194,917**	**2.53%**

Capital

The capital of the Corporation consists solely of common stock, retained earnings, and accumulated other comprehensive income. The Corporation offers dividend reinvestment and employee and director stock purchase plans. Under the provisions of these plans, the Corporation issued 30,531 shares or $728 of common stock during the first three months of 2011, as compared to 29,147 shares or $736 of common stock during the same period in 2010. The Corporation also offers a deferred compensation plan for its directors, which allows participants to purchase stock units, in lieu of cash payments. Pursuant to this plan, the Corporation increased shareholders equity by $180 and $181 during the three month periods ended March 31, 2011 and 2010, respectively.
The Board of Directors has approved a common stock repurchase plan to enable the Corporation to repurchase its common stock. During the first three months of 2011 and 2010, pursuant to this plan, the Corporation repurchased 31,739 shares of common stock at an average price of $18.18 and 34,165 shares of common stock at an average price of $18.41, respectively. As of March 31, 2011, the Corporation was authorized to repurchase up to an additional 7,698 shares of common stock.
Accumulated other comprehensive income increased $1,358 for the three month period ended March 31, 2011, net of tax. The increase is a result of unrealized gains on available-for-sale investment securities. Management has reviewed the credit quality of its investment portfolio and believes that there are no losses that are other-than-temporary.

There are no significant regulatory constraints placed on the Corporation s capital. The Federal Reserve Board s current recommended minimum primary capital to assets requirement is 6.0%. The Corporation s primary capital to adjusted average assets, which consists of shareholders equity plus the allowance for loan losses less acquisition intangibles, was 8.23% as of March 31, 2011.

There are no commitments for significant capital expenditures for the remainder of 2011.

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The Federal Reserve Board has established a minimum risk based capital standard. Under this standard, 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. The minimum standard is 8%, of which at least 4% must consist of equity capital net of goodwill. The following table sets forth the percentages required under the Risk Based Capital guidelines and the Corporation s values as of:

	March 31 2011	December 31 2010	Required
Equity Capital	12.53%	12.44%	4.00%
Secondary Capital	1.25%	1.25%	4.00%
Total Capital	13.78%	13.69%	8.00%

Isabella Bank Corporation s secondary capital includes only the allowance for loan losses. The percentage for the secondary capital under the required column is the maximum amount allowed from all sources.

The Federal Reserve and FDIC also prescribe minimum capital requirements for the Bank. At March 31, 2011, the Bank exceeded these minimum capital requirements. Recently passed legislation may increase the required level of capital for banks. This increase in capital levels may have an adverse impact on the Corporation s ability to grow and pay dividends.

Liquidity

The primary sources of the Corporation s liquidity are cash and demand deposits due from banks, certificates of deposit held in other financial institutions, trading securities, and available-for-sale securities, excluding money market preferred securities and preferred stocks due to their illiquidity. These categories totaled $394,197 or 31.2% of assets as of March 31, 2011 as compared to $360,677 or 29.4% as of December 31, 2010. 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 on a daily basis as a result of customer activity.

Historically, the primary source of funds for the Corporation has been deposits. The Corporation emphasizes interest bearing time deposits as part of its funding strategy. The Corporation also seeks noninterest bearing deposits, or checking accounts, which reduce the Corporation s cost of funds in an effort to expand the customer base.

In addition to these primary sources of liquidity, the Corporation has the ability to borrow in the federal funds market at the Federal Reserve Bank, the Federal Home Loan Bank, as well as other correspondent banks. The Corporation s liquidity is considered adequate by the management of the Corporation.

