ISABELLA BANK Corp
Form 10-Q
November 03, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ýQuarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2017
or
¨Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number: 0-18415

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

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

401 N. Main St, Mt. Pleasant, MI	48858
(Address of principal executive offices)	(Zip code)

(989) 772-9471
(Registrant’s telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ý 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). ý Yes ¨ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨		Accelerated filer	ý
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
¨ Yes ý No

The number of common shares outstanding of the registrant’s Common Stock (no par value) was 7,853,629 as of October 31, 2017.

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ISABELLA BANK CORPORATION
QUARTERLY REPORT ON FORM 10-Q
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Forward Looking Statements

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

Glossary of Acronyms and Abbreviations

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

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

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 and Exchange Commission

SOX: Sarbanes-Oxley Act of 2002

TDR: Troubled debt restructuring

XBRL: eXtensible Business Reporting Language

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements.
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(Dollars in thousands)

	September 30 2017	December 31 2016
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	$ 20,650	$ 20,167
Interest bearing balances due from banks	417	2,727
Total cash and cash equivalents	21,067	22,894
AFS securities (amortized cost of $548,468 in 2017 and $557,648 in 2016)	552,925	558,096
Mortgage loans AFS	1,237	1,816
Loans		
Commercial	620,135	575,664
Agricultural	132,998	126,492
Residential real estate	271,480	266,050
Consumer	52,931	42,409
Gross loans	1,077,544	1,010,615
Less allowance for loan and lease losses	7,700	7,400
Net loans	1,069,844	1,003,215
Premises and equipment	28,761	29,314
Corporate owned life insurance policies	26,837	26,300
Accrued interest receivable	7,388	6,580
Equity securities without readily determinable fair values	23,461	21,694
Goodwill and other intangible assets	48,575	48,666
Other assets	11,872	13,576
TOTAL ASSETS	$ 1,791,967	$ 1,732,151
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$ 212,608	$ 205,071
NOW accounts	220,601	209,325
Certificates of deposit under $250 and other savings	723,834	717,078
Certificates of deposit over $250	59,019	63,566
Total deposits	1,216,062	1,195,040
Borrowed funds	367,027	337,694
Accrued interest payable and other liabilities	12,415	11,518
Total liabilities	1,595,504	1,544,252
Shareholders' equity		
Common stock — no par value 15,000,000 shares authorized; issued and outstanding 7,856,664 shares (including 28,547 shares held in the Rabbi Trust) in 2017 and 7,821,069 shares (including 26,042 shares held in the Rabbi Trust) in 2016	140,368	139,525
Shares to be issued for deferred compensation obligations	5,364	5,038
Retained earnings	50,680	46,114
Accumulated other comprehensive income (loss)	51	(2,778)
Total shareholders' equity	196,463	187,899
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,791,967	$ 1,732,151

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

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Interest income				
Loans, including fees	$11,297	$9,965	$32,102	$28,320
AFS securities				
Taxable	2,075	2,037	6,452	6,740
Nontaxable	1,406	1,411	4,234	4,337
Federal funds sold and other	198	194	547	509
Total interest income	14,976	13,607	43,335	39,906
Interest expense				
Deposits	1,715	1,496	4,870	4,313
Borrowings	1,485	1,251	4,189	3,726
Total interest expense	3,200	2,747	9,059	8,039
Net interest income	11,776	10,860	34,276	31,867
Provision for loan losses	49	17	85	185
Net interest income after provision for loan losses	11,727	10,843	34,191	31,682
Noninterest income				
Service charges and fees	1,435	1,276	4,370	3,652
Net gain on sale of mortgage loans	153	263	507	472
Earnings on corporate owned life insurance policies	174	183	537	566
Net gains on sale of AFS securities	—	—	142	245
Other	936	1,224	2,546	2,986
Total noninterest income	2,698	2,946	8,102	7,921
Noninterest expenses				
Compensation and benefits	5,360	4,940	15,869	14,412
Furniture and equipment	1,377	1,353	4,073	3,988
Occupancy	809	845	2,461	2,443
Other	2,593	2,295	7,194	6,888
Total noninterest expenses	10,139	9,433	29,597	27,731
Income before federal income tax expense	4,286	4,356	12,696	11,872
Federal income tax expense	750	763	2,180	1,855
NET INCOME	$3,536	$3,593	$10,516	$10,017
Earnings per common share				
Basic	$0.45	$0.46	$1.34	$1.28
Diluted	$0.44	$0.45	$1.31	$1.25
Cash dividends per common share	$0.26	$0.25	$0.76	$0.73

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

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(Dollars in thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Net income	$3,536	$3,593	$10,516	$10,017
Unrealized gains (losses) on AFS securities				
Unrealized gains (losses) on AFS securities arising during the period	(96)	(2,548)	4,151	8,793
Reclassification adjustment for net realized (gains) losses included in net income	—	—	(142)	(245)
Tax effect (1)	54	937	(1,158)	(2,713)
Unrealized gains (losses) on AFS securities, net of tax	(42)	(1,611)	2,851	5,835
Unrealized gains (losses) on derivative instruments arising during the period	11	91	(33)	(61)
Tax effect (1)	(4)	(31)	11	21
Unrealized gains (losses) on derivative instruments, net of tax	7	60	(22)	(40)
Other comprehensive income, net of tax	(35)	(1,551)	2,829	5,795
Comprehensive income	$3,501	$2,042	$13,345	$15,812

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

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

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(Dollars in thousands except per share amounts)

	Common Stock					
	Common Shares Outstanding	Amount	Common Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Totals
Balance, January 1, 2016	7,799,867	$139,198	$ 4,592	$39,960	$ 221	$183,971
Comprehensive income (loss)	—	—	—	10,017	5,795	15,812
Issuance of common stock	131,697	3,683	—	—	—	3,683
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	127	(127)	—	—	—
Share-based payment awards under equity compensation plan	—	—	443	—	—	443
Common stock purchased for deferred compensation obligations	—	(279)	—	—	—	(279)
Common stock repurchased pursuant to publicly announced repurchase plan	(98,083)	(2,749)	—	—	—	(2,749)
Cash dividends paid ($0.73 per common share)	—	—	—	(5,697)	—	(5,697)
Balance, September 30, 2016	7,833,481	$139,980	$ 4,908	$44,280	$ 6,016	$195,184
Balance, January 1, 2017	7,821,069	$139,525	$ 5,038	$46,114	$ (2,778)	$187,899
Comprehensive income (loss)	—	—	—	10,516	2,829	13,345
Issuance of common stock	178,712	4,999	—	—	—	4,999
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	176	(176)	—	—	—
Share-based payment awards under equity compensation plan	—	—	502	—	—	502
Common stock purchased for deferred compensation obligations	—	(327)	—	—	—	(327)
Common stock repurchased pursuant to publicly announced repurchase plan	(143,117)	(4,005)	—	—	—	(4,005)
Cash dividends paid ($0.76 per common share)	—	—	—	(5,950)	—	(5,950)
Balance, September 30, 2017	7,856,664	$140,368	$ 5,364	$50,680	$ 51	$196,463

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

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollars in thousands)

