ISABELLA BANK CORP
Form 10-K
March 07, 2017
Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended December 31, 2016
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 x 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 x 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. x 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). x 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	x

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 x No
The aggregate market value of the voting stock held by non-affiliates of the registrant was $218,637,000 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 7,831,404 as of March 3, 2017.

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 2, 2017	Part III

1

Table of Contents

ISABELLA BANK CORPORATION
ANNUAL REPORT ON FORM 10-K
Table of Contents

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

FDIC: Federal Deposit Insurance Corporation

FFIEC: Federal Financial Institutions Examinations Council

FRB: Federal Reserve Bank

FHLB: Federal Home Loan Bank
Freddie Mac: Federal Home Loan Mortgage Corporation

FTE: Fully taxable equivalent

PCAOB: Public Company Accounting Oversight Board
Rabbi Trust: A trust established to fund the Directors Plan
SEC: U.S. Securities & Exchange Commission
SOX: Sarbanes-Oxley Act of 2002
TDR: Troubled debt restructuring
XBRL: eXtensible Business Reporting Language

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 and a loan production office located in Saginaw county. The area includes significant agricultural production, manufacturing, retail, gaming and tourism, and several 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 2016, 2015, and 2014 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, 2016, we had 372 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 respond to 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

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 2016 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 assesses insurance premiums based upon a financial ratios method 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

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 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, national, or global 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 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 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 assist 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 other means

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 our previous main office building. We also lease property in Saginaw, Michigan which serves as a loan production office. 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. 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 7,821,069 shares are issued and outstanding as of December 31, 2016. As of that date, there were 3,082 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.otcmarkets.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
2016			
First Quarter	81,184	$27.25	$29.90
Second Quarter	47,680	27.63	28.25
Third Quarter	71,614	27.60	28.08
Fourth Quarter	53,496	27.60	28.35
	253,974		
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		

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

	Per Share	
	2016	2015
First Quarter	$0.24	$0.23
Second Quarter	0.24	0.23
Third Quarter	0.25	0.24
Fourth Quarter	0.25	0.24
Total	$0.98	$0.94

We have adopted and publicly announced a common stock repurchase plan. The plan was last amended on December 21, 2016, to allow for the repurchase of an additional 200,000 shares of common stock after that date. These authorizations do not have expiration dates. As 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, 2016, with respect to our common stock repurchase plan:

	Common Shares Repurchased		Total Number of Common Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Common Shares That May Yet Be Purchased Under the Plans or Programs
	Number	Average Price Per Common Share		
Balance, September 30				60,575
October 1 - 31	19,538	$ 27.79	19,538	41,037
November 1 - 30	19,821	27.80	19,821	21,216
December 1-21	11,659	28.13	11,659	9,557
Additional Authorization (200,000 shares)				209,557
December 22 - 31	9,600	28.02	9,600	199,957
Balance, December 31	60,618	$ 27.90	60,618	199,957

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, 2011 and all dividends are reinvested.

Year	ISBA	NASDAQ	NASDAQ Banks
12/31/2011	$100.00	$ 100.00	$ 100.00
12/31/2012	95.00	117.70	118.55
12/31/2013	107.70	164.65	167.52
12/31/2014	105.60	188.87	175.58
12/31/2015	145.80	202.25	190.97
12/31/2016	140.60	220.13	262.04

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:

	2016	2015	2014	2013	2012
INCOME STATEMENT DATA					
Interest income	$53,666	$51,502	$51,148	$50,418	$53,123
Interest expense	10,865	10,163	9,970	11,021	13,423
Net interest income	42,801	41,339	41,178	39,397	39,700
Provision for loan losses	(135)	(2,771)	(668)	1,111	2,300
Noninterest income	11,108	10,359	9,325	10,175	11,530
Noninterest expenses	37,897	36,051	35,103	33,755	34,361
Federal income tax expense	2,348	3,288	2,344	2,196	2,363
Net Income	$13,799	$15,130	$13,724	$12,510	$12,206
PER SHARE					
Basic earnings	$1.77	$1.95	$1.77	$1.63	$1.61
Diluted earnings	$1.73	$1.90	$1.74	$1.59	$1.56
Dividends	$0.98	$0.94	$0.89	$0.84	$0.80
Tangible book value*	$18.16	$17.30	$16.59	$15.62	$14.72
Quoted market value					
High	$29.90	$29.90	$24.00	$26.00	$24.98
Low	$27.25	$22.00	$21.73	$21.12	$21.75
Close*	$27.85	$29.90	$22.50	$23.85	$21.75
Common shares outstanding*	7,821,069	7,799,867	7,776,274	7,723,023	7,671,846
PERFORMANCE RATIOS					
Return on average total assets	0.82 %	0.95 %	0.90 %	0.86 %	0.88 %
Return on average shareholders' equity	7.12 %	8.33 %	8.06 %	7.67 %	7.60 %
Return on average tangible shareholders' equity	9.95 %	11.46 %	10.80 %	10.71 %	11.41 %
Net interest margin yield (FTE)	3.00 %	3.10 %	3.24 %	3.22 %	3.43 %
BALANCE SHEET DATA*					
Gross loans	$1,010,615	$850,492	$836,550	$810,777	$774,627
AFS securities	$558,096	$660,136	$567,534	$512,062	$504,010
Total assets	$1,732,151	$1,668,112	$1,549,543	$1,493,137	$1,430,639
Deposits	$1,195,040	$1,164,563	$1,074,484	$1,043,766	$1,017,667
Borrowed funds	$337,694	$309,732	$289,709	$279,326	$241,001
Shareholders' equity	$187,899	$183,971	$174,594	$160,609	$164,489
Gross loans to deposits	84.57 %	73.03 %	77.86 %	77.68 %	76.12 %
ASSETS UNDER MANAGEMENT*					
Loans sold with servicing retained	$272,882	$287,029	$288,639	$293,665	$303,425
Assets managed by our Investment and Trust Services Department	$427,693	$405,109	$383,878	$351,420	$319,301
Total assets under management	$2,432,726	$2,360,250	$2,222,060	$2,138,222	$2,053,365
ASSET QUALITY*					
Nonperforming loans to gross loans	0.17 %	0.09 %	0.50 %	0.42 %	1.00 %
Nonperforming assets to total assets	0.11 %	0.07 %	0.33 %	0.32 %	0.68 %
ALLL to gross loans	0.73 %	0.87 %	1.21 %	1.42 %	1.54 %
CAPITAL RATIOS*					
Shareholders' equity to assets	10.85 %	11.03 %	11.27 %	10.76 %	11.50 %

