ISABELLA BANK CORP
Form 10-Q
August 08, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended June 30, 2012

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 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. x Yes ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of accelerated filer , large accelerated filer , and smaller reporting company , in

Rule 12b-2 of the Exchange Act (Check One).

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock no par value, 7,617,345 as of July 23, 2012

ISABELLA BANK CORPORATION

QUARTERLY REPORT ON FORM 10-Q

Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION

Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	June 30, 2012	December 31 2011
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	$ 19,492	$ 24,514
Interest bearing balances due from banks	759	4,076
Total cash and cash equivalents	**20,251**	**28,590**
Certificates of deposit held in other financial institutions	6,880	8,924
Trading securities	1,998	4,710
Available-for-sale securities (amortized cost of $464,931 in 2012 and $414,614 in 2011)	476,935	425,120
Mortgage loans available-for-sale	2,347	3,205
Loans		
Agricultural	81,222	74,645
Commercial	368,371	365,714
Consumer	31,357	31,572
Residential real estate	274,002	278,360
Total loans	**754,952**	**750,291**
Less allowance for loan losses	12,318	12,375
Net loans	**742,634**	**737,916**
Premises and equipment	24,729	24,626
Corporate owned life insurance	22,423	22,075
Accrued interest receivable	5,217	5,848
Equity securities without readily determinable fair values	17,708	17,189
Goodwill and other intangible assets	46,659	46,792
Other assets	13,715	12,930
TOTAL ASSETS	**$ 1,381,496**	**$ 1,337,925**
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 124,230	$ 119,072
NOW accounts	163,000	163,653
Certificates of deposit under $100 and other savings	450,159	440,123
Certificates of deposit over $100	241,439	235,316
Total deposits	**978,828**	**958,164**
Borrowed funds ($0 in 2012 and $5,242 in 2011 at fair value)	234,132	216,136
Accrued interest payable and other liabilities	8,681	8,842
Total liabilities	**1,221,641**	**1,183,142**
Shareholders equity		

Common stock no par value		
15,000,000 shares authorized; issued and outstanding 7,602,545 shares (including 19,990 shares held in the Rabbi Trust) in 2012 and 7,589,226 shares (including 16,585 shares held in the Rabbi Trust) in 2011	134,931	134,734
Shares to be issued for deferred compensation obligations	4,724	4,524
Retained earnings	16,240	13,036
Accumulated other comprehensive income	3,960	2,489
Total shareholders equity	**159,855**	**154,783**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,381,496**	**$ 1,337,925**

See notes to interim condensed consolidated financial statements.

Table of Contents

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Dollars in thousands except per share data)

	Common Stock Shares Outstanding	Common Stock	Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Totals
Balance, January 1, 2011	**7,550,074**	**$ 133,592**	**$ 4,682**	**$ 8,596**	**$ (1,709)**	**$ 145,161**
Comprehensive income				4,988	3,722	8,710
Issuance of common stock	61,218	1,346				1,346
Common stock issued for deferred compensation obligations	14,842	266	(254)			12
Share based payment awards under equity compensation plan			307			307
Common stock purchased for deferred compensation obligations		(227)				(227)
Common stock repurchased pursuant to publicly announced repurchase plan	(50,458)	(914)				(914)
Cash dividends ($0.38 per share)				(2,881)		(2,881)
Balance, June 30, 2011	**7,575,676**	**$ 134,063**	**$ 4,735**	**$ 10,703**	**$ 2,013**	**$ 151,514**
Balance, January 1, 2012	**7,589,226**	**$ 134,734**	**$ 4,524**	**$ 13,036**	**$ 2,489**	**$ 154,783**
Comprehensive income				6,238	1,471	7,709
Issuance of common stock	54,900	1,322				1,322
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations		95	(95)			
Share based payment awards under equity compensation plan			295			295
Common stock purchased for deferred compensation obligations		(225)				(225)
Common stock repurchased pursuant to publicly announced repurchase plan	(41,581)	(995)				(995)
Cash dividends ($0.40 per share)				(3,034)		(3,034)
Balance, June 30, 2012	**7,602,545**	**$ 134,931**	**$ 4,724**	**$ 16,240**	**$ 3,960**	**$ 159,855**

See notes to interim condensed consolidated financial statements.

Table of Contents

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share data)

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest income				
Loans, including fees	$ 10,849	$ 11,464	$ 21,789	$ 22,825
Investment securities				
Taxable	1,988	1,836	3,877	3,349
Nontaxable	1,216	1,189	2,420	2,368
Trading account securities	22	47	64	98
Federal funds sold and other	113	133	242	267
Total interest income	**14,188**	**14,669**	**28,392**	**28,907**
Interest expense				
Deposits	2,368	2,776	4,880	5,561
Borrowings	1,061	1,325	2,253	2,593
Total interest expense	**3,429**	**4,101**	**7,133**	**8,154**
Net interest income	**10,759**	**10,568**	**21,259**	**20,753**
Provision for loan losses	439	603	900	1,420
Net interest income after provision for loan losses	**10,320**	**9,965**	**20,359**	**19,333**
Noninterest income				
Service charges and fees	1,628	1,617	3,257	3,093
Gain on sale of mortgage loans	279	53	658	182
Net loss on trading securities	(16)	(8)	(32)	(27)
Net gain on borrowings measured at fair value		37	33	117
Gain on sale of available-for-sale investment securities			1,003	
Other	653	279	1,166	561
Total noninterest income	**2,544**	**1,978**	**6,085**	**3,926**
Noninterest expenses				
Compensation and benefits	5,232	4,746	10,533	9,751
Occupancy	599	613	1,240	1,259
Furniture and equipment	1,170	1,127	2,260	2,233
Other	2,187	2,293	4,446	4,123
Available-for-sale impairment loss				
Total other-than-temporary impairment loss			486	
Portion of loss reported in other comprehensive income			(204)	
Net available-for-sale impairment loss			282	
Total noninterest expenses	**9,188**	**8,779**	**18,761**	**17,366**
Income before federal income tax expense	**3,676**	**3,164**	**7,683**	**5,893**
Federal income tax expense	672	492	1,445	905

NET INCOME	**$ 3,004**	**$ 2,672**	**$ 6,238**	**$ 4,988**
Earnings per share				
Basic	**$ 0.40**	**$ 0.35**	**$ 0.82**	**$ 0.66**
Diluted	**$ 0.39**	**$ 0.34**	**$ 0.80**	**$ 0.64**
Cash dividends per basic share	**$ 0.20**	**$ 0.19**	**$ 0.40**	**$ 0.38**

See notes to interim condensed consolidated financial statements.