	Nine Months Ended September 30	
	2017	2016
OPERATING ACTIVITIES		
Net income	$10,516	$10,017
Reconciliation of net income to net cash provided by operating activities:		
Provision for loan losses	85	185
Impairment of foreclosed assets	2	—
Depreciation	2,163	2,116
Amortization of OMSR	257	299
Amortization of acquisition intangibles	91	128
Net amortization of AFS securities	1,614	2,115
Net (gains) losses on sale of AFS securities	(142)	(245)
Net gain on sale of mortgage loans	(507)	(472)
Increase in cash value of corporate owned life insurance policies	(537)	(566)
Share-based payment awards under equity compensation plan	502	443
Origination of loans held-for-sale	(28,436)	(22,994)
Proceeds from loan sales	29,522	23,968
Net changes in operating assets and liabilities which provided (used) cash:		
Accrued interest receivable	(808)	(599)
Other assets	(1,491)	1,005
Accrued interest payable and other liabilities	897	165
Net cash provided by (used in) operating activities	13,728	15,565
INVESTING ACTIVITIES		
Activity in AFS securities		
Sales	12,827	35,664
Maturities, calls, and principal payments	78,352	111,543
Purchases	(83,471)	(44,622)
Net loan principal (originations) collections	(66,928)	(138,870)
Proceeds from sales of foreclosed assets	203	348
Purchases of premises and equipment	(1,610)	(2,771)
Proceeds from redemption of corporate owned life insurance policies	—	1,004
Net cash provided by (used in) investing activities	(60,627)	(37,704)

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Dollars in thousands)

	Nine Months Ended September 30	
	2017	2016
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	$21,022	$11,270
Net increase (decrease) in borrowed funds	29,333	15,677
Cash dividends paid on common stock	(5,950)	(5,697)
Proceeds from issuance of common stock	4,999	3,683
Common stock repurchased	(4,005)	(2,749)
Common stock purchased for deferred compensation obligations	(327)	(279)
Net cash provided by (used in) financing activities	45,072	21,905
Increase (decrease) in cash and cash equivalents	(1,827)	(234)
Cash and cash equivalents at beginning of period	22,894	21,569
Cash and cash equivalents at end of period	$21,067	$21,335
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	$9,000	$8,042
Income taxes paid	$2,470	$1,350
SUPPLEMENTAL NONCASH INFORMATION:		
Transfers of loans to foreclosed assets	$214	$211

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

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(Dollars in thousands except per share amounts)

Note 1 – Basis of Presentation

As used in these notes, as well as in Management's Discussion and Analysis of Financial Condition and Results of Operations, references to “Isabella,” the “Corporation”, “we,” “our,” “us,” and similar terms refer to the consolidated entity consisting of Isabella Bank Corporation and its subsidiaries. Isabella Bank Corporation refers solely to the parent holding company, and Isabella Bank or the “Bank” refer to Isabella Bank Corporation’s subsidiary, Isabella Bank.

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2016.

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

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

Note 2 – Computation of Earnings Per Common Share

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Average number of common shares outstanding for basic calculation	7,848,317	7,824,751	7,839,172	7,813,084
Average potential effect of common shares in the Directors Plan (1)	192,572	186,667	191,548	184,996
Average number of common shares outstanding used to calculate diluted earnings per common share	8,040,889	8,011,418	8,030,720	7,998,080
Net income	$3,536	$ 3,593	$10,516	$ 10,017
Earnings per common share				
Basic	$0.45	$ 0.46	$1.34	$ 1.28
Diluted	$0.44	$ 0.45	$1.31	$ 1.25

(1) Exclusive of shares held in the Rabbi Trust

Note 3 – Accounting Standards Updates

Pending Accounting Standards Updates

ASU No. 2014-09: “Revenue from Contracts with Customers”

In May 2014, ASU No. 2014-09 created new Topic 606 to provide a common revenue standard to achieve consistency and clarification to the revenue recognition principles. The guidance outlines steps to achieve the core principle which states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. These steps consist of: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

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The new authoritative guidance was originally effective on January 1, 2017; however, ASU 2015-14 was issued which deferred the effective date of ASU 2014-09 by one year to January 1, 2018. The majority of our income, as well as that of the vast majority of financial institutions, is excluded from this guidance. We are reviewing our contracts related to trust and investment services and those related to other noninterest income to determine if changes in income recognition is required as a result of this guidance. While we anticipate some change as a result of implementing this guidance, we do not expect it to have a significant impact on our operating results or financial statement disclosures.

ASU No. 2016-02: "Leases (Topic 842)"

In February 2016, ASU No. 2016-02 was issued to create Topic 842 - Leases which will require recognition of lease assets and lease liabilities on the balance sheet for leases previously classified as operating leases. Accounting guidance is set forth for both lessee and lessor accounting. Under lessee accounting, a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term.

For finance leases, a lessee is required to do the following: 1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position; 2) recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income; and 3) classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, a lessee is required to do the following: 1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position; 2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and 3) classify all cash payments within operating activities in the statement of cash flows.

The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2018. We have and will continue to review our lease agreements to determine the appropriate treatment under this guidance. We do not expect these changes to have a significant impact on our operating results or financial statement disclosures.

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

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

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

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

ASU No. 2017-12: "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities"

In August 2017, ASU No. 2017-12 was issued to improve financial reporting of hedging activities to better portray the economic results of an entity's risk management activities. The update provides changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results.

The update addresses current GAAP designation limitations by permitting hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk as follows:
1. For a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, an entity could designate as the hedged risk the variability in cash flows attributable to changes in a contractually specified component stated in the contract. The amendments remove the requirement in current GAAP that only the overall variability in cash flows or variability related to foreign currency risk could be designated as the hedged risk in a cash flow hedge of a nonfinancial asset.

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2. For a cash flow hedge of interest rate risk of a variable-rate financial instrument, an entity could designate as the hedged risk the variability in cash flows attributable to the contractually specified interest rate. By eliminating the concept of benchmark interest rates for hedges of variable-rate instruments in current GAAP, the amendments remove the requirement to designate only the overall variability in cash flows as the hedged risk in a cash flow hedge of a variable-rate instrument indexed to a non-benchmark interest rate.
3. For a fair value hedge of interest rate risk, the amendments add the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate as an eligible benchmark interest rate in the United States in addition to those already permitted under current GAAP (the U.S. Treasury Rate, the London Interbank Offered Rate [LIBOR] Swap Rate, and the Fed Funds Effective Swap Rate [or Overnight Index Swap Rate]). This allows an entity that issues or invests in fixed-rate tax-exempt financial instruments to designate as the hedged risk changes in fair value attributable to interest rate risk related to the SIFMA Municipal Swap Rate rather than overall changes in fair value.

The amendments in this update provide further revisions to the current limitations on designation in a fair value hedge of interest rate risk. Specifically, the update changes the guidance for designating fair value hedges of interest rate risk and for measuring the change in fair value of the hedged item in fair value hedges of interest rate risk by providing four permissible accounting treatments.

In addition to the amendments to the designation and measurement guidance for qualifying hedging relationships, the amendments in this update also align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The following recognition and presentation guidance for qualifying hedges is required:

1. For fair value hedges, the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness is presented in the same income statement line that is used to present the earnings effect of the hedged item. The timing of recognition of the change in fair value of a hedging instrument included in the assessment of hedge effectiveness is the same as under current GAAP, but the presentation of hedge results could change because current GAAP does not specify a required presentation of the change in fair value of the hedging instrument.
2. For cash flow and net investment hedges, the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness is recorded in other comprehensive income (for cash flow hedges) or in the currency translation adjustment section of other comprehensive income (for net investment hedges). Those amounts are reclassified to earnings in the same income statement line item that is used to present the earnings effect of the hedged item when the hedged item affects earnings. The timing of recognition of the change in fair value of a hedging instrument could change relative to current GAAP because hedge ineffectiveness no longer is recognized in current period earnings. The presentation of hedge results also could change because current GAAP does not specify a required presentation of the change in fair value of the hedging instrument in the income statement.

