

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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

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

For the transition period from _____ to _____
Commission File Number: 0-18415

Isabella Bank Corporation
(Exact name of registrant as specified in its charter)
Michigan 38-2830092
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) identification No.)
401 North Main Street, Mount Pleasant, Michigan 48858
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code (989) 772-9471
Securities registered pursuant to Section 12(b) of the Act:
Title of each class Name of each exchange on which registered
Securities registered pursuant to Section 12(g) of the Act:
Common Stock - No Par Value
(Title of Class)

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

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Edgar Filing: ISABELLA BANK CORP - Form 10-K

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$218,637,000 as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of common shares outstanding of the registrant's Common Stock (no par value) was 7,831,404 as of March 3, 2017.

DOCUMENTS INCORPORATED BY REFERENCE

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

Documents Part of Form 10-K
Incorporated into

Portions of the Isabella Bank Corporation Proxy Statement for its Annual Meeting of Shareholders to be held May 2, 2017 Part III

Table of Contents

ISABELLA BANK CORPORATION
ANNUAL REPORT ON FORM 10-K

Table of Contents

PART I

Item 1.	<u>Business</u>	4
Item 1A.	<u>Risk Factors</u>	6
Item 1B.	<u>Unresolved Staff Comments</u>	9
Item 2.	<u>Properties</u>	9
Item 3.	<u>Legal Proceedings</u>	9
Item 4.	<u>Mine Safety Disclosures</u>	9

PART II

Item 5.	<u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	10
Item 6.	<u>Selected Financial Data</u>	12
Item 7.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	14
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	36
Item 8.	<u>Financial Statements and Supplementary Data</u>	36
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	87
Item 9A.	<u>Controls and Procedures</u>	87
Item 9B.	<u>Other Information</u>	88

PART III

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	89
Item 11.	<u>Executive Compensation</u>	89
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	89
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	90
Item 14.	<u>Principal Accountant Fees and Services</u>	90

PART IV		<u>91</u>
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	<u>91</u>
Item 16.	<u>Form 10-K Summary</u>	<u>92</u>
SIGNATURES		<u>93</u>

Table of Contents

Forward Looking Statements

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

Glossary of Acronyms and Abbreviations

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

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

Edgar Filing: ISABELLA BANK CORP - Form 10-K

FDIC: Federal Deposit Insurance Corporation

FFIEC: Federal Financial Institutions Examinations Council

FRB: Federal Reserve Bank

FHLB: Federal Home Loan Bank

Freddie Mac: Federal Home Loan Mortgage Corporation

FTE: Fully taxable equivalent

PCAOB: Public Company Accounting Oversight Board

Rabbi Trust: A trust established to fund the Directors Plan

SEC: U.S. Securities & Exchange Commission

SOX: Sarbanes-Oxley Act of 2002

TDR: Troubled debt restructuring

XBRL: eXtensible Business Reporting Language

Table of Contents

PART I

Item 1. Business. (Dollars in thousands)

General

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

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

Our reportable segments are based on legal entities that account for at least 10% of net operating results. Retail banking operations for 2016, 2015, and 2014 represent approximately 90% or greater of total assets and operating results. As such, we have only one reportable segment.

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

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

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

As of December 31, 2016, we had 372 full-time equivalent employees. We provide group life, health, accident, disability, and other insurance programs as well as a number of other employee benefit programs. None of our workforce is subject to collective bargaining agreements.

Available Information

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

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

Supervision and Regulation

The earnings and growth of the banking industry and, therefore, our earnings are affected by the credit policies of monetary authorities, including the FRB. An important function of the FRB is to regulate the national supply of bank credit in order to combat recessions and respond to inflationary pressures. Among the instruments of monetary policy used by the FRB to implement these objectives are open market operations in U.S. Treasury and U.S. Government Agency securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These methods are used in varying combinations to influence overall growth of bank loans, investments and deposits and also affect interest rates charged on loans or paid for deposits. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks and related financial service providers in the past and are expected to continue to do so in the future. The effect of such policies upon our

future business and earnings cannot be predicted.

