

ISABELLA BANK CORP
Form 10-K
March 14, 2016
Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2015

OR

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

For the transition period from _____ to _____
Commission File Number: 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 North Main Street, Mount Pleasant, Michigan 48858
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (989) 772-9471

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

Title of each class Name of each exchange on which registered

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

Common Stock - No Par Value

(Title of Class)

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

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

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

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$185,183,000 as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of common shares outstanding of the registrant's Common Stock (no par value) was 7,804,287 as of March 7, 2016.

DOCUMENTS INCORPORATED BY REFERENCE

(Such documents are incorporated herein only to the extent specifically set forth in response to an item herein.)

Documents Part of Form 10-K Incorporated into

Portions of the Isabella Bank Corporation Proxy

Statement for its Annual Meeting of Shareholders to be held May 3, 2016 Part III

Table of Contents

ISABELLA BANK CORPORATION
ANNUAL REPORT ON FORM 10-K

Table of Contents

PART I

Item 1.	<u>Business</u>	<u>6</u>
Item 1A.	<u>Risk Factors</u>	<u>8</u>
Item 1B.	<u>Unresolved Staff Comments</u>	<u>11</u>
Item 2.	<u>Properties</u>	<u>11</u>
Item 3.	<u>Legal Proceedings</u>	<u>11</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>11</u>

PART II

Item 5.	<u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>12</u>
Item 6.	<u>Selected Financial Data</u>	<u>14</u>
Item 7.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>16</u>
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>38</u>
Item 8.	<u>Financial Statements and Supplementary Data</u>	<u>38</u>
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>88</u>
Item 9A.	<u>Controls and Procedures</u>	<u>88</u>
Item 9B.	<u>Other Information</u>	<u>89</u>

PART III

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	<u>90</u>
Item 11.	<u>Executive Compensation</u>	<u>90</u>
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>90</u>
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>91</u>

Item 14.	<u>Principal Accountant Fees and Services</u>	<u>91</u>
PART IV		<u>92</u>
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	<u>92</u>
SIGNATURES		<u>94</u>

Table of Contents

Forward Looking Statements

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

Glossary of Acronyms and Abbreviations

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

AFS: Available-for-sale	GAAP: U.S. generally accepted accounting principles
ALLL: Allowance for loan and lease losses	GLB Act: Gramm-Leach-Bliley Act of 1999
AOCI: Accumulated other comprehensive income (loss)	IFRS: International Financial Reporting Standards
ASC: FASB Accounting Standards Codification	IRR: Interest rate risk
ASU: FASB Accounting Standards Update	JOBS Act: Jumpstart our Business Startups Act
ATM: Automated Teller Machine	LIBOR: London Interbank Offered Rate
BHC Act: Bank Holding Company Act of 1956	N/A: Not applicable
CFPB: Consumer Financial Protection Bureau	N/M: Not meaningful
CIK: Central Index Key	NASDAQ: NASDAQ Stock Market Index
CRA: Community Reinvestment Act	NASDAQ Banks: NASDAQ Bank Stock Index
DIF: Deposit Insurance Fund	NAV: Net asset value
DIFS: Department of Insurance and Financial Services	NOW: Negotiable order of withdrawal
Directors Plan: Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors	NSF: Non-sufficient funds
Dividend Reinvestment Plan: Isabella Bank Corporation Stockholder Dividend Reinvestment Plan and Employee Stock Purchase Plan	OCI: Other comprehensive income (loss)
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	OMSR: Originated mortgage servicing rights
ESOP: Employee stock ownership plan	OREO: Other real estate owned
Exchange Act: Securities Exchange Act of 1934	OTTI: Other-than-temporary impairment
FASB: Financial Accounting Standards Board	PBO: Projected benefit obligation
FDI Act: Federal Deposit Insurance Act	PCAOB: Public Company Accounting Oversight Board
FDIC: Federal Deposit Insurance Corporation	Rabbi Trust: A trust established to fund the Directors Plan
FFIEC: Federal Financial Institutions Examinations Council	SEC: U.S. Securities & Exchange Commission
FRB: Federal Reserve Bank	SOX: Sarbanes-Oxley Act of 2002
FHLB: Federal Home Loan Bank	TDR: Troubled debt restructuring
Freddie Mac: Federal Home Loan Mortgage Corporation	XBRL: eXtensible Business Reporting Language
FTE: Fully taxable equivalent	

Table of Contents

Restatement of Previously Filed Reports (Dollars in thousands)

Overview of Restatement

In this Annual Report on Form 10-K, certain prior period financial information has been restated due to an accounting correction. Impacted sections of this report include:

1. Selected Financial Data in Item 6 for the years ended December 31, 2014, 2013, 2012, and 2011;
2. Management's Discussion and Analysis in Item 7 as it relates to the years ended December 31, 2014, 2013, 2012, and 2011 and interim periods ended September 30, 2015, June 30, 2015, and March 31, 2015;
3. Financial Statements in Item 8:

Consolidated Balance Sheet as of December 31, 2014, Consolidated Statements of Income for the years ended
a. December 31, 2014 and 2013, and Consolidated Statements of Cash Flows for the years ended December 31, 2014 and 2013; and

b. Notes to Consolidated Financial Statements as of, and for the years ended, December 31, 2014 and 2013.

Background of Restatement

The necessary restatement was identified by management in the fourth quarter of 2015 during the course of our preparation of the consolidated financial statements and evaluation of financial results as of and for the year ended December 31, 2015. The restatements relate to the accounting for deferred costs associated with originating loans (under ASC 310-20) and the proper classification of the net deferred costs recorded in gross loans within the consolidated balance sheets and as a deferral of compensation expenses within the consolidated statements of income. Prior to December 31, 2015, loan origination cost deferrals (under ASC 310-20) were reported in loan interest and fee income instead of as a reduction of compensation and benefits, which is included in other noninterest expenses. Additionally, net deferred asset balances (under ASC 310-20) prior to December 31, 2015 were reported in other assets on the consolidated balance sheets instead of reported in gross loans. Amortization of the net deferred asset balance was recognized appropriately in loan interest and fee income.

Impact of Restatement

The overall impact of the restatement on our consolidated financial position and results of operations is not believed to be material and as such, previously filed Annual Reports on Form 10-K and Quarterly reports on Form 10-Q for the periods affected by the restatement have not been amended. The determination of materiality was, in part, concluded based on the following observations:

- No impact to net income for any prior periods;
- No impact to earnings per share, other stock data, or dividend data for any prior periods;
- No impact on total assets for any prior periods; and
- No impact on retained earnings or total equity for any prior periods.

The impact to the consolidated balance sheet as of December 31, 2014 was a \$2,968 increase in gross loans and a \$2,968 decline in other assets. There were no other changes to the consolidated balance sheets for any prior periods.

Table of Contents

The following table sets forth the effects of the restatement on items within the Consolidated Statements of Income. Since the restatement did not impact net income, pre-tax and adjustments net of tax are not included.

	December 31, 2014		December 31, 2013	
	Previously Reported	Restated	Previously Reported	Restated
Interest income				
Loans, including fees	\$39,432	\$36,629	\$41,233	\$37,575
All other interest income	14,519	14,519	12,843	12,843
Total interest income	53,951	51,148	54,076	50,418
Total interest expense	9,970	9,970	11,021	11,021
Net interest income	43,981	41,178	43,055	39,397
Provision for loan losses	(668	) (668	) 1,111	1,111
Net interest income after provision for loan losses	44,649	41,846	41,944	38,286
Total noninterest income	9,325	9,325	10,175	10,175
Noninterest expenses				
Compensation and benefits	21,305	18,502	21,465	17,807
All other noninterest expenses	16,601	16,601	15,948	15,948
Total noninterest expenses	37,906	35,103	37,413	33,755
Federal income tax expense	2,344	2,344	2,196	2,196
Net income	\$13,724	\$13,724	\$12,510	\$12,510

As demonstrated above, loan interest and fee income and compensation and benefits were reduced by \$2,803 and \$3,658 during the years ended December 31, 2014 and 2013, respectively.

All amounts in this Annual Report on Form 10-K affected by the restatement adjustments reflect such amounts as restated.

Table of Contents

PART I

Item 1. Business. (Dollars in thousands)

General

Isabella Bank Corporation is a registered financial services holding company that was incorporated in September 1988 under Michigan law. The Corporation's sole subsidiary, Isabella Bank, has 29 banking offices located throughout Clare, Gratiot, Isabella, Mecosta, Midland, Montcalm, and Saginaw counties. The area includes significant agricultural production, manufacturing, retail, gaming and tourism, and five colleges and universities.

As used in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations as well as in Item 8. Financial Statements and Supplementary Data, references to "the Corporation," "Isabella," "we," "our," "us," and similar terms refer to the consolidated entity consisting of Isabella Bank Corporation and its subsidiary. Isabella Bank Corporation refers solely to the parent holding company, and Isabella Bank or the "Bank" refer to Isabella Bank Corporation's subsidiary, Isabella Bank.

Our reportable segments are based on legal entities that account for at least 10% of net operating results. Retail banking operations for 2015, 2014, and 2013 represent approximately 90% or greater of total assets and operating results. As such, we have only one reportable segment.

We are a community bank with a focus on providing high quality, personalized service at a fair price. We offer a broad array of banking services to businesses, institutions, and individuals. We compete with other commercial banks, savings and loan associations, mortgage brokers, finance companies, credit unions, and retail brokerage firms.

Lending activities include loans for commercial and agricultural operating and real estate purposes, residential real estate loans, and consumer loans. We limit lending activities primarily to local markets and have not purchased any loans from the secondary market. We do not make loans to fund leveraged buyouts, have no foreign corporate or government loans, and have limited holdings of corporate debt securities. Our general lending philosophy is to limit concentrations to individuals and business segments. For additional information related to our lending strategies and policies, see "Note 5 – Loans and ALLL" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data.

Deposit services offered include checking accounts, savings accounts, certificates of deposit, direct deposits, cash management services, mobile and internet banking, electronic bill pay services, and automated teller machines. We also offer full service trust and brokerage services.

As of December 31, 2015, we had 374 full-time equivalent employees. We provide group life, health, accident, disability, and other insurance programs as well as a number of other employee benefit programs. None of our workforce is subject to collective bargaining agreements.

Available Information

Our SEC filings (including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Definitive Proxy Statements, Current Reports on Form 8-K and amendments to those reports) are available through our website (www.isabellabank.com). We will provide paper copies of our SEC reports free of charge upon request of a shareholder.

The SEC maintains a website (www.sec.gov) that contains reports, proxy and information statements and other information regarding Isabella Bank Corporation (CIK #0000842517) and other issuers.

Supervision and Regulation

The earnings and growth of the banking industry and, therefore, our earnings are affected by the credit policies of monetary authorities, including the FRB. An important function of the FRB is to regulate the national supply of bank credit in order to combat recessions and curb inflationary pressures. Among the instruments of monetary policy used by the FRB to implement these objectives are open market operations in U.S. Treasury and U.S. Government Agency securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These methods are used in varying combinations to influence overall growth of bank loans, investments and deposits and also affect interest rates charged on loans or paid for deposits. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks and related financial service providers in the past and are expected to continue to do so in the future. The effect of such policies upon our future business and earnings cannot be predicted.

We, as a financial holding company, are regulated under the BHC Act, and are subject to the supervision of the FRB. We are registered as a financial services holding company with the FRB and are subject to annual reporting requirements and

6

Table of Contents

inspections and audits. Under FRB policy, we are expected to act as a source of financial strength to the Bank and to commit resources to support its subsidiaries. This support may be required at times when, in the absence of such FRB policy, it would not otherwise be required to provide support.

Under Michigan law, if the capital of a Michigan state chartered bank has become impaired by losses or otherwise, the Commissioner of the DIFS may require that the deficiency in capital be met by assessment upon the bank's shareholders pro rata on the amount of capital stock held by each, and if any such assessment is not paid by any shareholder within 30 days of the date of mailing of notice thereof to such shareholder, cause the sale of the stock of such shareholder to pay such assessment and the costs of sale of such stock.

Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment. This priority would apply to guarantees of capital plans under the FDIC Improvement Act of 1991.

SOX contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with Section 302(a) of SOX, written certifications by our principal executive, financial, and accounting officers are required. These certifications attest that our quarterly and annual reports filed with the SEC do not contain any untrue statement of a material fact (see the certifications filed as Exhibits 31 (a) and (b) to this Form 10-K for such certification of consolidated financial statements and other information for this 2015 Form 10-K). We have also implemented a program designed to comply with Section 404 of SOX, which included the identification of significant processes and accounts, documentation of the design of control effectiveness over process and entity level controls, and testing of the operating effectiveness of key controls. See Item 9A. Controls and Procedures for our evaluation of disclosure controls and procedures and internal control over financial reporting.

Certain additional information concerning regulatory guidelines for capital adequacy and other regulatory matters is presented herein under the caption "Capital" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and in "Note 15 – Commitments and Other Matters" and "Note 16 – Minimum Regulatory Capital Requirements" of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

Isabella Bank

The Bank is supervised and regulated by DIFS and the FRB. The agencies and federal and state laws extensively regulate various aspects of the banking business including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and deposits, and the safety and soundness of banking practices.

Our deposits are insured up to applicable limits by the DIF of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system that assesses insurance premiums based upon a risk matrix that takes into account assets and capital levels and supervisory ratings.

Banking laws and regulations restrict transactions by insured banks owned by a bank holding company, including loans to and certain purchases from the parent holding company, non-bank and bank subsidiaries of the parent holding company, principal shareholders, officers, directors and their affiliates, and investments by the subsidiary bank in the shares or securities of the parent holding company (or any of the other non-bank or bank affiliates), or acceptance of such shares or securities as collateral security for loans to any borrower.

The Bank is subject to legal limitations on the frequency and amount of dividends that can be paid to Isabella Bank Corporation. For example, a Michigan state chartered bank may not declare a cash dividend or a dividend in kind except out of net profits then on hand after deducting all losses and bad debts, and then only if it will have a surplus amounting to not less than 20% of its capital after the payment of the dividend. Moreover, a Michigan state chartered bank may not declare or pay any cash dividend or dividend in kind until the cumulative dividends on its preferred stock, if any, have been paid in full. Further, if the surplus of a Michigan state chartered bank is at any time less than the amount of its capital, before the declaration of a cash dividend or dividend in kind, it must transfer to surplus not less than 10% of its net profits for the preceding six months (in the case of quarterly or semi-annual dividends) or the preceding two consecutive six month periods (in the case of annual dividends).

The payment of dividends by Isabella Bank Corporation and the Bank is also affected by various regulatory requirements and policies, such as the requirement to keep adequate capital in compliance with regulatory guidelines. Federal laws impose further restrictions on the payment of dividends by insured banks that fail to meet specified capital levels. The FDIC may

7

Table of Contents

prevent an insured bank from paying dividends if the bank is in default of payment of any assessment due to the FDIC. In addition, payment of dividends by a bank may be prevented by the applicable federal regulatory authority if such payment is determined, by reason of the financial condition of such bank, to be an unsafe and unsound banking practice. The FRB and the FDIC have issued policy statements providing that bank holding companies and insured banks should generally pay dividends only out of current operating earnings. Additionally, the FRB Board of Governors requires a bank holding company to notify the FRB prior to increasing its cash dividend by more than 10% over the prior year.

The aforementioned regulations and restrictions may limit our ability to obtain funds from the Bank for our cash needs, including payment of dividends and operating expenses.

The activities and operations of the Bank are also subject to various federal and state laws and regulations.

Item 1A. Risk Factors.

In the normal course of business we are exposed to various risks. These risks, if not managed correctly, could have a significant impact on our earnings, capital, share price, and ability to pay dividends. In order to effectively monitor and control the following risks, we utilize an enterprise risk model. We balance our strategic goals, including revenue and profitability objectives, with associated risks through the use of policies, systems, and procedures which have been adopted to identify, assess, control, monitor, and manage each risk area. We continually review the adequacy and effectiveness of these policies, systems, and procedures.

Our enterprise risk process covers each of the following areas.

Changes in credit quality and required allowance for loan and lease losses

To manage the credit risk arising from lending activities, our most significant source of credit risk, we maintain what we believe are sound underwriting policies and procedures. We continuously monitor asset quality in order to manage our credit risk to determine the appropriateness of valuation allowances. These valuation allowances take into consideration various factors including, but not limited to, local, regional, and national economic conditions.

We maintain an ALLL to reserve for estimated incurred loan losses and risks within our loan portfolio. The level of the ALLL reflects our evaluation of industry concentrations; specific credit risks; loan loss experience; loan portfolio quality; and economic, political and regulatory conditions. The determination of the appropriate level of the ALLL inherently involves a high degree of subjectivity and requires us to make significant estimates, all of which may undergo material changes.

Changes in economic conditions

An economic downturn within our local markets, as well as downturns in the state or national markets, could negatively impact household and corporate incomes. This could lead to decreased demand for both loan and deposit products and lead to an increase of customers who fail to pay interest or principal on their loans. We continually monitor key economic indicators in an effort to anticipate the possible effects of downturns in the local, regional, and national economies.

Our success depends primarily on the general economic conditions of the State of Michigan and the specific local markets in which we operate. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers located primarily in the Clare, Gratiot, Isabella, Mecosta, Midland, Montcalm, and Saginaw counties in Michigan. The local economic conditions in these areas have a significant impact on the demand for our products and services, as well as the ability of our customers to repay loans, the value of the collateral securing loans, and the stability of our deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on our financial condition and results of operations.

Interest rate risk

IRR results from the timing differences in the maturity or repricing frequency of a financial institution's interest earning assets and its interest bearing liabilities. We monitor the potential effects of changes in interest rates through simulations and gap analyses. To help mitigate the effects of changes in interest rates, we make significant efforts to stagger projected cash flows and maturities of interest sensitive assets and liabilities.

Table of Contents

Liquidity risk

Liquidity risk is the risk to earnings or capital arising from our inability to meet our obligations when they come due without incurring unacceptable costs. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources, or failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value. We have significant borrowing capacity through correspondent banks and the ability to sell certain investments to fund potential cash shortages, which we may use to help mitigate this risk. The value of investment securities may be negatively impacted by fluctuations in the market

A volatile, illiquid market or decline in credit quality could require us to recognize an OTTI loss related to the investment securities held in our portfolio. We consider many factors in determining whether an OTTI exists including the length of time and extent to which fair value has been less than cost, the investment credit rating, and the probability that the issuer will be unable to pay the amount when due. The presence of these factors could lead to impairment charges. These risks are mitigated by the fact that we assert that we do not intend to sell the security in an unrealized loss position and it is more likely than not that we will not have to sell the security before recovery of its cost basis.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems, or external events and includes reputation risk and transaction risk. Reputation risk is developing and retaining marketplace confidence in handling customers' financial transactions in an appropriate manner and protecting our safety and soundness. Transaction risk includes losses from fraud, error, the inability to deliver products or services, and loss or theft of information. Transaction risk also encompasses product development and delivery, transaction processing, information technology systems, and the internal control environment.

To minimize the potential losses due to operational risks, we have established a robust system of internal controls that is regularly tested by our internal audit department in conjunction with the services of certified public accounting firms who assists in performing such internal audit work. The focus of these internal audit procedures is to verify the validity and appropriateness of various transactions, processes, and controls. The results of these procedures are reported to our Audit Committee.

The adoption of, violations of, or nonconformance with laws, rules, regulations, or prescribed practices

The financial services industry and public companies are extensively regulated and must meet regulatory standards set by the FDIC, DIFS, FRB, FASB, SEC, PCAOB, the CFPB, and other regulatory bodies. Federal and state laws and regulations are designed primarily to protect the deposit insurance funds and consumers, and not necessarily to benefit our shareholders. The nature, extent, and timing of the adoption of significant new laws, changes in existing laws, or repeal of existing laws may have a material impact on our business, results of operations, and financial condition, the effect of which is impossible to predict at this time.

Our compliance department annually assesses the adequacy and effectiveness of our processes for controlling and managing our principal compliance risks.

We may not adjust to changes in the financial services industry

Our financial performance depends in part on our ability to maintain and grow our core deposit customer base and expand our financial services to our existing and new customers. The increasingly competitive environment is, in part, a result of changes in technology and product delivery systems and the accelerating pace of consolidation among financial service providers. New competitors may emerge to increase the degree of competition for our products and services. Financial services and products are also constantly changing. Our financial performance is also dependent upon customer demand for our products and services and our ability to develop and offer competitive financial products and services.