Lastly, the guidance within this update provides exclusions from the hedge effectiveness assessment and five other targeted improvements to current guidance also related to the assessment of hedge effectiveness. Excluding option premiums and forward points will still be permissible under the new guidance. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2018 and is not expected to have a significant impact on our operating results or financial statement disclosures.

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Note 4 – AFS Securities

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

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$231	$ 1	$ —	$232
States and political subdivisions	207,874	5,596	13	213,457
Auction rate money market preferred	3,200	—	28	3,172
Preferred stocks	3,800	—	149	3,651
Mortgage-backed securities	216,684	860	1,630	215,914
Collateralized mortgage obligations	116,679	600	780	116,499
Total	$548,468	$ 7,057	$ 2,600	$552,925

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$10,258	$ 3	$ 2	$10,259
States and political subdivisions	208,977	4,262	320	212,919
Auction rate money market preferred	3,200	—	406	2,794
Preferred stocks	3,800	—	375	3,425
Mortgage-backed securities	229,593	581	2,918	227,256
Collateralized mortgage obligations	101,820	600	977	101,443
Total	$557,648	$ 5,446	$ 4,998	$558,096

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

	Maturing					
	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	Securities with Variable Monthly Payments or Noncontractual Maturities	Total
Government sponsored enterprises	$—	$ 231	$—	$ —	$ —	$231
States and political subdivisions	25,689	73,810	75,598	32,777	—	207,874
Auction rate money market preferred	—	—	—	—	3,200	3,200
Preferred stocks	—	—	—	—	3,800	3,800
Mortgage-backed securities	—	—	—	—	216,684	216,684
Collateralized mortgage obligations	—	—	—	—	116,679	116,679
Total amortized cost	$25,689	$ 74,041	$75,598	$ 32,777	$ 340,363	$548,468
Fair value	$25,746	$ 76,105	$78,383	$ 33,455	$ 339,236	$552,925

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

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

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

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

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

	September 30, 2017				
	Less Than Twelve Months		Twelve Months or More		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Government sponsored enterprises	$ —	$ —	$ —	$ —	$ —
States and political subdivisions	12	3,321	1	221	13
Auction rate money market preferred	—	—	28	3,172	28
Preferred stocks	—	—	149	3,651	149
Mortgage-backed securities	1,277	106,229	353	12,777	1,630
Collateralized mortgage obligations	331	33,969	449	15,303	780
Total	$ 1,620	$ 143,519	$ 980	$ 35,124	$ 2,600
Number of securities in an unrealized loss position:		35		13	48

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

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

- Has the value of the investment declined more than what is deemed to be reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable the issuer will be unable to pay the amount when due?
- Is it more likely than not that we will have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended?

During the fourth quarter of 2016, we identified one municipal bond as other-than-temporarily impaired. While management estimated the OTTI to be realized, we also engaged the services of an independent investment valuation firm to estimate the amount of impairment as of December 31, 2016. The valuation calculated the estimated market value utilizing two different approaches:

1) Market - Appraisal and Comparable Investments

2) Income - Discounted Cash Flow Method

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The two methods were then weighted, with a higher weighting applied to the Market approach, to determine the estimated impairment. As a result of this analysis, we recognized an OTTI of $770 in earnings for the year ended December 31, 2016. Based on analysis of this bond, there was no additional OTTI recognized as of September 30, 2017.

Based on our analysis which included the criteria outlined above, the fact that we have asserted that we do not have the intent to sell AFS securities in an unrealized loss position, and considering it is unlikely that we will have to sell any AFS securities in an unrealized loss position before recovery of their cost basis, we do not believe that the values of any other AFS securities are other-than-temporarily impaired as of September 30, 2017 or December 31, 2016, with the exception of the one municipal bond discussed above.

Note 5 – Loans and ALLL

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

Loans that we have the intent and ability to hold in our portfolio are reported at their outstanding principal balance adjusted for any charge-offs, the ALLL, and any deferred fees or costs. Interest income is accrued over the term of the loan based on the principal amount outstanding. Loan origination fees and certain direct loan origination costs are capitalized and recognized as a component of interest income over the term of the loan using the level yield method.

The accrual of interest on commercial, agricultural, and residential real estate loans is discontinued at the time the loan is 90 days or more past due unless the credit is well-secured and in the process of collection. Upon transferring the loans to nonaccrual status, we perform an evaluation to determine the net realizable value of the underlying collateral. This evaluation is used to help determine if any charge-offs are necessary. Consumer loans are typically charged-off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful.

For loans that are placed on nonaccrual status or charged-off, all interest accrued in the current calendar year, but not collected, is reversed against interest income while interest accrued in prior calendar years, but not collected, is charged against the ALLL. Loans may be returned to accrual status after six months of continuous performance and achievement of current payment status.

Commercial and agricultural loans include loans for commercial real estate, commercial operating loans, advances to mortgage brokers, farmland and agricultural production, and states and political subdivisions. Repayment of these loans is dependent upon the successful operation and management of a business. We minimize our risk by limiting the amount of direct credit exposure to any one borrower to $15,000. Borrowers with direct credit needs of more than $15,000 are serviced through the use of loan participations with other commercial banks. Commercial and agricultural real estate loans commonly require loan-to-value limits of 80% or less. Depending upon the type of loan, past credit history, and current operating results, we may require the borrower to pledge accounts receivable, inventory, and property and equipment. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and sole proprietorships. In addition, we require annual financial statements, prepare cash flow analyses, and review credit reports.

We entered into a mortgage purchase program in 2016 with a financial institution where we participate in advances to mortgage brokers ("advances"). The mortgage brokers originate residential mortgage loans with the intent to sell them on the secondary market. We participate in the advance to the mortgage broker, which is secured by the underlying mortgage loan, until it is ultimately sold on the secondary market. As such, the average life of each participated advance is approximately 20-30 days. Funds from the sale of the loan are used to payoff our participation in the advance to the mortgage broker. We classify these advances as commercial loans and include the outstanding balance in commercial loans on our balance sheet. Under the participation agreement, we committed to a maximum outstanding aggregate amount of $30,000. The difference between our outstanding balances and the maximum outstanding aggregate amount is classified as “Unfunded commitments under lines of credit” in the “Contractual

Obligations and Loan Commitments” section of the Management's Discussion and Analysis of Financial Condition and Results of Operations of this report.

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

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Our lending policies generally limit the maximum loan-to-value ratio on residential real estate loans to 100% of the lower of the appraised value of the property or the purchase price. Private mortgage insurance is typically required on loans with loan-to-value ratios in excess of 80% unless the loan qualifies for government guarantees.
Underwriting criteria for originated residential real estate loans generally include:
- Evaluation of the borrower’s ability to make monthly payments.
- Evaluation of the value of the property securing the loan.
- Ensuring the payment of principal, interest, taxes, and hazard insurance does not exceed 28% of a borrower’s gross income.
- Ensuring all debt servicing does not exceed 40% of income.
- Verification of acceptable credit reports.
- Verification of employment, income, and financial information.