Tier 1 leverage	8.56	%	8.52	%	8.59	%	8.46	%	8.29	%
Common equity tier 1 capital	12.39	%	13.44	%	N/A		N/A		N/A	
Tier 1 risk-based capital	12.39	%	13.44	%	14.08	%	13.68	%	13.24	%
Total risk-based capital	13.04	%	14.17	%	15.19	%	14.93	%	14.49	%

* At end of year

12

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 2016	September 30 2016	June 30 2016	March 31 2016	December 31 2015	September 30 2015	June 30 2015	March 31 2015
Total interest income	$13,760	$ 13,607	$13,218	$13,081	$ 13,023	$ 12,967	$12,759	$12,753
Total interest expense	2,826	2,747	2,678	2,614	2,577	2,580	2,518	2,488
Net interest income	10,934	10,860	10,540	10,467	10,446	10,387	10,241	10,265
Provision for loan losses	(320)	17	12	156	(772)	(738)	(535)	(726)
Noninterest income	3,187	2,946	2,752	2,223	2,501	3,101	2,629	2,128
Noninterest expenses	10,166	9,433	9,218	9,080	9,885	9,161	8,330	8,675
Federal income tax expense	493	763	655	437	538	1,002	977	771
Net income	$3,782	$ 3,593	$3,407	$3,017	$ 3,296	$ 4,063	$4,098	$3,673
PER SHARE								
Basic earnings	$0.48	$ 0.46	$0.44	$0.39	$ 0.43	$ 0.52	$0.53	$0.47
Diluted earnings	0.47	0.45	0.43	0.38	0.41	0.51	0.52	0.46
Dividends	0.25	0.25	0.24	0.24	0.24	0.24	0.23	0.23
Quoted market value*	27.85	27.70	27.90	28.25	29.90	23.69	23.75	22.90
Tangible book value*	18.16	17.93	17.72	17.47	17.30	17.06	17.17	16.84

* At end of period

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 net income of $13,799 and earnings per common share of $1.77 for the year ended December 31, 2016. Our earnings have primarily been the result of increased interest income driven by outstanding loan growth during 2016. Our strong 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 $135 for the year ended December 31, 2016. Net loan recoveries during 2016 were $135 as compared to net loan recoveries of $71 in 2015.
During the year, total assets grew by 3.84% to $1,732,151, and assets under management increased to $2,432,726 which includes loans sold and serviced and assets managed by our Investment and Trust Services Department of $700,575. In 2016, we had total loan growth of $160,123 which was driven by commercial and agricultural loan growth of $137,864. Also contributing to this growth in 2016 were increases in both residential real estate and consumer loans of $22,259.
Our net yield on interest earning assets of 3.00% remains at historically low levels. While the FRB increased short term interest rates in December 2016 and projects increases in 2017, we do not anticipate 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 strategic growth in loans, investments, and other income earning assets. We are committed to increasing earnings and shareholder value through growth in our loan portfolio, growth in our investment and trust services, and increasing our geographical presence while managing operating costs.
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 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
Certain amounts reported in management's discussion and analysis of financial condition and results of operations for 2015 and 2014 have been reclassified to conform with the 2016 presentation.
Other
We have not received any notices of regulatory actions as of February 23, 2017.

Table of Contents

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 most AFS investment securities are typically obtained from outside sources and applied to individual securities within the portfolio. Municipal securities for which no readily determinable market values are available are priced using fair value curves which most closely match the security's credit ratings and maturities.