We may be required to recognize an impairment of goodwill

Goodwill represents the excess of the amounts paid to acquire subsidiaries over the fair value of their net assets at the date of acquisition. The majority of the recorded goodwill is related to acquisitions of other banks, which were subsequently merged into Isabella Bank. If it is determined that the goodwill has been impaired, we must write-down the goodwill by the amount of the impairment.

Table of Contents

We may face pressure from purchasers of our residential mortgage loans to repurchase loans sold or reimburse purchasers for losses related to such loans

We generally sell the fixed rate long term residential mortgage loans we originate to the secondary market. In response to the recent economic downturn, the purchasers of residential mortgage loans, such as government sponsored entities, increased their efforts to require sellers of residential mortgage loans to either repurchase loans previously sold, or reimburse the purchasers for losses incurred on foreclosed loans due to actual or alleged failure to strictly conform to the terms of the contract.

Consumers may decide not to use banks to complete their financial transactions

Technology and other changes are allowing customers to complete financial transactions without the involvement of banks. For example, consumers can now pay bills and transfer funds directly without banks. The process of eliminating banks as intermediaries in financial transactions could result in the loss of fee income, as well as the loss of customer deposits and income generated from those deposits.

Changes to the financial services industry as a result of regulatory changes or actions, or significant litigation

The financial services industry is extensively regulated by state and federal regulation that governs almost all aspects of our operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors, and the deposit insurance fund. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact us or our ability to increase the value of our business.

Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the appropriateness of an institution's ALLL. Future regulatory changes or accounting pronouncements may increase our regulatory capital requirements or adversely affect our regulatory capital levels. Additionally, actions by regulatory agencies or significant litigation against us could require the dedication of significant time and resources to defending our business and may lead to penalties.

Unauthorized disclosure of sensitive or confidential client or customer information, whether through cyber attacks, breach of computer systems or otherwise

As part of our business, we collect and retain sensitive and confidential client and customer information on our behalf and on behalf of other third parties. Despite the security measures we have in place for our facilities and systems, and the security measures of our third party service providers, we may be vulnerable to cyber attacks, security breaches, acts of vandalism, computer viruses, misplaced or lost data, human errors or other similar events. Risks related to cybersecurity continue to evolve within the industry. We continually review and monitor information and data related to cybersecurity to detect and mitigate attacks. A cyber attack could disrupt our operations and have a material adverse effect on our business. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by us or by our vendors, could severely damage our reputation, expose us to the risks of litigation and liability, disrupt our operations and have a material adverse effect on our business.

Our estimates and assumptions may be incorrect

Our consolidated financial statements conform with GAAP, which require us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. These estimates are based on information available to us at the time the estimates are made. Actual results could differ from those estimates. For further discussion regarding significant accounting estimates, see "Note 1 – Nature of Operations and Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

Disruption of infrastructure

Our operations depend upon our technological and physical infrastructure, including our equipment and facilities. Extended disruption of our vital infrastructure by fire, power loss, natural disaster, telecommunications failure, computer hacking and viruses, or other events outside of our control, could have a significant impact on our operations. We have developed and tested disaster recovery plans, which provide detailed instructions covering all significant aspects of our operations.

Anti-takeover provisions

Our articles of incorporation include anti-takeover provisions that require a two-thirds majority vote to approve a sale of the Corporation. Additionally, changes to our articles of incorporation must be approved by a two-thirds majority vote of our shareholders. These provisions may make our stock less attractive to potential shareholders.

Table of Contents

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our executive offices are located at 401 North Main Street in Mount Pleasant, Michigan. In addition to this location, we own 29 branches, an operations center, a mortgage operations center, and a previous main office building. Our facilities current, planned, and best use is for conducting our current activities, with the exception of approximately 75% of our previous main office location and approximately 25% of the building that houses our mortgage processing operations which are leased to non-related parties. We continually monitor and assess the need for expansion and/or improvement for all facilities. In our opinion, each facility has sufficient capacity and is in good condition.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

Table of Contents

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Common Stock and Dividend Information

Our authorized common stock consists of 15,000,000 shares, of which 7,799,867 shares are issued and outstanding as of December 31, 2015. As of that date, there were 3,044 shareholders of record.

Our common stock is traded in the over-the-counter market. Our common stock is quoted on the OTCQX market tier of the OTC Markets Group Inc.'s ("OTC Markets") electronic quotation system (www.otcm Markets.com) under the symbol "ISBA". Other trades in our common stock occur in privately negotiated transactions from time-to-time of which we may have little or no information.

We have reviewed the information available as to the range of reported high and low bid quotations, including high and low bid information as reported by OTC Markets. The following table sets forth our compilation of that information for the periods indicated. Price information obtained from OTC Markets reflects inter-dealer prices, without retail mark-up, mark-down, or commissions and may not necessarily represent actual transactions. The following compiled data is provided for information purposes only and should not be viewed as indicative of the actual or market value of our common stock.

	Number of Common Shares	Sale Price Low	High
2015			
First Quarter	81,754	\$22.00	\$23.50
Second Quarter	94,019	22.70	23.80
Third Quarter	143,183	22.75	23.85
Fourth Quarter	109,276	23.50	29.90
	428,232		
2014			
First Quarter	79,719	\$22.25	\$23.94
Second Quarter	72,142	22.44	23.50
Third Quarter	94,422	21.73	24.00
Fourth Quarter	67,771	22.10	23.99
	314,054		

The following table sets forth the cash dividends paid for the following quarters:

	Per Share	
	2015	2014
First Quarter	\$0.23	\$0.22
Second Quarter	0.23	0.22
Third Quarter	0.24	0.22
Fourth Quarter	0.24	0.23
Total	\$0.94	\$0.89

We have adopted and publicly announced a common stock repurchase plan. The plan was last amended on September 23, 2015, to allow for the repurchase of an additional 200,000 shares of common stock after that date. These authorizations do not have expiration dates. As shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued shares.

Table of Contents

The following table provides information for the unaudited three month period ended December 31, 2015, with respect to our common stock repurchase plan:

	Common Shares Repurchased	Average Price	Total Number of	Maximum Number of
	Number	Per Common	Common Shares	Common
		Share	Purchased	Shares That May Yet Be
			as Part of Publicly	Purchased Under the
			Announced Plan	Plans or Programs
			or Program	
Balance, September 30				198,436
October 1 - 31	22,923	\$24.21	22,923	175,513
November 1 - 30	12,362	25.89	12,362	163,151
December 1 - 31	4,493	26.93	4,493	158,658
Balance, December 31	39,778	\$25.04	39,778	158,658

Information concerning securities authorized for issuance under equity compensation plans appears under Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Stock Performance

The following graph compares the cumulative total shareholder return on our common stock for the last five years with the cumulative total return on (1) NASDAQ, which is comprised of all United States common shares traded on the NASDAQ and (2) the NASDAQ Banks, which is comprised of bank and bank holding company common shares traded on the NASDAQ over the same period. The graph assumes the value of an investment in the Corporation's common stock and each index was \$100 at December 31, 2010 and all dividends are reinvested.

Year	ISBA	NASDAQ	NASDAQ Banks
12/31/2010	\$100.00	\$100.00	\$100.00
12/31/2011	142.50	99.23	89.54
12/31/2012	135.30	116.79	106.15
12/31/2013	153.50	163.38	150.00
12/31/2014	150.50	187.43	157.22
12/31/2015	207.70	200.70	170.99

Table of Contents

Item 6. Selected Financial Data.

Results of Operations (Dollars in thousands except per share amounts)

The following table outlines the results of operations and provides certain key performance measures as of, and for the years ended, December 31:

	2015	2014	2013	2012	2011	
INCOME STATEMENT DATA						
Interest income	\$51,502	\$51,148	\$50,418	\$53,123	\$55,590	
Interest expense	10,163	9,970	11,021	13,423	16,203	
Net interest income	41,339	41,178	39,397	39,700	39,387	
Provision for loan losses	(2,771)	(668)	1,111	2,300	3,826	
Noninterest income	10,359	9,325	10,175	11,530	8,218	
Noninterest expenses	36,051	35,103	33,755	34,361	32,215	
Federal income tax expense	3,288	2,344	2,196	2,363	1,354	
Net Income	\$15,130	\$13,724	\$12,510	\$12,206	\$10,210	
PER SHARE						
Basic earnings	\$1.95	\$1.77	\$1.63	\$1.61	\$1.35	
Diluted earnings	\$1.90	\$1.74	\$1.59	\$1.56	\$1.31	
Dividends	\$0.94	\$0.89	\$0.84	\$0.80	\$0.76	
Tangible book value*	\$17.30	\$16.59	\$15.62	\$14.72	\$13.90	
Quoted market value						
High	\$29.90	\$24.00	\$26.00	\$24.98	\$24.45	
Low	\$22.00	\$21.73	\$21.12	\$21.75	\$17.10	
Close*	\$29.90	\$22.50	\$23.85	\$21.75	\$23.70	
Common shares outstanding*	7,799,867	7,776,274	7,723,023	7,671,846	7,589,226	
PERFORMANCE RATIOS						
Return on average total assets	0.95	% 0.90	% 0.86	% 0.88	% 0.79	%
Return on average shareholders' equity	8.33	% 8.06	% 7.67	% 7.60	% 6.74	%
Return on average tangible shareholders' equity	11.46	% 10.80	% 10.71	% 11.41	% 10.30	%
Net interest margin yield (FTE)	3.10	% 3.24	% 3.22	% 3.43	% 3.67	%
BALANCE SHEET DATA*						
Gross loans	\$850,492	\$836,550	\$810,777	\$774,627	\$751,610	
AFS securities	\$660,136	\$567,534	\$512,062	\$504,010	\$425,120	
Total assets	\$1,668,112	\$1,549,543	\$1,493,137	\$1,430,639	\$1,337,925	
Deposits	\$1,164,563	\$1,074,484	\$1,043,766	\$1,017,667	\$958,164	
Borrowed funds	\$309,732	\$289,709	\$279,326	\$241,001	\$216,136	
Shareholders' equity	\$183,971	\$174,594	\$160,609	\$164,489	\$154,783	
Gross loans to deposits	73.03	% 77.86	% 77.68	% 76.12	% 78.44	%
ASSETS UNDER MANAGEMENT*						
Loans sold with servicing retained	\$287,029	\$288,639	\$293,665	\$303,425	\$302,636	
Assets managed by our Investment and Trust Services Department	\$405,109	\$383,878	\$351,420	\$319,301	\$297,393	
Total assets under management	\$2,360,250	\$2,222,060	\$2,138,222	\$2,053,365	\$1,937,954	
ASSET QUALITY*						
Nonperforming loans to gross loans	0.09	% 0.50	% 0.42	% 1.00	% 0.95	%
Nonperforming assets to total assets	0.07	% 0.33	% 0.32	% 0.68	% 0.67	%
ALLL to gross loans	0.87	% 1.21	% 1.42	% 1.54	% 1.65	%

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CAPITAL RATIOS*

Shareholders' equity to assets	11.03	% 11.27	% 10.76	% 11.50	% 11.57	%
Tier 1 leverage	8.52	% 8.59	% 8.46	% 8.29	% 8.18	%
Common equity tier 1 capital	13.24	% N/A	N/A	N/A	N/A	
Tier 1 risk-based capital	13.24	% 14.08	% 13.68	% 13.24	% 12.93	%
Total risk-based capital	13.96	% 15.19	% 14.93	% 14.49	% 14.18	%

* At end of year

Table of Contents

The following table outlines our interim results of operations and key performance measures as of, and for the unaudited periods ended:

	Quarter to Date							
	December 31 2015	September 30 2015	June 30 2015	March 31 2015	December 31 2014	September 30 2014	June 30 2014	March 31 2014
Total interest income	\$ 13,023	\$ 12,967	\$ 12,759	\$ 12,753	\$ 13,030	\$ 12,800	\$ 12,625	\$ 12,693
Total interest expense	2,577	2,580	2,518	2,488	2,504	2,498	2,468	2,500
Net interest income	10,446	10,387	10,241	10,265	10,526	10,302	10,157	10,193
Provision for loan losses	(772)	(738)	(535)	(726)	(64)	(162)	(200)	(242)
Noninterest income	2,501	3,101	2,629	2,128	2,426	2,216	2,434	2,249
Noninterest expenses	9,885	9,161	8,330	8,675	8,923	8,831	8,534	8,815
Federal income tax expense	538	1,002	977	771	648	444	692	560
Net income	\$ 3,296	\$ 4,063	\$ 4,098	\$ 3,673	\$ 3,445	\$ 3,405	\$ 3,565	\$ 3,309
PER SHARE								
Basic earnings	\$ 0.43	\$ 0.52	\$ 0.53	\$ 0.47	\$ 0.44	\$ 0.44	\$ 0.46	\$ 0.43
Diluted earnings	0.41	0.51	0.52	0.46	0.44	0.43	0.45	0.42
Dividends	0.24	0.24	0.23	0.23	0.23	0.22	0.22	0.22
Quoted Market value*	29.90	23.69	23.75	22.90	22.50	23.60	22.95	23.00
Tangible book value*	17.30	17.06	17.17	16.84	16.59	16.33	16.08	15.82

* At end of period

Reclassifications and Restatements: Certain amounts previously reported in the Results of Operations section of this report have been either reclassified or restated to conform with the 2015 presentation. For a complete overview on restatements impacting the Results of Operations, see pages 4 and 52 of this report.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

ISABELLA BANK CORPORATION FINANCIAL REVIEW

(Dollars in thousands except per share amounts)

The following is management's discussion and analysis of the financial condition and results of our operations. This discussion and analysis is intended to provide a better understanding of the consolidated financial statements and statistical data included elsewhere in this Annual Report on Form 10-K.

Executive Summary

We reported record net income of \$15,130 and earnings per common share of \$1.95 for the year ended December 31, 2015. Our continued strong earnings have primarily been the result of increased interest income and continued improvement in credit quality. The improvement in credit quality resulted in a decline in the level of the ALLL in both amount and as a percentage of gross loans, resulting in a reversal of provision for loan losses of \$2,771 for the year ended December 31, 2015. Net loan recoveries during 2015 were \$71 as compared to net loan charge-offs \$732 in 2014. Additionally, we continue to see reductions in loans classified as less than satisfactory.

During the year, total assets grew by 7.65% to \$1,668,112, and assets under management increased to \$2,360,250 which includes loans sold and serviced and assets managed by our Investment and Trust Services Department of \$692,138. In 2015, we had total loan growth of \$13,942 which was driven by commercial and agricultural loan growth of \$26,301. This was partially offset by declines in both residential real estate and consumer loans of \$12,359 as new loan originations were less than principal payments by borrowers.

We increased our AFS securities portfolio by \$92,602 during 2015 to continue providing growth in our balance sheet to increase interest income. Our net yield on interest earning assets of 3.10% remains at historically low levels. While we expect the Federal Reserve Bank to increase short term interest rates in 2016, we do not anticipate any significant improvements in our net yield on interest earning assets as the rates paid on interest bearing liabilities will likely increase faster than those of interest earning assets. Net interest income will increase only through continued growth in loans, investments, and other income earning assets. We are committed to increasing earnings and dedicated to providing long term sustainable growth to enable us to increase shareholder value.

While we have been able to grow our commercial and agricultural loan portfolios, increasing our residential real estate and

consumer loan portfolios has been more challenging. To generate growth in these portfolios, we are implementing new

products, enhancing our marketing efforts, streamlining delivery channels for direct and indirect loans, and expanding our

service area. These initiatives are designed to attract new customers while expanding our relationships with current customers

to improve earnings.

Acquisitions

On July 31, 2015, we completed the acquisition of a branch from Flagstar Bank, FSB located in Saginaw, Michigan. In addition to real estate and equipment, we assumed deposit liabilities of \$44,290 and recorded \$156 of core deposit intangibles and \$2,061 of goodwill, which represented the excess of the purchase price over the fair value of identifiable net assets acquired.

On August 28, 2015, we completed the acquisition of a branch from Independent Bank located in Midland, Michigan. In addition to real estate and equipment, we assumed \$8,658 of deposit liabilities and recorded \$50 of core deposit intangibles and \$602 of goodwill, which represented the excess of the purchase price over the fair value of identifiable net assets acquired.

Recent Legislation

The Health Care and Education Act of 2010, the Patient Protection and Affordable Care Act, the Dodd-Frank Act, and the JOBS Act, have already had, and are expected to continue to have, a negative impact on our operating results. Of these four acts, the Dodd-Frank Act has had the most significant impact. The Dodd-Frank Act established the CFPB which has made significant changes in the regulation of financial institutions aimed at strengthening the oversight of

the federal government over the operation of the financial services sector and increasing the protection of consumers. New regulations issued by the CFPB regarding consumer lending, including residential mortgage lending, have increased our compensation and outside advisor costs and this trend is expected to continue.

On July 2, 2013, the FRB published revised BASEL III Capital standards for banks. The rules redefine what is included or deducted from equity capital, changes risk weighting for certain on and off-balance sheet assets, increases the minimum

Table of Contents

required equity capital to be considered well capitalized, and introduces a capital cushion buffer. The rules, which will be gradually phased in between 2015 and 2019, are not expected to have a material impact on the Corporation but will require us to hold more capital than we have historically.

Reclassifications and Restatements: Certain amounts previously reported in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report have been either reclassified or restated to conform with the 2015 presentation. For a complete overview on restatements impacting Management's Discussion and Analysis of Financial Condition and Results of Operations, see pages 4 and 52 of this report.

Other

We have not received any notices of regulatory actions as of February 19, 2016.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are set forth in "Note 1 – Nature of Operations and Summary of Significant Accounting Policies" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data. Of these significant accounting policies, we consider our policies regarding the ALLL, acquisition intangibles and goodwill, and the determination of the fair value and assessment of OTTI of investment securities to be our most critical accounting policies.

The ALLL requires our most subjective and complex judgment. Changes in economic conditions can have a significant impact on the ALLL and, therefore, the provision for loan losses and results of operations. We have developed policies and procedures for assessing the appropriateness of the ALLL, recognizing that this process requires a number of assumptions and estimates with respect to our loan portfolio. Our 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 us at the time of the issuance of the consolidated financial statements. For additional discussion concerning our ALLL and related matters, see the detailed discussion to follow under the caption "Allowance for Loan and Lease Losses" and "Note 5 – Loans and ALLL" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data.

U.S. generally accepted accounting principles require that we determine the fair value of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. We employ 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 we believe we have the appropriate expertise to determine the fair value, we may choose to use our own calculations of the value. In other cases, where the value is not easily determined, we consult 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 net value of assets acquired on our balance sheet, including identifiable intangibles, is recorded as goodwill. Acquisition intangibles and goodwill are qualitatively evaluated to determine if it is more likely than not that the carrying balance is impaired on at least an annual basis.

AFS securities are carried at fair value with changes in the fair value included as a component of other comprehensive income. Declines in the fair value of AFS securities below their cost that are other-than-temporary are reflected as realized losses in the consolidated statements of income. We evaluate AFS securities for indications of losses that are considered other-than-temporary, if any, on a regular basis. The market values for AFS investment securities are typically obtained from outside sources and applied to individual securities within the portfolio.

Table of Contents

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 for the last three years. These schedules also present an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a FTE basis using a 34% federal income tax rate. Loans in nonaccrual status, for the purpose of the following computations, are included in the average loan balances. FRB and FHLB restricted equity holdings are included in accrued income and other assets.