Table of Contents

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Net income	**$ 3,004**	**$ 2,672**	**$ 6,238**	**$ 4,988**
Unrealized holding gains on available-for-sale securities:				
Unrealized holding gains arising during the period	1,420	3,576	2,219	5,329
Reclassification adjustment for net realized gains included in net income			(1,003)	
Reclassification adjustment for impairment loss included in net income			282	
Net unrealized gains	1,420	3,576	1,498	5,329
Tax effect	(546)	(1,212)	(27)	(1,607)
Other comprehensive income, net of tax	874	2,364	1,471	3,722
COMPREHENSIVE INCOME	**$ 3,878**	**$ 5,036**	**$ 7,709**	**$ 8,710**

See notes to interim condensed consolidated financial statements.

Table of Contents

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Six Months Ended June 30 2012	Six Months Ended June 30 2011
OPERATING ACTIVITIES		
Net income	$ 6,238	$ 4,988
Reconciliation of net income to net cash provided by operations:		
Provision for loan losses	900	1,420
Impairment of foreclosed assets	17	35
Depreciation	1,195	1,282
Amortization and impairment of originated mortgage servicing rights	287	193
Amortization of acquisition intangibles	133	152
Net amortization of available-for-sale securities	1,076	693
Available-for-sale security impairment loss	282	
Gain on sale of available-for-sale securities	(1,003)	
Net unrealized losses on trading securities	32	27
Net gain on sale of mortgage loans	(658)	(182)
Net unrealized gains on borrowings measured at fair value	(33)	(117)
Increase in cash value of corporate owned life insurance	(348)	(287)
Share-based payment awards under equity compensation plan	295	307
Origination of loans held for sale	(46,386)	(17,247)
Proceeds from loan sales	47,902	17,847
Net changes in operating assets and liabilities which provided (used) cash:		
Trading securities	2,680	900
Accrued interest receivable	631	(123)
Other assets	(1,132)	653
Accrued interest payable and other liabilities	(161)	684
Net cash provided by operating activities	**11,947**	**11,225**
INVESTING ACTIVITIES		
Net change in certificates of deposit held in other financial institutions	2,044	4,934
Activity in available-for-sale securities		
Sales	24,241	
Maturities and calls	37,922	33,799
Purchases	(112,835)	(78,664)
Loan principal originations, net	(6,768)	(13,462)
Proceeds from sales of foreclosed assets	647	859
Purchases of premises and equipment	(1,298)	(884)
Net cash used in investing activities	**(56,047)**	**(53,418)**

7

Table of Contents

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Dollars in thousands)

	Six Months Ended June 30 2012	Six Months Ended June 30 2011
FINANCING ACTIVITIES		
Acceptances and withdrawals of deposits, net	20,664	$ 46,860
Increase in other borrowed funds	18,029	1,680
Cash dividends paid on common stock	(3,034)	(2,881)
Proceeds from issuance of common stock	1,322	1,092
Common stock repurchased	(995)	(648)
Common stock purchased for deferred compensation obligations	(225)	(227)
Net cash provided by financing activities	**35,761**	**45,876**
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(8,339)**	**3,683**
Cash and cash equivalents at beginning of period	28,590	18,109
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 20,251**	**$ 21,792**
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	$ 7,291	$ 8,156
Federal income taxes paid	836	365
SUPPLEMENTAL NONCASH INFORMATION:		
Transfers of loans to foreclosed assets	$ 1,150	$ 1,057
Common stock issued for deferred compensation obligations		254
Common stock repurchased from the Rabbi Trust		(266)

See notes to interim condensed consolidated financial statements.

Table of Contents

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 the Management s Discussion & Analysis of Financial Condition & 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 acronyms and abbreviations identified below are used in the Notes to Interim Condensed Consolidated Financial Statements as well as in the Management s Discussion and Analysis of Financial Condition and Results of Operations. You may find it helpful to refer back to this page as you read this report.

AFS: Available-for-sale
ALLL: Allowance for loan and lease losses
ASC: FASB Accounting Standards Codification
ASU: FASB Accounting Standards Update
ATM: Automated Teller Machine
Directors Plan: Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
FASB: Financial Accounting Standards Board
FDIC: Federal Deposit Insurance Corporation
FFIEC: Federal Financial Institutions Council
FRB: Board of Governors of the Federal Reserve System
FHLB: Federal Home Loan Bank
Freddie Mac: Federal Home Loan Mortgage Corporation
FTE: Fully taxable equivalent
GAAP: U.S. generally accepted accounting principles
IFRS: International Financial Reporting Standards
IRR: Interest Rate Risk
JOBS Act: Jumpstart our Business Startups Act
LIBOR: London Interbank Offered Rate
Moody s: Moody s Investors Service, Inc
N/A: Not applicable
N/M: Not meaningful
OCI: Other comprehensive income (loss)
OMSR: Originated mortgage servicing rights
OTTI: Other-than-temporary impairment
PBO: Projected Benefit Obligation
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

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report for the year ended December 31, 2011.

The accounting policies are materially the same as those discussed in Note 1 to the Consolidated Financial Statements included in our annual report for the year ended December 31, 2011.

Table of Contents

NOTE 2 COMPUTATION OF EARNINGS PER SHARE

Basic earnings per share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. 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 June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Average number of common shares outstanding for basic calculation	7,592,668	7,570,752	7,593,462	7,564,060
Average potential effect of shares in the Directors Plan (1)	203,603	194,964	201,743	194,051
Average number of common shares outstanding used to calculate diluted earnings per common share	7,796,271	7,765,716	7,795,205	7,758,111
Net income	$ 3,004	$ 2,672	$ 6,238	$ 4,988
Earnings per share				
Basic	**$ 0.40**	**$ 0.35**	**$ 0.82**	**$ 0.66**
Diluted	**$ 0.39**	**$ 0.34**	**$ 0.80**	**$ 0.64**

(1) Exclusive of shares held in the Rabbi Trust

NOTE 3 RECENTLY ADOPTED ACCOUNTING STANDARDS UPDATES

ASU No. 2011-03: Reconsideration of Effective Control for Repurchase Agreements

In April 2011, ASU No. 2011-03 amended ASC Topic 310, Transfers and Servicing to eliminate from the assessment of effective control, the criteria calling for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed upon terms, even in the event of the transferee s default. The assessment of effective control should instead focus on the transferor s contractual rights and obligations. The new authoritative guidance was effective for interim and annual periods beginning on or after December 15, 2011 and did not impact our consolidated financial statements.

ASU No. 2011-04: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS

In May 2011, ASU No. 2011-04 amended ASC Topic 820, Fair Value Measurement to align fair value measurements and disclosures in GAAP and IFRS. The ASU changes the wording used to describe the requirements in GAAP for measuring fair value and disclosures about fair value.

The ASU clarifies the application of existing fair value measurements and disclosure requirements related to:

- The application of highest and best use and valuation premise concepts.
- Measuring the fair value of an instrument classified in a reporting entity s stockholders equity.
- Disclosure about fair value measurements within Level 3 of the fair value hierarchy.

The ASU also changes particular principles or requirements for measuring fair value and disclosing information measuring fair value and disclosures related to:

- Measuring the fair value of financial instruments that are managed within a portfolio.
- Application of premiums and discounts in a fair value measurement.