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, non-earning 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								
	2016			2015			2014		
	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	$922,333	$38,537	4.18 %	$829,903	$35,853	4.32 %	$816,105	$36,629	4.49 %
Taxable investment securities	392,810	8,746	2.23 %	395,981	9,053	2.29 %	357,250	8,092	2.27 %
Nontaxable investment securities	205,450	9,351	4.55 %	205,242	9,870	4.81 %	194,751	9,877	5.07 %
Other	25,557	668	2.61 %	25,947	600	2.31 %	25,784	519	2.01 %
Total earning assets	1,546,150	57,302	3.71 %	1,457,073	55,376	3.80 %	1,393,890	55,117	3.95 %
NONEARNING ASSETS									
Allowance for loan losses	(7,638)			(9,275)			(10,973)		
Cash and demand deposits due from banks	18,178			17,925			18,552		
Premises and equipment	28,670			26,968			25,957		
Accrued income and other assets	101,995			98,805			94,754		
Total assets	$1,687,355			$1,591,496			$1,522,180		
INTEREST BEARING LIABILITIES									
Interest bearing demand deposits	$203,198	163	0.08 %	$195,260	155	0.08 %	$191,750	157	0.08 %
Savings deposits	336,859	663	0.20 %	293,703	449	0.15 %	260,469	374	0.14 %
Time deposits	429,731	5,010	1.17 %	433,409	5,246	1.21 %	448,971	5,764	1.28 %
Borrowed funds	319,049	5,029	1.58 %	295,641	4,313	1.46 %	274,080	3,675	1.34 %
Total interest bearing liabilities	1,288,837	10,865	0.84 %	1,218,013	10,163	0.83 %	1,175,270	9,970	0.85 %
NONINTEREST BEARING LIABILITIES									
Demand deposits	194,892			181,939			165,860		
Other	9,841			10,001			10,773		
Shareholders’ equity	193,785			181,543			170,277		

Total liabilities and shareholders’ equity	$1,687,355	$1,591,496	$1,522,180
Net interest income (FTE)	$46,437	$45,213	$45,147
Net yield on interest earning assets (FTE)	3.00 %	3.10 %	3.24 %

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.

	2016 Compared to 2015 Increase (Decrease) Due to			2015 Compared to 2014 Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
Changes in interest income						
Loans	$3,892	$(1,208)	$2,684	$612	$(1,388)	$(776)
Taxable investment securities	(72)	(235)	(307)	885	76	961
Nontaxable investment securities	10	(529)	(519)	518	(525)	(7)
Other	(9)	77	68	3	78	81
Total changes in interest income	3,821	(1,895)	1,926	2,018	(1,759)	259
Changes in interest expense						
Interest bearing demand deposits	6	2	8	3	(5)	(2)
Savings deposits	72	142	214	50	25	75
Time deposits	(44)	(192)	(236)	(195)	(323)	(518)
Borrowed funds	355	361	716	301	337	638
Total changes in interest expense	389	313	702	159	34	193
Net change in interest margin (FTE)	$3,432	$(2,208)	$1,224	$1,859	$(1,793)	$66

Our net yield on interest earning assets remains at historically low levels. The persistent low interest rate environment coupled with a high concentration of AFS securities as a percentage of earning assets has also placed downward pressure on net interest margin. While the FRB increased short term interest rates in late 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 faster than 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 2016	September 30 2016	June 30 2016	March 31 2016	December 31 2015
Total earning assets	3.73%	3.76%	3.66%	3.67%	3.73%
Total interest bearing liabilities	0.87%	0.86%	0.83%	0.82%	0.83%
Net yield on interest earning assets (FTE)	3.01%	3.05%	2.97%	2.98%	3.04%

Table of Contents

	Quarter to Date Net Interest Income (FTE)				
	December 31 2016	September 30 2016	June 30 2016	March 31 2016	December 31 2015
Total interest income (FTE)	$14,642	$ 14,508	$14,132	$14,020	$ 13,970
Total interest expense	2,826	2,747	2,678	2,614	2,577
Net interest income (FTE)	$11,816	$ 11,761	$11,454	$11,406	$ 11,393

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 2016	September 30 2016	June 30 2016	March 31 2016	December 31 2015
Total charge-offs	$ 236	$ 131	$208	$341	$ 238
Total recoveries	156	314	296	285	210
Net loan charge-offs	80	(183)	(88)	56	28
Net loan charge-offs to average loans outstanding	0.01 %	(0.02)%	(0.01)%	0.01 %	—
Provision for loan losses	$ (320)	$ 17	$12	$156	$ (772)
Provision for loan losses to average loans outstanding	(0.03)%	—	—	0.02 %	(0.09)%
ALLL	$ 7,400	$ 7,800	$7,600	$7,500	$ 7,400
ALLL as a % of loans at end of period	0.73 %	0.79 %	0.83 %	0.86 %	0.87 %

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

	2016	2015	2014	2013	2012
ALLL at beginning of period	$7,400	$10,100	$11,500	$11,936	$12,375
Charge-offs					
Commercial and agricultural	57	134	590	907	1,672
Residential real estate	574	397	722	1,004	1,142
Consumer	285	373	316	429	542
Total charge-offs	916	904	1,628	2,340	3,356
Recoveries					
Commercial and agricultural	540	549	550	363	240
Residential real estate	287	220	197	181	122
Consumer	224	206	149	249	255
Total recoveries	1,051	975	896	793	617
Provision for loan losses	(135)	(2,771)	(668)	1,111	2,300
ALLL at end of period	7,400	7,400	10,100	11,500	11,936
Net loan charge-offs	$(135)	$(71)	$732	$1,547	$2,739
Net loan charge-offs to average loans outstanding	(0.01)%	(0.01)%	0.09 %	0.20 %	0.36 %
ALLL as a% of loans at end of period	0.73 %	0.87 %	1.21 %	1.42 %	1.54 %