	Year Ended December 31									
	2015			2014			2013			
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate	
INTEREST EARNING ASSETS										
Loans	\$829,903	\$35,853	4.32 %	\$816,105	\$36,629	4.49 %	\$792,430	\$37,575	4.74 %	
Taxable investment securities	395,981	9,053	2.29 %	357,250	8,092	2.27 %	335,575	7,228	2.15 %	
Nontaxable investment securities	205,242	9,870	4.81 %	194,751	9,877	5.07 %	165,774	8,294	5.00 %	
Other	25,947	600	2.31 %	25,784	519	2.01 %	28,306	502	1.77 %	
Total earning assets	1,457,073	55,376	3.80 %	1,393,890	55,117	3.95 %	1,322,085	53,599	4.05 %	
NONEARNING ASSETS										
Allowance for loan losses	(9,275)			(10,973)			(11,877)			
Cash and demand deposits due from banks	17,925			18,552			18,162			
Premises and equipment	26,968			25,957			25,993			
Accrued income and other assets	98,805			94,754			94,077			
Total assets	\$1,591,496			\$1,522,180			\$1,448,440			
INTEREST BEARING LIABILITIES										
Interest bearing demand deposits	\$195,260	155	0.08 %	\$191,750	157	0.08 %	\$183,665	161	0.09 %	
Savings deposits	293,703	449	0.15 %	260,469	374	0.14 %	242,777	366	0.15 %	
Time deposits	433,409	5,246	1.21 %	448,971	5,764	1.28 %	456,774	6,613	1.45 %	
Borrowed funds	295,641	4,313	1.46 %	274,080	3,675	1.34 %	251,590	3,881	1.54 %	
Total interest bearing liabilities	1,218,013	10,163	0.83 %	1,175,270	9,970	0.85 %	1,134,806	11,021	0.97 %	
NONINTEREST BEARING										

LIABILITIES

Demand deposits	181,939	165,860	141,872
Other	10,001	10,773	8,752
Shareholders' equity	181,543	170,277	163,010
Total liabilities and shareholders' equity	\$1,591,496	\$1,522,180	\$1,448,440
Net interest income (FTE)	\$45,213	\$45,147	\$42,578
Net yield on interest earning assets (FTE)	3.10 %	3.24 %	3.22 %

Table of Contents

Net Interest Income

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

Volume and Rate Variance Analysis

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

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

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

	2015 Compared to 2014			Increase Net	2014 Compared to 2013			Increase Net
	(Decrease) Due to		Net		(Decrease) Due to		Net	
	Volume	Rate			Volume	Rate		
Changes in interest income								
Loans	\$612	\$(1,388)	) \$(776)	) \$1,101	\$(2,047)	) \$(946))	
Taxable investment securities	885	76	961	480	384	864		
Nontaxable investment securities	518	(525)	) (7)	) 1,468	115	1,583		
Other	3	78	81	(47)	) 64	17		
Total changes in interest income	2,018	(1,759)	) 259	) 3,002	(1,484)	) 1,518		
Changes in interest expense								
Interest bearing demand deposits	3	(5)	) (2)	) 7	(11)	) (4))	
Savings deposits	50	25	75	26	(18)	8		
Time deposits	(195)	) (323)	) (518)	) (111)	) (738)	) (849))	
Borrowed funds	301	337	638	329	(535)	) (206))	
Total changes in interest expense	159	34	193	251	(1,302)	) (1,051))	
Net change in interest margin (FTE)	\$1,859	\$(1,793)	) \$66	) \$2,751	\$(182)	) \$2,569		

Our net yield on interest earning assets remains at historically low levels. The persistent low interest rate environment coupled with an increase in the concentration of AFS securities as a percentage of earning assets has also placed downward pressure on net interest margin yield. While we anticipate that the FRB will increase short term interest rates in 2016, we do not expect any significant change in our net yield on interest earning assets as the rates paid on interest bearing liabilities will likely increase as fast as those of interest earning assets. Net interest income will increase only through continued balance sheet growth.

Average Yield / Rate for the Three Month Periods Ended:

	December 31	September 30	June 30	March 31	December 31	
	2015	2015	2015	2015	2014	
Total earning assets	3.73	% 3.79	% 3.81	% 3.88	% 3.97	%
Total interest bearing liabilities	0.83	% 0.84	% 0.84	% 0.84	% 0.85	%
Net yield on interest earning assets (FTE)	3.04	% 3.09	% 3.11	% 3.18	% 3.26	%

Table of Contents

	Quarter to Date Net Interest Income (FTE)				
	December 31 2015	September 30 2015	June 30 2015	March 31 2015	December 31 2014
Total interest income (FTE)	\$13,970	\$13,919	\$13,748	\$13,742	\$14,019
Total interest expense	2,577	2,580	2,518	2,488	2,504
Net interest income (FTE)	\$11,393	\$11,339	\$11,230	\$11,254	\$11,515

Allowance for Loan and Lease Losses

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

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

	December 31 2015	September 30 2015	June 30 2015	March 31 2015	December 31 2014
Total charge-offs	\$238	\$210	\$296	\$160	\$351
Total recoveries	210	148	231	386	115
Net loan charge-offs	28	62	65	(226)	236
Net loan charge-offs to average loans outstanding	—	0.01	% 0.01	% (0.03)	% 0.03
Provision for loan losses	\$(772)	\$(738)	\$(535)	\$(726)	\$(64)
Provision for loan losses to average loans outstanding	(0.09)%	(0.09)%	(0.07)%	(0.09)%	(0.01)%
ALLL	\$7,400	\$8,200	\$9,000	\$9,600	\$10,100
ALLL as a % of loans at end of period	0.87%	0.98%	1.08%	1.17%	1.21%

The following table summarizes our charge-off and recovery activity for the years ended December 31:

	2015	2014	2013	2012	2011
ALLL at beginning of period	\$10,100	\$11,500	\$11,936	\$12,375	\$12,373
Charge-offs					
Commercial and agricultural	134	590	907	1,672	1,984
Residential real estate	397	722	1,004	1,142	2,240
Consumer	373	316	429	542	552
Total charge-offs	904	1,628	2,340	3,356	4,776
Recoveries					
Commercial and agricultural	549	550	363	240	461
Residential real estate	220	197	181	122	177
Consumer	206	149	249	255	314
Total recoveries	975	896	793	617	952
Provision for loan losses	(2,771)	(668)	1,111	2,300	3,826
ALLL at end of period	7,400	10,100	11,500	11,936	12,375
Net loan charge-offs	\$(71)	\$732	\$1,547	\$2,739	\$3,824
Net loan charge-offs to average loans outstanding	(0.01)%	0.09%	0.20%	0.36%	0.51%
ALLL as a % of loans at end of period	0.87%	1.21%	1.42%	1.54%	1.65%

Table of Contents

As the level of net loans charged-off decline and credit quality indicators continue to improve, we have reduced the ALLL in

both amount and as a percentage of loans. While more volatile, loans individually evaluated for impairment have been relatively flat until the 4th quarter of 2015. The decline in loans collectively impaired illustrates the downward trend we are experiencing in our overall level of ALLL to gross loans. The following table illustrates our changes within the two main components of the ALLL.

	December 31 2015	September 30 2015	June 30 2015	March 31 2015	December 31 2014	
ALLL						
Individually evaluated for impairment	\$2,820	\$3,217	\$3,202	\$3,361	\$3,427	
Collectively evaluated for impairment	4,580	4,983	5,798	6,239	6,673	
Total	\$7,400	\$8,200	\$9,000	\$9,600	\$10,100	
ALLL to gross loans						
Individually evaluated for impairment	0.33	% 0.38	% 0.38	% 0.41	% 0.41	%
Collectively evaluated for impairment	0.54	% 0.60	% 0.70	% 0.76	% 0.80	%
Total	0.87	% 0.98	% 1.08	% 1.17	% 1.21	%

For further discussion of the allocation of the ALLL, see “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

Loans Past Due and Loans in Nonaccrual Status

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

	Total Past Due and Nonaccrual Loans as of December 31					
	2015	2014	2013	2012	2011	
Commercial and agricultural	\$2,247	\$4,805	\$3,621	\$7,271	\$7,420	
Residential real estate	2,520	4,181	7,008	5,431	5,297	
Consumer	31	138	259	199	186	
Total	\$4,798	\$9,124	\$10,888	\$12,901	\$12,903	
Total past due and nonaccrual loans to gross loans	0.56	% 1.09	% 1.34	% 1.67	% 1.72	%

Declines in past due and nonaccrual status loans during 2015 are the result of improved loan performance. A summary of loans past due and in nonaccrual status, including the composition of the ending balance of nonaccrual status loans by type, is included in “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

Troubled Debt Restructurings

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

We restructure debt with borrowers who due to temporary financial difficulties are unable to service their debt under the original terms. We may extend the amortization period, reduce interest rates, forgive principal, forgive interest, or a combination of these modifications. Typically, the modifications are for a period of five years or less. There were no TDRs that were Government sponsored as of December 31, 2015 or December 31, 2014.

Table of Contents

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

The following tables provide a roll-forward of TDRs for the years ended December 31, 2014 and 2015:

	Accruing Interest		Nonaccrual		Total	
	Number	Balance	Number	Balance	Number	Balance
	of Loans		of Loans		of Loans	
January 1, 2014	165	\$24,423	15	\$1,442	180	\$25,865
New modifications	30	2,647	5	367	35	3,014
Principal advances (payments)	—	(1,501)	—	(254)	—	(1,755)
Loans paid-off	(32)	(2,964)	(3)	(90)	(35)	(3,054)
Partial charge-offs	—	(70)	—	(193)	—	(263)
Balances charged-off	(3)	(13)	(3)	(115)	(6)	(128)
Transfers to OREO	—	—	(5)	(338)	(5)	(338)
Transfers to accrual status	5	502	(5)	(502)	—	—
Transfers to nonaccrual status	(9)	(2,093)	9	2,093	—	—
December 31, 2014	156	20,931	13	2,410	169	23,341
New modifications	28	6,490	4	491	32	6,981
Principal advances (payments)	—	(1,205)	—	(1,002)	—	(2,207)
Loans paid-off	(26)	(5,227)	(7)	(597)	(33)	(5,824)
Partial charge-offs	—	—	—	(87)	—	(87)
Balances charged-off	(2)	(83)	—	—	(2)	(83)
Transfers to OREO	—	—	(6)	(796)	(6)	(796)
Transfers to accrual status	3	292	(3)	(292)	—	—
Transfers to nonaccrual status	(4)	(267)	4	267	—	—
December 31, 2015	155	\$20,931	5	\$394	160	\$21,325

The following table summarizes our TDRs as of December 31:

	2015			2014			2013		
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total
Current	\$20,550	\$146	\$20,696	\$20,012	\$272	\$20,284	\$21,690	\$1,189	\$22,879
Past due 30-59 days	357	—	357	804	592	1,396	2,158	37	2,195
Past due 60-89 days	24	—	24	115	3	118	575	—	575
Past due 90 days or more	—	248	248	—	1,543	1,543	—	216	216
Total	\$20,931	\$394	\$21,325	\$20,931	\$2,410	\$23,341	\$24,423	\$1,442	\$25,865
	2012			2011					
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total
Current	\$16,301	\$941	\$17,242	\$16,125	\$514	\$16,639			
Past due 30-59 days	158	561	719	1,564	344	1,908			
Past due 60-89 days	72	41	113	50	85	135			
Past due 90 days or more	—	1,281	1,281	—	74	74			
Total	\$16,531	\$2,824	\$19,355	\$17,739	\$1,017	\$18,756			

Additional disclosures about TDRs are included in “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

Table of Contents

Impaired Loans

The following is a summary of information pertaining to impaired loans as of December 31:

	2015			2014		
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance
TDRs						
Commercial real estate	\$7,619	\$7,858	\$818	\$10,222	\$10,501	\$1,276
Commercial other	188	199	11	715	945	4
Agricultural real estate	3,549	3,549	—	1,423	1,423	—
Agricultural other	519	519	2	66	186	—
Residential real estate senior liens	9,155	9,457	1,851	10,462	11,019	1,847
Residential real estate junior liens	133	133	28	246	246	49
Home equity lines of credit	127	427	—	153	453	46
Consumer secured	35	35	—	54	54	1
Total TDRs	21,325	22,177	2,710	23,341	24,827	3,223
Other impaired loans						
Commercial real estate	162	175	—	1,009	1,195	3
Commercial other	—	—	—	83	95	—
Agricultural real estate	—	—	—	106	106	—
Agricultural other	—	—	—	—	—	—
Residential real estate senior liens	841	1,308	108	1,183	1,763	168
Residential real estate junior liens	10	30	2	19	29	4
Home equity lines of credit	—	7	—	97	197	29
Consumer secured	—	—	—	10	10	—
Total other impaired loans	1,013	1,520	110	2,507	3,395	204
Total impaired loans	\$22,338	\$23,697	\$2,820	\$25,848	\$28,222	\$3,427

Additional disclosure related to impaired loans is included in “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

Nonperforming Assets

The following table summarizes our nonperforming assets as of December 31:

	2015	2014	2013	2012	2011
Nonaccrual status loans	\$792	\$4,044	\$3,244	\$7,303	\$6,389
Accruing loans past due 90 days or more	—	148	142	428	760
Total nonperforming loans	792	4,192	3,386	7,731	7,149
Foreclosed assets	421	885	1,412	2,018	1,876
Total nonperforming assets	\$1,213	\$5,077	\$4,798	\$9,749	\$9,025
Nonperforming loans as a % of total loans	0.09	% 0.50	% 0.42	% 1.00	% 0.95
Nonperforming assets as a % of total assets	0.07	% 0.33	% 0.32	% 0.68	% 0.67

After a loan is 90 days past due, it is placed on nonaccrual status unless it is well secured and in the process of collection. Upon transferring a loan to nonaccrual status, we perform an evaluation to determine the net realizable value of the underlying collateral. This evaluation is used to help determine if any charge-offs are necessary. Loans

may be placed back on accrual status after six months months of continued performance. Total nonperforming loans continue to improve with current levels reflecting historic lows.

Table of Contents

Included in the nonaccrual loan balances above were loans currently classified as TDRs as of December 31:

	2015	2014	2013	2012	2011
Commercial and agricultural	\$232	\$1,995	\$833	\$2,325	\$520
Residential real estate	162	262	609	499	497
Consumer	—	153	—	—	—
Total	\$394	\$2,410	\$1,442	\$2,824	\$1,017

Additional disclosures about nonaccrual status loans are included in “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

We continue to devote considerable attention to identifying impaired loans and adjusting the net carrying value of these loans to their current net realizable values through the establishment of a specific reserve or the recording of a charge-off. We believe that we have identified all impaired loans as of December 31, 2015.

We believe that the level of the ALLL is appropriate as of December 31, 2015. We will continue to closely monitor overall credit quality indicators and our policies and procedures related to the analysis of the ALLL to ensure that the ALLL remains at the appropriate level.

Table of Contents

Noninterest Income and Noninterest Expenses

Significant noninterest account balances are highlighted in the following table with additional descriptions of significant fluctuations for the years ended December 31:

	2015	2014	Change		2013	Change		
			\$	%		\$	%	
Service charges and fees								
ATM and debit card fees	\$2,411	\$2,084	\$327	15.69 %	\$1,944	\$140	7.20 %	
NSF and overdraft fees	1,855	2,156	(301)	(13.96) %	2,243	(87)	(3.88) %	
Freddie Mac servicing fee	712	720	(8)	(1.11) %	737	(17)	(2.31) %	
Service charges on deposit accounts	345	354	(9)	(2.54) %	373	(19)	(5.09) %	
Net OMSR income (loss)	(14)	(36)	22	61.11 %	269	(305)	(113.38) %	
All other	128	133	(5)	(3.76) %	116	17	14.66 %	
Total service charges and fees	5,437	5,411	26	0.48 %	5,682	(271)	(4.77) %	
Net gain on sale of mortgage loans	573	514	59	11.48 %	962	(448)	(46.57) %	
Earnings on corporate owned life insurance policies	771	751	20	2.66 %	732	19	2.60 %	
Net gains (losses) on sale of AFS securities	163	97	66	68.04 %	171	(74)	(43.27) %	
Other								
Trust and brokerage advisory fees	2,161	2,069	92	4.45 %	1,858	211	11.36 %	
Corporate Settlement Solutions joint venture	463	76	387	509.21 %	143	(67)	(46.85) %	
Other	791	407	384	94.35 %	627	(220)	(35.09) %	
Total other	3,415	2,552	863	33.82 %	2,628	(76)	(2.89) %	
Total noninterest income	\$10,359	\$9,325	\$1,034	11.09 %	\$10,175	\$(850)	(8.35) %	

Significant changes in noninterest income are detailed below:

ATM and debit card fees increased during 2015 as a result of marketing incentives. While we do not anticipate significant changes to our ATM and debit card fees, we do expect that fees will continue to increase in 2016 as the usage of ATM and debit cards continues to increase.

NSF and overdraft fees fluctuate from period-to-period based on customer activity as well as the number of business days in the period. We anticipate NSF and overdraft fees in 2016 to approximate 2015 levels.

Offering rates on residential mortgage loans, as well as the decline in loan demand, have been the most significant drivers behind fluctuations in the gain on sale of mortgage loans and net OMSR income (loss). Mortgage rates are expected to approximate current levels in the foreseeable future and purchase money mortgage activity is anticipated to increase as a result of our various initiatives to drive growth. As such, we anticipate increases in origination volumes and in turn, an increase in gains on sale of mortgage loans.

We are continually analyzing our AFS securities for potential sale opportunities. These analyses identified several securities that made economic sense to sell in 2015, 2014, and 2013.

In recent periods, we have invested considerable efforts to increase our market share in trust and brokerage advisory services. These efforts have translated into increases in trust fees and brokerage and advisory fees. We anticipate that these fees will continue to increase in 2016.

The increase in earnings from our Corporate Settlement Solutions joint venture during 2015 can be attributed to their expansion of national sales and maintaining consistent margins with the increased sales volume.

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

Table of Contents

Significant noninterest expense account balances are highlighted in the following table with additional descriptions of significant fluctuations for the years ended December 31:

	2015	2014	Change		2013	Change			
			\$	%		\$	%		
Compensation and benefits									
Employee salaries	\$13,760	\$13,311	\$449	3.37	% \$12,019	\$1,292	10.75	%	
Employee benefits	5,308	5,191	117	2.25	% 5,788	(597)	(10.31))%	
Total compensation and benefits	19,068	18,502	566	3.06	% 17,807	695	3.90	%	
Furniture and equipment									
Service contracts	2,932	2,542	390	15.34	% 2,277	265	11.64	%	
Depreciation	1,949	1,850	99	5.35	% 1,889	(39)	(2.06))%	
ATM and debit card fees	742	722	20	2.77	% 710	12	1.69	%	
All other	116	59	57	96.61	% 69	(10)	(14.49))%	
Total furniture and equipment	5,739	5,173	566	10.94	% 4,945	228	4.61	%	
Occupancy									
Depreciation	728	701	27	3.85	% 667	34	5.10	%	
Outside services	701	718	(17)	(2.37)	)% 671	47	7.00	%	
Utilities	528	524	4	0.76	% 502	22	4.38	%	
Property taxes	526	515	11	2.14	% 499	16	3.21	%	
All other	351	340	11	3.24	% 314	26	8.28	%	
Total occupancy	2,834	2,798	36	1.29	% 2,653	145	5.47	%	
Other									
Director fees	827	775	52	6.71	% 819	(44)	(5.37))%	
Audit and related fees	821	809	12	1.48	% 738	71	9.62	%	
FDIC insurance premiums	813	842	(29)	(3.44)	)% 1,082	(240)	(22.18))%	
Donations and community relations	808	1,004	(196)	(19.52)	)% 715	289	40.42	%	
Marketing costs	491	427	64	14.99	% 416	11	2.64	%	
Legal fees	464	320	144	45.00	% 359	(39)	(10.86))%	
Education and travel	442	625	(183)	(29.28)	)% 502	123	24.50	%	
Printing and supplies	405	367	38	10.35	% 396	(29)	(7.32))%	
Postage and freight	377	397	(20)	(5.04)	)% 387	10	2.58	%	
Consulting fees	364	349	15	4.30	% 315	34	10.79	%	
Loan underwriting fees	347	361	(14)	(3.88)	)% 423	(62)	(14.66))%	
State taxes	218	171	47	27.49	% 140	31	22.14	%	
Amortization of deposit premium	169	183	(14)	(7.65)	)% 221	(38)	(17.19))%	
Other losses	150	250	(100)	(40.00)	)% 109	141	129.36	%	
Foreclosed asset and collection	53	122	(69)	(56.56)	)% 211	(89)	(42.18))%	
All other	1,661	1,628	33	2.03	% 1,517	111	7.32	%	
Total other	8,410	8,630	(220)	(2.55)	)% 8,350	280	3.35	%	
Total noninterest expenses	\$36,051	\$35,103	\$948	2.70	% \$33,755	\$1,348	3.99	%	

Table of Contents

Significant changes in noninterest expenses are detailed below:

Employee salaries have increased as a result of normal merit increases and additional staffing required by our continued growth. The decline in employee benefits from 2013 to 2014, is related to health care costs as a result of lower than anticipated claims. Employee benefits are expected to increase moderately in future periods as a result of anticipated increases in health care costs.