Table of Contents

The new authoritative guidance was effective for interim and annual periods beginning on or after December 15, 2011 and did not have a financial impact but increased the level of disclosures related to fair value measurements in our interim condensed consolidated financial statements in 2012.

ASU No. 2011-05: Presentation of Comprehensive Income

In June 2011, ASU No. 2011-05 amended ASC Topic 220, Comprehensive Income to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. In addition, to increase the prominence of items reported in other comprehensive income, and to facilitate the convergence of GAAP and IFRS, the FASB eliminated the option to present components of other comprehensive income as part of the statement of changes in shareholders equity.

The new authoritative guidance was effective for interim and annual periods beginning on or after December 15, 2011 and did not have an impact on our consolidated financial statements as we have historically elected to present a separate statement of comprehensive income.

NOTE 4 TRADING SECURITIES

Trading securities, at fair value, consist of the following investments at:

	June 30 2012	December 31 2011
States and political subdivisions	$ 1,998	$ 4,710

Included in the net trading losses of $32 during the first six months of 2012 were $10 of net unrealized trading losses on securities that were held in our trading portfolio as of June 30, 2012. Included in the net trading losses of $27 during the first six months of 2011 were $32 of net unrealized trading losses on securities that were held in the trading portfolio as of June 30, 2011.

Table of Contents

NOTE 5 AVAILABLE-FOR-SALE SECURITIES

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

	June 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$ 2,197	$ 34	$	$ 2,231
States and political subdivisions	170,958	8,243	547	178,654
Auction rate money market preferred	3,200		626	2,574
Preferred stocks	6,800		873	5,927
Mortgage-backed securities	161,521	2,991	15	164,497
Collateralized mortgage obligations	120,255	2,844	47	123,052
Total	**$ 464,931**	**$ 14,112**	**$ 2,108**	**$ 476,935**

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$ 395	$ 2	$	$ 397
States and political subdivisions	166,832	8,157	51	174,938
Auction rate money market preferred	3,200		1,151	2,049
Preferred stocks	6,800		1,767	5,033
Mortgage-backed securities	140,842	2,807	47	143,602
Collateralized mortgage obligations	96,545	2,556		99,101
Total	**$ 414,614**	**$ 13,522**	**$ 3,016**	**$ 425,120**

The amortized cost and fair value of AFS securities by contractual maturity at June 30, 2012 are as follows:

	Maturing					
	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	Securities With Variable Monthly Payments or Continual Call Dates	Total
Government sponsored enterprises	$	$	$ 72	$ 2,125	$	$ 2,197
States and political subdivisions	7,573	34,073	85,055	44,257		170,958
Auction rate money market preferred					3,200	3,200
Preferred stocks					6,800	6,800
Mortgage-backed securities					161,521	161,521

Collateralized mortgage obligations					120,255	120,255
Total amortized cost	**$ 7,573**	**$ 34,073**	**$ 85,127**	**$ 46,382**	**$ 291,776**	**$ 464,931**
Fair value	**$ 7,589**	**$ 35,243**	**$ 90,845**	**$ 47,208**	**$ 296,050**	**$ 476,935**

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.

Table of Contents

As 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.

A summary of the activity related to sales of AFS securities was as follows for the six month period ended June 30, 2012:

Proceeds from sales of securities	$ 24,241
Gross realized gains	$ 1,003
Applicable income tax expense	$ 341

There were no sales of AFS securities in the first six months of 2011. The cost basis used to determine the realized gains or losses of securities sold was the amortized cost of the individual investment security as of the trade date.

Information pertaining to AFS securities with gross unrealized losses at June 30, 2012 and December 31, 2011 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	June 30, 2012				
	Less Than Twelve Months		Over Twelve Months		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
States and political subdivisions	$ 55	$ 6,768	$ 492	$ 2,482	$ 547
Auction rate money market preferred			626	2,574	626
Preferred stocks			873	5,927	873
Mortgage-backed securities	15	15,283			15
Collateralized mortgage obligations	47	4,686			47
Total	**$ 117**	**$ 26,737**	**$ 1,991**	**$ 10,983**	**$ 2,108**
Number of securities in an unrealized loss position:		**24**		**8**	**32**

	December 31, 2011				
	Less Than Twelve Months		Over Twelve Months		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
States and political subdivisions	$ 51	$ 1,410	$	$	$ 51
Auction rate money market preferred			1,151	2,049	1,151
Preferred stocks			1,767	5,033	1,767
Mortgage-backed securities	47	24,291			47
Total	**$ 98**	**$ 25,701**	**$ 2,918**	**$ 7,082**	**$ 3,016**
Number of securities in an unrealized loss position:		**6**		**6**	**12**

As of June 30, 2012 and December 31, 2011, we conducted an analysis to determine whether any 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 issuer s investment credit rating below investment grade?

Is it probable that the issuer will be unable to pay the amount when due?

Table of Contents

Is it more likely than not that we will not have to sell the security before recovery of its cost basis?

Has the duration of the investment been extended?

As of June 30, 2012, we held an auction rate money market preferred security and preferred stocks which continued to be in an unrealized loss position as a result of the securities interest rates, as they are currently lower than the offering rates of securities with similar characteristics. We determined that any declines in the fair value of these securities are the result of changes in interest rates and not risks related to the underlying credit quality of the security. Additionally, none of the issuers of these securities are deemed to be below investment grade, we do not intend to sell the securities in an unrealized loss position, and it is more likely than not that we will not have to sell the securities before recovery of their cost basis.

During the three month period ended March 31, 2012, we had one state issued student loan auction rate AFS investment security (which is included in states and political subdivisions) that was downgraded by Moody s from A3 to Caa3. As a result of this downgrade, we engaged the services of an independent investment valuation firm to estimate the amount of credit losses (if any) related to this particular issue as of March 31, 2012. The evaluation calculated a range of estimated credit losses utilizing two different bifurcation methods: 1) Estimated Cash Flow Method and 2) Credit Yield Analysis Method. The two methods were then weighted, with a higher weighting applied to the Estimated Cash Flow Method, to determine the estimated credit related impairment. As a result of this analysis we, recognized an OTTI of $282 in the first quarter of 2012.

A summary of key valuation assumptions used in the aforementioned analysis as of March 31, 2012, follows:

	Discounted Cash Flow Method
Ratings	
Fitch	Not Rated
Moody s	Caa3
S&P	A
Seniority	Senior
Discount rate	LIBOR + 6.35%

	Credit Yield Analysis Method
Credit discount rate	LIBOR + 4.00%
Average observed discounts based on closed transactions	14.00%

To test for additional impairment of this security during the three months ended June 30, 2012, we obtained another investment valuation (from the same firm engaged to perform the March 31, 2012 valuation) as of June 30, 2012. Based on the results of this valuation, no additional OTTI was observed as of June 30, 2012.