Appraisals are performed by independent appraisers and reviewed for appropriateness. All originated mortgage loan requests are reviewed by our mortgage loan committee or through a secondary market underwriting system; loans in excess of $500 require the approval of our Internal Loan Committee, the Executive Loan Committee, the Board of Directors’ Loan Committee, or the Board of Directors.
Consumer loans include secured and unsecured personal loans. Loans are amortized for a period of up to 12 years based on the age and value of the underlying collateral. The underwriting emphasis is on a borrower’s perceived intent and ability to pay rather than collateral value. No consumer loans are sold to the secondary market.
The ALLL is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the ALLL when we believe the uncollectability of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALLL.
The appropriateness of the ALLL is evaluated on a quarterly basis and is based upon a periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.
The primary factors behind the determination of the level of the ALLL are specific allocations for impaired loans, historical loss percentages, as well as unallocated components. Specific allocations for impaired loans are primarily determined based on the difference between the loan’s outstanding balance and the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price, or the fair value of the collateral, less cost to sell. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio, with the exception of advances to mortgage brokers, over the preceding five years. With no historical losses on advances to mortgage brokers, there is no allocation in the commercial segment displayed in the following tables based on historical loss factors. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.
A summary of changes in the ALLL and the recorded investment in loans by segments follows:

	Allowance for Loan Losses					
	Three Months Ended September 30, 2017					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
July 1, 2017	$1,978	$ 475	$ 2,598	$ 583	$ 1,966	$7,600
Charge-offs	(8)	—	(77)	(72)	—	(157)
Recoveries	134	—	41	33	—	208
Provision for loan losses	65	(40)	(71)	89	6	49
September 30, 2017	$2,169	$ 435	$ 2,491	$ 633	$ 1,972	$7,700

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	Allowance for Loan Losses Nine Months Ended September 30, 2017					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2017	$1,814	$ 884	$ 2,664	$ 624	$ 1,414	$7,400
Charge-offs	(60)	—	(120)	(190)	—	(370)
Recoveries	322	—	140	123	—	585
Provision for loan losses	93	(449)	(193)	76	558	85
September 30, 2017	$2,169	$ 435	$ 2,491	$ 633	$ 1,972	$7,700

	Allowance for Loan Losses and Recorded Investment in Loans September 30, 2017					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	$933	$ —	$ 1,618	$ —	$ —	$2,551
Collectively evaluated for impairment	1,236	435	873	633	1,972	5,149
Total	$2,169	$ 435	$ 2,491	$ 633	$ 1,972	$7,700
Loans						
Individually evaluated for impairment	$8,525	$ 10,976	$ 8,426	$ 18		$27,945
Collectively evaluated for impairment	611,610	122,022	263,054	52,913		1,049,599
Total	$620,135	$ 132,998	$ 271,480	$ 52,931		$1,077,544

	Allowance for Loan Losses Three Months Ended September 30, 2016					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
July 1, 2016	$2,119	$ 534	$ 3,130	$ 541	$ 1,276	$7,600
Charge-offs	—	—	(57)	(74)	—	(131)
Recoveries	118	—	153	43	—	314
Provision for loan losses	(367)	612	(452)	94	130	17
September 30, 2016	$1,870	$ 1,146	$ 2,774	$ 604	$ 1,406	$7,800

	Allowance for Loan Losses Nine Months Ended September 30, 2016					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2016	$2,171	$ 329	$ 3,330	$ 522	$ 1,048	$7,400
Charge-offs	(48)	—	(426)	(206)	—	(680)
Recoveries	396	92	248	159	—	895
Provision for loan losses	(649)	725	(378)	129	358	185
September 30, 2016	$1,870	$ 1,146	$ 2,774	$ 604	$ 1,406	$7,800

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	Allowance for Loan Losses and Recorded Investment in Loans December 31, 2016					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	$741	$ 1	$ 1,629	$ —	$ —	$2,371
Collectively evaluated for impairment	1,073	883	1,035	624	1,414	5,029
Total	$1,814	$ 884	$ 2,664	$ 624	$ 1,414	$7,400
Loans						
Individually evaluated for impairment	$7,859	$ 5,545	$ 8,638	$ 26		$22,068
Collectively evaluated for impairment	567,805	120,947	257,412	42,383		988,547
Total	$575,664	$ 126,492	$ 266,050	$ 42,409		$1,010,615

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

	September 30, 2017							
	Commercial				Agricultural			
	Real Estate	Other	Advances to Mortgage Brokers	Total	Real Estate	Other	Total	Total
Rating								
1 - Excellent	$25	$227	$ —	$252	$—	$—	$—	$252
2 - High quality	6,736	10,474	—	17,210	3,088	1,001	4,089	21,299
3 - High satisfactory	117,596	41,844	22,834	182,274	21,743	9,822	31,565	213,839
4 - Low satisfactory	327,648	77,519	—	405,167	48,902	21,363	70,265	475,432
5 - Special mention	4,402	1,912	—	6,314	11,206	9,115	20,321	26,635
6 - Substandard	6,303	2,402	—	8,705	3,861	1,912	5,773	14,478
7 - Vulnerable	210	3	—	213	488	497	985	1,198
8 - Doubtful	—	—	—	—	—	—	—	—
Total	$462,920	$134,381	$ 22,834	$620,135	$89,288	$43,710	$132,998	$753,133

	December 31, 2016							
	Commercial				Agricultural			
	Real Estate	Other	Advances to Mortgage Brokers	Total	Real Estate	Other	Total	Total
Rating								
1 - Excellent	$28	$438	$ —	$466	$—	$—	$—	$466
2 - High quality	11,821	12,091	19,688	43,600	3,566	1,426	4,992	48,592
3 - High satisfactory	103,529	41,982	—	145,511	21,657	11,388	33,045	178,556
4 - Low satisfactory	299,317	74,432	—	373,749	48,955	22,715	71,670	445,419
5 - Special mention	3,781	1,178	—	4,959	6,009	3,085	9,094	14,053
6 - Substandard	5,901	1,474	—	7,375	3,650	3,508	7,158	14,533
7 - Vulnerable	4	—	—	4	—	533	533	537
8 - Doubtful	—	—	—	—	—	—	—	—
Total	$424,381	$131,595	$ 19,688	$575,664	$83,837	$42,655	$126,492	$702,156

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

1. EXCELLENT – Substantially Risk Free

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

- High liquidity, strong cash flow, low leverage.
- Unquestioned ability to meet all obligations when due.
- Experienced management, with management succession in place.
- Secured by cash.

2. HIGH QUALITY – Limited Risk

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

- Favorable liquidity and leverage ratios.
- Ability to meet all obligations when due.
- Management with successful track record.
- Steady and satisfactory earnings history.
- If loan is secured, collateral is of high quality and readily marketable.
- Access to alternative financing.
- Well defined primary and secondary source of repayment.
- If supported by guaranty, the financial strength and liquidity of the guarantor(s) are clearly evident.