Table of Contents

As the level of net loans charged-off declines and credit quality indicators remain stable, we have reduced the ALLL in both amount and as a percentage of loans. While they can be more volatile, loans individually evaluated for impairment have been steadily declining since December 31, 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 2016		September 30 2016		June 30 2016		March 31 2016		December 31 2015	
ALLL										
Individually evaluated for impairment	$ 2,371		$ 2,523		$2,602		$2,731		$ 2,820	
Collectively evaluated for impairment	5,029		5,277		4,998		4,769		4,580	
Total	$ 7,400		$ 7,800		$7,600		$7,500		$ 7,400	
ALLL to gross loans										
Individually evaluated for impairment	0.23	%	0.26	%	0.28	%	0.31	%	0.33	%
Collectively evaluated for impairment	0.50	%	0.53	%	0.55	%	0.55	%	0.54	%
Total	0.73	%	0.79	%	0.83	%	0.86	%	0.87	%

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									
	2016		2015		2014		2013		2012	
Commercial and agricultural	$4,598		$2,247		$4,805		$3,621		$7,271	
Residential real estate	2,716		2,520		4,181		7,008		5,431	
Consumer	115		31		138		259		199	
Total	$7,429		$4,798		$9,124		$10,888		$12,901	
Total past due and nonaccrual loans to gross loans	0.74	%	0.56	%	1.09	%	1.34	%	1.67	%

Past due and nonaccrual status loans continue to be below historical norms and 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 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, 2016 or December 31, 2015.

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.

Table of Contents

The following tables provide a roll-forward of TDRs for the years ended December 31, 2015 and 2016:

	Accruing Interest		Nonaccrual		Total	
	Number of Loans	Balance	Number of Loans	Balance	Number of Loans	Balance
January 1, 2015	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
New modifications	16	3,362	2	459	18	3,821
Principal advances (payments)	—	(1,036)	—	(37)	—	(1,073)
Loans paid-off	(15)	(2,105)	(1)	(221)	(16)	(2,326)
Partial charge-offs	—	—	—	(133)	—	(133)
Balances charged-off	(3)	(197)	—	—	(3)	(197)
Transfers to OREO	—	—	(1)	(35)	(1)	(35)
Transfers to accrual status	5	340	(5)	(340)	—	—
Transfers to nonaccrual status	(5)	(702)	5	702	—	—
December 31, 2016	153	$20,593	5	$789	158	$21,382

The following table summarizes our TDRs as of December 31:

	2016			2015			2014		
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total
Current	$17,557	$ 559	$18,116	$20,550	$ 146	$20,696	$20,012	$ 272	$20,284
Past due 30-59 days	2,898	230	3,128	357	—	357	804	592	1,396
Past due 60-89 days	138	—	138	24	—	24	115	3	118
Past due 90 days or more	—	—	—	—	248	248	—	1,543	1,543
Total	$20,593	$ 789	$21,382	$20,931	$ 394	$21,325	$20,931	$ 2,410	$23,341

	2013			2012		
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total
Current	$21,690	$ 1,189	$22,879	$16,301	$ 941	$17,242
Past due 30-59 days	2,158	37	2,195	158	561	719
Past due 60-89 days	575	—	575	72	41	113
Past due 90 days or more	—	216	216	—	1,281	1,281
Total	$24,423	$ 1,442	$25,865	$16,531	$ 2,824	$19,355

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:

	2016			2015		
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance
TDRs						
Commercial real estate	$6,264	$6,383	$ 713	$7,619	$7,858	$ 818
Commercial other	1,444	1,455	25	188	199	11
Agricultural real estate	4,037	4,037	—	3,549	3,549	—
Agricultural other	1,380	1,380	1	519	519	2
Residential real estate senior liens	8,058	8,437	1,539	9,155	9,457	1,851
Residential real estate junior liens	71	71	13	133	133	28
Home equity lines of credit	102	402	—	127	427	—
Consumer secured	26	26	—	35	35	—
Total TDRs	21,382	22,191	2,291	21,325	22,177	2,710
Other impaired loans						
Commercial real estate	151	226	3	162	175	—
Commercial other	—	—	—	—	—	—
Agricultural real estate	—	—	—	—	—	—
Agricultural other	128	128	—	—	—	—
Residential real estate senior liens	406	612	76	841	1,308	108
Residential real estate junior liens	1	11	1	10	30	2
Home equity lines of credit	—	—	—	—	7	—
Consumer secured	—	—	—	—	—	—
Total other impaired loans	686	977	80	1,013	1,520	110
Total impaired loans	$22,068	$23,168	$ 2,371	$22,338	$23,697	$ 2,820

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:

	2016	2015	2014	2013	2012
Nonaccrual status loans	$1,060	$792	$4,044	$3,244	$7,303
Accruing loans past due 90 days or more	633	—	148	142	428
Total nonperforming loans	1,693	792	4,192	3,386	7,731
Foreclosed assets	231	421	885	1,412	2,018
Total nonperforming assets	$1,924	$1,213	$5,077	$4,798	$9,749
Nonperforming loans as a % of total loans	0.17 %	0.09 %	0.50 %	0.42 %	1.00 %
Nonperforming assets as a % of total assets	0.11 %	0.07 %	0.33 %	0.32 %	0.68 %

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. Current levels of nonperforming loans continue to reflect historic lows.

Table of Contents

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

	2016	2015	2014	2013	2012
Commercial and agricultural	$405	$232	$1,995	$833	$2,325
Residential real estate	384	162	262	609	499
Consumer	—	—	153	—	—
Total	$789	$394	$2,410	$1,442	$2,824

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, 2016.

