ISABELLA BANK CORP
Form 10-Q
May 04, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 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 N. Main St, Mt. Pleasant, MI	48858
(Address of principal executive offices)	(Zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ý Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ý Yes ¨ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ý
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 number of common shares outstanding of the registrant's Common Stock (no par value) was 7,789,803 as of April 30, 2015.

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

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

The acronyms and abbreviations identified below may be used throughout this Quarterly Report on Form 10-Q, or in our other 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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PART I – FINANCIAL INFORMATION
Item 1. Interim Condensed Consolidated Financial Statements (Unaudited)
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	March 31 2015	December 31 2014
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	$19,243	$18,058
Interest bearing balances due from banks	1,354	1,268
Total cash and cash equivalents	20,597	19,326
Certificates of deposit held in other financial institutions	580	580
AFS securities (amortized cost of $595,211 in 2015 and $561,893 in 2014)	605,208	567,534
Mortgage loans AFS	1,057	901
Loans		
Commercial	418,311	431,961
Agricultural	107,299	104,721
Residential real estate	257,516	264,595
Consumer	32,342	32,305
Gross loans	815,468	833,582
Less allowance for loan and lease losses	9,600	10,100
Net loans	805,868	823,482
Premises and equipment	26,170	25,881
Corporate owned life insurance policies	25,839	25,152
Accrued interest receivable	6,798	5,851
Equity securities without readily determinable fair values	20,049	20,076
Goodwill and other intangible assets	46,090	46,128
Other assets	13,319	14,632
TOTAL ASSETS	$1,571,575	$1,549,543
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$176,160	$181,826
NOW accounts	197,364	190,984
Certificates of deposit under $100 and other savings	478,590	456,774
Certificates of deposit over $100	246,541	244,900
Total deposits	1,098,655	1,074,484
Borrowed funds	283,321	289,709
Accrued interest payable and other liabilities	9,946	10,756
Total liabilities	1,391,922	1,374,949
Shareholders' equity		
Common stock — no par value 15,000,000 shares authorized; issued and outstanding 7,781,820 shares (including 11,385 shares held in the Rabbi Trust) in 2015 and 7,776,274 shares (including 13,934 shares held in the Rabbi Trust) in 2014	138,903	138,755
Shares to be issued for deferred compensation obligations	4,265	4,242
Retained earnings	34,001	32,103
Accumulated other comprehensive income (loss)	2,484	(506)
Total shareholders' equity	179,653	174,594
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,571,575	$1,549,543

See notes to interim condensed consolidated financial statements.

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

	Three Months Ended March 31	
	2015	2014
Interest income		
Loans, including fees	$9,684	$9,751
AFS securities		
Taxable	2,107	1,998
Nontaxable	1,482	1,457
Trading securities	—	5
Federal funds sold and other	139	153
Total interest income	13,412	13,364
Interest expense		
Deposits	1,466	1,616
Borrowings	1,022	884
Total interest expense	2,488	2,500
Net interest income	10,924	10,864
Provision for loan losses	(726)	(242)
Net interest income after provision for loan losses	11,650	11,106
Noninterest income		
Service charges and fees	1,163	1,394
Net gain on sale of mortgage loans	149	115
Earnings on corporate owned life insurance policies	187	184
Other	629	556
Total noninterest income	2,128	2,249
Noninterest expenses		
Compensation and benefits	5,425	5,486
Furniture and equipment	1,314	1,268
Occupancy	721	742
Other	1,874	1,990
Total noninterest expenses	9,334	9,486
Income before federal income tax expense	4,444	3,869
Federal income tax expense	771	560
NET INCOME	$3,673	$3,309
Earnings per common share		
Basic	$0.47	$0.43
Diluted	$0.46	$0.42
Cash dividends per common share	$0.23	$0.22

See notes to interim condensed consolidated financial statements.

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

	Three Months Ended March 31	
	2015	2014
Net income	$3,673	$3,309
Unrealized gains (losses) on AFS securities arising during the period	4,356	5,520
Tax effect (1)	(1,366)	(1,739)
Other comprehensive income (loss), net of tax	2,990	3,781
Comprehensive income (loss)	$6,663	$7,090

(1) See “Note 11 – Accumulated Other Comprehensive Income (Loss)” for tax effect reconciliation.