The following table summarizes the Corporation s sources and uses of cash for the three month periods ended March 31:

	2011	2010	$ Variance
Net cash provided by operating activities	$ 4,460	$ 9,416	$ (4,956)
Net cash used in investing activities	(32,157)	(21,278)	(10,879)
Net cash provided by financing activities	32,920	8,194	24,726
Increase (Decrease) in cash and cash equivalents	5,223	(3,668)	8,891
Cash and cash equivalents January 1	18,109	22,706	(4,597)
Cash and cash equivalents March 31	$ 23,332	$ 19,038	$ 4,294

The increase in cash and cash equivalents has resulted in an increase in interest bearing balances due from banks, which is primarily comprised of balances held at the Federal Reserve Bank**.**

FINANCIAL INSTRUMENTS WITH OFF BALANCE SHEET ARRANGEMENTS

The Corporation is 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 its customers. These financial instruments, which include commitments to extend credit and standby letters of credit, 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 the Corporation has in a particular class of financial instrument.

	Contract Amount	
	March 31 2011	December 31 2010
Unfunded commitments under lines of credit	$ 104,082	$ 110,201
Commercial and standby letters of credit	4,711	4,881
Commitments to grant loans	19,459	13,382

Unfunded commitments under commercial lines of credit, revolving credit home equity lines of credit, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These commitments may expire without being drawn upon and may not be drawn upon to the total extent to which the Corporation is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

Commercial and standby letters of credit are conditional commitments issued by the Corporation 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 mature within one year. The credit risk involved in these transactions is essentially the same as that involved in extending loans to customers. The Corporation evaluates each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon the extension of credit, is based on management s credit evaluation of the borrower. While the Corporation considers 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.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Corporation, is based on management s credit evaluation of the customer.

The Corporation s 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 is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in deciding to make these commitments as it does for extending loans to customers. No significant losses are anticipated as a result of these commitments.

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. The Corporation intends 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 is including 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 of the Corporation, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Corporation s 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 of the Corporation and its subsidiaries include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, 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 the Corporation s 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 the Corporation and its business, including additional factors that could materially affect the Corporation s financial results, is included in the Corporation s filings with the Securities and Exchange Commission.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

The Corporation s primary market risks are interest rate risk and liquidity risk. The Corporation has no significant foreign exchange risk and does not utilize interest rate swaps or derivatives, except for interest rate locks and forward loan commitments, in the management of its interest rate risk. Any changes in foreign exchange rates or commodity prices would have an insignificant impact on the Corporation s interest income and cash flows. The Corporation does have a significant amount of loans extended to borrowers in agricultural production. The cash flow of such borrowers and ability to service debt is largely dependent on commodity prices. The Corporation mitigates these risks by using conservative price and production yields when calculating a borrower s available cash flow to service their debt.

Interest rate risk (IRR) is the exposure of the Corporation s net interest income, its primary source of 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 in which financial institutions earn income and create shareholder value. Excessive exposure to IRR could pose a significant risk to the Corporation s earnings and capital.

The Federal Reserve Board, the Corporation s primary Federal regulator, has adopted a policy requiring the Board of Directors and senior management to effectively manage the various risks that can have a material impact on the safety and soundness of the Corporation. The risks include credit, interest rate, liquidity, operational, and reputational. The Corporation has policies, procedures and internal controls for measuring and managing these risks. Specifically, the IRR policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to the Board of Directors.

The Corporation uses several techniques to manage IRR. The first method is gap analysis. Gap analysis measures the cash flows and/or the earliest repricing of the Corporation s interest bearing assets and liabilities. This analysis is useful for measuring trends in the repricing characteristics of the balance sheet. Significant assumptions are required in this process because of the imbedded repricing options contained in assets and liabilities. A substantial portion of the Corporation s assets are invested in loans and investment securities with issuer call options. Residential real estate and other consumer loans have imbedded options that allow the borrower to repay the balance prior to maturity without penalty, while commercial and agricultural loans have prepayment penalties. The amount of prepayments is dependent upon many factors, including the interest rate of a given loan in comparison to the current interest rate for residential mortgages, the level of sales of used homes, and the overall availability of credit in the market place. Generally, a decrease in interest rates will result in an increase in the Corporation s cash flows from these assets. A significant portion of the Corporation s securities are callable or subject to prepayment. The call option is more likely to be exercised in a period of decreasing interest rates. Investment securities, other than those that are callable, do not have any significant imbedded options. Savings and checking deposits may generally be withdrawn on request without prior notice. The timing of cash flows from these deposits is estimated based on historical experience. Time deposits have penalties that discourage early withdrawals.