3. HIGH SATISFACTORY – Reasonable Risk

Credit with satisfactory financial condition and further characterized by:

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

4. LOW SATISFACTORY – Acceptable Risk

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

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

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

5. SPECIAL MENTION – Criticized

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

- Downward trend in sales, profit levels, and margins.
- Impaired working capital position.
- Cash flow is strained in order to meet debt repayment.
- Loan delinquency (30-60 days) and overdrafts may occur.
-

- Shrinking equity cushion.
- Diminishing primary source of repayment and questionable secondary source.

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- Management abilities are questionable.
- Weak industry conditions.
- Litigation pending against the borrower.
- Collateral or guaranty offers limited protection.
- Negative debt service coverage, however the credit is well collateralized and payments are current.

6. SUBSTANDARD – Classified

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

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

7. VULNERABLE – Classified

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

- Insufficient cash flow to service debt.
- Minimal or no payments being received.
- Limited options available to avoid the collection process.
- Transition status, expect action will take place to collect loan without immediate progress being made.

8. DOUBTFUL – Workout

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

- Normal operations are severely diminished or have ceased.
- Seriously impaired cash flow.
- Original repayment terms materially altered.
- Secondary source of repayment is inadequate.
- Survivability as a "going concern" is impossible.
- Collection process has begun.
- Bankruptcy petition has been filed.
- Judgments have been filed.
- Portion of the loan balance has been charged-off.

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

	September 30, 2017						
	Accruing Interest and Past Due:				Total Past Due and Nonaccrual		
	30-59 Days	60-89 Days	90 Days or More	Nonaccrual		Current	Total
Commercial							
Commercial real estate	$466	$ —	$ —	$ 211	$ 677	$462,243	$462,920
Commercial other	823	29	—	3	855	133,526	134,381
Advances to mortgage brokers	—	—	—	—	—	22,834	22,834
Total commercial	1,289	29	—	214	1,532	618,603	620,135
Agricultural							
Agricultural real estate	—	—	590	488	1,078	88,210	89,288
Agricultural other	490	3	—	497	990	42,720	43,710
Total agricultural	490	3	590	985	2,068	130,930	132,998
Residential real estate							
Senior liens	1,514	—	56	383	1,953	225,215	227,168
Junior liens	8	—	—	23	31	7,348	7,379
Home equity lines of credit	217	—	—	—	217	36,716	36,933
Total residential real estate	1,739	—	56	406	2,201	269,279	271,480
Consumer							
Secured	39	11	—	—	50	49,027	49,077
Unsecured	2	—	—	—	2	3,852	3,854
Total consumer	41	11	—	—	52	52,879	52,931
Total	$3,559	$ 43	$ 646	$ 1,605	$ 5,853	$1,071,691	$1,077,544

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

Impaired Loans

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

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

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

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

	September 30, 2017			December 31, 2016		
	Recorded Balance	Unpaid Principal Balance	Valuation Allowance	Recorded Balance	Unpaid Principal Balance	Valuation Allowance
Impaired loans with a valuation allowance						
Commercial real estate	$4,209	$4,328	$ 766	$5,811	$5,992	$ 716
Commercial other	2,239	2,239	167	1,358	1,358	25
Agricultural real estate	—	—	—	—	—	—
Agricultural other	—	—	—	134	134	1
Residential real estate senior liens	8,273	8,903	1,605	8,464	9,049	1,615
Residential real estate junior liens	70	70	13	72	82	14
Home equity lines of credit	—	—	—	—	—	—
Consumer secured	—	—	—	—	—	—
Total impaired loans with a valuation allowance	14,791	15,540	2,551	15,839	16,615	2,371
Impaired loans without a valuation allowance						
Commercial real estate	1,988	2,062		604	617	
Commercial other	89	89		86	97	
Agricultural real estate	7,834	7,834		4,037	4,037	
Agricultural other	3,142	3,142		1,374	1,374	
Home equity lines of credit	83	383		102	402	
Consumer secured	18	18		26	26	
Total impaired loans without a valuation allowance	13,154	13,528		6,229	6,553	
Impaired loans						
Commercial	8,525	8,718	933	7,859	8,064	741
Agricultural	10,976	10,976	—	5,545	5,545	1
Residential real estate	8,426	9,356	1,618	8,638	9,533	1,629
Consumer	18	18	—	26	26	—
Total impaired loans	$27,945	$29,068	$ 2,551	$22,068	$23,168	$ 2,371

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

	Three Months Ended September 30			
	2017		2016	
	Average Recorded Balance	Interest Income Recognized	Average Recorded Balance	Interest Income Recognized
Impaired loans with a valuation allowance				
Commercial real estate	$4,636	$ 68	$5,699	$ 90
Commercial other	1,669	28	746	2
Agricultural real estate	—	—	181	4
Agricultural other	—	—	67	1
Residential real estate senior liens	8,333	79	8,896	85
Residential real estate junior liens	73	1	105	—
Home equity lines of credit	35	—	—	—
Consumer secured	—	—	—	—
Total impaired loans with a valuation allowance	14,746	176	15,694	182
Impaired loans without a valuation allowance				
Commercial real estate	1,546	31	705	10
Commercial other	93	2	67	2
Agricultural real estate	7,830	98	3,360	42
Agricultural other	3,221	39	767	11
Home equity lines of credit	86	5	112	4
Consumer secured	19	—	31	1
Total impaired loans without a valuation allowance	12,795	175	5,042	70
Impaired loans				
Commercial	7,944	129	7,217	104
Agricultural	11,051	137	4,375	58
Residential real estate	8,527	85	9,113	89
Consumer	19	—	31	1
Total impaired loans	$27,541	$ 351	$20,736	$ 252

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	Nine Months Ended September 30			
	2017		2016	
	Average Recorded Balance	Interest Income Recognized	Average Recorded Balance	Interest Income Recognized
Impaired loans with a valuation allowance				
Commercial real estate	$4,765	$ 225	$5,748	$ 259
Commercial other	1,363	75	298	5
Agricultural real estate	—	—	91	6
Agricultural other	22	—	78	1
Residential real estate senior liens	8,379	245	9,439	278
Residential real estate junior liens	75	2	126	2
Home equity lines of credit	23	—	—	—
Consumer secured	—	—	—	—
Total impaired loans with a valuation allowance	14,627	547	15,780	551
Impaired loans without a valuation allowance				
Commercial real estate	1,483	83	995	57
Commercial other	109	6	92	6
Agricultural real estate	5,936	218	3,454	130
Agricultural other	2,353	85	574	27
Home equity lines of credit	115	15	118	12
Consumer secured	22	—	33	3
Total impaired loans without a valuation allowance	10,018	407	5,266	235
Impaired loans				
Commercial	7,720	389	7,133	327
Agricultural	8,311	303	4,197	164
Residential real estate	8,592	262	9,683	292
Consumer	22	—	33	3
Total impaired loans	$24,645	$ 954	$21,046	$ 786

We had committed to advance $125 and $117 in connection with impaired loans, which includes TDRs, as of September 30, 2017 and December 31, 2016, respectively.

Troubled Debt Restructurings

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

Typical concessions granted include, but are not limited to:

- Agreeing to interest rates below prevailing market rates for debt with similar risk characteristics.
- Extending the amortization period beyond typical lending guidelines for loans with similar risk characteristics.
- Agreeing to an interest only payment structure and delaying principal payments.
- Forgiving principal.
- Forgiving accrued interest.

