ISABELLA BANK CORP
Form 10-K
March 14, 2016
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2015

OR

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

For the transition period from to

Commission File Number: 0-18415

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

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

401 North Main Street, Mount Pleasant, Michigan 48858
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code (989) 772-9471
Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|

Securities registered pursuant to Section 12(g) of the Act:
Common Stock - No Par Value
(Title of Class)

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

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

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

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

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

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

| | |
|---|---|
| Large accelerated filer ¨ | Accelerated filer x |

Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes ý No
The aggregate market value of the voting stock held by non-affiliates of the registrant was $185,183,000 as of the last business day of the registrant's most recently completed second fiscal quarter.
The number of common shares outstanding of the registrant's Common Stock (no par value) was 7,804,287 as of March 7, 2016.

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

| Documents | Part of Form 10-K Incorporated into |
|---|---|
| Portions of the Isabella Bank Corporation Proxy Statement for its Annual Meeting of Shareholders to be held May 3, 2016 | Part III |

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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 consolidated financial results, is included in our filings with the SEC.

Glossary of Acronyms and Abbreviations

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

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

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Restatement of Previously Filed Reports (Dollars in thousands)

Overview of Restatement

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

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

Background of Restatement

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

Impact of Restatement

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

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

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

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

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

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

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

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PART I

Item 1. Business. (Dollars in thousands)

General

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

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

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

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

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

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

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

Available Information

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

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

Supervision and Regulation

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

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

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

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

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

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

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

Isabella Bank

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

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

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

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

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

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

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

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

## Item 1A. Risk Factors.

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

Our enterprise risk process covers each of the following areas.

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

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

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

### Changes in economic conditions

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

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

### Interest rate risk

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

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Liquidity risk

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

The value of investment securities may be negatively impacted by fluctuations in the market

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

Operational risk

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

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

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

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

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

We may not adjust to changes in the financial services industry

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

We may be required to recognize an impairment of goodwill

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

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

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

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

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

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

The financial services industry is extensively regulated by state and federal regulation that governs almost all aspects of our operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors, and the deposit insurance fund. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact us or our ability to increase the value of our business. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the appropriateness of an institution’s ALLL. Future regulatory changes or accounting pronouncements may increase our regulatory capital requirements or adversely affect our regulatory capital levels. Additionally, actions by regulatory agencies or significant litigation against us could require the dedication of significant time and resources to defending our business and may lead to penalties.

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

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

Our estimates and assumptions may be incorrect

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

Disruption of infrastructure

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

Anti-takeover provisions

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

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

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

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

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PART II

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

Common Stock and Dividend Information

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

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

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

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

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

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

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

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

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

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

Stock Performance

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

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

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Item 6. Selected Financial Data.