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

4

Table of Contents

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

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

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

SOX contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with Section 302(a) of SOX, written certifications by our principal executive, financial, and accounting officers are required. These certifications attest that our quarterly and annual reports filed with the SEC do not contain any untrue statement of a material fact (see the certifications filed as Exhibits 31 (a) and (b) to this Form 10-K for such certification of consolidated financial statements and other information for this 2016 Form 10-K). We have also implemented a program designed to comply with Section 404 of SOX, which included the identification of significant processes and accounts, documentation of the design of control effectiveness over process and entity level controls, and testing of the operating effectiveness of key controls. See Item 9A. Controls and Procedures for our evaluation of disclosure controls and procedures and internal control over financial reporting.

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

Isabella Bank

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

Our deposits are insured up to applicable limits by the DIF of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC assesses insurance premiums based upon a financial ratios method that takes into account assets and capital levels and supervisory ratings.

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

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

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

Table of Contents

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

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

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

Item 1A. Risk Factors.

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

Our enterprise risk process covers each of the following areas.

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

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

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

Changes in economic conditions

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

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

Interest rate risk

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

Table of Contents

Liquidity risk

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

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

Operational risk

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

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

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

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

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

We may not adjust to changes in the financial services industry

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

We may be required to recognize an impairment of goodwill

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

Table of Contents

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

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

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

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

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

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

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

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

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

Our estimates and assumptions may be incorrect

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

Disruption of infrastructure

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

Anti-takeover provisions

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

Table of Contents

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our executive offices are located at 401 North Main Street in Mount Pleasant, Michigan. In addition to this location, we own 29 branches, an operations center, a mortgage operations center, and our previous main office building. We also lease property in Saginaw, Michigan which serves as a loan production office. Our facilities' current, planned, and best use is for conducting our current activities, with the exception of approximately 75% of our previous main office location. We continually monitor and assess the need for expansion and/or improvement for all facilities. In our opinion, each facility has sufficient capacity and is in good condition.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

Table of Contents

PART II

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

Common Stock and Dividend Information

Our authorized common stock consists of 15,000,000 shares, of which 7,821,069 shares are issued and outstanding as of December 31, 2016. As of that date, there were 3,082 shareholders of record.

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

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

	Number of Common Shares	Sale Price Low	High
2016			
First Quarter	81,184	\$27.25	\$29.90
Second Quarter	47,680	27.63	28.25
Third Quarter	71,614	27.60	28.08
Fourth Quarter	53,496	27.60	28.35
	253,974		
2015			
First Quarter	81,754	\$22.00	\$23.50
Second Quarter	94,019	22.70	23.80
Third Quarter	143,183	22.75	23.85
Fourth Quarter	109,276	23.50	29.90
	428,232		

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

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

We have adopted and publicly announced a common stock repurchase plan. The plan was last amended on December 21, 2016, to allow for the repurchase of an additional 200,000 shares of common stock after that date. These authorizations do not have expiration dates. As shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued shares.

Table of Contents

The following table provides information for the unaudited three month period ended December 31, 2016, with respect to our common stock repurchase plan:

	Common Shares Repurchased	Average Price Per Common Share	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
Balance, September 30				60,575
October 1 - 31	19,538	\$ 27.79	19,538	41,037
November 1 - 30	19,821	27.80	19,821	21,216
December 1-21	11,659	28.13	11,659	9,557
Additional Authorization (200,000 shares)				209,557
December 22 - 31	9,600	28.02	9,600	199,957
Balance, December 31	60,618	\$ 27.90	60,618	199,957

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

Stock Performance

The following graph compares the cumulative total shareholder return on our common stock for the last five years with the cumulative total return on (1) NASDAQ, which is comprised of all United States common shares traded on the NASDAQ and (2) the NASDAQ Banks, which is comprised of bank and bank holding company common shares traded on the NASDAQ over the same period. The graph assumes the value of an investment in the Corporation's common stock and each index was \$100 at December 31, 2011 and all dividends are reinvested.

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

Table of Contents

Item 6. Selected Financial Data.