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

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

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

	Three Months Ended September 30					
	2017			2016		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial other	3	$ 1,385	$ 1,385	1	$ 1,315	$ 1,315
Agricultural other	—	—	—	2	319	319
Residential real estate						
Senior liens	2	179	179	—	—	—
Junior liens	—	—	—	—	—	—
Total residential real estate	2	179	179	—	—	—
Consumer unsecured	—	—	—	—	—	—
Total	5	$ 1,564	$ 1,564	3	$ 1,634	$ 1,634

	Nine Months Ended September 30					
	2017			2016		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial other	6	$ 1,698	$ 1,698	1	$ 1,315	$ 1,315
Agricultural other	7	5,445	5,445	5	520	520
Residential real estate						
Senior liens	5	434	434	2	26	26
Junior liens	1	8	8	—	—	—
Total residential real estate	6	442	442	2	26	26
Consumer unsecured	—	—	—	1	2	2
Total	19	$ 7,585	$ 7,585	9	$ 1,863	$ 1,863

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

	Three Months Ended September 30							
	2017				2016			
	Below Market Interest Rate		Below Market Interest Rate and Extension of Amortization Period		Below Market Interest Rate		Below Market Interest Rate and Extension of Amortization Period	
	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment
Commercial other	—	$ —	3	$ 1,385	—	$ —	1	$ 1,315
Agricultural other	—	—	—	—	1	14	1	305
Residential real estate								
Senior liens	—	—	2	179	—	—	—	—
Junior liens	—	—	—	—	—	—	—	—
Total residential real estate	—	—	2	179	—	—	—	—
Consumer unsecured	—	—	—	—	—	—	—	—
Total	—	$ —	5	$ 1,564	1	$ 14	2	$ 1,620

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	Nine Months Ended September 30							
	2017				2016			
	Below Market Interest Rate		Below Market Interest Rate and Extension of Amortization Period		Below Market Interest Rate		Below Market Interest Rate and Extension of Amortization Period	
	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment
Commercial other	—	$ —	6	$ 1,698	—	$ —	1	$ 1,315
Agricultural other	4	1,349	3	4,096	1	14	4	506
Residential real estate								
Senior liens	—	—	5	434	2	26	—	—
Junior liens	1	8	—	—	—	—	—	—
Total residential real estate	1	8	5	434	2	26	—	—
Consumer unsecured	—	—	—	—	—	—	1	2
Total	5	$ 1,357	14	$ 6,228	3	$ 40	6	$ 1,823

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

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

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

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

	September 30, 2017	December 31, 2016
TDRs	$ 27,259	$ 21,382

Note 6 – Equity Securities Without Readily Determinable Fair Values

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

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

	September 30 2017	December 31 2016
FHLB Stock	$ 13,700	$ 11,900
Corporate Settlement Solutions, LLC	7,428	7,461
FRB Stock	1,999	1,999
Other	334	334
Total	$ 23,461	$ 21,694

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Note 7 – Foreclosed Assets

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

	September 30 2017	December 31 2016
Consumer mortgage loans collateralized by residential real estate foreclosed as a result of obtaining physical possession	$ 20	$ 18
All other foreclosed assets	220	213
Total	$ 240	$ 231

There were $260 and $18 of consumer mortgage loans collateralized by residential real estate in the process of foreclosure as of September 30, 2017 and December 31, 2016.

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

	Three Months Ended September 30	
	2017	2016
Balance, July 1	$229	$249
Properties transferred	118	95
Impairments	(2)	—
Proceeds from sale	(105)	(60)
Balance, September 30	$240	$284

	Nine Months Ended September 30	
	2017	2016
Balance, January 1	$231	$421
Properties transferred	214	211
Impairments	(2)	—
Proceeds from sale	(203)	(348)
Balance, September 30	$240	$284

Note 8 – Borrowed Funds

Borrowed funds consist of the following obligations as of:

	September 30, 2017		December 31, 2016	
	Amount	Rate	Amount	Rate
FHLB advances	$310,000	1.83 %	$270,000	1.82 %
Securities sold under agreements to repurchase without stated maturity dates	54,977	0.12 %	60,894	0.13 %
Federal funds purchased	2,050	1.39 %	6,800	1.00 %
Total	$367,027	1.57 %	$337,694	1.50 %

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

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

	September 30, 2017		December 31, 2016	
	Amount	Rate	Amount	Rate
Fixed rate due 2017	$40,000	1.13%	$70,000	1.39%
Fixed rate due 2018	50,000	2.16%	50,000	2.16%
Fixed rate due 2019	85,000	1.87%	60,000	1.99%
Fixed rate due 2020	35,000	1.52%	10,000	1.98%
Fixed rate due 2021	50,000	1.91%	50,000	1.91%
Variable rate due 2021 [1]	10,000	1.61%	10,000	1.21%
Fixed rate due 2022	20,000	1.97%	—	— %
Fixed rate due 2023	10,000	3.90%	10,000	3.90%
Fixed rate due 2026	10,000	1.17%	10,000	1.17%
Total	$310,000	1.83%	$270,000	1.82%

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

Securities sold under agreements to repurchase are classified as secured borrowings and are reflected at the amount of cash received in connection with the transaction. The securities underlying the agreements have a carrying value and a fair value of $54,996 and $60,918 at September 30, 2017 and December 31, 2016, respectively. Such securities remain under our control. We may be required to provide additional collateral based on the fair value of underlying securities.

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

	Three Months Ended September 30					
	2017			2016		
	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period
Securities sold under agreements to repurchase without stated maturity dates	$58,464	$53,846	0.13 %	$56,057	$54,446	0.13 %
Federal funds purchased	3,815	1,474	1.20 %	20,600	8,848	0.69 %
FRB Discount Window	—	82	1.60 %	—	—	— %

	Nine Months Ended September 30					
	2017			2016		
	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period	Maximum Month End Balance	Average Balance	Weighted Average Interest Rate During the Period
Securities sold under agreements to repurchase without stated maturity dates	$58,464	$55,051	0.13 %	$61,783	$57,159	0.13 %
Federal funds purchased	5,965	3,280	1.13 %	20,600	8,614	0.69 %
FRB Discount Window	—	57	1.54 %	—	—	— %

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

	September 30 2017	December 31 2016
Pledged to secure borrowed funds	$ 416,279	$ 363,427

Pledged to secure repurchase agreements	54,996	60,918
Pledged for public deposits and for other purposes necessary or required by law	29,774	33,916
Total	$ 501,049	$ 458,261

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

	September 30 2017	December 31 2016
States and political subdivisions	$ 4,256	$ 5,676
Mortgage-backed securities	15,419	11,383
Collateralized mortgage obligations	35,321	43,859
Total	$ 54,996	$ 60,918

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

As of September 30, 2017, we had the ability to borrow up to an additional $114,839, based on assets pledged as collateral. We had no investment securities that are restricted to be pledged for specific purposes.