A rollforward of credit related impairment recognized in earnings on available-for-sale securities in the three and six months ended June 30, 2012 was as follows:

	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Balance at beginning of period	$ 282	$
Additions to credit losses for which no previous OTTI was recognized		282

June 30, 2012	**$**	**282**	**$**	**282**

There were no credit losses recognized in on available-for-sale securities during 2011.

Based on our analysis using the above criteria, the fact that we have asserted that we do not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not that we will not have to sell the securities before recovery of their cost basis, we do not believe that the values of any other securities are other-than-temporarily impaired as of as of June 30, 2012 or December 31, 2011.

NOTE 6 LOANS AND ALLOWANCE FOR LOAN LOSSES

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 and tourism, higher education, and general economic conditions of this region. Substantially all of the 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 on loans 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. 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 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 allowance for loan losses. The interest on these loans is accounted for on the cash basis, until qualifying for return to accrual status. 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 state and political subdivisions. Repayment of these loans is often dependent upon the successful operation and management of a business; thus, these loans generally involve greater risk than other types of lending. We minimize our risk by limiting the amount of loans to any one borrower to $12,500. Borrowers with credit needs of more than $12,500 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 less than 80%. 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, fixed rate balloon mortgages, construction loans, and fixed rate mortgage loans which typically have amortization periods up to a maximum of 30 years. Fixed rate 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, held for future sale, or sold 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 loans to Freddie Mac.

Table of Contents

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 $400 require the approval of our Internal Loan Committee, the Board of Directors Loan Committee, or the Board of Directors.

Consumer loans include automobile loans, secured and unsecured personal loans, and overdraft protection related loans. Loans are amortized generally for a period of up to 6 years. The underwriting emphasis is on a borrower s perceived intent and ability to pay rather than collateral value. No consumer loans are sold to the secondary market.

The ALLL is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the ALLL when we believe the uncollectibility 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 collectibility 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 net realizable value of the loan s underlying collateral or the net present value of the projected payment stream and our recorded investment. Historical loss allocations were calculated at the loan class and segment levels based on a migration analysis of the loan portfolio over the preceding four years. An unallocated component is 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 June 30, 2012					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
April 1, 2012	$ 5,728	$ 859	$ 3,702	$ 625	$ 1,461	$ 12,375
Loans charged off	(237)		(238)	(146)		(621)
Recoveries	42		20	63		125
Provision for loan losses	475	(426)	185	125	80	439
June 30, 2012	**$ 6,008**	**$ 433**	**$ 3,669**	**$ 667**	**$ 1,541**	**$ 12,318**

Table of Contents

Allowance for Loan Losses
Six Months Ended June 30, 2012

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
January 1, 2012	$ 6,284	$ 1,003	$ 2,980	$ 633	$ 1,475	$ 12,375
Loans charged off	(686)		(353)	(237)		(1,276)
Recoveries	128		61	130		319
Provision for loan losses	282	(570)	981	141	66	900
June 30, 2012	**$ 6,008**	**$ 433**	**$ 3,669**	**$ 667**	**$ 1,541**	**$ 12,318**

Allowance for Loan Losses and Recorded Investment in Loans
As of June 30, 2012

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Individually evaluated for impairment	$ 2,115	$ 133	$ 1,308	$	$	$ 3,556
Collectively evaluated for impairment	3,893	300	2,361	667	1,541	8,762
Total	**$ 6,008**	**$ 433**	**$ 3,669**	**$ 667**	**$ 1,541**	**$ 12,318**
Loans						
Individually evaluated for impairment	15,271	2,955	8,248	82		26,556
Collectively evaluated for impairment	353,100	78,267	265,754	31,275		728,396
Total	**$ 368,371**	**$ 81,222**	**$ 274,002**	**$ 31,357**		**$ 754,952**

Allowance for Loan Losses
Three Months Ended June 30, 2011

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
April 1, 2011	$ 6,246	$ 776	$ 3,422	$ 622	$ 1,315	$ 12,381
Loans charged off	(214)	(1)	(555)	(139)		(909)
Recoveries	209		29	65		303
Provision for loan losses	497	(11)	(11)	112	16	603
June 30, 2011	**$ 6,738**	**$ 764**	**$ 2,885**	**$ 660**	**$ 1,331**	**$ 12,378**

Table of Contents

	Allowance for Loan Losses Six Months Ended June 30, 2011					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
January 1, 2011	$ 6,048	$ 1,033	$ 3,198	$ 605	$ 1,489	$ 12,373
Loans charged off	(869)	(1)	(878)	(284)		(2,032)
Recoveries	346		103	168		617
Provision for loan losses	1,213	(268)	462	171	(158)	1,420
June 30, 2011	**$ 6,738**	**$ 764**	**$ 2,885**	**$ 660**	**$ 1,331**	**$ 12,378**

	Allowance for Loan Losses and Recorded Investment in Loans As of December 31, 2011					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Individually evaluated for impairment	$ 2,152	$ 822	$ 1,146	$	$	$ 4,120
Collectively evaluated for impairment	4,132	181	1,834	633	1,475	8,255
Total	**$ 6,284**	**$ 1,003**	**$ 2,980**	**$ 633**	**$ 1,475**	**$ 12,375**
Loans						
Individually evaluated for impairment	$ 14,097	$ 3,384	$ 7,664	$ 105		$ 25,250
Collectively evaluated for impairment	351,617	71,261	270,696	31,467		725,041
Total	**$ 365,714**	**$ 74,645**	**$ 278,360**	**$ 31,572**		**$ 750,291**

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

	June 30, 2012					
	Commercial			Agricultural		
	Real Estate	Other	Total	Real Estate	Other	Total
Rating						
2 High quality	$ 27,077	$ 14,143	$ 41,220	$ 2,578	$ 2,199	$ 4,777
3 High satisfactory	81,883	28,314	110,197	15,964	8,273	24,237
4 Low satisfactory	124,323	51,092	175,415	25,173	19,382	44,555
5 Special mention	12,303	2,691	14,994	1,088	3,022	4,110
6 Substandard	17,658	5,196	22,854	1,704	1,363	3,067
7 Vulnerable	2,556	92	2,648			
8 Doubtful	1,019	24	1,043	190	286	476
Total	**$ 266,819**	**$ 101,552**	**$ 368,371**	**$ 46,697**	**$ 34,525**	**$ 81,222**

Table of Contents

	December 31, 2011					
	Commercial			Agricultural		
	Real Estate	Other	Total	Real Estate	Other	Total
Rating						
2 High quality	$ 11,113	$ 11,013	$ 22,126	$ 3,583	$ 1,390	$ 4,973
3 High satisfactory	90,064	29,972	120,036	11,154	5,186	16,340
4 Low satisfactory	118,611	57,572	176,183	24,253	15,750	40,003
5 Special mention	15,482	4,200	19,682	3,863	2,907	6,770
6 Substandard	19,017	4,819	23,836	1,640	4,314	5,954
7 Vulnerable	187		187			
8 Doubtful	3,621	43	3,664	190	415	605
Total	**$ 258,095**	**$ 107,619**	**$ 365,714**	**$ 44,683**	**$ 29,962**	**$ 74,645**

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

1. **EXCELLENT Substantially Risk Free**

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

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

2. **HIGH QUALITY Limited Risk**

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

- Favorable liquidity and leverage ratios.
- Ability to meet all obligations when due.
- Management with successful track record.
- Steady and satisfactory earnings history.