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

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

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

Edgar Filing: ISABELLA BANK CORP - Form 10-K

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

* At end of year

12

Table of Contents

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

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

* At end of period

Table of Contents

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

ISABELLA BANK CORPORATION FINANCIAL REVIEW

(Dollars in thousands except per share amounts)

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

Executive Summary

We reported net income of \$13,799 and earnings per common share of \$1.77 for the year ended December 31, 2016. Our earnings have primarily been the result of increased interest income driven by outstanding loan growth during 2016. Our strong credit quality resulted in a decline in the level of the ALLL in both amount and as a percentage of gross loans, resulting in a reversal of provision for loan losses of \$135 for the year ended December 31, 2016. Net loan recoveries during 2016 were \$135 as compared to net loan recoveries of \$71 in 2015.

During the year, total assets grew by 3.84% to \$1,732,151, and assets under management increased to \$2,432,726 which includes loans sold and serviced and assets managed by our Investment and Trust Services Department of \$700,575. In 2016, we had total loan growth of \$160,123 which was driven by commercial and agricultural loan growth of \$137,864. Also contributing to this growth in 2016 were increases in both residential real estate and consumer loans of \$22,259.

Our net yield on interest earning assets of 3.00% remains at historically low levels. While the FRB increased short term interest rates in December 2016 and projects increases in 2017, we do not anticipate significant improvements in our net yield on interest earning assets as the rates paid on interest bearing liabilities will likely increase faster than those of interest earning assets. Net interest income will increase only through continued strategic growth in loans, investments, and other income earning assets. We are committed to increasing earnings and shareholder value through growth in our loan portfolio, growth in our investment and trust services, and increasing our geographical presence while managing operating costs.

Recent Legislation

The Health Care and Education Act of 2010, the Patient Protection and Affordable Care Act, the Dodd-Frank Act, and the JOBS Act, have already had, and are expected to continue to have, a negative impact on our operating results. Of these four acts, the Dodd-Frank Act has had the most significant impact. The Dodd-Frank Act established the CFPB which has made significant changes in the regulation of financial institutions aimed at strengthening the oversight of the federal government over the operation of the financial services sector and increasing the protection of consumers. New regulations issued by the CFPB regarding consumer lending, including residential mortgage lending, have increased our compensation and outside advisor costs and this trend is expected to continue.

On July 2, 2013, the FRB published revised BASEL III Capital standards for banks. The rules redefine what is included or deducted from equity capital, changes risk weighting for certain on and off-balance sheet assets, increases the minimum required equity capital to be considered well capitalized, and introduces a capital cushion buffer. The rules, which will be gradually phased in between 2015 and 2019, are not expected to have a material impact on the Corporation but will require us to hold more capital than we have historically.

Reclassifications

Certain amounts reported in management's discussion and analysis of financial condition and results of operations for 2015 and 2014 have been reclassified to conform with the 2016 presentation.

Other

We have not received any notices of regulatory actions as of February 23, 2017.

Table of Contents

CRITICAL ACCOUNTING POLICIES

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

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

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

AFS securities are carried at fair value with changes in the fair value included as a component of other comprehensive income. Declines in the fair value of AFS securities below their cost that are other-than-temporary are reflected as realized losses in the consolidated statements of income. We evaluate AFS securities for indications of losses that are considered other-than-temporary, if any, on a regular basis. The market values for most AFS investment securities are typically obtained from outside sources and applied to individual securities within the portfolio. Municipal securities for which no readily determinable market values are available are priced using fair value curves which most closely match the security's credit ratings and maturities.