Service contracts include approximately \$147 of conversion related costs incurred as a result of two branch acquisitions during the third quarter of 2015.

FDIC insurance premiums were elevated in 2013 due to us receiving less of a refund for prepaid FDIC insurance premiums than we had anticipated. FDIC insurance premiums have returned to normalized levels and are anticipated to approximate current levels in 2016.

We have consistently been a strong supporter of the various communities, schools, and charities in the markets we serve. We sponsor a foundation, which we established in 1996, that is funded by discretionary donations. The foundation provides centralized oversight for charitable donations to organizations that benefit our communities. Included in donations and community relations were discretionary donations to the foundation of \$258, \$500, and \$200 for the years ended December 31, 2015, 2014, and 2013, respectively.

- Legal fees include approximately \$133 of legal service expense incurred as a result of two branch acquisitions during the third quarter of 2015. Legal fees are expected to approximate 2014 levels in 2016.

We place a strong emphasis on employee development through continuous education. Education and travel expenses vary from year to year based on the timing of various programs that our employees attend.

- Other losses increased significantly in 2014 primarily as a result of losses related to fraudulent activities associated with debit cards. Also contributing to losses in 2014 were losses related to the repurchase of loans that we previously sold to a third party. While other losses fluctuate from period to period, they are expected to approximate 2015 levels in 2016.

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

Table of Contents

Analysis of Changes in Financial Condition

The following table shows the composition and changes in our balance sheet as of December 31:

	2015	2014	Change		
			\$	%	
ASSETS					
Cash and cash equivalents	\$21,569	\$19,906	\$1,663	8.35	%
AFS securities					
Amortized cost of AFS securities	654,348	561,893	92,455	16.45	%
Unrealized gains (losses) on AFS securities	5,788	5,641	147	2.61	%
AFS securities	660,136	567,534	92,602	16.32	%
Mortgage loans AFS	1,187	901	286	31.74	%
Loans					
Gross loans	850,492	836,550	13,942	1.67	%
Less allowance for loan and lease losses	7,400	10,100	(2,700)	(26.73))%
Net loans	843,092	826,450	16,642	2.01	%
Premises and equipment	28,331	25,881	2,450	9.47	%
Corporate owned life insurance policies	26,423	25,152	1,271	5.05	%
Accrued interest receivable	6,269	5,851	418	7.14	%
Equity securities without readily determinable fair values	22,286	20,076	2,210	11.01	%
Goodwill and other intangible assets	48,828	46,128	2,700	5.85	%
Other assets	9,991	11,664	(1,673)	(14.34))%
TOTAL ASSETS	\$1,668,112	\$1,549,543	\$118,569	7.65	%
LIABILITIES AND SHAREHOLDERS' EQUITY					
Liabilities					
Deposits	\$1,164,563	\$1,074,484	\$90,079	8.38	%
Borrowed funds	309,732	289,709	20,023	6.91	%
Accrued interest payable and other liabilities	9,846	10,756	(910)	(8.46))%
Total liabilities	1,484,141	1,374,949	109,192	7.94	%
Shareholders' equity	183,971	174,594	9,377	5.37	%
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,668,112	\$1,549,543	\$118,569	7.65	%

As shown above, total assets have increased \$118,569 since December 31, 2014. During 2015, we increased our cost basis of AFS securities by \$92,455 while loans grew by \$13,942. Included in the increase in our AFS securities portfolio was \$147 increase in unrealized gains. This balance sheet growth was funded by increases in both deposits (through branch acquisitions) and borrowed funds. While we do anticipate that generating quality loans will continue to be competitive, we expect that loans will continue to grow in 2016.

A discussion of changes in balance sheet amounts by major categories follows:

Cash and cash equivalents

Included in cash and cash equivalents are funds held with FRB which fluctuate from period-to-period.

AFS investment securities

The primary objective of our investing activities is to provide for safety of the principal invested. Secondary considerations include the need for earnings, liquidity, and our overall exposure to changes in interest rates. The current interest rate environment has made it almost impossible to increase net interest income without increasing earning assets. As deposit growth outpaced loan demand in recent periods, we deployed funds from deposit growth into purchases of AFS securities to provide additional interest income. We anticipate that future increases in our AFS securities will be in the form of mortgage-backed securities and collateralized mortgage obligations.

Table of Contents

The following is a schedule of the carrying value of AFS investment securities as of December 31:

	2015	2014	2013	2012	2011
Government sponsored enterprises	\$24,345	\$24,136	\$23,745	\$25,776	\$397
States and political subdivisions	232,217	215,345	201,988	182,743	174,938
Auction rate money market preferred	2,866	2,619	2,577	2,778	2,049
Preferred stocks	3,299	6,140	5,827	6,363	5,033
Mortgage-backed securities	263,384	166,926	144,115	155,345	143,602
Collateralized mortgage obligations	134,025	152,368	133,810	131,005	99,101
Total	\$660,136	\$567,534	\$512,062	\$504,010	\$425,120

Excluding those holdings in government sponsored enterprises and municipalities within the State of Michigan, there were no investments in securities of any one issuer that exceeded 10% of shareholders' equity. We have a policy prohibiting investments in securities that we deem are unsuitable due to their inherent credit or market risks.

Prohibited investments include stripped mortgage backed securities, zero coupon bonds, nongovernment agency asset backed securities, and structured notes. Our holdings in mortgage-backed securities and collateralized mortgage obligations include only government agencies and government sponsored agencies as we hold no investments in private label mortgage-backed securities or collateralized mortgage obligations.

The following is a schedule of maturities of AFS investment securities and their weighted average yield as of December 31, 2015. Weighted average yields have been computed on an FTE basis using a tax rate of 34%. Our auction rate money market preferred is a long term floating rate instrument for which the interest rate is set at periodic auctions. At each successful auction, we have the option to sell the security at par value. Additionally, the issuers of auction rate securities generally have the right to redeem or refinance the debt. Because of their lack of contractual maturities, auction rate money market preferred and preferred stocks are not reported by a specific maturity group. Mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group due to their variable monthly payments. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Maturing									
	Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years		After Ten Years		Securities with Variable Monthly Payments or Noncontractual Maturities	
	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)
Government sponsored enterprises	\$—	—	\$23,963	1.45	\$382	2.05	\$—	—	\$—	—
States and political subdivisions	30,217	2.01	71,489	4.75	96,489	4.22	34,022	4.91	—	—
Mortgage-backed securities	—	—	—	—	—	—	—	—	263,384	2.28
Collateralized mortgage obligations	—	—	—	—	—	—	—	—	134,025	2.35
Auction rate money market preferred	—	—	—	—	—	—	—	—	2,866	6.35
Preferred stocks	—	—	—	—	—	—	—	—	3,299	5.44
Total	\$30,217	2.01	\$95,452	3.92	\$96,871	4.21	\$34,022	4.91	\$403,574	2.36

Table of Contents

Loans

Loans are the largest component of earning assets. The proper management of credit and market risk inherent in the loan portfolio is critical to our financial well-being. To control these risks, we have adopted strict underwriting standards. These standards include specific criteria against lending outside our defined market areas, lending limits to a single borrower, and strict loan to collateral value limits. We also monitor and limit loan concentrations to specific industries. We have no foreign loans and there were no concentrations greater than 10% of total loans that are not disclosed as a separate category in the following table.

The following table presents the composition of the loan portfolio for the years ended December 31:

	2015	2014	2013	2012	2011
Commercial	\$448,381	\$433,270	\$393,164	\$372,332	\$366,440
Agricultural	115,911	104,721	92,589	83,606	74,645
Residential real estate	251,501	266,155	291,499	285,070	278,803
Consumer	34,699	32,404	33,525	33,619	31,722
Total	\$850,492	\$836,550	\$810,777	\$774,627	\$751,610

The following table presents the change in the loan portfolio categories for the years ended December 31:

	2015		2014		2013		
	\$ Change	% Change	\$ Change	% Change	\$ Change	% Change	
Commercial	\$15,111	3.49	% \$40,106	10.20	% \$20,832	5.60	%
Agricultural	11,190	10.69	% 12,132	13.10	% 8,983	10.74	%
Residential real estate	(14,654)	(5.51)%	(25,344)	(8.69)%	6,429	2.26	%
Consumer	2,295	7.08	% (1,121)	(3.34)%	(94)	(0.28)%	%
Total	\$13,942	1.67	% \$25,773	3.18	% \$36,150	4.67	%

While competition for commercial loans continues to be strong, we experienced growth in this segment of the portfolio during 2015 and anticipate strong growth in 2016. Residential real estate loans declined during 2015; however, we anticipate growth in 2016 as a result of initiatives designed to increase both loan volume and the number of originations.

Equity securities without readily determinable fair values

Included in equity securities without readily determinable fair values are restricted securities, which are carried at cost and investments in unconsolidated entities accounted for under the equity method of accounting (see "Note 1 – Nature of Operations and Summary of Significant Accounting Policies" and "Note 20 – Fair Value" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data).

Deposits

Deposits are our primary source of funding. The following table presents the composition of the deposit portfolio as of December 31:

	2015	2014	2013	2012	2011
Noninterest bearing demand deposits	\$191,376	\$181,826	\$158,428	\$143,735	\$119,072
Interest bearing demand deposits	212,666	190,984	192,089	181,259	163,653
Savings deposits	337,641	261,412	243,237	228,338	193,902
Certificates of deposit	324,101	339,824	362,473	376,790	395,777
Brokered certificates of deposit	73,815	72,134	56,329	55,348	54,326
Internet certificates of deposit	24,964	28,304	31,210	32,197	31,434
Total	\$1,164,563	\$1,074,484	\$1,043,766	\$1,017,667	\$958,164

Table of Contents

The following table presents the change in the deposit categories for the years ended December 31:

	2015		2014		2013			
	\$ Change	% Change	\$ Change	% Change	\$ Change	% Change		
Noninterest bearing demand deposits	\$9,550	5.25	% \$23,398	14.77	% \$14,693	10.22	%	
Interest bearing demand deposits	21,682	11.35	% (1,105)	(0.58)%	10,830	5.97	%	
Savings deposits	76,229	29.16	% 18,175	7.47	% 14,899	6.52	%	
Certificates of deposit	(15,723)	(4.63)%	(22,649)	(6.25)%	(14,317)	(3.80)%		
Brokered certificates of deposit	1,681	2.33	% 15,805	28.06	% 981	1.77	%	
Internet certificates of deposit	(3,340)	(11.80)%	(2,906)	(9.31)%	(987)	(3.07)%		
Total	\$90,079	8.38	% \$30,718	2.94	% \$26,099	2.56	%	

Deposit demand continues to be driven by non-contractual deposits while certificates of deposit gradually decline. Our significant growth in savings deposits during 2015 is the result of our recent branch acquisitions. In 2016, growth is anticipated to continue to come in the form of non-contractual deposits, while certificates of deposit are expected to continue to decline but at a slower rate than the past 5 years. We look to retain and attract new customers with the recent branch acquisitions to provide growth in deposits in future periods.

The remaining maturity of time certificates and other time deposits of \$100 or more as of December 31, 2015 was as follows:

Maturity

Within 3 months	\$37,988
Within 3 to 6 months	17,377
Within 6 to 12 months	50,180
Over 12 months	133,183
Total	\$238,728

Borrowed Funds

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

The following table presents borrowed funds balances for the years ended December 31:

	2015	2014	2013	2012	2011
FHLB advances	\$235,000	\$192,000	\$162,000	\$152,000	\$142,242
Securities sold under agreements to repurchase without stated maturity dates	70,532	95,070	106,025	66,147	57,198
Securities sold under agreements to repurchase with stated maturity dates	—	439	11,301	16,284	16,696
Federal funds purchased	4,200	2,200	—	6,570	—
Total	\$309,732	\$289,709	\$279,326	\$241,001	\$216,136

For additional disclosure related to borrowed funds, see "Note 10 – Borrowed Funds" of "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data.

Accrued interest payable and other liabilities

Included in accrued interest payable and other liabilities are obligations related to our defined benefit pension plan and obligations related to other employee benefits. For more information on the defined benefit pension plan and other employee benefits, see "Note 17 – Benefit Plans" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data.

Table of Contents

Contractual Obligations and Loan Commitments

We have various financial obligations, including contractual obligations and commitments, which may require future cash payments. The following schedule summarizes our non-cancelable obligations and future minimum payments as of December 31, 2015:

	Minimum Payments Due by Period				Total
	Due in One Year or Less	After One Year But Within Three Years	After Three Years But Within Five Years	After Five Years	
Deposits					
Deposits with no stated maturity	\$741,683	\$—	\$—	\$—	\$741,683
Certificates of deposit with stated maturities	191,858	153,099	56,895	21,028	422,880
Total deposits	933,541	153,099	56,895	21,028	1,164,563
Borrowed funds					
Short-term borrowings	74,732	—	—	—	74,732
Long-term borrowings	45,000	100,000	20,000	70,000	235,000
Total borrowed funds	119,732	100,000	20,000	70,000	309,732
Total contractual obligations	\$1,053,273	\$253,099	\$76,895	\$91,028	\$1,474,295

We also have loan commitments that may impact liquidity. The following schedule summarizes our loan commitments and expiration dates by period as of December 31, 2015. Commitments to grant loans include residential mortgage loans with the majority being loans committed to be sold to the secondary market. Since many of these commitments historically have expired without being drawn upon, the total amount of these commitments does not necessarily represent our future cash requirements.

	Expiration Dates by Period				Total
	Due in One Year or Less	After One Year But Within Three Years	After Three Years But Within Five Years	After Five Years	
Unused commitments under lines of credit	\$69,954	\$35,488	\$19,513	\$9,457	\$134,412
Commitments to grant loans	53,946	—	—	—	53,946
Commercial and standby letters of credit	915	—	—	—	915
Total loan commitments	\$124,815	\$35,488	\$19,513	\$9,457	\$189,273

For additional disclosure related to Contractual Obligations and Loan Commitments, see “Note 13 – Off-Balance-Sheet Activities” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

Capital

Capital consists solely of common stock, retained earnings, and accumulated other comprehensive income (loss). We are authorized to raise capital through dividend reinvestment, employee and director stock purchases, and shareholder stock purchases. Pursuant to these authorizations, we issued 216,700 shares or \$5,201 of common stock during 2015, and 182,755 shares or \$4,227 of common stock in 2014. We also offer the Directors Plan in which participants either directly purchase stock or purchase stock units through deferred fees, in lieu of cash payments. Pursuant to this plan, we increased shareholders’ equity by \$550 and \$495 during 2015 and 2014, respectively.

We have a publicly announced common stock repurchase plan. Pursuant to this plan, we repurchased 193,107 shares or \$4,590 of common stock compared to 135,630 shares or \$3,122 during 2015 and 2014, respectively. As of December 31, 2015, we were authorized to repurchase up to an additional 158,658 shares of common stock.

The FRB has established minimum risk based capital guidelines. Pursuant to these guidelines, a framework has been established that assigns risk weights to each category of on and off-balance-sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum

standard to determine whether a corporation has adequate capital. On July 2, 2013, the FRB published revised BASEL III Capital standards for banks. The final rules redefine what is included or deducted from equity capital, changes risk weighting for certain on and

Table of Contents

off-balance sheet assets, increases the minimum required equity capital to be considered well capitalized, and introduces a capital cushion buffer. The rules, which are being gradually phased in between 2015 and 2019, are not expected to have a material impact on the Corporation but will require us to hold more capital than we have historically.

There are no significant regulatory constraints placed on our capital. The FRB's current recommended minimum primary capital to assets requirement is 6.00%. Our primary capital to adjusted average assets, or tier 1 leverage ratio, was 8.52% as of December 31, 2015.

Effective January 1, 2015, the minimum standard for primary, or tier 1, capital increased from 4.00% to 6.00%. The minimum standard for total capital remains at 8.00%. Also effective January 1, 2015 is the new common equity tier 1 capital ratio which has a minimum requirement of 4.50%. The following table sets forth the percentages required under the Risk Based Capital guidelines and our values as of December 31:

	2015	2014	Required	
Common equity tier 1 capital	13.24	% N/A	4.50	%
Tier 1 capital	13.24	% 14.08	% 6.00	%
Tier 2 capital	0.72	% 1.11	% 2.00	%
Total Capital	13.96	% 15.19	% 8.00	%

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

The FRB and FDIC also prescribe minimum capital requirements for Isabella Bank. At December 31, 2015, the Bank exceeded these minimum capital requirements. For further information regarding the Bank's capital requirements, see "Note 16 – Minimum Regulatory Capital Requirements" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data.

Fair Value

We utilize fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. AFS securities and certain liabilities are recorded at fair value on a recurring basis.

Additionally, from time-to-time, we may be required to record at fair value other assets on a nonrecurring basis, such as mortgage loans AFS, foreclosed assets, OMSR, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

For further information regarding fair value measurements, see "Note 1 – Nature of Operations and Summary of Significant Accounting Policies" and "Note 20 – Fair Value" of the "Notes to Consolidated Financial Statements" in Item 8. Financial Statements and Supplementary Data.

Interest Rate Sensitivity

Interest rate sensitivity is determined by the amount of earning assets and interest bearing liabilities repricing within a specific time period, and their relative sensitivity to a change in interest rates. We strive to achieve reasonable stability in the net interest margin through periods of changing interest rates. One tool we use to measure interest rate sensitivity is gap analysis. As shown in the following table, the gap analysis depicts our position for specific time periods and the cumulative gap as a percentage of total assets.

Fixed interest rate AFS securities are scheduled according to their contractual maturity. Fixed rate loans are included in the appropriate time frame based on their scheduled amortization. Variable rate loans, which totaled \$168,534 as of December 31, 2015, are included in the time frame of their earliest repricing. Time deposit liabilities are scheduled based on their contractual maturity except for variable rate time deposits in the amount of \$1,601 that are included in the 0 to 3 month time frame.

Savings and NOW accounts have no contractual maturity date and are believed by us to be predominantly noninterest rate sensitive. These accounts have been classified in the gap table according to their estimated withdrawal rates based upon our analysis of deposit decay over the past five years. We believe this decay experience is consistent with our expectation for the future. As of December 31, 2015, we had a positive cumulative gap within one year. A positive

gap position results when more assets, within a specified time frame, have the potential to mature or reprice than liabilities.

33

Table of Contents

The following table shows the time periods and the amount of assets and liabilities available for interest rate repricing as of December 31, 2015. The interest rate sensitivity information for investment securities is based on the expected prepayments and call dates versus stated maturities. For purposes of this analysis, nonaccrual loans and the ALLL are excluded.

	0 to 3 Months	4 to 12 Months	1 to 5 Years	Over 5 Years	
Interest sensitive assets					
AFS securities	\$35,776	\$112,916	\$347,042	\$164,402	
Loans	204,408	79,477	409,031	156,784	
Total	\$240,184	\$192,393	\$756,073	\$321,186	
Interest sensitive liabilities					
Borrowed funds	\$99,732	\$20,000	\$150,000	\$40,000	
Time deposits	60,100	132,001	209,751	21,028	
Savings	42,141	26,360	103,694	165,446	
NOW	2,936	8,805	40,641	160,284	
Total	\$204,909	\$187,166	\$504,086	\$386,758	
Cumulative gap	\$35,275	\$40,502	\$292,489	\$226,917	
Cumulative gap as a % of assets	2.11	% 2.43	% 17.53	% 13.60	%

The following table shows the maturity of commercial and agricultural loans outstanding at December 31, 2015. Also provided are the amounts due after one year, classified according to the sensitivity to changes in interest rates.

	1 Year or Less	1 to 5 Years	Over 5 Years	Total
Commercial and agricultural	\$78,188	\$310,530	\$175,574	\$564,292
Interest sensitivity				
Loans maturing after one year that have:				
Fixed interest rates		\$275,064	\$168,591	
Variable interest rates		35,466	6,983	
Total		\$310,530	\$175,574	

Table of Contents**Liquidity**

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

Our primary sources of liquidity are cash and cash equivalents and AFS securities. These categories totaled \$681,705 or 40.87% of assets as of December 31, 2015 as compared to \$587,440 or 37.91% as of December 31, 2014. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests, and various other commitments including expansion of operations, investment opportunities, and payment of cash dividends. Liquidity varies significantly daily, based on customer activity.