See notes to interim condensed consolidated financial statements.

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

	Common Stock					
	Common Shares Outstanding	Amount	Common Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Totals
Balance, January 1, 2014	7,723,023	$137,580	$4,148	$25,222	$(6,341)	$160,609
Comprehensive income (loss)	—	—	—	3,309	3,781	7,090
Issuance of common stock	35,814	850	—	—	—	850
Common stock issued for deferred compensation obligations	6,125	143	(143)	—	—	—
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	250	(250)	—	—	—
Share-based payment awards under equity compensation plan	—	—	137	—	—	137
Common stock purchased for deferred compensation obligations	—	(126)	—	—	—	(126)
Common stock repurchased pursuant to publicly announced repurchase plan	(37,415)	(893)	—	—	—	(893)
Cash dividends paid ($0.22 per common share)	—	—	—	(1,696)	—	(1,696)
Balance, March 31, 2014	7,727,547	$137,804	$3,892	$26,835	$(2,560)	$165,971
Balance, January 1, 2015	7,776,274	$138,755	$4,242	$32,103	$(506)	$174,594
Comprehensive income (loss)	—	—	—	3,673	2,990	6,663
Issuance of common stock	41,217	945	—	—	—	945
Common stock issued for deferred compensation obligations	—	—	—	—	—	—
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	123	(123)	—	—	—
Share-based payment awards under equity compensation plan	—	—	146	—	—	146
Common stock purchased for deferred compensation obligations	—	(100)	—	—	—	(100)
Common stock repurchased pursuant to publicly announced repurchase plan	(35,671)	(820)	—	—	—	(820)
	—	—	—	(1,775)	—	(1,775)

Cash dividends paid ($0.23 per common share)						
Balance, March 31, 2015	7,781,820	$138,903	$ 4,265	$34,001	$ 2,484	$179,653

See notes to interim condensed consolidated financial statements.

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

	Three Months Ended March 31	
	2015	2014
OPERATING ACTIVITIES		
Net income	$3,673	$3,309
Reconciliation of net income to net cash provided by operating activities:		
Provision for loan losses	(726)	(242)
Impairment of foreclosed assets	—	43
Depreciation	654	619
Amortization of OMSR	70	68
Amortization of acquisition intangibles	38	48
Net amortization of AFS securities	478	457
Net unrealized (gains) losses on trading securities	—	4
Net gain on sale of mortgage loans	(149)	(115)
Increase in cash value of corporate owned life insurance policies	(187)	(184)
Share-based payment awards under equity compensation plan	146	137
Origination of loans held-for-sale	(11,209)	(5,364)
Proceeds from loan sales	11,202	6,094
Net changes in operating assets and liabilities which provided (used) cash:		
Accrued interest receivable	(947)	(1,283)
Other assets	(264)	(272)
Accrued interest payable and other liabilities	(810)	(507)
Net cash provided by (used in) operating activities	1,969	2,812
INVESTING ACTIVITIES		
Activity in AFS securities		
Maturities, calls, and principal repayments	14,419	11,096
Purchases	(48,215)	(49,115)
Net loan principal (originations) collections	18,206	(856)
Proceeds from sales of foreclosed assets	302	567
Purchases of premises and equipment	(943)	(909)
Purchases of corporate owned life insurance policies	(500)	—
Net cash provided by (used in) investing activities	(16,731)	(39,217)

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

	Three Months Ended March 31	
	2015	2014
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	$24,171	$22,169
Net increase (decrease) in borrowed funds	(6,388)	(6,790)
Cash dividends paid on common stock	(1,775)	(1,696)
Proceeds from issuance of common stock	945	850
Common stock repurchased	(820)	(893)
Common stock purchased for deferred compensation obligations	(100)	(126)
Net cash provided by (used in) financing activities	16,033	13,514
Increase (decrease) in cash and cash equivalents	1,271	(22,891)
Cash and cash equivalents at beginning of period	19,326	41,558
Cash and cash equivalents at end of period	$20,597	$18,667
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	$2,462	$2,547
Federal income taxes paid	1,393	552
SUPPLEMENTAL NONCASH INFORMATION:		
Transfers of loans to foreclosed assets	$134	$324