Table of Contents

Average Balances, Interest Rate, and Net Interest Income

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

	Year Ended December 31								
	2016			2015			2014		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS									
Loans	\$922,333	\$ 38,537	4.18 %	\$829,903	\$ 35,853	4.32 %	\$816,105	\$ 36,629	4.49 %
Taxable investment securities	392,810	8,746	2.23 %	395,981	9,053	2.29 %	357,250	8,092	2.27 %
Nontaxable investment securities	205,450	9,351	4.55 %	205,242	9,870	4.81 %	194,751	9,877	5.07 %
Other	25,557	668	2.61 %	25,947	600	2.31 %	25,784	519	2.01 %
Total earning assets	1,546,150	57,302	3.71 %	1,457,073	55,376	3.80 %	1,393,890	55,117	3.95 %
NONEARNING ASSETS									
Allowance for loan losses	(7,638)			(9,275)			(10,973)		
Cash and demand deposits due from banks	18,178			17,925			18,552		
Premises and equipment	28,670			26,968			25,957		
Accrued income and other assets	101,995			98,805			94,754		
Total assets	\$1,687,355			\$1,591,496			\$1,522,180		
INTEREST BEARING LIABILITIES									
Interest bearing demand deposits	\$203,198	163	0.08 %	\$195,260	155	0.08 %	\$191,750	157	0.08 %
Savings deposits	336,859	663	0.20 %	293,703	449	0.15 %	260,469	374	0.14 %
Time deposits	429,731	5,010	1.17 %	433,409	5,246	1.21 %	448,971	5,764	1.28 %
Borrowed funds	319,049	5,029	1.58 %	295,641	4,313	1.46 %	274,080	3,675	1.34 %
Total interest bearing liabilities	1,288,837	10,865	0.84 %	1,218,013	10,163	0.83 %	1,175,270	9,970	0.85 %
NONINTEREST BEARING LIABILITIES									
Demand deposits	194,892			181,939			165,860		
Other	9,841			10,001			10,773		
Shareholders' equity	193,785			181,543			170,277		

Edgar Filing: ISABELLA BANK CORP - Form 10-K

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

16

Table of Contents

Net Interest Income

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

Volume and Rate Variance Analysis

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

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

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

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

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

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

	Average Yield / Rate for the Three Month Periods							
	Ended:							
	December 31	September 30	June 30	March 31	December 31	September 30	June 30	March 31
	2016	2016	2016	2016	2015	2015	2015	2015
Total earning assets	3.73 %	3.76 %	3.66 %	3.67 %	3.73 %	3.73 %	3.73 %	3.73 %
Total interest bearing liabilities	0.87 %	0.86 %	0.83 %	0.82 %	0.83 %	0.83 %	0.83 %	0.83 %
Net yield on interest earning assets (FTE)	3.01 %	3.05 %	2.97 %	2.98 %	3.04 %	3.04 %	3.04 %	3.04 %

Table of Contents

Quarter to Date Net Interest Income (FTE)

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

Allowance for Loan and Lease Losses

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

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

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

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

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

Table of Contents

As the level of net loans charged-off declines and credit quality indicators remain stable, we have reduced the ALLL in both amount and as a percentage of loans. While they can be more volatile, loans individually evaluated for impairment have been steadily declining since December 31, 2015. The decline in loans collectively impaired illustrates the downward trend we are experiencing in our overall level of ALLL to gross loans. The following table illustrates our changes within the two main components of the ALLL.

	December 31 2016	September 30 2016	June 30 2016	March 31 2016	December 31 2015	
ALLL						
Individually evaluated for impairment	\$ 2,371	\$ 2,523	\$2,602	\$2,731	\$ 2,820	
Collectively evaluated for impairment	5,029	5,277	4,998	4,769	4,580	
Total	\$ 7,400	\$ 7,800	\$7,600	\$7,500	\$ 7,400	
ALLL to gross loans						
Individually evaluated for impairment	0.23	% 0.26	% 0.28	% 0.31	% 0.33	%
Collectively evaluated for impairment	0.50	% 0.53	% 0.55	% 0.55	% 0.54	%
Total	0.73	% 0.79	% 0.83	% 0.86	% 0.87	%

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

Loans Past Due and Loans in Nonaccrual Status

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

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

Past due and nonaccrual status loans continue to be below historical norms and are the result of improved loan performance. A summary of loans past due and in nonaccrual status, including the composition of the ending balance of nonaccrual status loans by type, is included in “Note 5 – Loans and ALLL” of the “Notes to Consolidated Financial Statements” in Item 8. Financial Statements and Supplemental