Derivative Instruments

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

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

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

	September 30, 2017					
	Pay Rate	Receive Rate	Remaining Life (Years)	Notional Amount	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments						
Cash Flow Hedges:						
Interest rate swaps	1.56 %	3-Month LIBOR	3.6	$ 10,000	Other Assets	$ 215

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

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

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Note 9 – Other Noninterest Expenses

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
ATM and debit card fees	$253	$210	$873	$627
Audit and related fees	322	319	757	664
Consulting fees	259	198	672	567
Director fees	212	207	634	630
Loan underwriting fees	237	142	546	377
Donations and community relations	190	134	488	399
FDIC insurance premiums	172	224	480	646
Marketing costs	172	101	361	359
Education and travel	143	73	332	309
Printing and supplies	110	105	320	325
Postage and freight	85	96	304	293
All other	438	486	1,427	1,692
Total other	$2,593	$2,295	$7,194	$6,888

Note 10 – Federal Income Taxes

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Income taxes at 34% statutory rate	$1,458	$1,481	$4,317	$4,036
Effect of nontaxable income				
Interest income on tax exempt municipal securities	(452)	(457)	(1,361)	(1,400)
Earnings on corporate owned life insurance policies	(60)	(62)	(183)	(192)
Effect of tax credits	(186)	(188)	(566)	(575)
Other	(18)	(19)	(54)	(55)
Total effect of nontaxable income	(716)	(726)	(2,164)	(2,222)
Effect of nondeductible expenses	8	8	27	41
Federal income tax expense	$750	$763	$2,180	$1,855

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Note 11 – Fair Value

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

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

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

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

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

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

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

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

	September 30, 2017		
Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
		Real Estate	20% - 30%
		Equipment	20% - 45%
		Accounts receivable	50%
Discounted value	$16,158	Cash crop inventory	30% - 40%
		Other inventory	50% - 75%
		Liquor license	75%
		Furniture, fixtures & equipment	35% - 45%

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	December 31, 2016		
Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
		Real Estate	20% - 30%
		Equipment	20% - 45%
Discounted value	$9,166	Cash crop inventory	30% - 40%
		Liquor license	75%
		Furniture, fixtures & equipment	45%

Collateral discount rates may have ranges to accommodate differences in the age of the independent appraisal, broker price opinion, or internal evaluation.

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

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

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

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

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

	September 30, 2017		
Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
Discounted value	$240	Real Estate	20% - 30%

	December 31, 2016		
Valuation Technique	Fair Value	Unobservable Input	Range
		Discount applied to collateral:	
Discounted value	$231	Real Estate	20% - 30%

Collateral discount rates may have ranges to accommodate differences in the age of the independent appraisal, broker price opinion, or internal evaluations.

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

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OMSR: OMSR (which are included in other assets) are subject to impairment testing. To test for impairment, we utilize a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and discount rates. If the valuation model reflects a value less than the carrying value, OMSR are adjusted to fair value through a valuation allowance as determined by the model. As such, we classify OMSR subject to nonrecurring fair value adjustments as Level 2.

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

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

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

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

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

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

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

	September 30, 2017				
	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
ASSETS					
Cash and cash equivalents	$21,067	$ 21,067	$21,067	$ —	$ —
Mortgage loans AFS	1,237	1,245	—	1,245	—
Gross loans	1,077,544	1,056,912	—	—	1,056,912
Less allowance for loan and lease losses	7,700	7,700	—	—	7,700
Net loans	1,069,844	1,049,212	—	—	1,049,212
Accrued interest receivable	7,388	7,388	7,388	—	—
Equity securities without readily determinable fair values (1)	23,461	N/A	—	—	—
OMSR	2,413	2,413	—	2,413	—
LIABILITIES					
Deposits without stated maturities	791,567	791,567	791,567	—	—
Deposits with stated maturities	424,495	423,536	—	423,536	—
Borrowed funds	367,027	367,873	—	367,873	—
Accrued interest payable	633	633	633	—	—

	December 31, 2016				
	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
ASSETS					
Cash and cash equivalents	$22,894	$ 22,894	$22,894	$ —	$ —
Mortgage loans AFS	1,816	1,836	—	1,836	—
Gross loans	1,010,615	991,009	—	—	991,009
Less allowance for loan and lease losses	7,400	7,400	—	—	7,400
Net loans	1,003,215	983,609	—	—	983,609
Accrued interest receivable	6,580	6,580	6,580	—	—
Equity securities without readily determinable fair values (1)	21,694	N/A	—	—	—
OMSR	2,306	2,306	—	2,306	—
LIABILITIES					
Deposits without stated maturities	761,626	761,626	761,626	—	—
Deposits with stated maturities	433,414	430,088	—	430,088	—
Borrowed funds	337,694	336,975	—	336,975	—
Accrued interest payable	574	574	574	—	—

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

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Financial Instruments Recorded at Fair Value

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

	September 30, 2017				December 31, 2016			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
Recurring items								
AFS securities								
Government-sponsored enterprises	$232	$—	$232	$—	$10,259	$—	$10,259	$—
States and political subdivisions	213,457	—	213,457	—	212,919	—	212,919	—
Auction rate money market preferred	3,172	—	3,172	—	2,794	—	2,794	—
Preferred stocks	3,651	3,651	—	—	3,425	3,425	—	—
Mortgage-backed securities	215,914	—	215,914	—	227,256	—	227,256	—
Collateralized mortgage obligations	116,499	—	116,499	—	101,443	—	101,443	—
Total AFS securities	552,925	3,651	549,274	—	558,096	3,425	554,671	—
Derivative instruments	215	—	215	—	248	—	248	—
Nonrecurring items								
Impaired loans (net of the ALLL)	16,158	—	—	16,158	9,166	—	—	9,166
Foreclosed assets	240	—	—	240	231	—	—	231
Total	$569,538	$3,651	$549,489	$16,398	$567,741	$3,425	$554,919	$9,397
Percent of assets and liabilities measured at fair value		0.64 %	96.48 %	2.88 %		0.60 %	97.74 %	1.66 %

We had no assets or liabilities recorded at fair value with changes in fair value recognized through earnings, on a recurring basis, as of September 30, 2017. Foreclosed assets, which are recorded at fair value with changes in fair value recognized through earnings on a nonrecurring basis, were written down to $240 as of September 30, 2017 which resulted in an impairment recorded through earnings in the amount of $2 for the nine month period ended September 30, 2017. We had no other assets or liabilities recorded at fair value with changes in fair value recognized through earnings, on a nonrecurring basis, as of September 30, 2017.

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Note 12 – Accumulated Other Comprehensive Income

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

	Three Months Ended September 30							
	2017				2016			
	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total
Balance, July 1	$2,923	$ 135	$ (2,972)	$86	$10,982	$ (100)	$ (3,315)	$7,567
OCI before reclassifications	(96)	11	—	(85)	(2,548)	91	—	(2,457)
Amounts reclassified from AOCI	—	—	—	—	—	—	—	—
Subtotal	(96)	11	—	(85)	(2,548)	91	—	(2,457)
Tax effect	54	(4)	—	50	937	(31)	—	906
OCI, net of tax	(42)	7	—	(35)	(1,611)	60	—	(1,551)
Balance, September 30	$2,881	$ 142	$ (2,972)	$51	$9,371	$ (40)	$ (3,315)	$6,016

	Nine Months Ended September 30							
	2017				2016			
	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Gains (Losses) on Derivative Instruments	Defined Benefit Pension Plan	Total
Balance, January 1	$30	$ 164	$ (2,972)	$(2,778)	$3,536	$ —	$ (3,315)	$221
OCI before reclassifications	4,151	(33)	—	4,118	8,793	(61)	—	8,732
Amounts reclassified from AOCI	(142)	—	—	(142)	(245)	—	—	(245)
Subtotal	4,009	(33)	—	3,976	8,548	(61)	—	8,487
Tax effect	(1,158)	11	—	(1,147)	(2,713)	21	—	(2,692)
OCI, net of tax	2,851	(22)	—	2,829	5,835	(40)	—	5,795
Balance, September 30	$2,881	$ 142	$ (2,972)	$51	$9,371	$ (40)	$ (3,315)	$6,016