Our primary source of funds is deposit accounts. We also have the ability to borrow from the FHLB, the FRB, and through various correspondent banks in the form of federal funds purchased and a line of credit. These funding methods typically carry a higher interest rate than traditional market deposit accounts. Some borrowed funds, including FHLB advances, FRB Discount Window advances, and repurchase agreements, require us to pledge assets, typically in the form of AFS securities or loans as collateral. As of December 31, 2015, we had available lines of credit of \$121,960.

The following table summarizes our sources and uses of cash for the years ended December 31:

	2015	2014	\$ Variance
Net cash provided by (used in) operating activities	\$ 12,090	\$ 17,562	\$(5,472)
Net cash provided by (used in) investing activities	(113,499)	(74,826)	(38,673)
Net cash provided by (used in) financing activities	103,072	35,032	68,040
Increase (decrease) in cash and cash equivalents	1,663	(22,232)	23,895
Cash and cash equivalents January 1	19,906	42,138	(22,232)
Cash and cash equivalents December 31	\$21,569	\$ 19,906	\$ 1,663

Market Risk

Our primary market risks are interest rate risk and liquidity risk. We have no significant foreign exchange risk and do not utilize interest rate swaps or derivatives, except for interest rate locks and forward loan commitments, in the management of IRR. Any changes in foreign exchange rates or commodity prices would not have a significant impact on our interest income and cash flows.

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

The FRB has adopted a policy requiring us to effectively manage the various risks that can have a material impact on our safety and soundness. The risks include credit, interest rate, liquidity, operational, and reputational. We have policies, procedures, and internal controls for measuring and managing these risks. Specifically, our Funds Management policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to our Board.

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

components, interest rate changes, changes in market conditions, and management strategies.

35

Table of Contents

Our interest rate sensitivity is estimated by first forecasting the next 12 and 24 months of net interest income under an assumed environment of a constant balance sheet and constant market interest rates (base case). We then compare the results of various simulation analyses to the base case. At December 31, 2015, we projected the change in net interest income during the next 12 and 24 months assuming market interest rates were to immediately decrease by 100 basis points and increase by 100, 200, 300, and 400 basis points in a parallel fashion over the entire yield curve during the same time period. We did not project scenarios showing decreases in interest rates beyond 100 basis points as this is considered extremely unlikely given current interest rate levels. These projections were based on our assets and liabilities remaining static over the next 12 and 24 months, while factoring in probable calls and prepayments of certain investment securities and real estate residential and consumer loans. While it is extremely unlikely that interest rates would immediately increase to these levels, we feel that these extreme scenarios help us identify potential gaps and mismatches in the repricing characteristics of assets and liabilities. We regularly monitor our projected net interest income sensitivity to ensure that it remains within established limits.

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

	December 31, 2015									
	12 Months					24 Months				
Immediate basis point change assumption (short-term)	-100	+100	+200	+300	+400	-100	+100	+200	+300	+400
Percent change in net interest income vs. constant rates	(2.08)%	1.27 %	2.00 %	2.11 %	2.23 %	(1.77)%	2.00 %	3.47 %	4.02 %	4.39 %

	December 31, 2014									
	12 Months					24 Months				
Immediate basis point change assumption (short-term)	-100	+100	+200	+300	+400	-100	+100	+200	+300	+400
Percent change in net interest income vs. constant rates	(1.66)%	0.29 %	0.45 %	(3.18)%	(4.39)%	(1.83)%	0.25 %	1.04 %	(2.70)%	(3.98)%

Gap analysis, the secondary method to measure IRR, measures the cash flows and/or the earliest repricing of our 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 embedded repricing options contained in assets and liabilities. Residential real estate and consumer loans 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 offering rates, 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 cash flows from these assets. A significant portion of our securities are callable or have prepayment options. The call and prepayment options are more likely to be exercised in a period of decreasing interest rates. Savings and demand accounts may generally be withdrawn on request without prior notice. The timing of cash flows from these deposits is estimated based on historical experience. Certificates of deposit have penalties that discourage early withdrawals.

Table of Contents

The following tables provide information about assets and liabilities that are sensitive to changes in interest rates as of December 31, 2015 and December 31, 2014. The principal amounts of investments, loans, other interest earning assets, borrowings, and time deposits maturing were calculated based on the contractual maturity dates. Estimated cash flows for savings and NOW accounts are based on our estimated deposit decay rates.

	December 31, 2015							
	2016	2017	2018	2019	2020	Thereafter	Total	Fair Value
Rate sensitive assets								
Other interest bearing assets	\$2,659	\$100	\$—	\$—	\$—	\$—	\$2,759	\$2,758
Average interest rates	0.23	% 0.35	% —	—	—	—	0.24	%
AFS securities	\$148,692	\$120,692	\$81,726	\$73,541	\$71,083	\$164,402	\$660,136	\$660,136
Average interest rates	2.16	% 2.11	% 2.18	% 2.25	% 2.37	% 2.43	% 2.25	%
Fixed interest rate loans (1)	\$116,143	\$130,873	\$103,265	\$83,457	\$91,436	\$156,784	\$681,958	\$670,864
Average interest rates	4.56	% 4.42	% 4.27	% 4.36	% 4.18	% 4.28	% 4.35	%
Variable interest rate loans (1)	\$61,672	\$24,289	\$24,359	\$14,398	\$16,842	\$26,974	\$168,534	\$168,534
Average interest rates	4.08	% 4.12	% 4.19	% 3.45	% 3.40	% 3.69	% 3.92	%
Rate sensitive liabilities								
Fixed rate borrowed funds	\$104,732	\$50,000	\$50,000	\$40,000	\$10,000	\$40,000	\$294,732	\$297,495
Average interest rates	0.47	% 1.56	% 2.16	% 2.35	% 1.98	% 2.67	% 1.55	%
Variable rate borrowed funds	\$15,000	\$—	\$—	\$—	\$—	\$—	\$15,000	\$15,000
Average interest rates	0.62	% —	—	—	—	—	0.62	%
Savings and NOW accounts	\$80,242	\$42,064	\$37,773	\$33,950	\$30,548	\$325,730	\$550,307	\$550,307
Average interest rates	0.59	% 0.11	% 0.11	% 0.11	% 0.11	% 0.11	% 0.18	%
Fixed interest rate certificates of deposit	\$190,500	\$89,689	\$63,167	\$23,883	\$33,012	\$21,028	\$421,279	\$419,828
Average interest rates	0.92	% 1.26	% 1.27	% 1.50	% 1.59	% 1.84	% 1.18	%
Variable interest rate certificates of deposit	\$1,358	\$243	\$—	\$—	\$—	\$—	\$1,601	\$1,601
Average interest rates	0.49	% 0.40	% —	—	—	—	0.48	%
	December 31, 2014							

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	2015	2016	2017	2018	2019	Thereafter	Total	Fair Value
Rate sensitive assets								
Other interest bearing assets	\$ 1,748	\$—	\$ 100	\$—	\$—	\$—	\$ 1,848	\$ 1,847
Average interest rates	0.36	% —	0.35	% —	—	—	0.36	%
AFS securities	\$ 109,261	\$ 93,324	\$ 80,147	\$ 53,017	\$ 47,112	\$ 184,673	\$ 567,534	\$ 567,534
Average interest rates	2.22	% 2.26	% 2.32	% 2.39	% 2.46	% 2.62	% 2.41	%
Fixed interest rate loans (1)	\$ 121,996	\$ 98,865	\$ 128,954	\$ 91,854	\$ 71,293	\$ 151,156	\$ 664,118	\$ 657,985
Average interest rates	4.78	% 4.83	% 4.53	% 4.32	% 4.47	% 4.25	% 4.52	%
Variable interest rate loans (1)	\$ 71,435	\$ 26,938	\$ 19,836	\$ 13,929	\$ 14,706	\$ 25,588	\$ 172,432	\$ 172,432
Average interest rates	4.46	% 3.97	% 3.95	% 3.39	% 3.37	% 4.01	% 4.08	%
Rate sensitive liabilities								
Fixed rate borrowed funds	\$ 139,709	\$ 10,000	\$ 30,000	\$ 40,000	\$ 20,000	\$ 50,000	\$ 289,709	\$ 293,401
Average interest rates	0.33	% 2.15	% 1.95	% 2.35	% 3.11	% 2.53	% 1.41	%
Savings and NOW accounts	\$ 40,395	\$ 36,417	\$ 32,717	\$ 29,423	\$ 26,487	\$ 286,957	\$ 452,396	\$ 452,396
Average interest rates	0.11	% 0.11	% 0.11	% 0.11	% 0.11	% 0.10	% 0.11	%
Fixed interest rate certificates of deposit	\$ 216,852	\$ 74,722	\$ 56,391	\$ 50,550	\$ 22,901	\$ 17,723	\$ 439,139	\$ 439,841
Average interest rates	0.96	% 1.66	% 1.47	% 1.31	% 1.48	% 1.77	% 1.25	%
Variable interest rate certificates of deposit	\$ 653	\$ 470	\$—	\$—	\$—	\$—	\$ 1,123	\$ 1,123
Average interest rates	0.40	% 0.40	% —	—	—	—	0.40	%

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

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

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information presented in the section captioned “Market Risk” in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

The following consolidated financial statements accompanied by the report of our independent registered public accounting firm are set forth beginning on page 40 of this report:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Changes in Shareholders' Equity

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income (Loss)

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Supplementary data regarding quarterly results of operations is included in Item 6. Selected Financial Data.

Restatements: Certain amounts previously reported in the 2014 and 2013 consolidated financial statements have been restated. For a complete overview on restatements impacting the consolidated financial statements and the “Notes to Consolidated Financial Statements”, see the “Restatements” section of “Note 1 – Nature of Operations and Summary of Significant Accounting Policies” in the “Notes to Consolidated Financial Statements”.

Table of Contents

Report of Independent Registered Public Accounting Firm

Shareholders and Board of Directors

Isabella Bank Corporation

Mount Pleasant, Michigan

We have audited the accompanying consolidated balance sheets of Isabella Bank Corporation as of December 31, 2015 and 2014, and the related consolidated statements of changes in shareholders' equity, income, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2015. We also have audited Isabella Bank Corporation's internal control over financial reporting as of December 31, 2015, based on criteria established in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Isabella Bank Corporation's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the effectiveness of Isabella Bank Corporation's internal control over financial reporting, based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material misstatement exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. We believe that our audits provide a reasonable basis for our opinion.

A corporation's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. A corporation's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and directors of the corporation; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the corporation's assets that could have a material effect on the consolidated financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Isabella Bank Corporation as of December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion Isabella Bank Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

/s/Rehmann Robson LLC
Saginaw, Michigan

March 9, 2016

39

Table of Contents

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	December 31	
	2015	2014
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	\$18,810	\$18,058
Interest bearing balances due from banks	2,759	1,848
Total cash and cash equivalents	21,569	19,906
AFS securities (amortized cost of \$654,348 in 2015 and \$561,893 in 2014)	660,136	567,534
Mortgage loans AFS	1,187	901
Loans		
Commercial	448,381	433,270
Agricultural	115,911	104,721
Residential real estate	251,501	266,155
Consumer	34,699	32,404
Gross loans	850,492	836,550
Less allowance for loan and lease losses	7,400	10,100
Net loans	843,092	826,450
Premises and equipment	28,331	25,881
Corporate owned life insurance policies	26,423	25,152
Accrued interest receivable	6,269	5,851
Equity securities without readily determinable fair values	22,286	20,076
Goodwill and other intangible assets	48,828	46,128
Other assets	9,991	11,664
TOTAL ASSETS	\$1,668,112	\$1,549,543
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	\$191,376	\$181,826
NOW accounts	212,666	190,984
Certificates of deposit under \$100 and other savings	521,793	456,774
Certificates of deposit over \$100	238,728	244,900
Total deposits	1,164,563	1,074,484
Borrowed funds	309,732	289,709
Accrued interest payable and other liabilities	9,846	10,756
Total liabilities	1,484,141	1,374,949
Shareholders' equity		
Common stock — no par value 15,000,000 shares authorized; issued and outstanding		
7,799,867 shares (including 19,401 shares held in the Rabbi Trust) in 2015 and	139,198	138,755
7,776,274 shares (including 13,934 shares held in the Rabbi Trust) in 2014		
Shares to be issued for deferred compensation obligations	4,592	4,242
Retained earnings	39,960	32,103
Accumulated other comprehensive income (loss)	221	(506)
Total shareholders' equity	183,971	174,594
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,668,112	\$1,549,543

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

40

Table of Contents

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in thousands except per share amounts)

	Common Stock		Common Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Totals
	Common Shares Outstanding	Amount				
Balance, January 1, 2013	7,671,846	\$136,580	\$ 3,734	\$19,168	\$ 5,007	\$164,489
Comprehensive income (loss)	—	—	—	12,510	(11,348)	1,162
Issuance of common stock	149,191	3,618	—	—	—	3,618
Common stock issued for deferred compensation obligations	—	—	—	—	—	—
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	140	(140)	—	—	—
Share-based payment awards under equity compensation plan	—	—	554	—	—	554
Common stock purchased for deferred compensation obligations	—	(383)	—	—	—	(383)
Common stock repurchased pursuant to publicly announced repurchase plan	(98,014)	(2,375)	—	—	—	(2,375)
Cash dividends paid (\$0.84 per common share)	—	—	—	(6,456)	—	(6,456)
Balance, December 31, 2013	7,723,023	137,580	4,148	25,222	(6,341)	160,609
Comprehensive income (loss)	—	—	—	13,724	5,835	19,559
Issuance of common stock	182,755	4,227	—	—	—	4,227
Common stock issued for deferred compensation obligations	6,126	143	(143)	—	—	—
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	258	(258)	—	—	—
Share-based payment awards under equity compensation plan	—	—	495	—	—	495
Common stock purchased for deferred compensation obligations	—	(331)	—	—	—	(331)
Common stock repurchased pursuant to publicly announced repurchase plan	(135,630)	(3,122)	—	—	—	(3,122)
Cash dividends paid (\$0.89 per common share)	—	—	—	(6,843)	—	(6,843)
Balance, December 31, 2014	7,776,274	138,755	4,242	32,103	(506)	174,594
Comprehensive income (loss)	—	—	—	15,130	727	15,857
Issuance of common stock	216,700	5,201	—	—	—	5,201
Common stock issued for deferred compensation obligations	—	—	—	—	—	—
	—	200	(200)	—	—	—

Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations						
Share-based payment awards under equity compensation plan	—	—	550	—	—	550
Common stock purchased for deferred compensation obligations	—	(368)	—	—	—	(368)
Common stock repurchased pursuant to publicly announced repurchase plan	(193,107)	(4,590)	—	—	—	(4,590)
Cash dividends paid (\$0.94 per common share)	—	—	—	(7,273)	—	(7,273)
Balance, December 31, 2015	7,799,867	\$139,198	\$ 4,592	\$39,960	\$ 221	\$183,971

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

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share amounts)

	Year Ended December 31		
	2015	2014	2013
Interest income			
Loans, including fees	\$35,853	\$36,629	\$37,575
AFS securities			
Taxable	9,053	8,092	7,228
Nontaxable	5,996	5,911	5,132
Federal funds sold and other	600	516	483
Total interest income	51,502	51,148	50,418
Interest expense			
Deposits	5,850	6,295	7,140
Borrowings	4,313	3,675	3,881
Total interest expense	10,163	9,970	11,021
Net interest income	41,339	41,178	39,397
Provision for loan losses	(2,771	) (668	) 1,111
Net interest income after provision for loan losses	44,110	41,846	38,286
Noninterest income			
Service charges and fees	5,437	5,411	5,682
Net gain on sale of mortgage loans	573	514	962
Earnings on corporate owned life insurance policies	771	751	732
Net gains (losses) on sale of AFS securities	163	97	171
Other	3,415	2,552	2,628
Total noninterest income	10,359	9,325	10,175
Noninterest expenses			
Compensation and benefits	19,068	18,502	17,807
Furniture and equipment	5,739	5,173	4,945
Occupancy	2,834	2,798	2,653
Other	8,410	8,630	8,350
Total noninterest expenses	36,051	35,103	33,755
Income before federal income tax expense	18,418	16,068	14,706
Federal income tax expense	3,288	2,344	2,196
NET INCOME	\$15,130	\$13,724	\$12,510
Earnings per common share			
Basic	\$1.95	\$1.77	\$1.63
Diluted	\$1.90	\$1.74	\$1.59
Cash dividends per common share	\$0.94	\$0.89	\$0.84

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

42

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

	Year Ended December 31		
	2015	2014	2013
Net income	\$15,130	\$13,724	\$12,510
Unrealized gains (losses) on AFS securities			
Unrealized gains (losses) arising during the year	310	11,290	(18,971)
Reclassification adjustment for net realized (gains) losses included in net income	(163)	(97)	(171)
Net unrealized gains (losses)	147	11,193	(19,142)
Tax effect (1)	87	(3,684)	6,257
Unrealized gains (losses), net of tax	234	7,509	(12,885)
Change in unrecognized pension cost on defined benefit pension plan			
Change in unrecognized pension cost arising during the year	255	(2,836)	2,120
Reclassification adjustment for net periodic benefit cost included in net income	492	300	208
Net change in unrecognized pension cost	747	(2,536)	2,328
Tax effect	(254)	862	(791)
Change in unrealized pension cost, net of tax	493	(1,674)	1,537
Other comprehensive income (loss), net of tax	727	5,835	(11,348)
Comprehensive income (loss)	\$15,857	\$19,559	\$1,162

(1) See "Note 18 – Accumulated Other Comprehensive Income (Loss)" in the accompanying notes to consolidated financial statements for tax effect reconciliation.

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

43

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31			
	2015	2014	2013	
OPERATING ACTIVITIES				
Net income	\$15,130	\$13,724	\$12,510	
Reconciliation of net income to net cash provided by operating activities:				
Provision for loan losses	(2,771	) (668	) 1,111
Impairment of foreclosed assets	99	123	156	
Depreciation	2,677	2,551	2,556	
Amortization of OMSR	340	265	522	
Amortization of acquisition intangibles	169	183	221	
Net amortization of AFS securities	2,074	1,830	2,028	
Net (gains) losses on sale of AFS securities	(163) (97) (171)
Net gain on sale of mortgage loans	(573) (514) (962)
Increase in cash value of corporate owned life insurance policies	(771) (751) (732)
Share-based payment awards under equity compensation plan	550	495	554	
Deferred income tax (benefit) expense	1,692	207	(1,208)
Origination of loans held-for-sale	(42,887) (28,135) (53,632)
Proceeds from loan sales	43,174	28,852	57,123	
Net changes in operating assets and liabilities which provided (used) cash:				
Accrued interest receivable	(418) (409) (215)
Other assets	(5,322	) (1,392	) 1,792
Accrued interest payable and other liabilities	(910	) 1,298	1,954
Net cash provided by (used in) operating activities	12,090	17,562	23,607	
INVESTING ACTIVITIES				
Activity in AFS securities				
Sales	1,319	13,362	16,229	
Maturities, calls, and principal payments	90,036	68,188	86,225	
Purchases	(185,721) (127,562) (131,505)
Net loan principal (originations) collections	(15,029) (27,876) (39,369)
Proceeds from sales of foreclosed assets	1,523	1,775	2,122	
Purchases of premises and equipment	(5,127) (2,713) (2,488)
Purchases of corporate owned life insurance policies	(500) —	(1,092)
Proceeds from redemption of corporate owned life insurance policies	—	—	196	
Net cash provided by (used in) investing activities	(113,499) (74,826) (69,682)

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Dollars in thousands)

	Year Ended December 31		
	2015	2014	2013
FINANCING ACTIVITIES			
Net increase (decrease) in deposits	90,079	30,718	26,099
Net increase (decrease) in borrowed funds	20,023	10,383	38,325
Cash dividends paid on common stock	(7,273	) (6,843	) (6,456
Proceeds from issuance of common stock	5,201	4,227	3,618
Common stock repurchased	(4,590	) (3,122	) (2,375
Common stock purchased for deferred compensation obligations	(368	) (331	) (383
Net cash provided by (used in) financing activities	103,072	35,032	58,828
Increase (decrease) in cash and cash equivalents	1,663	(22,232	) 12,753
Cash and cash equivalents at beginning of period	19,906	42,138	29,385
Cash and cash equivalents at end of period	21,569	\$19,906	\$42,138
SUPPLEMENTAL CASH FLOWS INFORMATION:			
Interest paid	\$10,176	\$10,045	\$11,139
Income taxes paid	3,493	1,454	2,093
SUPPLEMENTAL NONCASH INFORMATION:			
Transfers of loans to foreclosed assets	\$1,158	\$1,371	\$1,672

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

45

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share amounts)

Note 1 – Nature of Operations and Summary of Significant Accounting Policies

BASIS OF PRESENTATION AND CONSOLIDATION: The consolidated financial statements include the accounts of Isabella Bank Corporation, a financial services holding company, and its wholly owned subsidiary, Isabella Bank.