The second technique used in the management of IRR is to combine the projected cash flows and repricing characteristics generated by the gap analysis and the interest rates associated with those cash flows to project future interest income. By changing the amount and timing of the cash flows and the repricing interest rates of those cash flows, the Corporation can project the effect of changing interest rates on its interest income. Based on the projections prepared for the year ending December 31, 2011, the Corporation s net interest income would decrease during a period of increasing interest rates.

The following tables provide information about the Corporation s assets and liabilities that are sensitive to changes in interest rates as of March 31, 2011 and December 31, 2010. The Corporation has no interest rate swaps, futures contracts, or other derivative financial options. The principal amounts of assets and time deposits maturing were calculated based on the contractual maturity dates. Savings and NOW accounts are based on management s estimate of their future cash flows.

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(dollars in thousands)	March 31, 2011 2012	2013	2014	2015	2016	Thereafter	Total	Fair Value 03/31/11
Rate sensitive assets								
Other interest bearing assets	$ 13,454	$ 4,345	$ 1,060	$	$	$	$ 18,859	$ 18,947
Average interest rates	0.86%	1.77%	1.98%				1.13%	
Trading securities	$ 1,818	$ 2,066	$ 1,028	$ 521	$	$	$ 5,433	$ 5,433
Average interest rates	3.52%	2.52%	2.49%	2.54%			2.85%	
Fixed interest rate securities	$ 68,144	$ 40,075	$ 35,716	$ 33,653	$ 28,525	$ 155,847	$ 361,960	$ 361,960
Average interest rates	3.50%	3.34%	3.35%	3.39%	3.40%	3.22%	3.33%	
Fixed interest rate loans	$ 112,374	$ 121,528	$ 135,246	$ 72,049	$ 70,019	$ 75,374	$ 586,590	$ 591,231
Average interest rates	7.33%	6.50%	6.06%	6.38%	5.84%	5.74%	6.37%	
Variable interest rate loans	$ 66,097	$ 19,981	$ 21,408	$ 17,067	$ 15,677	$ 11,157	$ 151,387	$ 151,387
Average interest rates	4.60%	4.48%	4.09%	3.82%	3.72%	5.12%	4.37%	
Rate sensitive liabilities								
Borrowed funds	$ 62,482	$ 28,146	$ 20,102	$ 17,533	$ 35,000	$ 20,000	$ 183,263	$ 188,111
Average interest rates	0.83%	3.91%	2.36%	3.44%	4.22%	2.56%	2.56%	
Savings and NOW accounts	$ 92,162	$ 82,813	$ 56,591	$ 37,990	$ 25,797	$ 58,385	$ 353,738	$ 353,738
Average interest rates	0.22%	0.22%	0.21%	0.19%	0.18%	0.16%	0.20%	
Fixed interest rate time deposits	$ 228,055	$ 106,179	$ 44,673	$ 33,678	$ 41,376	$ 4,874	$ 458,835	$ 457,059
Average interest rates	1.71%	2.72%	3.22%	2.83%	2.90%	2.13%	2.28%	
Variable interest rate time deposits	$ 1,135	$ 819	$	$	$	$	$ 1,954	$ 1,954
Average interest rates	1.16%	0.96%					1.08%	

	December 31, 2010 2011	2012	2013	2014	2015	Thereafter	Total	Fair Value 12/31/10
Rate sensitive assets								
Other interest bearing assets	$ 10,550	$ 5,429	$ 960	$	$	$	$ 16,939	$ 17,039
Average interest rates	0.96%	1.82%	2.16%				1.30%	
	$ 1,918	$ 2,366	$ 1,031	$ 522	$	$	$ 5,837	$ 5,837