We believe that the level of the ALLL is appropriate as of December 31, 2016. 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:

	2016	2015	Change $	Change %	2014	Change $	Change %
Service charges and fees							
ATM and debit card fees	$2,444	$2,411	$33	1.37 %	$2,084	$327	15.69 %
NSF and overdraft fees	1,815	1,855	(40)	(2.16)%	2,156	(301)	(13.96)%
Freddie Mac servicing fee	696	712	(16)	(2.25)%	720	(8)	(1.11)%
Service charges on deposit accounts	349	345	4	1.16 %	354	(9)	(2.54)%
Net OMSR income (loss)	(199)	(14)	(185)	N/M	(36)	22	61.11 %
All other	125	128	(3)	(2.34)%	133	(5)	(3.76)%
Total service charges and fees	5,230	5,437	(207)	(3.81)%	5,411	26	0.48 %
Net gain on sale of mortgage loans	651	573	78	13.61 %	514	59	11.48 %
Earnings on corporate owned life insurance policies	761	771	(10)	(1.30)%	751	20	2.66 %
Net gains (losses) on sale of AFS securities	245	163	82	50.31 %	97	66	68.04 %
Other							
Trust and brokerage advisory fees	2,705	2,161	544	25.17 %	2,069	92	4.45 %
Corporate Settlement Solutions joint venture	415	463	(48)	(10.37)%	76	387	509.21 %
Other	1,101	791	310	39.19 %	407	384	94.35 %
Total other	4,221	3,415	806	23.60 %	2,552	863	33.82 %
Total noninterest income	$11,108	$10,359	$749	7.23 %	$9,325	$1,034	11.09 %

Significant changes in noninterest income are detailed below:

- ATM and debit card fees fluctuate from period-to-period based on usage of ATM and debit cards. While we do not anticipate significant changes to our ATM and debit card fees, we do expect that fees will continue to increase in 2017 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 2017 to approximate 2016 levels.
- Offering rates on residential mortgage loans and increased prepayment speeds have been the most significant drivers behind the fluctuations in net OMSR income (loss). We anticipate increases in our originations in purchase money mortgage activity as a result of our various initiatives to drive growth. Additionally, we anticipate increased mortgage rates; therefore, we anticipate net OMSR income to improve into 2017.
- We are continually analyzing our AFS securities for potential sale opportunities. Securities with unrealized gains and less than desirable yields may be sold for funding and profitability purposes. During the second quarter of 2016, we identified several mortgage-backed securities that were desirable to be sold and recognized gains with these sales. We will continue to analyze our AFS securities portfolio for potential sale opportunities in 2017 and sell AFS securities when appropriate.
- 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 in 2017 will approximate 2016 levels.
- Included in other income in 2016 is a $469 gain on a redemption of a bank owned life insurance policy. All other 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:

	2016	2015	Change $	Change %	2014	Change $	Change %
Compensation and benefits							
Employee salaries	$13,941	$13,760	$181	1.32 %	$13,311	$449	3.37 %
Employee benefits	5,541	5,309	232	4.37 %	5,191	118	2.27 %
Total compensation and benefits	19,482	19,069	413	2.17 %	18,502	567	3.06 %
Furniture and equipment							
Service contracts	3,061	2,951	110	3.73 %	2,542	409	16.09 %
Depreciation	2,039	1,949	90	4.62 %	1,850	99	5.35 %
ATM and debit card fees	887	742	145	19.54 %	722	20	2.77 %
All other	175	244	(69)	(28.28)%	223	21	9.42 %
Total furniture and equipment	6,162	5,886	276	4.69 %	5,337	549	10.29 %
Occupancy							
Depreciation	782	728	54	7.42 %	701	27	3.85 %
Outside services	740	701	39	5.56 %	718	(17)	(2.37)%
Property taxes	554	526	28	5.32 %	515	11	2.14 %
Utilities	551	528	23	4.36 %	524	4	0.76 %
All other	600	554	46	8.30 %	521	33	6.33 %
Total occupancy	3,227	3,037	190	6.26 %	2,979	58	1.95 %
Other							
Audit and related fees	944	889	55	6.19 %	809	80	9.89 %
Director fees	851	827	24	2.90 %	775	52	6.71 %
Consulting fees	800	487	313	64.27 %	349	138	39.54 %
OTTI on AFS securities	770	—	770	N/M	—	—	— %
FDIC insurance premiums	719	813	(94)	(11.56)%	842	(29)	(3.44)%
Marketing costs	586	497	89	17.91 %	427	70	16.39 %
Donations and community relations	582	841	(259)	(30.80)%	1,004	(163)	(16.24)%
Education and travel	536	343	193	56.27 %	461	(118)	(25.60)%
Loan underwriting fees	535	347	188	54.18 %	361	(14)	(3.88)%
Postage and freight	396	381	15	3.94 %	397	(16)	(4.03)%
Printing and supplies	391	461	(70)	(15.18)%	367	94	25.61 %
Legal fees	208	295	(87)	(29.49)%	320	(25)	(7.81)%
Amortization of deposit premium	162	169	(7)	(4.14)%	183	(14)	(7.65)%
Other losses	241	150	91	60.67 %	250	(100)	(40.00)%
All other	1,305	1,559	(254)	(16.29)%	1,740	(181)	(10.40)%
Total other	9,026	8,059	967	12.00 %	8,285	(226)	(2.73)%
Total noninterest expenses	$37,897	$36,051	$1,846	5.12 %	$35,103	$948	2.70 %