All intercompany balances and accounts have been eliminated in consolidation. References to "the Corporation," "Isabella," "we," "our," "us," and similar terms refer to the consolidated entity consisting of Isabella Bank Corporation and its subsidiary. Isabella Bank Corporation refers solely to the parent holding company, and Isabella Bank or the "Bank" refer to Isabella Bank Corporation's subsidiary, Isabella Bank.

For additional information, see "Note 19 – Related Party Transactions."

NATURE OF OPERATIONS: Isabella Bank Corporation is a financial services holding company offering a wide array of financial products and services in several mid-Michigan counties. Our banking subsidiary, Isabella Bank, offers banking services through 29 locations, 24 hour banking services locally and nationally through shared automatic teller machines, 24 hour online banking, mobile banking, and direct deposits to businesses, institutions, and individuals. Lending services offered include commercial loans, agricultural loans, residential real estate loans, and consumer loans. Deposit services include interest and noninterest bearing checking accounts, savings accounts, money market accounts, and certificates of deposit. Other related financial products include trust and investment services, safe deposit box rentals, and credit life insurance. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of our principal markets. Our results of operations can be significantly affected by changes in interest rates and changes in the local economic environment.

USE OF ESTIMATES: In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, we make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the ALLL, the fair value of AFS investment securities, and the valuation of goodwill and other intangible assets.

FAIR VALUE MEASUREMENTS: Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, such as the reporting entity's own data. We may choose to measure eligible items at fair value at specified election dates.

For assets and liabilities recorded at fair value, it is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements for those financial instruments for which there is an active market. In cases where the market for a financial asset or liability is not active, we include appropriate risk adjustments that market participants would make for nonperformance and liquidity risks when developing fair value measurements. Fair value measurements for assets and liabilities for which limited or no observable market data exists are accordingly based primarily upon estimates, are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values.

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

Table of Contents

Fair Value Hierarchy

Under fair value measurement and disclosure authoritative guidance, we group assets and liabilities measured at fair value into three levels, based on the markets in which the assets and liabilities are traded, and the reliability of the assumptions used to determine fair value, based on the prioritization of inputs in the valuation techniques. These levels are:

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model based valuation techniques for which all significant assumptions are observable in the market.
- Level 3: Valuation is generated from model based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. Transfers between measurement levels are recognized at the end of reporting periods.

For further discussion of fair value considerations, refer to "Note 20 – Fair Value."

SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK: Most of our activities conducted are with customers located within the central Michigan area. A significant amount of our outstanding loans are secured by commercial and residential real estate. Other than these types of loans, there is no significant concentration to any other industry or any one customer.

CASH AND CASH EQUIVALENTS: For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other deposit accounts. Generally, federal funds sold are for a one day period. We maintain deposit accounts in various financial institutions which generally exceed federally insured limits or are not insured. We do not believe we are exposed to any significant interest, credit or other financial risk as a result of these deposits.

AFS SECURITIES: Purchases of investment securities are generally classified as AFS. However, we may elect to classify securities as either held to maturity or trading. Securities classified as AFS are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, excluded from earnings and reported in other comprehensive income. Included in AFS securities are auction rate money market preferreds and preferred stocks. These investments are considered equity securities for federal income tax purposes, and as such, no estimated federal income tax impact is expected or recorded. Auction rate money market preferred securities and preferred stocks are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses on the sale of AFS securities are determined using the specific identification method.

AFS securities are reviewed quarterly for possible OTTI. In determining whether an OTTI exists for debt securities, we assert that: (a) we do not have the intent to sell the security; and (b) it is more likely than not we will not have to sell the security before recovery of its cost basis. If these conditions are not met, we recognize an OTTI charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For debt securities that do not meet the above criteria, and we do not expect to recover the security's amortized cost basis, the security is considered other-than-temporarily impaired. For these debt securities, we separate the total impairment into the credit risk loss component and the amount of the loss related to market and other risk factors. In order to determine the amount of the credit loss for a debt security, we calculate the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows we expect to recover. The amount of the total OTTI related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total OTTI related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an OTTI through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis

and the cash flows expected to be collected is accreted as interest income.

AFS equity securities are reviewed for OTTI at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and our ability and intent to hold the securities until fair value recovers. If it is determined that we do not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may not recover in value then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income.

Table of Contents

LOANS: Loans that we have 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 ALLL, 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 level yield method.

The accrual of interest on agricultural, commercial and mortgage 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. Consumer loans are typically charged-off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. For loans that are placed on nonaccrual status or charged-off, all interest accrued in the current calendar year, but not collected, is reversed against interest income while interest accrued in prior calendar years, but not collected is charged against the ALLL. 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.

ALLOWANCE FOR LOAN LOSSES: The ALLL is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when we believe the uncollectability of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. We evaluate the ALLL on a regular basis which is based upon our periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The ALLL consists of specific, general, and unallocated components. The specific component relates to loans that are deemed to be impaired. For such loans that are also analyzed for specific allowance allocations, an allowance is established when the discounted cash flows or collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non classified loans and is based on historical loss experience. An unallocated component is maintained to cover uncertainties that we believe affect our 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.

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

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

Impairment is measured on a loan by loan basis 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.

LOANS HELD FOR SALE: Mortgage loans held for sale on the secondary market are carried at the lower of cost or fair value as determined by aggregating outstanding commitments from investors or current investor yield requirements. Net unrealized losses, if any, would be recognized as a component of other noninterest expenses. Mortgage loans held for sale are sold with the mortgage servicing rights retained by us. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

TRANSFERS OF FINANCIAL ASSETS: Transfers of financial assets, including mortgage loans and participation loans, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is determined to be surrendered when 1) the assets have been legally isolated from us, 2) the transferee obtains the right

(free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets, and 3) we do not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, we have no substantive continuing involvement related to these loans. **SERVICING:** Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. We have no purchased servicing rights. For sales of mortgage loans, a portion of the cost of originating the

Table of Contents

loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If we later determine that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the valuation allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. The unpaid principal balance of mortgages serviced for others was \$287,029 and \$288,639 with capitalized servicing rights of \$2,505 and \$2,519 at December 31, 2015 and 2014, respectively.

Servicing fee income is recorded for fees earned for servicing loans for others. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. We recorded servicing fee revenue of \$712, \$720, and \$737 related to residential mortgage loans serviced for others during 2015, 2014, and 2013, respectively, which is included in other noninterest income.

FORECLOSED ASSETS: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of our carrying amount or fair value less estimated selling costs at the date of transfer, establishing a new cost basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the ALLL. After foreclosure, property held for sale is carried at the lower of the new cost basis or fair value less costs to sell. Impairment losses on property to be held and used are measured at the amount by which the carrying amount of property exceeds its fair value. Costs relating to holding these assets are expensed as incurred. We periodically perform valuations and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of our carrying amount or fair value less costs to sell. Foreclosed assets of \$421 and \$885 as of December 31, 2015 and 2014, respectively, are included in other assets.

PREMISES AND EQUIPMENT: Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. We annually review these assets to determine whether carrying values have been impaired.

EQUITY SECURITIES WITHOUT READILY DETERMINABLE FAIR VALUES: Included in equity securities without readily determinable fair values are our holdings in FHLB stock and FRB stock as well as our ownership interests in Corporate Settlement Solutions, LLC and Valley Financial Corporation. Our investment in Corporate Settlement Solutions, LLC, a title insurance company, was made in the 1st quarter of 2008. We are not the managing entity of Corporate Settlement Solutions, LLC, and account for our investment in that entity under the equity method of accounting. Valley Financial Corporation is the parent company of 1st State Bank in Saginaw, Michigan, which is a bank that opened in 2005. We made investments in Valley Financial Corporation in 2004 and in 2007.

Equity securities without readily determinable fair values consist of the following as of December 31:

	2015	2014
FHLB Stock	\$11,700	\$9,800
Corporate Settlement Solutions, LLC	7,249	6,936
FRB Stock	1,999	1,999
Valley Financial Corporation	1,000	1,000
Other	338	341
Total	\$22,286	\$20,076

EQUITY COMPENSATION PLAN: At December 31, 2015, the Directors Plan had 200,017 shares eligible to be issued to participants, for which the Rabbi Trust held 19,401 shares. We had 187,369 shares to be issued in 2014, with 13,934 shares held in the Rabbi Trust. Compensation costs relating to share based payment transactions are recognized as the services are

Table of Contents

rendered, with the cost measured based on the fair value of the equity or liability instruments issued (see “Note 17 – Benefit Plans”). We have no other equity-based compensation plans.

CORPORATE OWNED LIFE INSURANCE: We have purchased life insurance policies on key members of management. In the event of death of one of these individuals, we would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be realized on the balance sheet dates. Increases in cash surrender value in excess of single premiums paid are reported as other noninterest income.

As of December 31, 2015 and 2014, the present value of the post retirement benefits payable by us to the covered employees was estimated to be \$2,853 and \$2,782, respectively, and is included in accrued interest payable and other liabilities. The periodic policy maintenance costs were \$71, \$83, and \$75 for 2015, 2014, and 2013, respectively and are included in other noninterest expenses.

ACQUISITION INTANGIBLES AND GOODWILL: We previously acquired branch facilities and related deposits in business combinations accounted for as a purchase. The acquisitions included amounts related to the valuation of customer deposit relationships (core deposit intangibles). Core deposit intangibles arising from acquisitions are included in goodwill and other intangible assets are being amortized over their estimated lives and evaluated for potential impairment on at least an annual basis. Goodwill, which represents the excess of the purchase price over identifiable assets, is not amortized but is evaluated for impairment on at least an annual basis. Acquisition intangibles and goodwill are typically qualitatively evaluated to determine if it is more likely than not that the carrying balance is impaired. If it is determined that the carrying balance is more likely than not to be impaired, we perform a cash flow valuation to determine the extent of the potential impairment. This valuation method requires a significant degree of our judgment. In the event the projected undiscounted net operating cash flows for these intangible assets are less than the carrying value, the asset is recorded at fair value as determined by the valuation model.

OFF BALANCE SHEET CREDIT RELATED FINANCIAL INSTRUMENTS: In the ordinary course of business, we have entered into commitments to extend credit, including commitments under credit card arrangements, home equity lines of credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded only when funded.

FEDERAL INCOME TAXES: Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax assets or liability is determined based on the tax effects of the temporary differences between the book and tax basis on the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

We analyze our filing positions in the jurisdictions where we are required to file income tax returns, as well as all open tax years in these jurisdictions. We have also elected to retain our existing accounting policy with respect to the treatment of interest and penalties attributable to income taxes, and continue to reflect any charges for such, to the extent they arise, as a component of our noninterest expenses.

DEFINED BENEFIT PENSION PLAN: We maintain a noncontributory defined benefit pension plan, which was curtailed effective March 1, 2007. Defined benefit pension plan expenses are included in “compensation and benefits” on the consolidated statements of income and are funded consistent with the requirements of federal laws and regulations. The current benefit obligation is included in “accrued interest payable and other liabilities” on the consolidated balance sheets. Inherent in the determination of defined benefit pension costs are assumptions concerning future events that will affect the amount and timing of required benefit payments under the plan. These assumptions include demographic assumptions such as mortality, a discount rate used to determine the current benefit obligation and a long-term expected rate of return on plan assets. Net periodic benefit cost includes interest cost based on the assumed discount rate, an expected return on plan assets based on an actuarially derived market-related value of assets, and amortization of unrecognized net actuarial gains or losses. Actuarial gains and losses result from experience different from that assumed and from changes in assumptions (excluding asset gains and losses not yet reflected in market-related value). Amortization of actuarial gains and losses is included as a component of net periodic defined benefit pension cost.

For additional information, see "Note 17 – Benefit Plans."

MARKETING COSTS: Marketing costs are expensed as incurred (see "Note 11 – Other Noninterest Expenses").

RECLASSIFICATIONS: Certain amounts reported in the 2014 and 2013 consolidated financial statements have been reclassified to conform with the 2015 presentation.

Table of Contents

RESTATEMENTS: In this Annual Report on Form 10-K, certain prior period financial information has been restated due to an accounting correction. Impacted sections of the Consolidated Financial Statements include:

- Consolidated Balance Sheet as of December 31, 2014, Consolidated Statements of Income for the years ended
1. December 31, 2014 and 2013, and Consolidated Statements of Cash Flows for the years ended December 31, 2014 and 2013; and
 2. Notes to Consolidated Financial Statements as of, and for the years ended, December 31, 2014 and 2013.

Background of Restatement

The necessary restatement was identified by management in the fourth quarter of 2015 during the course of our preparation of the consolidated financial statements and evaluation of financial results as of and for the year ended December 31, 2015. The restatements relate to the accounting for deferred costs associated with originating loans (under ASC 310-20) and the proper classification of the net deferred costs recorded in gross loans within the consolidated balance sheets and as a deferral of compensation expenses within the consolidated statements of income. Prior to December 31, 2015, loan origination cost deferrals (under ASC 310-20) were reported in loan interest and fee income instead of as a reduction of compensation and benefits, which is included in other noninterest expenses. Additionally, net deferred asset balances (under ASC 310-20) prior to December 31, 2015 were reported in other assets on the consolidated balance sheets instead of reported in gross loans. Amortization of the net deferred asset balance was recognized appropriately in loan interest and fee income.

Impact of Restatement

The overall impact of the restatement on our consolidated financial position and results of operations is not believed to be material and as such, previously filed Annual Reports on Form 10-K and Quarterly reports on Form 10-Q for the periods affected by the restatement have not been amended. The determination of materiality was, in part, concluded based on the following observations:

- ✦ No impact to net income for any prior periods;
- ✦ No impact to earnings per share, other stock data, or dividend data for any prior periods;
- ✦ No impact on total assets for any prior periods; and
- ✦ No impact on retained earnings or total equity for any prior periods.

The impact to the consolidated balance sheet as of December 31, 2014 was a \$2,968 increase in gross loans and a \$2,968 decline in other assets. There were no other changes to the consolidated balance sheets for any prior periods. The following table sets forth the effects of the restatement on items within the Consolidated Statements of Income. Since the restatement did not impact net income, pre-tax and adjustments net of tax are not included.

	December 31, 2014		December 31, 2013	
	Previously Reported	Restated	Previously Reported	Restated
Interest income				
Loans, including fees	\$39,432	\$36,629	\$41,233	\$37,575
All other interest income	14,519	14,519	12,843	12,843
Total interest income	53,951	51,148	54,076	50,418
Total interest expense	9,970	9,970	11,021	11,021
Net interest income	43,981	41,178	43,055	39,397
Provision for loan losses	(668	) (668	) 1,111	1,111
Net interest income after provision for loan losses	44,649	41,846	41,944	38,286
Total noninterest income	9,325	9,325	10,175	10,175
Noninterest expenses				
Compensation and benefits	21,305	18,502	21,465	17,807
All other noninterest expenses	16,601	16,601	15,948	15,948
Total noninterest expenses	37,906	35,103	37,413	33,755
Federal income tax expense	2,344	2,344	2,196	2,196
Net income	\$13,724	\$13,724	\$12,510	\$12,510

As demonstrated above, loan interest and fee income and compensation and benefits were reduced by \$2,803 and \$3,658 during the years ended December 31, 2014 and 2013, respectively. All amounts in this Annual Report on Form 10-K affected by the restatement adjustments reflect such amounts as restated.

Table of Contents

Note 2 – Computation of Earnings Per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate solely to outstanding shares in the Directors Plan, see “Note 17 – Benefit Plans.”

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

	2015	2014	2013
Average number of common shares outstanding for basic calculation	7,775,988	7,734,161	7,694,392
Average potential effect of common shares in the Directors Plan (1)	177,988	171,393	168,948
Average number of common shares outstanding used to calculate diluted earnings per common share	7,953,976	7,905,554	7,863,340
Net income	\$15,130	\$13,724	\$12,510
Earnings per common share			
Basic	\$1.95	\$1.77	\$1.63
Diluted	\$1.90	\$1.74	\$1.59

(1) Exclusive of shares held in the Rabbi Trust

Note 3 – Accounting Standards Updates

Recently Adopted Accounting Standards Updates

ASU No. 2014-04: “Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)”

In January 2014, ASU No. 2014-04 amended ASC Topic 310, “Receivables” to provide clarification as to when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. Specifically, the update defined physical possession to appropriately derecognize the loan and recognize the real estate as OREO. The adoption of this ASU did not have a significant impact on our operations or financial statement disclosures.

ASU No. 2014-11: “Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures”

In June 2014, ASU No. 2014-11 amended ASC Topic 860, “Transfers and Servicing” to address concerns that current accounting guidance distinguishes between repurchase agreements that settle at the same time as the maturity of the transferred financial asset and those that settle any time before maturity. The update changed the accounting for repurchase-to-maturity transactions to secured borrowing accounting and, for repurchase financing arrangements, separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which resulted in secured borrowing accounting for the repurchase agreement. The adoption of this ASU did not have a significant impact on our operations or financial statement disclosures.

Pending Accounting Standards Updates

ASU No. 2015-01: “Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items”

In January 2015, ASU No. 2015-01 amended ASC Topic 225, “Income Statement” to eliminate the concept of extraordinary items. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include items that are both unusual in nature and infrequently occurring. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2015 and is not expected to have a significant impact on our operations or financial statement disclosures.

ASU No. 2015-02: “Consolidation (Topic 810): Amendments to the Consolidation Analysis”

In February 2015, ASU No. 2015-02 amended ASC Topic 810, “Consolidation” to provide consolidation guidance on legal entities when the reporting entity’s contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity’s voting rights, or the reporting entity is not exposed to a majority of the legal entity’s economic benefits or obligations. The amendments in this update affect reporting entities that are required to evaluate

Table of Contents

whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments:

1. Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities.
2. Eliminate the presumption that a general partner should consolidate a limited partnership.
3. Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships.
Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are
4. required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

The amendments of this update affect limited partnerships and similar legal entities including fees paid and fee arrangements on the primary beneficiary. The following three main provisions affect limited partnerships and similar legal entities:

1. There is an additional requirement that limited partnerships and similar legal entities must meet to qualify as voting interest entities. A limited partnership must provide partners with either substantive kick-out rights or substantive participating rights over the general partner to meet this requirement.
2. The specialized consolidation model and guidance for limited partnerships and similar legal entities have been eliminated. There is no longer a presumption that a general partner should consolidate a limited partnership.
For limited partnerships and similar legal entities that qualify as voting interest entities, a limited partner with a
3. controlling financial interest should consolidate a limited partnership. A controlling financial interest may be achieved through holding a limited partner interest that provides substantive kick-out rights.

The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2015 and is not expected to have a significant impact on our operations or financial statement disclosures.

ASU No. 2015-05: “Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement”

In April 2015, ASU No. 2015-05 amended ASC Topic 350, “Goodwill and Other” to provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change GAAP for a customer’s accounting for service contracts. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2015 and is not expected to have a significant impact on our operations or financial statement disclosures.

ASU No. 2015-07: “Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)”

In May 2015, ASU No. 2015-07 amended ASC Topic 820, “Fair Value Measurement” to remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2015 and is not expected to have a significant impact on our operations or financial statement disclosures.

ASU No. 2015-14: “Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date”

In August 2015, ASU No. 2015-14 was issued to defer the effective date of ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” by one year. The new authoritative guidance is now effective for interim and annual periods beginning after December 15, 2017. The new authoritative guidance is not expected to have a significant impact on our operations or financial statement disclosures.

Table of Contents

ASU No. 2015-16: “Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments“

In September 2015, ASU No. 2015-16 was issued to require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The update requires that the acquirer record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments in this update eliminate the requirement to retrospectively account for those adjustments. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2015 and is not expected to have a significant impact on our operations or financial statement disclosures.

ASU No. 2016-01: “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities“

In January 2016, ASU No. 2016-01 set forth the following: 1) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment and when an impairment exists, an entity is required to measure the investment at fair value; 3) for public entities, eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (4) for public entities, requires the use of exit price notion when measuring the fair value of financial instruments for disclosure purposes; (5) requires an entity to present separately in other comprehensive income, the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and (8) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017 and is not expected to have a significant impact on our operations or financial statement disclosures.