If loan is secured, collateral is of high quality and readily marketable.

Access to alternative financing.

Well defined primary and secondary source of repayment.

If supported by guaranty, the financial strength and liquidity of the guarantor(s) are clearly evident.

3. **HIGH SATISFACTORY Reasonable Risk**
Credit with satisfactory financial condition and further characterized by:

Working capital adequate to support operations.

Cash flow sufficient to pay debts as scheduled.

Management experience and depth appear favorable.

Loan performing according to terms.

If loan is secured, collateral is acceptable and loan is fully protected.

4. **LOW SATISFACTORY Acceptable Risk**
Credit with bankable risks, although some signs of weaknesses are shown:

Would include most start-up businesses.

Table of Contents

Occasional instances of trade slowness or repayment delinquency may have been 10-30 days slow within the past year.

Management s abilities are apparent, yet unproven.

Weakness in primary source of repayment with adequate secondary source of repayment.

Loan structure generally in accordance with policy.

If secured, loan collateral coverage is marginal.

Adequate cash flow to service debt, but coverage is low.

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

5. **SPECIAL MENTION Criticized**

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

Downward trend in sales, profit levels, and margins.

Impaired working capital position.

Cash flow is strained in order to meet debt repayment.

Loan delinquency (30-60 days) and overdrafts may occur.

Shrinking equity cushion.

Diminishing primary source of repayment and questionable secondary source.

Management abilities are questionable.

Weak industry conditions.

Litigation pending against the borrower.

Collateral or guaranty offers limited protection.

Negative debt service coverage, however the credit is well collateralized and payments are current.

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

Sustained losses have severely eroded the equity and cash flow.

Deteriorating liquidity.

Serious management problems or internal fraud.

Original repayment terms liberalized.

Likelihood of bankruptcy.

Inability to access other funding sources.

Reliance on secondary source of repayment.

Litigation filed against borrower.

Collateral provides little or no value.

Requires excessive attention of the loan officer.

Borrower is uncooperative with loan officer.

Table of Contents

7. **VULNERABLE Classified**

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

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

8. **DOUBTFUL Workout**

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

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

9. **LOSS Charge off**

Credits are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification is for charged off loans but does not mean that the asset has absolutely no recovery or salvage value. These loans are further characterized by:

- Liquidation or reorganization under bankruptcy, with poor prospects of collection.
- Fraudulently overstated assets and/or earnings.
- Collateral has marginal or no value.
- Debtor cannot be located.
- Over 120 days delinquent.

Table of Contents

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

	June 30, 2012					
	Accruing Interest and Past Due: 30-89 Days	90 Days or More	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial						
Commercial real estate	$ 3,505	$ 309	$ 3,818	$ 7,632	$ 259,186	$ 266,818
Commercial other	411	50	199	660	100,893	101,553
Total commercial	3,916	359	4,017	8,292	360,079	368,371
Agricultural						
Agricultural real estate	206		356	562	46,135	46,697
Agricultural other	319		286	605	33,920	34,525
Total agricultural	525		642	1,167	80,055	81,222
Residential real estate						
Senior liens	2,463	346	876	3,685	212,392	216,077
Junior liens	239	33	65	337	18,293	18,630
Home equity lines of credit	284		190	474	38,821	39,295
Total residential real estate	2,986	379	1,131	4,496	269,506	274,002
Consumer						
Secured	145	1		146	26,290	26,436
Unsecured	33			33	4,888	4,921
Total consumer	178	1		179	31,178	31,357
Total	**$ 7,605**	**$ 739**	**$ 5,790**	**$ 14,134**	**$ 740,818**	**$ 754,952**

	December 31, 2011					
	Accruing Interest and Past Due: 30-89 Days	90 Days or More	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial						
Commercial real estate	$ 1,721	$ 364	$ 4,176	$ 6,261	$ 251,834	$ 258,095
Commercial other	426	3	25	454	107,165	107,619
Total commercial	2,147	367	4,201	6,715	358,999	365,714
Agricultural						
Agricultural real estate		99	189	288	44,395	44,683
Agricultural other	2		415	417	29,545	29,962

Total agricultural	2	99	604	705	73,940	74,645
Residential real estate						
Senior liens	3,004	124	1,292	4,420	213,181	217,601
Junior liens	235	40	94	369	20,877	21,246
Home equity lines of credit	185	125	198	508	39,005	39,513
Total residential real estate	3,424	289	1,584	5,297	273,063	278,360
Consumer						
Secured	158	5		163	26,011	26,174
Unsecured	23			23	5,375	5,398
Total consumer	181	5		186	31,386	31,572
Total	**$ 5,754**	**$ 760**	**$ 6,389**	**$ 12,903**	**$ 737,388**	**$ 750,291**

Table of Contents

Impaired Loans

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

1. There has been a chargeoff of its principal balance (in whole or in part);

2. The loan has been classified as a Troubled Debt Restructuring (TDR); or

3. The loan is in nonaccrual status.

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

Interest income is recognized on impaired loans in nonaccrual status on the cash basis, but only after all principal has been collected. For impaired loans not in nonaccrual status, interest income is recognized daily as earned according to the terms of the loan agreement.

The following is a summary of information pertaining to impaired loans as of and for the periods ended:

	June 30, 2012			December 31, 2011		
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance
Impaired loans with a valuation allowance						
Commercial real estate	$ 6,128	$ 6,408	$ 1,893	$ 5,014	$ 5,142	$ 1,881
Commercial other	944	944	222	734	734	271
Agricultural other	2,046	2,046	133	2,689	2,689	822
Residential real estate senior liens	7,894	9,077	1,278	7,271	8,827	1,111
Residential real estate junior liens	164	268	30	195	260	35
Total impaired loans with a valuation allowance	**$ 17,176**	**$ 18,743**	**$ 3,556**	**$ 15,903**	**$ 17,652**	**$ 4,120**
Impaired loans without a valuation allowance						
Commercial real estate	$ 5,946	$ 6,628		$ 7,984	$ 10,570	
Commercial other	2,253	2,294		365	460	
Agricultural real estate	357	357		190	190	
Agricultural other	552	672		505	625	
Home equity lines of credit	190	490		198	498	
Consumer secured	82	95		105	114	
Total impaired loans without a valuation allowance	**$ 9,380**	**$ 10,536**		**$ 9,347**	**$ 12,457**	
Impaired loans						
Commercial	$ 15,271	$ 16,274	$ 2,115	$ 14,097	$ 16,906	$ 2,152
Agricultural	2,955	3,075	133	3,384	3,504	822
Residential real estate	8,248	9,835	1,308	7,664	9,585	1,146