Table of Contents

Significant changes in noninterest expenses are detailed below:

- We acquired two branches in mid-2015 which resulted in increased expenses in 2016 for most of the categories presented above. None of the increases are individually significant.
- Consulting fees in 2016 increased as a result of outsourced operational functions related to our investment and trust services, consulting services to streamline processes, and talent recruitment services. Fees in 2017 are expected to approximate 2016 levels.
- During the fourth quarter of 2016, we identified an AFS security that was impaired which resulted in an OTTI expense of $770.
- We have consistently been a strong supporter of the various communities, schools, and charities in the markets we serve. Included in donations and community relations were discretionary donations to The Isabella Bank Foundation, a non-controlled affiliated entity, of $258 and $500 for the years ended December 31, 2015, and 2014, respectively. Donations and community relations fluctuate from period-to-period with 2017 expenses expected to approximate 2016 levels.
- 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. Expenses in 2017 are expected to approximate 2016 levels.
- The increase in loan underwriting fees is related to the increase in loan volume throughout 2016. Loan underwriting fees are expected to approximate 2016 levels in 2017.
- Legal fees in 2015 include approximately $133 of legal service expense incurred as a result of two branch acquisitions during the third quarter of that year. Legal fees are expected to approximate 2016 levels in 2017.
- 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:

	2016	2015	Change $	%
ASSETS				
Cash and cash equivalents	$22,894	$21,569	$1,325	6.14 %
AFS securities				
Amortized cost of AFS securities	557,648	654,348	(96,700)	(14.78)%
Unrealized gains (losses) on AFS securities	448	5,788	(5,340)	(92.26)%
AFS securities	558,096	660,136	(102,040)	(15.46)%
Mortgage loans AFS	1,816	1,187	629	52.99 %
Loans				
Gross loans	1,010,615	850,492	160,123	18.83 %
Less allowance for loan and lease losses	7,400	7,400	—	—
Net loans	1,003,215	843,092	160,123	18.99 %
Premises and equipment	29,314	28,331	983	3.47 %
Corporate owned life insurance policies	26,300	26,423	(123)	(0.47)%
Accrued interest receivable	6,580	6,269	311	4.96 %
Equity securities without readily determinable fair values	21,694	22,286	(592)	(2.66)%
Goodwill and other intangible assets	48,666	48,828	(162)	(0.33)%
Other assets	13,576	9,991	3,585	35.88 %
TOTAL ASSETS	$1,732,151	$1,668,112	$64,039	3.84 %
LIABILITIES AND SHAREHOLDERS' EQUITY				
Liabilities				
Deposits	$1,195,040	$1,164,563	$30,477	2.62 %
Borrowed funds	337,694	309,732	27,962	9.03 %
Accrued interest payable and other liabilities	11,518	9,846	1,672	16.98 %
Total liabilities	1,544,252	1,484,141	60,111	4.05 %
Shareholders' equity	187,899	183,971	3,928	2.14 %
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,732,151	$1,668,112	$64,039	3.84 %

As shown above, total assets have increased $64,039 since December 31, 2015 which was primarily driven by loan growth of $160,123. This growth was funded by the sale of AFS securities and increases in both deposits and borrowed funds. While generating quality loans will continue to be competitive, we expect that loans will continue to grow in 2017.

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 loan demand outpaced deposit growth in recent periods, we sold AFS securities to provide funding. 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:

	2016	2015	2014	2013	2012
Government sponsored enterprises	$10,259	$24,345	$24,136	$23,745	$25,776
States and political subdivisions	212,919	232,217	215,345	201,988	182,743
Auction rate money market preferred	2,794	2,866	2,619	2,577	2,778
Preferred stocks	3,425	3,299	6,140	5,827	6,363
Mortgage-backed securities	227,256	263,384	166,926	144,115	155,345
Collateralized mortgage obligations	101,443	134,025	152,368	133,810	131,005
Total	$558,096	$660,136	$567,534	$512,062	$504,010

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, 2016. 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	$32	7.91	$9,936	2.01	$291	2.05	$—	—	$—	—
States and political subdivisions	27,672	2.25	72,622	4.52	84,408	4.18	28,217	4.72	—	—
Mortgage-backed securities	—	—	—	—	—	—	—	—	227,256	2.34
Collateralized mortgage obligations	—	—	—	—	—	—	—	—	101,443	2.38
Auction rate money market preferred	—	—	—	—	—	—	—	—	2,794	6.29
Preferred stocks	—	—	—	—	—	—	—	—	3,425	5.44
Total	$27,704	2.26	$82,558	4.22	$84,699	4.17	$28,217	4.72	$334,918	2.42

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 which include lending limits to a single borrower, strict loan to collateral value limits, and a defined market area. 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:

	2016	2015	2014	2013	2012
Commercial	$575,664	$448,381	$433,270	$393,164	$372,332
Agricultural	126,492	115,911	104,721	92,589	83,606
Residential real estate	266,050	251,501	266,155	291,499	285,070
Consumer	42,409	34,699	32,404	33,525	33,619
Total	$1,010,615	$850,492	$836,550	$810,777	$774,627