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

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

	Three Months Ended September 30					
	2017			2016		
	Auction Rate Money Market Preferred and Preferred Stocks	All Other AFS Securities	Total	Auction Rate Money Market Preferred and Preferred Stocks	All Other AFS Securities	Total
Unrealized gains (losses) arising during the period	$63	$ (159)	$(96)	$208	$(2,756)	$(2,548)
Reclassification adjustment for net realized (gains) losses included in net income	—	—	—	—	—	—
Net unrealized gains (losses)	63	(159)	(96)	208	(2,756)	(2,548)
Tax effect	—	54	54	—	937	937
Unrealized gains (losses), net of tax	$63	$ (105)	$(42)	$208	$(1,819)	$(1,611)

	Nine Months Ended September 30					
	2017			2016		
	Auction Rate Money Market Preferred and Preferred Stocks	All Other AFS Securities	Total	Auction Rate Money Market Preferred and Preferred Stocks	All Other AFS Securities	Total
Unrealized gains (losses) arising during the period	$604	$ 3,547	$4,151	$568	$ 8,225	$8,793
Reclassification adjustment for net realized (gains) losses included in net income	—	(142)	(142)	—	(245)	(245)
Net unrealized gains (losses)	604	3,405	4,009	568	7,980	8,548
Tax effect	—	(1,158)	(1,158)	—	(2,713)	(2,713)
Unrealized gains (losses), net of tax	$604	$ 2,247	$2,851	$568	$ 5,267	$5,835

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Note 13 – Parent Company Only Financial Information

Interim Condensed Balance Sheets

	September 30 2017	December 31 2016
ASSETS		
Cash on deposit at the Bank	$ 945	$ 1,297
AFS securities	—	251
Investments in subsidiaries	146,138	138,549
Premises and equipment	1,961	1,991
Other assets	52,795	52,846
TOTAL ASSETS	$ 201,839	$ 194,934
LIABILITIES AND SHAREHOLDERS' EQUITY		
Other liabilities	$ 5,376	$ 7,035
Shareholders' equity	196,463	187,899
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 201,839	$ 194,934

Interim Condensed Statements of Income

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Income				
Dividends from subsidiaries	$2,900	$2,000	$7,200	$5,600
Interest income	—	3	2	11
Management fee and other	1,660	1,680	4,901	4,962
Total income	4,560	3,683	12,103	10,573
Expenses				
Compensation and benefits	1,118	1,196	3,608	3,580
Occupancy and equipment	456	438	1,332	1,281
Audit and related fees	148	193	412	389
Other	556	427	1,731	1,561
Total expenses	2,278	2,254	7,083	6,811
Income before income tax benefit and equity in undistributed earnings of subsidiaries	2,282	1,429	5,020	3,762
Federal income tax benefit	209	199	737	616
Income before equity in undistributed earnings of subsidiaries	2,491	1,628	5,757	4,378
Undistributed earnings of subsidiaries	1,045	1,965	4,759	5,639
Net income	$3,536	$3,593	$10,516	$10,017

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Interim Condensed Statements of Cash Flows

	Nine Months Ended September 30	
	2017	2016
Operating activities		
Net income	$10,516	$10,017
Adjustments to reconcile net income to cash provided by operations		
Undistributed earnings of subsidiaries	(4,759)	(5,639)
Undistributed earnings of equity securities without readily determinable fair values	33	(287)
Share-based payment awards under equity compensation plan	502	443
Depreciation	116	117
Changes in operating assets and liabilities which provided (used) cash		
Other assets	19	177
Accrued interest and other liabilities	(1,659)	(2,575)
Net cash provided by (used in) operating activities	4,768	2,253
Investing activities		
Maturities, calls, principal payments, and sales of AFS securities	249	—
Purchases of premises and equipment	(86)	(86)
Net cash provided by (used in) investing activities	163	(86)
Financing activities		
Cash dividends paid on common stock	(5,950)	(5,697)
Proceeds from the issuance of common stock	4,999	3,683
Common stock repurchased	(4,005)	(2,749)
Common stock purchased for deferred compensation obligations	(327)	(279)
Net cash provided by (used in) financing activities	(5,283)	(5,042)
Increase (decrease) in cash and cash equivalents	(352)	(2,875)
Cash and cash equivalents at beginning of period	1,297	4,125
Cash and cash equivalents at end of period	$945	$1,250

Note 14 – Operating Segments

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

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
ISABELLA BANK CORPORATION FINANCIAL REVIEW
(Dollars in thousands except per share amounts)
This section reviews our financial condition and results of our operations for the unaudited three and nine month periods ended September 30, 2017 and 2016. This analysis should be read in conjunction with our 2016 Annual Report on Form 10-K and with the unaudited interim condensed consolidated financial statements and notes, beginning on page 4 of this report.
Executive Summary
During the three and nine months ended September 30, 2017, we reported net income of $3,536 and $10,516 and earnings per common share of $0.45 and $1.34, respectively. Net income and earnings per common share for the same periods of 2016 were $3,593 and $10,017 and $0.46 and $1.28, respectively. The increase in year-to-date earnings was primarily driven by interest income which increased $3,429 for the first nine months of 2017 in comparison to the same period in 2016. Increased interest income resulted primarily from strong loan growth during the past year.
During the nine month period ended September 30, 2017, total assets grew by 3.45% to $1,791,967, and assets under management increased to $2,528,385 which includes loans sold and serviced, and assets managed by our Investment and Trust Services Department of $736,418. Total loans increased by $66,929 from December 31, 2016 which was largely driven by growth of $44,471 in the commercial loan portfolio. The growth in the loan portfolio was funded by an increase of $21,022 in deposits since December 31, 2016, with the remainder being funded through additional borrowed funds.
Our net yield on interest earning assets (FTE) remained low at 3.03% for the nine month period ended September 30, 2017. The growth in net interest income will increase primarily through continued growth in a strategic mix of loans, investments, and other income earning assets. We do not anticipate that the Federal Reserve Bank will increase short term interest rates significantly in the near future; therefore, we anticipate marginal improvements in our net yield on interest earning assets in the short term. We are committed to increasing earnings and shareholder value through growth in our loan portfolio, investment and trust services, and in deposits while managing operating costs.
Reclassifications: Certain amounts reported in the 2016 consolidated financial statements have been reclassified to conform with the 2017 presentation.

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Results of Operations

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

	September 30 2017	June 30 2017	March 31 2017	December 31 2016	September 30 2016
INCOME STATEMENT DATA					
Interest income	$ 14,976	$ 14,498	$ 13,861	$ 13,760	$ 13,607
Interest expense	3,200	3,028	2,831	2,826	2,747
Net interest income	11,776	11,470	11,030	10,934	10,860
Provision for loan losses	49	9	27	(320)	17
Noninterest income	2,698	2,788	2,616	3,187	2,946
Noninterest expenses	10,139	9,507	9,951	10,166	9,433
Federal income tax expense	750	898	532	493	763
Net Income	$ 3,536	$ 3,844	$ 3,136	$ 3,782	$ 3,593
PER SHARE					