Trading securities								
Average interest rates	3.46%	2.31%	2.42%	2.47%			2.72%	
Fixed interest rate securities	$ 64,652	$ 42,984	$ 32,871	$ 29,395	$ 24,438	$ 136,384	$ 330,724	$ 330,724
Average interest rates	3.68%	3.42%	3.30%	3.33%	3.28%	3.13%	3.32%	
Fixed interest rate loans	$ 128,277	$ 121,434	$ 140,019	$ 67,423	$ 68,569	$ 66,010	$ 591,732	$ 603,435
Average interest rates	6.80%	6.63%	6.26%	6.47%	6.08%	5.83%	6.41%	
Variable interest rate loans	$ 59,536	$ 17,306	$ 22,523	$ 15,118	$ 18,830	$ 10,259	$ 143,572	$ 143,572
Average interest rates	4.94%	4.76%	4.27%	3.78%	3.69%	5.21%	4.55%	
Rate sensitive liabilities								
Borrowed funds	$ 74,151	$ 33,013	$ 15,127	$ 37,087	$ 25,539	$ 10,000	$ 194,917	$ 200,603
Average interest rates	0.62%	3.46%	2.55%	3.11%	4.60%	2.35%	2.33%	
Savings and NOW accounts	$ 74,278	$ 73,818	$ 53,174	$ 35,872	$ 24,520	$ 58,414	$ 320,076	$ 320,076
Average interest rates	0.21%	0.21%	0.20%	0.19%	0.18%	0.15%	0.19%	
Fixed interest rate time deposits	$ 215,648	$ 113,338	$ 44,269	$ 31,414	$ 39,474	$ 6,278	$ 450,421	$ 452,392
Average interest rates	1.79%	2.67%	3.35%	2.86%	2.97%	3.26%	2.36%	
Variable interest rate time deposits	$ 1,279	$ 661	$	$	$	$	$ 1,940	$ 1,940
Average interest rates	1.21%	1.06%					1.16%	

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Item 4 Controls and Procedures

DISCLOSURE CONTROLS AND PROCEDURES

The Corporation s management 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 the Corporation s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of March 31, 2011, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Corporation s disclosure controls and procedures as of March 31, 2011, were effective to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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PART II OTHER INFORMATION

Item 1 Legal Proceedings

The Corporation is not involved in any material legal proceedings. The Corporation is involved in ordinary, routine litigation incidental to its business; however, no such routine proceedings are expected to result in any material adverse effect on operations, earnings, or financial condition.

Item 1A Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2010.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

(A) None

(B) None

(C) Repurchases of Common Stock

The Board of Directors has adopted a common stock repurchase plan. On June 23, 2010, the Board of Directors amended the plan to allow for the repurchase of an additional 100,000 shares of the Corporation s common stock. These authorizations do not have expiration dates. As shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued shares.

The following table provides information for the three month period ended March 31, 2011, with respect to this plan:

	Shares Repurchased		Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
	Number	Average Price Per Share		
Balance, December 31, 2011				39,437
January 1 - 31, 2011	7,702	$ 17.92	7,702	31,735
February 1 - 28, 2011	17,355	18.27	17,355	14,380
March 1 - 31, 2011	6,682	18.26	6,682	7,698
Balance, March 31, 2011	31,739	$ 18.18	31,739	7,698

Item 6 Exhibits

(a) 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

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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: May 2, 2011	/s/ Richard J. Barz Richard J. Barz Chief Executive Officer (Principal Executive Officer)
Date: May 2, 2011	/s/ Dennis P. Angner Dennis P. Angner President, Chief Financial Officer (Principal Financial Officer, Principal Accounting Officer)

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