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

	2016		2015		2014	
	$ Change	% Change	$ Change	% Change	$ Change	% Change
Commercial	$127,283	28.39 %	$15,111	3.49 %	$40,106	10.20 %
Agricultural	10,581	9.13 %	11,190	10.69 %	12,132	13.10 %
Residential real estate	14,549	5.78 %	(14,654)	(5.51)%	(25,344)	(8.69)%
Consumer	7,710	22.22 %	2,295	7.08 %	(1,121)	(3.34)%
Total	$160,123	18.83 %	$13,942	1.67 %	$25,773	3.18 %

While competition for commercial loans continues to be strong, we experienced significant growth in this segment of the portfolio during 2016 and anticipate strong growth in 2017. Residential real estate and consumer loans increased during 2016 and we anticipate continued growth in 2017 as a result of initiatives implemented during 2016 designed to increase loan volume.

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:

	2016	2015	2014	2013	2012
Noninterest bearing demand deposits	$205,071	$191,376	$181,826	$158,428	$143,735
Interest bearing demand deposits	209,325	212,666	190,984	192,089	181,259
Savings deposits	347,230	337,641	261,412	243,237	228,338
Certificates of deposit	321,914	324,101	339,824	362,473	376,790
Brokered certificates of deposit	88,632	73,815	72,134	56,329	55,348
Internet certificates of deposit	22,868	24,964	28,304	31,210	32,197
Total	$1,195,040	$1,164,563	$1,074,484	$1,043,766	$1,017,667

Table of Contents

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

	2016		2015		2014	
	$ Change	% Change	$ Change	% Change	$ Change	% Change
Noninterest bearing demand deposits	$13,695	7.16 %	$9,550	5.25 %	$23,398	14.77 %
Interest bearing demand deposits	(3,341)	(1.57)%	21,682	11.35 %	(1,105)	(0.58)%
Savings deposits	9,589	2.84 %	76,229	29.16 %	18,175	7.47 %
Certificates of deposit	(2,187)	(0.67)%	(15,723)	(4.63)%	(22,649)	(6.25)%
Brokered certificates of deposit	14,817	20.07 %	1,681	2.33 %	15,805	28.06 %
Internet certificates of deposit	(2,096)	(8.40)%	(3,340)	(11.80)%	(2,906)	(9.31)%
Total	$30,477	2.62 %	$90,079	8.38 %	$30,718	2.94 %

Deposit demand continues to be driven by non-contractual deposits, such as demand and savings deposits, while certificates of deposit and Internet certificates of deposit have gradually declined. Our significant growth in savings deposits during 2015 was the result of branch acquisitions. We look to retain and attract new customers with the recent branch acquisitions to provide growth in deposits in future periods. Brokered certificates of deposit offer another source of funding and fluctuate from period-to-period based on our funding needs, including changes in assets such as loans and investments.

The remaining maturity of time certificates and other time deposits of $100 or more as of December 31, 2016 was as follows:

Maturity	
Within 3 months	$39,898
Within 3 to 6 months	14,352
Within 6 to 12 months	56,191
Over 12 months	149,984
Total	$260,425

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:

	2016	2015	2014	2013	2012
FHLB advances	$270,000	$235,000	$192,000	$162,000	$152,000
Securities sold under agreements to repurchase without stated maturity dates	60,894	70,532	95,070	106,025	66,147
Securities sold under agreements to repurchase with stated maturity dates	—	—	439	11,301	16,284
Federal funds purchased	6,800	4,200	2,200	—	6,570
Total	$337,694	$309,732	$289,709	$279,326	$241,001

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, 2016:

	Minimum Payments Due by Period				
	Due in One Year or Less	After One Year But Within Three Years	After Three Years But Within Five Years	After Five Years	Total
Deposits					
Deposits with no stated maturity	$761,626	$ —	$—	$ —	$761,626
Certificates of deposit with stated maturities	196,467	127,159	84,907	24,881	433,414
Total deposits	958,093	127,159	84,907	24,881	1,195,040
Borrowed funds					
Short-term borrowings	67,694	—	—	—	67,694
Long-term borrowings	70,000	110,000	70,000	20,000	270,000
Total borrowed funds	137,694	110,000	70,000	20,000	337,694
Total contractual obligations	$1,095,787	$ 237,159	$154,907	$ 44,881	$1,532,734

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, 2016. 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				
	Due in One Year or Less	After One Year But Within Three Years	After Three Years But Within Five Years	After Five Years	Total
Unused commitments under lines of credit	$85,112	$ 55,992	$ 16,749	$10,987	$168,840
Commitments to grant loans	29,339	—	—	—	29,339
Commercial and standby letters of credit	1,223	—	—	—	1,223
Total loan commitments	$115,674	$ 55,992	$ 16,749	$10,987	$199,402

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 179,903 shares or $5,023 of common stock during 2016, and 216,700 shares or $5,201 of common stock in 2015. 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 $573 and $550 during 2016 and 2015, respectively.

We have a publicly announced common stock repurchase plan. Pursuant to this plan, we repurchased 158,701 shares or $4,440 of common stock during 2016 and 193,107 shares or $4,590 during 2015. As of December 31, 2016, we were authorized to repurchase up to an additional 199,957 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 conservation buffer. The rules, which are being gradually phased in between 2015 and 2019, are not expected to have a material impact on the Corporation but will require us to hold more capital than 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 8.56% as of December 31, 2016.