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

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

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

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

* At end of year

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

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

* At end of period

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

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.
ISABELLA BANK CORPORATION FINANCIAL REVIEW
(Dollars in thousands except per share amounts)
The following is management's discussion and analysis of the financial condition and results of our operations. This discussion and analysis is intended to provide a better understanding of the consolidated financial statements and statistical data included elsewhere in this Annual Report on Form 10-K.
Executive Summary
We reported record net income of $15,130 and earnings per common share of $1.95 for the year ended December 31, 2015. Our continued strong earnings have primarily been the result of increased interest income and continued improvement in credit quality. The improvement in credit quality resulted in a decline in the level of the ALLL in both amount and as a percentage of gross loans, resulting in a reversal of provision for loan losses of $2,771 for the year ended December 31, 2015. Net loan recoveries during 2015 were $71 as compared to net loan charge-offs $732 in 2014. Additionally, we continue to see reductions in loans classified as less than satisfactory.
During the year, total assets grew by 7.65% to $1,668,112, and assets under management increased to $2,360,250 which includes loans sold and serviced and assets managed by our Investment and Trust Services Department of $692,138. In 2015, we had total loan growth of $13,942 which was driven by commercial and agricultural loan growth of $26,301. This was partially offset by declines in both residential real estate and consumer loans of $12,359 as new loan originations were less than principal payments by borrowers.
We increased our AFS securities portfolio by $92,602 during 2015 to continue providing growth in our balance sheet to increase interest income. Our net yield on interest earning assets of 3.10% remains at historically low levels. While we expect the Federal Reserve Bank to increase short term interest rates in 2016, we do not anticipate any significant improvements in our net yield on interest earning assets as the rates paid on interest bearing liabilities will likely increase faster than those of interest earning assets. Net interest income will increase only through continued growth in loans, investments, and other income earning assets. We are committed to increasing earnings and dedicated to providing long term sustainable growth to enable us to increase shareholder value.
While we have been able to grow our commercial and agricultural loan portfolios, increasing our residential real estate and consumer loan portfolios has been more challenging. To generate growth in these portfolios, we are implementing new products, enhancing our marketing efforts, streamlining delivery channels for direct and indirect loans, and expanding our service area. These initiatives are designed to attract new customers while expanding our relationships with current customers to improve earnings.
Acquisitions
On July 31, 2015, we completed the acquisition of a branch from Flagstar Bank, FSB located in Saginaw, Michigan. In addition to real estate and equipment, we assumed deposit liabilities of $44,290 and recorded $156 of core deposit intangibles and $2,061 of goodwill, which represented the excess of the purchase price over the fair value of identifiable net assets acquired.
On August 28, 2015, we completed the acquisition of a branch from Independent Bank located in Midland, Michigan. In addition to real estate and equipment, we assumed $8,658 of deposit liabilities and recorded $50 of core deposit intangibles and $602 of goodwill, which represented the excess of the purchase price over the fair value of identifiable net assets acquired.

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

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

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

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

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

Other

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

CRITICAL ACCOUNTING POLICIES

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

The ALLL requires our most subjective and complex judgment. Changes in economic conditions can have a significant impact on the ALLL and, therefore, the provision for loan losses and results of operations. We have developed policies and procedures for assessing the appropriateness of the ALLL, recognizing that this process requires a number of assumptions and estimates with respect to our loan portfolio. Our assessments may be impacted in future periods by changes in economic conditions, and the discovery of information with respect to borrowers which is not known to us at the time of the issuance of the consolidated financial statements. For additional discussion concerning our ALLL and related matters, see the detailed discussion to follow under the caption “Allowance for Loan and Lease Losses” and “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplementary Data.

U.S. generally accepted accounting principles require that we determine the fair value of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. We employ a variety of measures in the determination of the fair value, including the use of discounted cash flow analysis, market appraisals, and projected future revenue streams. For certain items that we believe we have the appropriate expertise to determine the fair value, we may choose to use our own calculations of the value. In other cases, where the value is not easily determined, we consult with outside parties to determine the fair value of the identified asset or liability. Once valuations have been adjusted, the net difference between the price paid for the acquired entity and the net value of assets acquired on our balance sheet, including identifiable intangibles, is recorded as goodwill. Acquisition intangibles and goodwill are qualitatively evaluated to determine if it is more likely than not that the carrying balance is impaired on at least an annual basis.

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

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Average Balances, Interest Rate, and Net Interest Income

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

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

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

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Net Interest Income

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

Volume and Rate Variance Analysis

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

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

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

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

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

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

| | Average Yield / Rate for the Three Month Periods Ended: | | | | |
|---|---|---|---|---|---|
| | December 31 2015 | September 30 2015 | June 30 2015 | March 31 2015 | December 31 2014 |
| Total earning assets | 3.73 % | 3.79 % | 3.81 % | 3.88 % | 3.97 % |
| Total interest bearing liabilities | 0.83 % | 0.84 % | 0.84 % | 0.84 % | 0.85 % |
| Net yield on interest earning assets (FTE) | 3.04 % | 3.09 % | 3.11 % | 3.18 % | 3.26 % |