See notes to interim condensed consolidated financial statements.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share amounts)
Note 1 – Basis of Presentation
As used in these notes as well as in Management's Discussion and Analysis of Financial Condition and Results of Operations, references to “Isabella,” “we,” “our,” “us,” and similar terms refer to the consolidated entity consisting of Isabella Bank Corporation and its subsidiaries. Isabella Bank Corporation refers solely to the parent holding company, and Isabella Bank refers to Isabella Bank Corporation’s subsidiary, Isabella Bank.
The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014.
Our accounting policies are materially the same as those discussed in Note 1 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2014.
Note 2 – Computation of Earnings Per Common Share
Basic earnings per common share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate solely to outstanding shares in the Directors Plan.
Earnings per common share have been computed based on the following:

	Three Months Ended March 31	
	2015	2014
Average number of common shares outstanding for basic calculation	7,773,428	7,721,254
Average potential effect of common shares in the Directors Plan (1)	177,001	173,279
Average number of common shares outstanding used to calculate diluted earnings per common share	7,950,429	7,894,533
Net income	$3,673	$3,309
Earnings per common share		
Basic	$0.47	$0.43
Diluted	$0.46	$0.42

(1) Exclusive of shares held in the Rabbi Trust
Note 3 – Accounting Standards Updates
Recent Adopted Accounting Standards Updates
ASU No. 2014-04: “Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)”
In January 2014, ASU No. 2014-04 amended ASC Topic 310, "Receivables" to provide clarification as to when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. Specifically, the amendment defines physical possession to appropriately derecognize the loan and recognize the real estate as OREO. The adoption of this ASU did not have a significant impact on our operations.
ASU No. 2014-11: “Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures”
In June 2014, ASU No. 2014-11 amended ASC Topic 860, “Transfers and Servicing” to address concerns that current accounting guidance distinguishes between repurchase agreements that settle at the same time as the maturity of the transferred

financial asset and those that settle any time before maturity. The update changes the accounting for repurchase-to-maturity transactions to secured borrowing accounting and, for repurchase financing arrangements, separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The adoption of this ASU did not have a significant impact on our operations.

Pending Accounting Standards Updates

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

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

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

In February 2015, ASU No. 2015-02 amended ASC Topic 810, "Consolidation" to provide consolidation guidance on legal entities when the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments:

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

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

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

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

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Note 4 – AFS Securities

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

	March 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$24,561	$11	$175	$24,397
States and political subdivisions	215,108	8,001	630	222,479
Auction rate money market preferred	3,200	—	425	2,775
Preferred stocks	6,800	47	523	6,324
Mortgage-backed securities	200,141	2,675	819	201,997
Collateralized mortgage obligations	145,401	2,394	559	147,236
Total	$595,211	$13,128	$3,131	$605,208

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$24,597	$10	$471	$24,136
States and political subdivisions	209,153	6,986	794	215,345
Auction rate money market preferred	3,200	—	581	2,619
Preferred stocks	6,800	31	691	6,140
Mortgage-backed securities	165,888	2,042	1,004	166,926
Collateralized mortgage obligations	152,255	1,533	1,420	152,368
Total	$561,893	$10,602	$4,961	$567,534

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

	Maturing				Securities with Variable Monthly Payments or Noncontractual Maturities	Total
	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years		
Government sponsored enterprises	$—	$19,068	$5,493	$—	$ —	$24,561
States and political subdivisions	15,087	59,213	94,106	46,702	—	215,108
Auction rate money market preferred	—	—	—	—	3,200	3,200
Preferred stocks	—	—	—	—	6,800	6,800
Mortgage-backed securities	—	—	—	—	200,141	200,141
Collateralized mortgage obligations	—	—	—	—	145,401	145,401
Total amortized cost	$15,087	$78,281	$99,599	$46,702	$ 355,542	$595,211
Fair value	$15,133	$80,404	$103,432	$47,907	$ 358,332	$605,208