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 remained at 8.00%. Also effective January 1, 2015 was the new common equity tier 1 capital ratio which had a minimum requirement of 4.50%. Beginning on January 1, 2016, the capital conservation buffer went into effect which further increased the required levels. The following table sets forth the percentages required under the Risk Based Capital guidelines and our values as of December 31:

	2016		2015	
	Actual	Required	Actual	Required
Common equity tier 1 capital	12.39%	5.125 %	13.44%	4.50 %
Tier 1 capital	12.39%	6.625 %	13.44%	6.00 %
Tier 2 capital	0.65 %	2.000 %	0.73 %	2.00 %
Total Capital	13.04%	8.625 %	14.17%	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, 2016, 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, impaired loans, 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 $212,240 as of December 31, 2016, 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 $2,988 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, 2016, 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.

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, 2016. 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	$27,546	$86,701	$266,277	$177,572
Loans	279,954	91,190	439,251	199,160
Total	$307,500	$177,891	$705,528	$376,732
Interest sensitive liabilities				
Borrowed funds	$97,694	$40,000	$180,000	$20,000
Time deposits	68,705	129,672	210,156	24,881
Savings	46,418	26,878	105,675	168,259
NOW	2,919	8,757	40,325	157,324
Total	$215,736	$205,307	$536,156	$370,464
Cumulative gap	$91,764	$64,348	$233,720	$239,988
Cumulative gap as a % of assets	5.30 %	3.71 %	13.49 %	13.85 %

The following table shows the maturity of commercial and agricultural loans outstanding at December 31, 2016. 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	$115,973	$363,221	$222,962	$702,156
Interest sensitivity				
Loans maturing after one year that have:				
Fixed interest rates		$300,999	$215,298	
Variable interest rates		62,222	7,664	
Total		$363,221	$222,962	

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 unencumbered AFS securities. These categories totaled $307,112 or 17.73% of assets as of December 31, 2016 as compared to $387,707 or 23.24% as of December 31, 2015. 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, 2016, we had available lines of credit of $99,118.

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

	2016	2015	$ Variance
Net cash provided by (used in) operating activities	$19,162	$12,090	$7,072
Net cash provided by (used in) investing activities	(68,831)	(113,499)	44,668
Net cash provided by (used in) financing activities	50,994	103,072	(52,078)
Increase (decrease) in cash and cash equivalents	1,325	1,663	(338)
Cash and cash equivalents January 1	21,569	19,906	1,663
Cash and cash equivalents December 31	$22,894	$21,569	$1,325

Market Risk

Our primary market risks are interest rate risk and liquidity risk. We have no significant foreign exchange risk, 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.

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, 2016, 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. As of December 31, 2016, our interest rate sensitivity results were within Board approved limits.

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

	December 31, 2016									
	12 Months					24 Months				
Immediate basis point change assumption (short-term)	-100	+100	+200	+300	+400	-100	+100	+200	+300	+400
Percent change in net interest income vs. constant rates	(4.49)%	2.19%	4.31%	5.68%	6.67%	(5.32)%	2.64%	5.01%	6.33%	6.75%

	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%

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, 2016 and December 31, 2015. 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, 2016							
	2017	2018	2019	2020	2021	Thereafter	Total	Fair Value
Rate sensitive assets								
Other interest bearing assets	$2,727	$—	$—	$—	$—	$—	$2,727	$2,727
Average interest rates	0.34 %	—	—	—	—	—	0.34 %	
AFS securities	$114,247	$71,220	$64,931	$63,150	$66,976	$177,572	$558,096	$558,096
Average interest rates	2.35 %	2.38 %	2.45 %	2.64 %	2.57 %	2.50 %	2.47 %	
Fixed interest rate loans (1)	$159,964	$115,741	$103,514	$107,185	$112,811	$199,160	$798,375	$778,769
Average interest rates	4.15 %	4.25 %	4.34 %	4.16 %	4.15 %	4.10 %	4.18 %	
Variable interest rate loans (1)	$69,024	$29,179	$38,248	$16,179	$23,632	$35,978	$212,240	$212,240
Average interest rates	4.83 %	4.32 %	4.16 %	3.62 %	3.74 %	3.86 %	4.26 %	
Rate sensitive liabilities								
Fixed rate borrowed funds	$137,694	$50,000	$60,000	$10,000	$50,000	$20,000	$327,694	$326,975
Average interest rates	0.83 %	2.16 %	1.99 %	1.98 %	1.91 %	2.54 %	1.55 %	
Variable rate borrowed funds	$—	$—	$—	$—	$10,000	$—	$10,000	$10,000
Average interest rates	—	—	—	—	1.21 %	—	1.21 %	
Savings and NOW accounts	$84,972	$42,596	$38,220	$34,326	$30,858	$325,583	$556,555	$556,555
Average interest rates	0.57 %	0.12 %	0.11 %	0.11 %	0.11 %	0.11 %	0.18 %	
Fixed interest rate certificates of deposit	$195,389	$80,139	$45,110	$33,929	$50,978	$24,881	$430,426	$427,100
Average interest rates	0.86 %	1.18 %	1.35 %	1.58 %	1.68 %	1.84 %	1.18 %	
Variable interest rate certificates of deposit	$1,078	$1,910	$—	$—	$—	$—	$2,988	$2,988
Average interest rates	0.62 %	0.99 %	—	—	—	—	0.85 %	

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				