Consumer	82	95		105	114	
Total impaired loans	**$ 26,556**	**$ 29,279**	**$ 3,556**	**$ 25,250**	**$ 30,109**	**$ 4,120**

Table of Contents

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Average Outstanding Balance	Interest Income Recognized	Average Outstanding Balance	Interest Income Recognized
Impaired loans with a valuation allowance				
Commercial real estate	$ 6,444	$ 83	$ 6,165	$ 181
Commercial other	829	16	777	28
Agricultural other	2,145	36	2,306	73
Residential real estate senior liens	7,862	92	7,706	175
Residential real estate junior liens	175	2	183	4
Total impaired loans with a valuation allowance	**$ 17,455**	**$ 229**	**$ 17,137**	**$ 461**
Impaired loans without a valuation allowance				
Commercial real estate	$ 6,789	$ 112	$ 7,299	$ 179
Commercial other	2,249	34	1,777	65
Agricultural real estate	274		232	
Agricultural other	607	3	595	7
Home equity lines of credit	195	4	197	8
Consumer secured	89	1	95	3
Total impaired loans without a valuation allowance	**$ 10,203**	**$ 154**	**$ 10,195**	**$ 262**
Impaired loans				
Commercial	$ 16,311	$ 245	$ 16,018	$ 453
Agricultural	3,026	39	3,133	80
Residential real estate	8,232	98	8,086	187
Consumer	89	1	95	3
Total impaired loans	**$ 27,658**	**$ 383**	**$ 27,332**	**$ 723**

Table of Contents

	Three Months Ended June 30, 2011		Six Months Ended June 30, 2011	
	Average Outstanding Balance	Interest Income Recognized	Average Outstanding Balance	Interest Income Recognized
Impaired loans with a valuation allowance				
Commercial real estate	$ 2,570	$ 96	$ 3,490	$ 120
Commercial other			9	
Agricultural other	1,776	9	1,776	42
Residential real estate senior liens	4,980	70	4,845	106
Residential real estate junior liens	184	3	186	4
Total impaired loans with a valuation allowance	**$ 9,510**	**$ 178**	**$ 10,306**	**$ 272**
Impaired loans without a valuation allowance				
Commercial real estate	$ 4,085	$ 69	$ 3,151	$ 102
Commercial other	1,780	28	968	88
Agricultural real estate	190		95	(1)
Agricultural other	641	39	641	39
Residential real estate senior liens	337	(6)	201	
Home equity lines of credit	1			
Consumer secured	36	1	38	3
Total impaired loans without a valuation allowance	**$ 7,070**	**$ 131**	**$ 5,094**	**$ 231**
Impaired loans				
Commercial	$ 8,435	$ 193	$ 7,618	$ 310
Agricultural	2,607	48	2,512	80
Residential real estate	5,502	67	5,232	110
Consumer	36	1	38	3
Total impaired loans	**$ 16,580**	**$ 309**	**$ 15,400**	**$ 503**

Impaired loans, which include TDRs, had $290 of unfunded commitments under lines of credit as of June 30, 2012.

Table of Contents

Troubled Debt Restructurings

Loan modifications are considered to be TDR s when a concession has been granted to a borrower who is experiencing financial difficulties.

Typical concessions granted include, but are not limited to:

1. Agreeing to interest rates below prevailing market rates for debt with similar risk characteristics.

2. Extending the amortization period beyond typical lending guidelines for debt with similar risk characteristics.

3. Forbearance of principal.

4. Forbearance of accrued interest.

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

1. The borrower is currently in default on any of their debt.

2. It is likely that the borrower would default on any of their debt if the concession was not granted.

3. The borrower s cash flow was sufficient to service all of their debt if the concession was not granted.

4. The borrower has declared, or is in the process of declaring, bankruptcy.

5. The borrower is unlikely to continue as a going concern (if the entity is a business).

The following is a summary of information pertaining to TDR s for the three and six month periods ended June 30, 2012:

	Loans Restructured in the Three Month Period ended June 30, 2012			Loans Restructured in the Six Month Period ended June 30, 2012		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial other	5	$ 305	$ 305	$ 26	$ 4,891	$ 4,891
Agricultural other				6	561	561
Residential real estate senior liens	7	684	684	12	1,405	1,405
Total	**$ 12**	**$ 989**	**$ 989**	**$ 44**	**$ 6,857**	**$ 6,857**

	Loans Restructured in the Three Month Period Ended June 30, 2012				Loans Restructured in the Six Month Period Ended June 30, 2012			
	Below Market Interest Rate		Below Market Interest Rate and Extension of Amortization Period		Below Market Interest Rate		Below Market Interest Rate and Extension of Amortization Period	
	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment
Commercial other	3	$ 160	2	$ 145	24	$ 4,746	2	$ 145
Agricultural other					6	561		
Residential real estate senior liens	4	324	3	360	4	324	8	1,081
Total	**7**	**$ 484**	**5**	**$ 505**	**34**	**$ 5,631**	**10**	**$ 1,226**

Table of Contents

We did not restructure any loans through the forbearance of principal or accrued interest in the three or six month periods ended June 30, 2012.

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

Following is a summary of loans that defaulted in the three and six month periods ended June 30, 2012, which were modified within 12 months prior to the default date:

	Three Months Ended June 30, 2012				Six Months Ended June 30, 2012			
	Number of Loans	Pre-Default Recorded Investment	Charge Off Recorded Upon Default	Post-Default Recorded Investment	Number of Loans	Pre-Default Recorded Investment	Charge Off Recorded Upon Default	Post-Default Recorded Investment
Commercial other	2	$ 50	$ 25	$ 25	3	$ 132	$ 67	$ 65
Residential real estate senior liens					1	47	43	4
Consumer secured	1	8	8		1	8	8	
Total	**3**	**$ 58**	**$ 33**	**$ 25**	**5**	**$ 187**	**$ 118**	**$ 69**

We had no loans that defaulted during the first six months of 2011, which were modified within 12 months prior to the default date.

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

	June 30 2012	December 31 2011
Troubled debt restructurings	$ 22,543	$ 18,756

NOTE 7 EQUITY SECURITIES WITHOUT READILY DETERMINABLE FAIR VALUES

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

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

	June 30 2012	December 31 2011
Federal Home Loan Bank Stock	$ 7,700	$ 7,380
Investment in Corporate Settlement Solutions	6,810	6,611
Federal Reserve Bank Stock	1,879	1,879
Investment in Valley Financial Corporation	1,000	1,000
Other	319	319

Total	**$ 17,708**	**$ 17,189**

Table of Contents

NOTE 8 BORROWED FUNDS

Borrowed funds consist of the following obligations as of:

	June 30, 2012		December 31, 2011	
	Amount	Rate	Amount	Rate
Federal Home Loan Bank advances	$ 154,000	2.18%	$ 142,242	3.16%
Securities sold under agreements to repurchase without stated maturity dates	53,824	0.20%	57,198	0.25%
Securities sold under agreements to repurchase with stated maturity dates	16,708	3.51%	16,696	3.51%
Federal funds purchased	9,600	0.50%		
Total	**$ 234,132**	**1.75%**	**$ 216,136**	**2.42%**

The FHLB advances are collateralized by a blanket lien on all qualified 1-4 family residential real estate loans and certain mortgage-backed securities and collateralized mortgage obligations. Advances are also secured by our holdings of FHLB stock. We had the ability to borrow up to an additional $100,781 based on assets currently pledged as collateral as of June 30, 2012. During the first quarter of 2012, we reduced funding costs by modifying the terms of $60,000 of FHLB advances.