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

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

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Information pertaining to AFS securities with gross unrealized losses at March 31, 2015 and December 31, 2014, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	March 31, 2015				
	Less Than Twelve Months		Twelve Months or More		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Government sponsored enterprises	$—	$—	$175	$23,822	$175
States and political subdivisions	103	12,496	527	3,346	630
Auction rate money market preferred	—	—	425	2,775	425
Preferred stocks	—	—	523	3,277	523
Mortgage-backed securities	53	9,772	766	41,873	819
Collateralized mortgage obligations	26	11,973	533	30,389	559
Total	$182	$34,241	$2,949	$105,482	$3,131
Number of securities in an unrealized loss position:		35		28	63

	December 31, 2014				
	Less Than Twelve Months		Twelve Months or More		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Government sponsored enterprises	$—	$—	$471	$23,525	$471
States and political subdivisions	48	5,323	746	17,416	794
Auction rate money market preferred	—	—	581	2,619	581
Preferred stocks	—	—	691	3,109	691
Mortgage-backed securities	5	9,456	999	52,407	1,004
Collateralized mortgage obligations	105	29,435	1,315	39,540	1,420
Total	$158	$44,214	$4,803	$138,616	$4,961
Number of securities in an unrealized loss position:		22		72	94

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

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

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

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Note 5 – Loans and ALLL

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

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

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

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

For impaired loans not classified as nonaccrual, interest income continues to be accrued over the term of the loan based on the principal amount outstanding.

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

We offer adjustable rate mortgages, construction loans, and fixed rate residential real estate loans which typically have amortization periods up to a maximum of 30 years. Fixed rate residential real estate loans with an amortization of greater than 15 years are generally sold upon origination to Freddie Mac. Fixed rate residential real estate loans with an amortization of 15 years or less may be held in our portfolio or sold to Freddie Mac upon origination. We consider the direction of interest rates, the sensitivity of our balance sheet to changes in interest rates, and overall loan demand to determine whether or not to sell these loans to Freddie Mac.

Our lending policies generally limit the maximum loan-to-value ratio on residential real estate loans to 95% of the lower of the appraised value of the property or the purchase price, with the condition that private mortgage insurance is required on loans with loan-to-value ratios in excess of 80%. Substantially all loans upon origination have a loan to value ratio of less than 80%. Underwriting criteria for residential real estate loans include: evaluation of the borrower’s ability to make monthly payments, the value of the property securing the loan, ensuring the payment of principal, interest, taxes, and hazard insurance does not exceed 28% of a borrower’s gross income, all debt servicing does not exceed 36% of income, acceptable credit reports, verification of employment, income, and financial information. Appraisals are performed by independent appraisers and reviewed internally. All mortgage loan requests are reviewed by our mortgage loan committee or through a secondary market automated underwriting system; loans in excess of $500 require the approval of our Internal Loan Committee, the Executive Loan Committee, the Board of Directors’

Loan Committee, or the Board of Directors.

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

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

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

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

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

	Allowance for Loan Losses Three Months Ended March 31, 2015					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2015	$3,823	$216	$4,238	$645	$1,178	$10,100
Charge-offs	(17)	—	(50)	(93)	—	(160)
Recoveries	213	72	33	68	—	386
Provision for loan losses	(209)	(82)	(492)	91	(34)	(726)
March 31, 2015	$3,810	$206	$3,729	$711	$1,144	$9,600

	Allowance for Loan Losses and Recorded Investment in Loans March 31, 2015					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	$1,349	$—	$2,011	$1	$—	$3,361
Collectively evaluated for impairment	2,461	206	1,718	710	1,144	6,239
Total	$3,810	$206	$3,729	$711	$1,144	$9,600
Loans						
Individually evaluated for impairment	$10,786	$1,566	$12,066	$50		$24,468
Collectively evaluated for impairment	407,525	105,733	245,450	32,292		791,000
Total	$418,311	$107,299	$257,516	$32,342		$815,468

	Allowance for Loan Losses Three Months Ended March 31, 2014					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2014	$6,048	$434	$3,845	$639	$534	$11,500
Charge-offs	(192)	(31)	(113			