Note 4 – AFS Securities

The amortized cost and fair value of AFS securities, with gross unrealized gains and losses, are as follows as of December 31:

	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	\$24,407	\$13	\$75	\$24,345
States and political subdivisions	224,752	7,511	46	232,217
Auction rate money market preferred	3,200	—	334	2,866
Preferred stocks	3,800	—	501	3,299
Mortgage-backed securities	264,109	1,156	1,881	263,384
Collateralized mortgage obligations	134,080	1,136	1,191	134,025
Total	\$654,348	\$9,816	\$4,028	\$660,136
	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	\$24,597	\$10	\$471	\$24,136
States and political subdivisions	209,153	6,986	794	215,345

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Auction rate money market preferred	3,200	—	581	2,619
Preferred stocks	6,800	31	691	6,140
Mortgage-backed securities	165,888	2,042	1,004	166,926
Collateralized mortgage obligations	152,255	1,533	1,420	152,368
Total	\$561,893	\$10,602	\$4,961	\$567,534

54

Table of Contents

The amortized cost and fair value of AFS securities by contractual maturity at December 31, 2015 are as follows:

	Maturing				Securities with	
	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	Variable Monthly Payments or Noncontractual Maturities	Total
Government sponsored enterprises	\$—	\$24,029	\$378	\$—	\$—	\$24,407
States and political subdivisions	30,174	69,245	92,561	32,772	—	224,752
Auction rate money market preferred	—	—	—	—	3,200	3,200
Preferred stocks	—	—	—	—	3,800	3,800
Mortgage-backed securities	—	—	—	—	264,109	264,109
Collateralized mortgage obligations	—	—	—	—	134,080	134,080
Total amortized cost	\$30,174	\$93,274	\$92,939	\$32,772	\$405,189	\$654,348
Fair value	\$30,217	\$95,452	\$96,871	\$34,022	\$403,574	\$660,136

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

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

A summary of the sales activity of AFS securities was as follows during the years ended December 31:

	2015	2014	2013
Proceeds from sales of AFS securities	\$1,319	\$13,362	\$16,229
Gross realized gains (losses)	\$163	\$97	\$171
Applicable income tax expense (benefit)	\$55	\$33	\$58

The cost basis used to determine the realized gains or losses of AFS securities sold was the amortized cost of the individual investment security as of the trade date.

Information pertaining to AFS securities with gross unrealized losses at December 31 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	2015				
	Less Than Twelve Months		Twelve Months or More		Total Unrealized Losses
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	
Government sponsored enterprises	\$—	\$—	\$75	\$4,925	\$75
States and political subdivisions	14	3,355	32	2,623	46
Auction rate money market preferred	—	—	334	2,866	334
Preferred stocks	—	—	501	3,299	501
Mortgage-backed securities	882	131,885	999	37,179	1,881
Collateralized mortgage obligations	415	53,441	776	26,717	1,191
Total	\$1,311	\$188,681	\$2,717	\$77,609	\$4,028
Number of securities in an unrealized loss position:		36		26	62

Table of Contents

	2014		Less Than Twelve Months		Twelve Months or More	Total Unrealized Losses
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses	
Government sponsored enterprises	\$—	\$—	\$471	\$23,525	\$471	\$471
States and political subdivisions	48	5,323	746	17,416	794	794
Auction rate money market preferred	—	—	581	2,619	581	581
Preferred stocks	—	—	691	3,109	691	691
Mortgage-backed securities	5	9,456	999	52,407	1,004	1,004
Collateralized mortgage obligations	105	29,435	1,315	39,540	1,420	1,420
Total	\$158	\$44,214	\$4,803	\$138,616	\$4,961	\$4,961
Number of securities in an unrealized loss position:		22		72		94

As of December 31, 2015 and 2014, we conducted an analysis to determine whether any securities currently in an unrealized loss position, should be other-than-temporarily impaired. Such analyses considered, among other factors, the following criteria:

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

• Is the investment credit rating below investment grade?

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

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

• Has the duration of the investment been extended?

During the three month period ended March 31, 2012, we had one state issued student loan auction rate AFS investment security (which is included in states and political subdivisions) that was downgraded by Moody's from A3 to Caa3. As a result of this downgrade, we engaged the services of an independent investment valuation firm to estimate the amount of credit losses (if any) related to this particular issue as of March 31, 2012. The evaluation calculated a range of estimated credit losses utilizing two different bifurcation methods:

1) Discounted Cash Flow Method

2) Credit Yield Analysis Method

The two methods were then weighted, with a higher weighting applied to the Discounted Cash Flow Method, to determine the estimated credit related impairment. As a result of this analysis, we recognized an OTTI of \$282 in earnings in the three month period ended March 31, 2012.

A summary of key valuation assumptions used in the aforementioned analysis as of March 31, 2012, follows:

Ratings	Discounted Cash Flow Method
Fitch	Not Rated
Moody's	Caa3
S&P	A
Seniority	Senior
Discount rate	LIBOR + 6.35%
Credit discount rate	Credit Yield Analysis Method
Average observed discounts based on closed transactions	LIBOR + 4.00% 14.00%

Table of Contents

To test for additional impairment of this security, we obtained investment valuations (from the same firm engaged to perform the initial valuation as of March 31, 2012) on a quarterly basis until the security was sold on November 25, 2015. Based on our analyses, no additional OTTI was recorded while the security was held. The following table provides a roll-forward of credit related impairment recognized in earnings for the years ended December 31:

	2015	2014	2013
Balance at beginning of year	\$282	\$282	\$282
Additions to credit losses for which no previous OTTI was recognized	—	—	—
Reductions for credit losses realized on securities sold during the quarter	(282) —	—
Balance at end of year	\$—	\$282	\$282

Based on our analyses, the fact that we have asserted that we do not have the intent to sell AFS securities in an unrealized loss position, and considering it is unlikely that we will have to sell any AFS securities in an unrealized loss position before recovery of their cost basis, we do not believe that the values of any AFS securities were other-than-temporarily impaired as of December 31, 2015, or December 31, 2014.

Note 5 – Loans and ALLL

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

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

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

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

Table of Contents

Underwriting criteria for residential real estate loans include:

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

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

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

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

• Verification of acceptable credit reports.

• Verification of employment, income, and financial information.

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

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

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

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

The primary factors behind the determination of the level of the ALLL are specific allocations for impaired loans, historical loss percentages, as well as unallocated components. Specific allocations for impaired loans are primarily determined based on the difference between the loan's outstanding balance to the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio over the preceding five years. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

	Allowance for Loan Losses					
	Year Ended December 31, 2015					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2015	\$3,821	\$216	\$4,235	\$645	\$1,183	\$10,100
Charge-offs	(89	) (45	) (397	) (373	) —	(904
Recoveries	477	72	220	206	—	975
Provision for loan losses	(2,038	) 86	(728	) 44	(135	) (2,771
December 31, 2015	\$2,171	\$329	\$3,330	\$522	\$1,048	\$7,400

Table of Contents

Allowance for Loan Losses and Recorded Investment in Loans As of December 31, 2015						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	\$829	\$2	\$1,989	\$—	\$—	\$2,820
Collectively evaluated for impairment	1,342	327	1,341	522	1,048	4,580
Total	\$2,171	\$329	\$3,330	\$522	\$1,048	\$7,400
Loans						
Individually evaluated for impairment	\$7,969	\$4,068	\$10,266	\$35		\$22,338
Collectively evaluated for impairment	440,412	111,843	241,235	34,664		828,154
Total	\$448,381	\$115,911	\$251,501	\$34,699		\$850,492
Allowance for Loan Losses Year Ended December 31, 2014						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2014	\$6,048	\$434	\$3,845	\$639	\$534	\$11,500
Charge-offs	(559)	(31)	(722)	(316)	—	(1,628)
Recoveries	550	—	197	149	—	896
Provision for loan losses	(2,218)	(187)	915	173	649	(668)
December 31, 2014	\$3,821	\$216	\$4,235	\$645	\$1,183	\$10,100
Allowance for Loan Losses and Recorded Investment in Loans As of December 31, 2014						
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	\$1,283	\$—	\$2,143	\$1	\$—	\$3,427
Collectively evaluated for impairment	2,538	216	2,092	644	1,183	6,673
Total	\$3,821	\$216	\$4,235	\$645	\$1,183	\$10,100
Loans						
Individually evaluated for impairment	\$12,029	\$1,595	\$12,160	\$64		\$25,848
Collectively evaluated for impairment	421,241	103,126	253,995	32,340		810,702
Total	\$433,270	\$104,721	\$266,155	\$32,404		\$836,550

Table of Contents

The following table displays the credit quality indicators for commercial and agricultural credit exposures based on internally assigned credit risk ratings as of December 31:

Rating	2015			2014		
	Commercial Real Estate	Other	Total	Agricultural Real Estate	Other	Total
1 - Excellent	\$—	\$499	\$499	\$—	\$—	\$—
2 - High quality	7,397	11,263	18,660	4,647	2,150	6,797
3 - High satisfactory	99,136	29,286	128,422	28,886	13,039	41,925
4 - Low satisfactory	222,431	62,987	285,418	37,279	22,166	59,445
5 - Special mention	4,501	473	4,974	3,961	1,875	5,836
6 - Substandard	9,941	256	10,197	1,623	139	1,762
7 - Vulnerable	211	—	211	146	—	146
8 - Doubtful	—	—	—	—	—	—
Total	\$343,617	\$104,764	\$448,381	\$76,542	\$39,369	\$115,911

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

1. EXCELLENT – Substantially Risk Free

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

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

• Experienced management, with management succession in place.

• Secured by cash.

2. HIGH QUALITY – Limited Risk

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

• Favorable liquidity and leverage ratios.

• Ability to meet all obligations when due.

• Management with successful track record.

• Steady and satisfactory earnings history.

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

• Access to alternative financing.

• Well defined primary and secondary source of repayment.

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

Table of Contents

3. HIGH SATISFACTORY – Reasonable Risk

Credit with satisfactory financial condition and further characterized by:

- Working capital adequate to support operations.
- Cash flow sufficient to pay debts as scheduled.
- Management experience and depth appear favorable.
- Loan performing according to terms.
- If loan is secured, collateral is acceptable and loan is fully protected.

4. LOW SATISFACTORY – Acceptable Risk

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

- Would include most start-up businesses.
 - Occasional instances of trade slowness or repayment delinquency – may have been 10-30 days slow within the past year.
 - Management's abilities are apparent, yet unproven.
 - Weakness in primary source of repayment with adequate secondary source of repayment.
 - Loan structure generally in accordance with policy.
 - If secured, loan collateral coverage is marginal.
 - Adequate cash flow to service debt, but coverage is low.
- To be classified as less than satisfactory, only one of the following criteria must be met.

5. SPECIAL MENTION – Criticized

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

- Downward trend in sales, profit levels, and margins.
- Impaired working capital position.
- Cash flow is strained in order to meet debt repayment.
- Loan delinquency (30-60 days) and overdrafts may occur.
 - Shrinking equity cushion.
- Diminishing primary source of repayment and questionable secondary source.
- Management abilities are questionable.
- Weak industry conditions.
- Litigation pending against the borrower.
- Collateral or guaranty offers limited protection.
- Negative debt service coverage, however the credit is well collateralized and payments are current.

6. SUBSTANDARD – Classified

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

- Sustained losses have severely eroded the equity and cash flow.
- Deteriorating liquidity.
- Serious management problems or internal fraud.
- Original repayment terms liberalized.
- Likelihood of bankruptcy.
- Inability to access other funding sources.
- Reliance on secondary source of repayment.
- Litigation filed against borrower.
- Collateral provides little or no value.
- Requires excessive attention of the loan officer.

Borrower is uncooperative with loan officer.

61

Table of Contents

7. VULNERABLE – Classified

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

• Insufficient cash flow to service debt.

• Minimal or no payments being received.

• Limited options available to avoid the collection process.

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

8. DOUBTFUL – Workout

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

• Normal operations are severely diminished or have ceased.

• Seriously impaired cash flow.

• Original repayment terms materially altered.

• Secondary source of repayment is inadequate.

• Survivability as a “going concern” is impossible.

• Collection process has begun.

• Bankruptcy petition has been filed.

• Judgments have been filed.

• Portion of the loan balance has been charged-off.

Our primary credit quality indicator for residential real estate and consumer loans is the individual loan’s past due aging. The following tables summarize the past due and current loans as of December 31:

	2015				Total Past Due and Nonaccrual	Current	Total
	Accruing Interest and Past Due:		90 Days or More	Nonaccrual			
	30-59 Days	60-89 Days					
Commercial							
Commercial real estate	\$505	\$281	\$—	\$211	\$997	\$342,620	\$343,617
Commercial other	18	—	—	—	18	104,746	104,764
Total commercial	523	281	—	211	1,015	447,366	448,381
Agricultural							
Agricultural real estate	196	890	—	146	1,232	75,310	76,542
Agricultural other	—	—	—	—	—	39,369	39,369
Total agricultural	196	890	—	146	1,232	114,679	115,911
Residential real estate							
Senior liens	1,551	261	—	429	2,241	199,622	201,863
Junior liens	40	8	—	6	54	9,325	9,379
Home equity lines of credit	225	—	—	—	225	40,034	40,259
Total residential real estate	1,816	269	—	435	2,520	248,981	251,501
Consumer							
Secured	27	—	—	—	27	30,839	30,866
Unsecured	4	—	—	—	4	3,829	3,833
Total consumer	31	—	—	—	31	34,668	34,699
Total	\$2,566	\$1,440	\$—	\$792	\$4,798	\$845,694	\$850,492

Table of Contents

	2014		90 Days or More	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
	Accruing Interest and Past Due: 30-59 Days	60-89 Days					
Commercial							
Commercial real estate	\$ 1,155	\$282	\$—	\$2,764	\$4,201	\$310,173	\$314,374
Commercial other	153	24	2	116	295	118,601	118,896
Total commercial	1,308	306	2	2,880	4,496	428,774	433,270
Agricultural							
Agricultural real estate	101	—	—	106	207	70,990	71,197
Agricultural other	102	—	—	—	102	33,422	33,524
Total agricultural	203	—	—	106	309	104,412	104,721
Residential real estate							
Senior liens	1,821	425	146	668	3,060	211,698	214,758
Junior liens	235	18	—	130	383	10,750	11,133
Home equity lines of credit	468	20	—	250	738	39,526	40,264
Total residential real estate	2,524	463	146	1,048	4,181	261,974	266,155
Consumer							
Secured	107	2	—	10	119	28,328	28,447
Unsecured	19	—	—	—	19	3,938	3,957
Total consumer	126	2	—	10	138	32,266	32,404
Total	\$4,161	\$771	\$148	\$4,044	\$9,124	\$827,426	\$836,550

Impaired Loans

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

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

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

Table of Contents

We do not recognize interest income on impaired loans in nonaccrual status. For impaired loans not classified as nonaccrual, interest income is recognized daily, as earned, according to the terms of the loan agreement and the principal amount outstanding. The following summarizes information pertaining to impaired loans as of, and for the years ended, December 31:

	2015				
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Average Outstanding Balance	Interest Income Recognized
Impaired loans with a valuation allowance					
Commercial real estate	\$5,659	\$5,777	\$818	\$7,221	\$376
Commercial other	8	8	11	362	19
Agricultural real estate	—	—	—	22	1
Agricultural other	335	335	2	126	8
Residential real estate senior liens	9,996	10,765	1,959	10,610	425
Residential real estate junior liens	143	163	30	183	16
Home equity lines of credit	—	—	—	31	—
Consumer secured	—	—	—	39	3
Total impaired loans with a valuation allowance	16,141	17,048	2,820	18,594	848
Impaired loans without a valuation allowance					
Commercial real estate	2,122	2,256		2,170	201
Commercial other	180	191		106	11
Agricultural real estate	3,549	3,549		1,903	95
Agricultural other	184	184		290	15
Home equity lines of credit	127	434		144	18
Consumer secured	35	35		6	1
Total impaired loans without a valuation allowance	6,197	6,649		4,619	341
Impaired loans					
Commercial	7,969	8,232	829	9,859	607
Agricultural	4,068	4,068	2	2,341	119
Residential real estate	10,266	11,362	1,989	10,968	459
Consumer	35	35	—	45	4
Total impaired loans	\$22,338	\$23,697	\$2,820	\$23,213	\$1,189

Table of Contents

	2014				
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Average Outstanding Balance	Interest Income Recognized
Impaired loans with a valuation allowance					
Commercial real estate	\$7,115	\$7,234	\$1,279	\$6,958	\$392
Commercial other	609	828	4	704	51
Agricultural real estate	—	—	—	85	—
Agricultural other	—	—	—	—	—
Residential real estate senior liens	11,645	12,782	2,015	12,713	509
Residential real estate junior liens	265	275	53	133	—
Home equity lines of credit	250	650	75	229	21
Consumer secured	54	54	1	68	4
Total impaired loans with a valuation allowance	19,938	21,823	3,427	20,890	977
Impaired loans without a valuation allowance					
Commercial real estate	4,116	4,462		4,997	309
Commercial other	189	212		360	17
Agricultural real estate	1,529	1,529		1,455	89
Agricultural other	66	186		100	30
Home equity lines of credit	—	—		24	—
Consumer secured	10	10		6	—
Total impaired loans without a valuation allowance	5,910	6,399		6,942	445
Impaired loans					
Commercial	12,029	12,736	1,283	13,019	769
Agricultural	1,595	1,715	—	1,640	119
Residential real estate	12,160	13,707	2,143	13,099	530
Consumer	64	64	1	74	4
Total impaired loans	\$25,848	\$28,222	\$3,427	\$27,832	\$1,422

We had committed to advance \$0 in connection with impaired loans, which include TDRs, as of December 31, 2015 and 2014.

Troubled Debt Restructurings

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

Typical concessions granted include, but are not limited to:

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

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

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

Table of Contents

The following is a summary of information pertaining to TDRs granted in the years ended December 31:

	2015			2014		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial other	13	\$ 3,073	\$ 3,073	9	\$ 1,533	\$ 1,533
Agricultural other	11	3,106	3,106	1	49	49
Residential real estate						
Senior liens	6	678	678	15	1,011	1,011
Junior liens	1	30	30	4	233	233
Home equity lines of credit	1	94	94	1	160	160
Total residential real estate	8	802	802	20	1,404	1,404
Consumer unsecured	—	—	—	4	18	18
Total	32	\$ 6,981	\$ 6,981	34	\$ 3,004	\$ 3,004

The following tables summarize concessions we granted to borrowers in financial difficulty in the years ended December 31:

	2015				2014			
	Below Market Interest Rate	Pre-Modification Recorded Investment	Below Market Interest Rate and Extension of Amortization Period	Pre-Modification Recorded Investment	Below Market Interest Rate	Pre-Modification Recorded Investment	Below Market Interest Rate and Extension of Amortization Period	Pre-Modification Recorded Investment
Commercial other	11	\$ 2,742	2	\$ 331	8	\$ 1,525	1	\$ 8
Agricultural other	9	1,360	2	1,746	—	—	1	49
Residential real estate								
Senior liens	3	280	3	398	3	97	12	914
Junior liens	—	—	1	30	2	152	2	81
Home equity lines of credit	—	—	1	94	1	160	—	—
Total residential real estate	3	280	5	522	6	409	14	995
Consumer unsecured	—	—	—	—	3	15	1	3
Total	23	\$ 4,382	9	\$ 2,599	17	\$ 1,949	17	\$ 1,055

We did not restructure any loans by forgiving principal or accrued interest during 2015 or 2014.

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

Following is a summary of loans that defaulted in the years ended December 31, which were modified within 12 months prior to the default date:

	2015				2014			
	Number of Loans	Pre-Default Recorded Investment	Charge-Off Recorded Upon Default	Post-Default Recorded Investment	Number of Loans	Pre-Default Recorded Investment	Charge-Off Recorded Upon Default	Post-Default Recorded Investment

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Commercial other	1	\$ 216	\$ 25	\$ 191	—	\$—	\$—	\$—
Residential real estate junior liens	1	39	39	—	—	—	—	—
Consumer unsecured	—	—	—	—	2	7	7	—
Total	2	\$255	\$ 64	\$ 191	2	\$7	\$7	\$—

66

Table of Contents

The following is a summary of TDR loan balances as of December 31:

	2015	2014
TDRs	\$21,325	\$23,341

Note 6 – Premises and Equipment

A summary of premises and equipment at December 31 follows:

	2015	2014
Land	\$6,190	\$5,429
Buildings and improvements	27,580	25,441
Furniture and equipment	31,568	31,011
Total	65,338	61,881
Less: accumulated depreciation	37,007	36,000
Premises and equipment, net	\$28,331	\$25,881

Depreciation expense amounted to \$2,677, \$2,551, and \$2,556 in 2015, 2014, and 2013, respectively.