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

	June 30 2012		December 31 2011	
	Amount	Rate	Amount	Rate
Fixed rate advances due 2012	$ 2,000	4.90%	$ 17,000	2.97%
One year putable fixed rate advances due 2012	5,000	3.48%	15,000	4.10%
Variable rate advances due 2012	5,000	0.50%		
Fixed rate advances due 2013			5,242	4.14%
One year putable fixed rate advances due 2013			5,000	3.15%
Fixed rate advances due 2014			25,000	3.16%
Fixed rate advances due 2015	42,000	1.12%	45,000	3.30%
Fixed rate advances due 2016	10,000	2.15%	10,000	2.15%
Fixed rate advances due 2017	40,000	2.15%	20,000	2.56%
Fixed rate advances due 2018	20,000	2.86%		
Fixed rate advances due 2019	20,000	3.73%		
Fixed rate advances due 2020	10,000	1.98%		
Total	**$ 154,000**	**2.18%**	**$ 142,242**	**3.16%**

Securities sold under agreements to repurchase are classified as secured borrowings. Securities sold under agreements to repurchase without stated maturity dates generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The securities underlying the agreements have a carrying value and a fair value of $120,878 and $99,869 at June 30, 2012 and December 31, 2011, respectively. Such securities remain under our control. We may be required to provide additional collateral based on the fair value of underlying securities.

Table of Contents

The following table provides a summary of short term borrowings for the three and six month periods ended June 30:

	Three Months Ended June 30					
	2012			2011		
	Maximum Month-End Balance	Quarter to Date Average Balance	Weighted Average Interest Rate During the Period	Maximum Month-End Balance	Quarter to Date Average Balance	Weighted Average Interest Rate During the Period
Securities sold under agreements to repurchase without stated maturity dates	$ 58,584	$ 58,045	0.20%	$ 43,138	$ 44,680	0.25%
Federal funds purchased	17,900	7,025	0.47%	18,300	4,539	0.54%

	Six Months Ended June 30					
	2012			2011		
	Maximum Month-End Balance	YTD Average Balance	Weighted Average Interest Rate During the Period	Maximum Month-End Balance	YTD Average Balance	Weighted Average Interest Rate During the Period
Securities sold under agreements to repurchase without stated maturity dates	$ 58,584	$ 55,436	0.11%	$ 43,138	$ 40,715	0.25%
Federal funds purchased	17,900	3,552	0.23%	18,300	2,906	0.53%

We had pledged certificates of deposit held in other financial institutions, trading securities, available-for-sale securities, and 1-4 family residential real estate loans in the following amounts at:

	June 30 2012	December 31 2011
Pledged to secure borrowed funds	$ 316,349	$ 292,092
Pledged to secure repurchase agreements	120,878	99,869
Pledged for public deposits and for other purposes necessary or required by law	24,177	26,761
Total	**$ 461,404**	**$ 418,722**

We had no investment securities that are restricted to be pledged for specific purposes.

29

Table of Contents

NOTE 9 OTHER NONINTEREST EXPENSES

A summary of expenses included in other noninterest expenses are as follows for the three month and six month periods ended:

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Marketing and donations	$ 535	$ 527	$ 1,029	$ 750
FDIC insurance premiums	213	331	428	665
Directors fees	209	206	419	417
Audit fees	154	167	330	323
Education and travel	139	99	266	204
Consulting fees	71	67	258	100
Printing and supplies	110	89	219	189
Postage and freight	94	96	195	196
Foreclosed asset and collection	(18)	177	79	277
Amortization of deposit premium	67	76	133	152
Legal fees	81	54	143	116
Other Losses	107	10	137	11
All other	425	394	810	723
Total	**$ 2,187**	**$ 2,293**	**$ 4,446**	**$ 4,123**

NOTE 10 FEDERAL INCOME TAXES

The reconciliation of the provision for federal income taxes and the amount computed at the federal statutory tax rate of 34% of income before federal income tax expense is as follows for the three and six month periods ended June 30:

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Income taxes at 34% statutory rate	$ 1,250	$ 1,076	2,612	$ 2,004
Effect of nontaxable income				
Interest income on tax exempt municipal bonds	(388)	(385)	(779)	(768)
Earnings on corporate owned life insurance	(60)	(50)	(118)	(98)
Other	(141)	(162)	(292)	(256)
Total effect of nontaxable income	(589)	(597)	(1,189)	(1,122)
Effect of nondeductible expenses	11	13	22	23
Federal income tax expense	**$ 672**	**$ 492**	**$ 1,445**	**$ 905**

Table of Contents

Included in OCI for the three and six month periods ended June 30, 2012 and 2011 are changes in unrealized holding gains, related to auction rate money market preferred and preferred stocks. For federal income tax purposes, these securities are considered equity investments. As such, no deferred federal income taxes related to unrealized holding gains or losses are expected or recorded.

A summary of OCI follows for the three and six month periods ended June 30:

	Three Months Ended					
	June 30, 2012			June 30, 2011		
	Auction Rate Money Market Preferreds and Preferred Stocks	All Other AFS Securities	Total	Auction Rate Money Market Preferreds and Preferred Stocks	All Other AFS Securities	Total
Unrealized (losses) gains arising during the period	$ (185)	$ 1,605	$ 1,420	$ 8	$ 3,568	$ 3,576
Tax effect		(546)	(546)		(1,212)	(1,212)
Other comprehensive (loss) income, net of tax	**$ (185)**	**$ 1,059**	**$ 874**	**$ 8**	**$ 2,356**	**$ 2,364**

	Six Months Ended					
	June 30, 2012			June 30, 2011		
	Auction Rate Money Market Preferreds and Preferred Stocks	All Other AFS Securities	Total	Auction Rate Money Market Preferreds and Preferred Stocks	All Other AFS Securities	Total
Unrealized gains arising during the period	$ 1,419	$ 800	$ 2,219	$ 603	$ 4,726	$ 5,329
Reclassification adjustment for net realized gains included in net income		(1,003)	(1,003)			
Reclassification adjustment for impairment loss included in net income		282	282			
Net unrealized gains	1,419	79	1,498	603	4,726	5,329
Tax effect		(27)	(27)		(1,607)	(1,607)
Other comprehensive income, net of tax	**$ 1,419**	**$ 52**	**$ 1,471**	**$ 603**	**$ 3,119**	**$ 3,722**

Table of Contents

NOTE 11 DEFINED BENEFIT PENSION PLAN

We maintain a noncontributory defined benefit pension plan, which was curtailed effective March 1, 2007. As a result of the curtailment, future salary increases are no longer considered and plan benefits are based on years of service and the employees five highest consecutive years of compensation out of the last ten years of service through March 1, 2007. We contributed $709 to the pension plan during the six month period ended June 30, 2012 and made no contributions to the plan in the six month period ended June 30, 2011. We do not anticipate any additional contributions to the plan over the remainder of 2012.