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

Allowance for Loan and Lease Losses

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

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

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

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

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

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

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

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

Loans Past Due and Loans in Nonaccrual Status

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

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

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

Troubled Debt Restructurings

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

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

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

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

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

The following table summarizes our TDRs as of December 31:

| | 2015 | | | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Accruing Interest | Nonaccrual | Total | Accruing Interest | Nonaccrual | Total | Accruing Interest | Nonaccrual | Total |
| Current | $20,550 | $146 | $20,696 | $20,012 | $272 | $20,284 | $21,690 | $1,189 | $22,879 |
| Past due 30-59 days | 357 | — | 357 | 804 | 592 | 1,396 | 2,158 | 37 | 2,195 |
| Past due 60-89 days | 24 | — | 24 | 115 | 3 | 118 | 575 | — | 575 |
| Past due 90 days or more | — | 248 | 248 | — | 1,543 | 1,543 | — | 216 | 216 |
| Total | $20,931 | $394 | $21,325 | $20,931 | $2,410 | $23,341 | $24,423 | $1,442 | $25,865 |

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Accruing Interest | Nonaccrual | Total | Accruing Interest | Nonaccrual | Total |
| Current | $16,301 | $941 | $17,242 | $16,125 | $514 | $16,639 |
| Past due 30-59 days | 158 | 561 | 719 | 1,564 | 344 | 1,908 |
| Past due 60-89 days | 72 | 41 | 113 | 50 | 85 | 135 |
| Past due 90 days or more | — | 1,281 | 1,281 | — | 74 | 74 |
| Total | $16,531 | $2,824 | $19,355 | $17,739 | $1,017 | $18,756 |

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

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Impaired Loans

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

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

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

Nonperforming Assets

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

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

After a loan is 90 days past due, it is placed on nonaccrual status unless it is well secured and in the process of collection. Upon transferring a loan to nonaccrual status, we perform an evaluation to determine the net realizable value of the underlying collateral. This evaluation is used to help determine if any charge-offs are necessary. Loans may be placed back on accrual status after six months months of continued performance. Total nonperforming loans continue to improve with current levels reflecting historic lows.

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

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

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

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

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

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Noninterest Income and Noninterest Expenses

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

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

Significant changes in noninterest income are detailed below:

- ATM and debit card fees increased during 2015 as a result of marketing incentives. While we do not anticipate significant changes to our ATM and debit card fees, we do expect that fees will continue to increase in 2016 as the usage of ATM and debit cards continues to increase.
- NSF and overdraft fees fluctuate from period-to-period based on customer activity as well as the number of business days in the period. We anticipate NSF and overdraft fees in 2016 to approximate 2015 levels.
- Offering rates on residential mortgage loans, as well as the decline in loan demand, have been the most significant drivers behind fluctuations in the gain on sale of mortgage loans and net OMSR income (loss). Mortgage rates are expected to approximate current levels in the foreseeable future and purchase money mortgage activity is anticipated to increase as a result of our various initiatives to drive growth. As such, we anticipate increases in origination volumes and in turn, an increase in gains on sale of mortgage loans.
- We are continually analyzing our AFS securities for potential sale opportunities. These analyses identified several securities that made economic sense to sell in 2015, 2014, and 2013.
- In recent periods, we have invested considerable efforts to increase our market share in trust and brokerage advisory services. These efforts have translated into increases in trust fees and brokerage and advisory fees. We anticipate that these fees will continue to increase in 2016.
- The increase in earnings from our Corporate Settlement Solutions joint venture during 2015 can be attributed to their expansion of national sales and maintaining consistent margins with the increased sales volume.
- The fluctuations in all other income is spread throughout various categories, none of which are individually significant.

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

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

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Significant changes in noninterest expenses are detailed below:

- Employee salaries have increased as a result of normal merit increases and additional staffing required by our continued growth. The decline in employee benefits from 2013 to 2014, is related to health care costs as a result of lower than anticipated claims. Employee benefits are expected to increase moderately in future periods as a result of anticipated increases in health care costs.
- Service contracts include approximately $147 of conversion related costs incurred as a result of two branch acquisitions during the third quarter of 2015.
- FDIC insurance premiums were elevated in 2013 due to us receiving less of a refund for prepaid FDIC insurance premiums than we had anticipated. FDIC insurance premiums have returned to normalized levels and are anticipated to approximate current levels in 2016.
- We have consistently been a strong supporter of the various communities, schools, and charities in the markets we serve. We sponsor a foundation, which we established in 1996, that is funded by discretionary donations. The foundation provides centralized oversight for charitable donations to organizations that benefit our communities. Included in donations and community relations were discretionary donations to the foundation of $258, $500, and $200 for the years ended December 31, 2015, 2014, and 2013, respectively.
- Legal fees include approximately $133 of legal service expense incurred as a result of two branch acquisitions during the third quarter of 2015. Legal fees are expected to approximate 2014 levels in 2016.
- We place a strong emphasis on employee development through continuous education. Education and travel expenses vary from year to year based on the timing of various programs that our employees attend.
- Other losses increased significantly in 2014 primarily as a result of losses related to fraudulent activities associated with debit cards. Also contributing to losses in 2014 were losses related to the repurchase of loans that we previously sold to a third party. While other losses fluctuate from period to period, they are expected to approximate 2015 levels in 2016.
- The fluctuations in all other expenses are spread throughout various categories, none of which are individually significant.

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Analysis of Changes in Financial Condition

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

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

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

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

Cash and cash equivalents

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

AFS investment securities

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

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

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

Excluding those holdings in government sponsored enterprises and municipalities within the State of Michigan, there were no investments in securities of any one issuer that exceeded 10% of shareholders' equity. We have a policy prohibiting investments in securities that we deem are unsuitable due to their inherent credit or market risks. Prohibited investments include stripped mortgage backed securities, zero coupon bonds, nongovernment agency asset backed securities, and structured notes. Our holdings in mortgage-backed securities and collateralized mortgage obligations include only government agencies and government sponsored agencies as we hold no investments in private label mortgage-backed securities or collateralized mortgage obligations.

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

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

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Loans

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

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

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

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

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

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

Equity securities without readily determinable fair values

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

Deposits

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

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

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

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

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

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

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

Borrowed Funds

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

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

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

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

Accrued interest payable and other liabilities

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

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Contractual Obligations and Loan Commitments

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

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

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

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

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

Capital

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

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

The FRB has established minimum risk based capital guidelines. Pursuant to these guidelines, a framework has been established that assigns risk weights to each category of on and off-balance-sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum standard to determine whether a corporation has adequate capital. On July 2, 2013, the FRB published revised BASEL III Capital standards for banks. The final rules redefine what is included or deducted from equity capital, changes risk weighting for certain on and

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

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

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

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

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

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

Fair Value

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

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

Interest Rate Sensitivity

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

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

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

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

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

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

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

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## Liquidity

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

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

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

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

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

## Market Risk

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

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

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

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

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

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

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

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

Gap analysis, the secondary method to measure IRR, measures the cash flows and/or the earliest repricing of our interest bearing assets and liabilities. This analysis is useful for measuring trends in the repricing characteristics of the balance sheet. Significant assumptions are required in this process because of the embedded repricing options contained in assets and liabilities. Residential real estate and consumer loans allow the borrower to repay the balance prior to maturity without penalty, while commercial and agricultural loans have prepayment penalties. The amount of prepayments is dependent upon many factors, including the interest rate of a given loan in comparison to the current offering rates, the level of sales of used homes, and the overall availability of credit in the market place. Generally, a decrease in interest rates will result in an increase in cash flows from these assets. A significant portion of our securities are callable or have prepayment options. The call and prepayment options are more likely to be exercised in a period of decreasing interest rates. Savings and demand accounts may generally be withdrawn on request without prior notice. The timing of cash flows from these deposits is estimated based on historical experience. Certificates of deposit have penalties that discourage early withdrawals.

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

| | December 31, 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | Thereafter | Total | Fair Value |
| Rate sensitive assets | | | | | | | | |
| Other interest bearing assets | $2,659 | $100 | $— | $— | $— | $— | $2,759 | $2,758 |
| Average interest rates | 0.23 % | 0.35 % | — | — | — | — | 0.24 % | |
| AFS securities | $148,692 | $120,692 | $81,726 | $73,541 | $71,083 | $164,402 | $660,136 | $660,136 |
| Average interest rates | 2.16 % | | | | | | | |