Note 7 – Goodwill and Other Intangible Assets

The carrying amount of goodwill was \$48,282 at December 31, 2015 and \$45,618 at December 31, 2014. Branch acquisitions during 2015 provided \$2,664 of additional goodwill.

Identifiable intangible assets were as follows as of December 31:

	2015 Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Core deposit premium resulting from acquisitions	\$5,579	\$5,033	\$546
	2014 Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Core deposit premium resulting from acquisitions	\$5,373	\$4,863	\$510

Branch acquisitions during 2015 resulted in \$206 of core deposit premiums. Amortization expense associated with identifiable intangible assets was \$169, \$183, and \$221 in 2015, 2014, and 2013, respectively.

Estimated amortization expense associated with identifiable intangibles for each of the next five years succeeding December 31, 2015, and thereafter is as follows:

	Estimated Amortization Expense
2016	\$163
2017	119
2018	96
2019	71
2020	48
Thereafter	49
Total	\$546

Table of Contents

Note 8 – Foreclosed Assets

The following is a summary of foreclosed assets as of December 31:

	2015	2014
Consumer mortgage loans collateralized by residential real estate foreclosed as a result of obtaining physical possession (1)	\$—	N/A
All other foreclosed assets	421	885
Total	\$421	\$885

(1) Disclosure requirement from the adoption of ASU No. 2014-04 on January 1, 2015. As such, measurement was not applicable for December 31, 2014.

Changes in foreclosed assets are summarized as follows during the years ended December 31:

	2015	2014
Balance, January 1	\$885	\$1,412
Properties transferred	1,158	1,371
Impairments	(99)	(123)
Proceeds from sale	(1,523)	(1,775)
Balance, December 31	\$421	\$885

Consumer mortgage loans collateralized by residential real estate in the process of foreclosure were \$56 as of December 31, 2015.

Note 9 – Deposits

Scheduled maturities of time deposits for the next five years, and thereafter, are as follows:

	Scheduled Maturities of Time Deposits
2016	\$191,858
2017	89,932
2018	63,167
2019	23,883
2020	33,012
Thereafter	21,028
Total	\$422,880

Interest expense on time deposits greater than \$100 was \$2,806 in 2015, \$2,920 in 2014 and \$3,203 in 2013.

Note 10 – Borrowed Funds

Borrowed funds consist of the following obligations at December 31:

	2015		2014		
	Amount	Rate	Amount	Rate	%
FHLB advances	\$235,000	1.93	% \$192,000	2.05	%
Securities sold under agreements to repurchase without stated maturity dates	70,532	0.12	% 95,070	0.14	%
Securities sold under agreements to repurchase with stated maturity dates	—	—	439	3.25	%
Federal funds purchased	4,200	0.75	% 2,200	0.50	%
Total	\$309,732	1.50	% \$289,709	1.41	%

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

Table of Contents

The following table lists the maturities and weighted average interest rates of FHLB advances as of December 31:

	2015		2014		
	Amount	Rate	Amount	Rate	
Fixed rate due 2015	\$—	—	\$42,000	0.72	%
Fixed rate due 2016	30,000	1.25	% 10,000	2.15	%
Variable rate due 2016	15,000	0.62	% —	—	
Fixed rate due 2017	50,000	1.56	% 30,000	1.95	%
Fixed rate due 2018	50,000	2.16	% 40,000	2.35	%
Fixed rate due 2019	40,000	2.35	% 20,000	3.11	%
Fixed rate due 2020	10,000	1.98	% 10,000	1.98	%
Fixed rate due 2021	30,000	2.26	% 30,000	2.26	%
Fixed rate due 2023	10,000	3.90	% 10,000	3.90	%
Total	\$235,000	1.93	% \$192,000	2.05	%

Securities sold under agreements to repurchase are classified as secured borrowings and are reflected at the amount of cash received in connection with the transaction. The securities underlying the agreements have a carrying value and a fair value of \$70,555 and \$94,537 at December 31, 2015 and 2014, respectively. Such securities remain under our control. We may be required to provide additional collateral based on the fair value of underlying securities.

The following table lists the maturity and weighted average interest rates of securities sold under agreements to repurchase with stated maturity dates at December 31:

	2015		2014		
	Amount	Rate	Amount	Rate	
Repurchase agreements due 2015	—	—	439	3.25	%
Total	\$—	—	\$439	3.25	%

Securities sold under repurchase agreements without stated maturity dates, federal funds purchased, and FRB Discount Window advances generally mature within one to four days from the transaction date. The following table provides a summary of securities sold under repurchase agreements without stated maturity dates, federal funds purchased, and FRB Discount Window advances for the years ended December 31:

	2015			2014		
	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period
Securities sold under agreements to repurchase without stated maturity dates	\$84,859	\$70,368	0.13 %	\$95,070	\$91,422	0.13 %
Federal funds purchased	13,100	5,783	0.50 %	17,700	4,589	0.48 %

We had pledged AFS securities and 1-4 family residential real estate loans in the following amounts at December 31:

	2015	2014
Pledged to secure borrowed funds	\$339,078	\$324,584
Pledged to secure repurchase agreements	70,555	94,537
Pledged for public deposits and for other purposes necessary or required by law	39,038	19,851
Total	\$448,671	\$438,972

Table of Contents

AFS securities pledged to repurchase agreements without stated maturity dates consisted of the following at December 31:

	2015	2014
States and political subdivisions	\$3,639	\$6,643
Mortgage-backed securities	23,075	29,655
Collateralized mortgage obligations	43,841	58,239
Total	\$70,555	\$94,537

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

As of December 31, 2015, we had the ability to borrow up to an additional \$121,960, based on assets pledged as collateral. We had no investment securities that are restricted to be pledged for specific purposes.

Note 11 – Other Noninterest Expenses

A summary of expenses included in other noninterest expenses is as follows for the years ended December 31:

	2015	2014	2013
Director fees	\$827	\$775	\$819
Audit and related fees	821	809	738
FDIC insurance premiums	813	842	1,082
Donations and community relations	808	1,004	715
Marketing costs	491	427	416
Legal fees	464	320	359
Education and travel	442	625	502
Printing and supplies	405	367	396
Postage and freight	377	397	387
Consulting fees	364	349	315
Loan underwriting fees	347	361	423
State taxes	218	171	140
Amortization of deposit premium	169	183	221
Other losses	150	250	109
Foreclosed asset and collection	53	122	211
All other	1,661	1,628	1,517
Total other	\$8,410	\$8,630	\$8,350

Note 12 – Federal Income Taxes

Components of the consolidated provision for federal income taxes are as follows for the years ended December 31:

	2015	2014	2013
Currently payable	\$1,596	\$2,159	\$3,404
Deferred expense (benefit)	1,692	185	(1,208)
Income tax expense	\$3,288	\$2,344	\$2,196

Table of Contents

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 year ended December 31:

	2015	2014	2013
Income taxes at 34% statutory rate	\$6,262	\$5,463	\$5,000
Effect of nontaxable income			
Interest income on tax exempt municipal securities	(2,026)	(1,999)	(1,746)
Earnings on corporate owned life insurance policies	(262)	(255)	(249)
Other	(88)	(263)	(154)
Total effect of nontaxable income	(2,376)	(2,517)	(2,149)
Effect of nondeductible expenses	157	156	146
Effect of tax credits	(755)	(758)	(801)
Federal income tax expense	\$3,288	\$2,344	\$2,196

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for federal income tax purposes. Significant components of our deferred tax assets and liabilities, included in other assets in the accompanying consolidated balance sheets, are as follows as of December 31:

	2015	2014
Deferred tax assets		
Allowance for loan losses	\$1,582	\$2,507
Deferred directors' fees	2,549	2,414
Employee benefit plans	229	255
Core deposit premium and acquisition expenses	1,098	1,037
Net unrecognized actuarial losses on pension plan	1,708	1,962
Life insurance death benefit payable	804	804
Alternative minimum tax	650	650
Other	53	564
Total deferred tax assets	8,673	10,193
Deferred tax liabilities		
Prepaid pension cost	890	989
Premises and equipment	166	247
Accretion on securities	55	49
Core deposit premium and acquisition expenses	1,289	1,229
Net unrealized gains on available-for-sale securities	2,252	2,339
Other	989	449
Total deferred tax liabilities	5,641	5,302
Net deferred tax assets	\$3,032	\$4,891

We are subject to U.S. federal income tax; however, we are no longer subject to examination by taxing authorities for years before 2012. There are no material uncertain tax positions requiring recognition in our consolidated financial statements. We do not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

We recognize interest and/or penalties related to income tax matters in income tax expense. We do not have any amounts accrued for interest and penalties at December 31, 2015 and 2014 and we not aware of any claims for such amounts by federal income tax authorities.

Table of Contents

Note 13 – Off-Balance-Sheet Activities

Credit-Related Financial Instruments

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

	December 31	
	2015	2014
Unfunded commitments under lines of credit	\$134,412	\$116,935
Commercial and standby letters of credit	915	4,985
Commitments to grant loans	53,946	13,988

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. These commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements.

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

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

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

Note 14 – On-Balance Sheet Activities

Derivative Loan Commitments

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. We enter into commitments to fund residential mortgage loans at specific times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds us to lend funds to a potential borrower at a specified interest rate within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose us to the risk that the price of the loans arising from the exercise of the loan commitment might decline from the inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increase. The notional amount of undesignated interest rate lock commitments was \$234 and \$632 at December 31, 2015 and 2014, respectively.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments, we utilize both "mandatory delivery" and "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loan that would result from the exercise of the derivative loan commitments.

Table of Contents

With a “mandatory delivery” contract, we commit to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If we fail to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, we are obligated to pay a “pair-off” fee, based on then current market prices, to the investor to compensate the investor for the shortfall.

With a “best efforts” contract, we commit to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g. on the same day the lender commits to lend funds to a potential borrower).

We expect that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of undesignated forward loan sale commitments was \$1,421 and \$1,533 at December 31, 2015 and 2014, respectively.

The fair values of the rate lock loan commitments related to the origination of mortgage loans that will be held for sale and the forward loan sale commitments are deemed insignificant by management and, accordingly, are not recorded in our consolidated financial statements.

Note 15 – Commitments and Other Matters

Banking regulations require us to maintain cash reserve balances in currency or as deposits with the FRB. At December 31, 2015 and 2014, the reserve balances amounted to \$1,169 and \$963, respectively.

Banking regulations limit the transfer of assets in the form of dividends, loans, or advances from the Bank to the Corporation. At December 31, 2015, substantially all of the Bank’s assets were restricted from transfer to the Corporation in the form of loans or advances. Consequently, Bank dividends are the principal source of funds for the Corporation. Payment of dividends without regulatory approval is limited to the current year’s retained net income plus retained net income for the preceding two years, less any required transfers to common stock. At January 1, 2015, the amount available to the Corporation for dividends from the Bank, without regulatory approval, was approximately \$24,700.

Note 16 – Minimum Regulatory Capital Requirements

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the FRB and the FDIC. Failure to meet minimum capital requirements can initiate mandatory and possibly additional discretionary actions by the FRB and the FDIC that if undertaken, could have a material effect on our financial statements. Under regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that include quantitative measures of assets, liabilities, capital, and certain off-balance-sheet items, as calculated under regulatory accounting standards. Our capital amounts and classifications are also subject to qualitative judgments by the FRB and the FDIC about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies. Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the following table) of total, tier 1 capital, and common equity tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and tier 1 capital to average assets (as defined). We believe, as of December 31, 2015 and 2014, that we met all capital adequacy requirements.

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

Effective January 1, 2015, the minimum standard for primary, or tier 1, capital increased from 4.00% to 6.00%. The minimum standard for total capital remains at 8.00%. Also effective January 1, 2015 is the new common equity tier 1

capital ratio which has a minimum requirement of 4.50%.

73

Table of Contents

As of December 31, 2015 and 2014, the most recent notifications from the FRB and the FDIC categorized us as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notifications that we believe have changed our categories. Our actual capital amounts and ratios are also presented in the table.

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions			
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
December 31, 2015								
Common Equity Tier 1 capital to risk weighted assets								
Isabella Bank	\$124,917	12.31	% \$40,589	4.50	% \$60,883	6.50	%	
Consolidated	135,250	13.24	% 40,886	4.50	% N/A	N/A		
Tier 1 capital to risk weighted assets								
Isabella Bank	124,917	12.31	% 40,589	6.00	% 60,883	8.00	%	
Consolidated	135,250	13.24	% 40,886	6.00	% N/A	N/A		
Total capital to risk weighted assets								
Isabella Bank	132,317	13.04	% 81,178	8.00	% 101,472	10.00	%	
Consolidated	142,650	13.96	% 81,772	8.00	% N/A	N/A		
Tier 1 capital to average assets								
Isabella Bank	124,917	7.93	% 63,032	4.00	% 78,790	5.00	%	
Consolidated	135,250	8.52	% 63,524	4.00	% N/A	N/A		
	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions			
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
December 31, 2014								
Total capital to risk weighted assets								
Isabella Bank	\$128,074	14.18	% \$72,278	8.00	% \$90,348	10.00	%	
Consolidated	138,820	15.19	% 73,108	8.00	% N/A	N/A		
Tier 1 capital to risk weighted assets								
Isabella Bank	117,974	13.06	% 36,139	4.00	% 54,209	6.00	%	
Consolidated	128,720	14.08	% 36,554	4.00	% N/A	N/A		
Tier 1 capital to average assets								
Isabella Bank	117,974	7.96	% 59,297	4.00	% 74,121	5.00	%	
Consolidated	128,720	8.59	% 59,908	4.00	% N/A	N/A		

Table of Contents

Note 17 – Benefit Plans

401(k) Plan

We have a 401(k) plan in which substantially all employees are eligible to participate. Employees may contribute up to 100% of their compensation subject to certain limits based on federal tax laws. The plan was amended in 2013 to provide a matching safe harbor contribution for all eligible employees equal to 100% of the first 5.0% of an employee's compensation contributed to the Plan during the year. Employees are 100% vested in the safe harbor matching contributions.

For 2012, we made a 3.0% safe harbor contribution for all eligible employees and matching contributions equal to 50% of the first 4.0% of an employee's compensation contributed to the Plan during the year. Employees were 100% vested in the safe harbor contributions and were 0% vested through their first two years of employment and were 100% vested after 6 years of service for matching contributions.

For 2015, 2014 and 2013, expenses attributable to the Plan were \$664, \$655, and \$608, respectively.

Defined Benefit Pension Plan

We maintain a noncontributory defined benefit pension plan, which was curtailed effective March 1, 2007. As a result of the curtailment, future salary increases are no longer considered (the projected benefit obligation is equal to the accumulated benefit obligation), and plan benefits are based on years of service and the individual employee's five highest consecutive years of compensation out of the last ten years of service through March 1, 2007.

Changes in the projected benefit obligation and plan assets during each year, the funded status of the plan, and the net amount recognized in our consolidated balance sheets using an actuarial measurement date of December 31, are summarized as follows during the years ended December 31:

	2015	2014
Change in benefit obligation		
Benefit obligation, January 1	\$13,250	\$10,732
Interest cost	494	486
Actuarial (gain) loss	(744	) 3,049
Benefits paid, including plan expenses	(1,023	) (1,017)
Benefit obligation, December 31	11,977	13,250
Change in plan assets		
Fair value of plan assets, January 1	10,390	10,508
Investment return	5	699
Contributions	200	200
Benefits paid, including plan expenses	(1,023	) (1,017)
Fair value of plan assets, December 31	9,572	10,390
Deficiency in funded status at December 31, included on the consolidated balance sheets in accrued interest payable and other liabilities	\$(2,405	) \$(2,860)
	2015	2014
Change in accrued pension benefit costs		
Accrued benefit cost at January 1	\$(2,860	) \$(224)
Contributions	200	200
Net periodic benefit cost	(492	) (300)
Net change in unrecognized actuarial loss and prior service cost	747	(2,536)
Accrued pension benefit cost at December 31	\$(2,405	) \$(2,860)

Table of Contents

We have recorded the funded status of the Plan in our consolidated balance sheets. We adjust the underfunded status in a liability account to reflect the current funded status of the plan. Our liability increased in 2014 as a result of changes in mortality tables and discount rates used to determine the current benefit obligation. Any gains or losses that arise during the year but are not recognized as components of net periodic benefit cost are recognized as a component of other comprehensive income (loss). The components of net periodic benefit cost are as follows for the years ended December 31:

	2015	2014	2013
Interest cost on benefit obligation	\$494	\$486	\$450
Expected return on plan assets	(607)	(615)	(572)
Amortization of unrecognized actuarial net loss	355	169	330
Settlement loss	250	260	—
Net periodic benefit cost	\$492	\$300	\$208

During 2015 and 2014, additional settlement loss of \$250 and \$260 were recognized in connection with lump-sum benefits distributions. Many plan participants elect to receive their retirement benefit payments in the form of lump-sum settlements. Pro rata settlement losses, which can occasionally occur as a result of these lump sum distributions, are recognized only in years when the total of such distributions exceed the sum of the service and interest expense components of net periodic benefit cost.

Accumulated other comprehensive income at December 31, 2015 includes net unrecognized pension costs before income taxes of \$5,022, of which \$238 is expected to be amortized into benefit cost during 2016.

The actuarial assumptions used in determining the benefit obligation are as follows for the years ended December 31:

	2015	2014	2013
Discount rate	4.13	% 3.80	% 4.64
Expected long-term rate of return	6.00	% 6.00	% 6.00

The actuarial weighted average assumptions used in determining the net periodic pension costs are as follows for the years ended December 31:

	2015	2014	2013
Discount rate	3.80	% 4.64	% 3.75
Expected long-term return on plan assets	6.00	% 6.00	% 6.00

As a result of the curtailment of the Plan, there is no rate of compensation increase considered in the above assumptions.

The expected long term rate of return is an estimate of anticipated future long term rates of return on plan assets as measured on a market value basis. Factors considered in arriving at this assumption include:

• Historical long term rates of return for broad asset classes.

• Actual past rates of return achieved by the plan.

• The general mix of assets held by the plan.

• The stated investment policy for the plan.

The selected rate of return is net of anticipated investment related expenses.

Plan Assets

Our overall investment strategy is to moderately grow the portfolio by investing 50% of the portfolio in equity securities and 50% in fixed income securities. This strategy is designed to generate a long term rate of return of 6.00%. Equity securities primarily consist of the S&P 500 Index with a smaller allocation to the Small Cap and International Index. Fixed income securities are invested in the Bond Market Index. The Plan has appropriate assets invested in short term investments to meet near-term benefit payments.

The asset mix and the sector weighting of the investments are determined by our pension committee, which is comprised of members of our management. To manage the Plan, we retain a third party investment advisor to conduct consultations. We review the performance of the advisor at least annually.

Table of Contents

The fair values of our pension plan assets by asset category were as follows as of December 31:

	2015		2014	
	Total	(Level 2)	Total	(Level 2)
Short-term investments	\$157	\$157	\$804	\$804
Common collective trusts				
Fixed income	4,662	4,662	4,738	4,738
Equity investments	4,753	4,753	4,848	4,848
Total	\$9,572	\$9,572	\$10,390	\$10,390

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2015 and 2014:

• Short-term investments: Shares of a money market portfolio, which is valued using amortized cost, which approximates fair value.

Common collective trusts: These investments are public investment securities valued using the NAV provided by a third party investment advisor. The NAV is quoted on a private market that is not active; however, the unit price is based on underlying investments which are traded on an active market.

We anticipate contributions to the Plan in 2016 to approximate net contribution costs.

The components of projected net periodic benefit cost are as follows for the year ending:

	December 31, 2016
Interest cost on projected benefit obligation	\$484
Expected return on plan assets	(559)
Amortization of unrecognized actuarial net loss	313
Net periodic benefit cost	\$238

Estimated future benefit payments are as follows for the next ten years:

	Estimated Benefit Payments
2016	\$500
2017	527
2018	529
2019	570
2020	614
2021 - 2025	3,290