Following are the components of net periodic benefit cost for the three and six month periods ended June 30:

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest cost on PBO	$ 117	$ 127	$ 235	$ 254
Expected return on plan assets	(127)	(130)	(254)	(261)
Amortization of unrecognized actuarial net loss	73	39	146	77
Net periodic benefit cost	**$ 63**	**$ 36**	**$ 127**	**$ 70**

NOTE 12 FAIR VALUE

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

Cash and demand deposits due from banks: The carrying amounts of cash and short term investments, including Federal funds sold, approximate fair values. As such, we classify cash and demand deposits due from banks as Level 1.

Certificates of deposit held in other financial institutions: Interest bearing balances held in unaffiliated financial institutions include certificates of deposit and other short term interest bearing balances that mature within 3 years. Fair value is determined using prices for similar assets with similar characteristics. As such, we classify certificates of deposits held in other financial institutions as Level 2.

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

Due to the limited trading activity of certain auction rate money market preferred securities and preferred stocks we measured these securities using Level 3 inputs as of June 30, 2011. As the markets for these securities normalized and established regular trading patterns, we measured preferred stocks utilizing Level 1 inputs and an auction rate money market preferred security utilizing Level 2 inputs as of December 31, 2011 and continued to measure at these levels as of June 30, 2012.

Table of Contents

The table below represents the activity in auction rate money market preferred available-for-sale investment securities measured with Level 3 inputs on a recurring basis for the:

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Level 3 inputs at beginning of period	$ 2,803	$ 2,865
Net unrealized gains (losses)	31	(31)
Level 3 inputs June 30	$ 2,834	$ 2,834

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The table below represents the activity in preferred stock available-for-sale investment securities measured with Level 3 inputs on a recurring basis for the:

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Level 3 inputs at beginning of period	$ 7,593	$ 6,936
Net unrealized (losses) gains	(23)	634
Level 3 inputs June 30	$ 7,570	$ 7,570

We had no financial instruments measured with Level 3 inputs on a recurring basis during 2012.

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

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

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

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

Impaired loans where an allowance is established based on the net realizable value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraisal value, we record the loan as nonrecurring Level 2. When a current appraised value is not available or we determine the fair value of collateral is further impaired below the appraised value, the impaired loan is classified as nonrecurring Level 3.

Table of Contents

The table below lists the quantitative information about impaired loans measured utilizing Level 3 fair value measurements as of June 30, 2012:

Valuation Techniques	Fair Value	Unobservable Input	Range
		Duration of cash flows	20 - 120 Months
Discounted cash flow	$ 6,750	Reduction in interest rate from original loan terms	2.13% - 3.38%
		Discount applied to collateral appraisal:	
		Real Estate	20% - 30%
		Equipment	50%
Discounted appraisal value	$ 16,250	Livestock	50%
		Cash crop inventory	50%
		Other inventory	75%
		Accounts receivable	75%
		Estimated liquidation costs	10%

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

Goodwill and other intangible assets: Acquisition intangibles and goodwill are evaluated for potential impairment on at least an annual basis. Goodwill is typically qualitatively evaluated to determine if it is more likely than not that the carrying balance is impaired. If it is determined that the carrying balance of goodwill is more likely than not to be impaired, we perform a cash flow valuation to determine the extent of the potential impairment. Acquisition intangibles are tested for impairment with a cash flow valuation. This valuation method requires a significant degree of judgment. In the event the projected undiscounted net operating cash flows for these intangible assets are less than the carrying value, the asset is recorded at fair value as determined by the valuation model. If the testing resulted in impairment, we would classify goodwill and other acquisition intangibles subjected to nonrecurring fair value adjustments as Level 3. During 2012 and 2011 there were no impairments recorded on goodwill and other acquisition intangibles.

Equity securities without readily determinable fair values: We have investments in equity securities without readily determinable fair values as well as investments in joint ventures. The assets are individually reviewed for impairment on an annual basis, or more frequently if an indication of impairment exists, by comparing the carrying value to the estimated fair value. The lack of an independent source to validate fair value estimates, including the impact of future capital calls and transfer restrictions, is an inherent limitation in the valuation process. We classify nonmarketable equity securities and investments in joint ventures subjected to nonrecurring fair value adjustments as Level 3. During 2012 and 2011, there were no impairments recorded on equity securities without readily determinable fair values.

Foreclosed assets: Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Net realizable value is based upon independent market prices, appraised values of the collateral, or management s estimation of the value of the collateral and as such, we classify foreclosed assets as a nonrecurring Level 2. When the net realizable value of the collateral is further impaired below the appraised value but there is no observable market price, we record the foreclosed asset as nonrecurring Level 3.

Originated mortgage servicing rights: OMSR is subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, originated mortgage servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, we classify loan servicing rights subject to nonrecurring fair value adjustments as Level 2.

Table of Contents

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

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

We elected to measure a portion of borrowed funds at fair value as of December 31, 2011. These borrowings were recorded at fair value on a recurring basis, with the fair value measurement estimated using discounted cash flow analysis based on current incremental borrowing rates for similar types of borrowing arrangements. Changes in the fair value of these borrowings are included in noninterest income. As such, other borrowed funds are classified as Level 2.

The activity in borrowings which the Corporation has elected to carry at fair value was as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Borrowings carried at fair value beginning of year	$	$ 10,343	$ 5,242	$ 10,423
Paydowns and maturities			(5,209)	
Net unrealized change in fair value		(37)	(33)	(117)
Borrowings carried at fair value June 30	**$**	**$ 10,306**	**$**	**$ 10,306**
Unpaid principal balance June 30	**$**	**$ 10,000**	**$**	**$ 10,000**

Commitments to extend credit, standby letters of credit and undisbursed loans: Fair values for off balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the counterparties credit standings. As we do not charge fees for lending commitments outstanding, it is not practicable to estimate the fair value of these instruments.

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

Table of Contents

Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis

Disclosure of the estimated fair values of financial instruments, which differ from carrying values, often requires the use of estimates. In cases where quoted market values in an active market are not available, we use present value techniques and other valuation methods to estimate the fair values of our financial instruments. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used.

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on our consolidated balance sheets are as follows as of:

	June 30, 2012				
	Carrying Value	Estimated Fair Value	(Level 1)	(Level 2)	(Level 3)
ASSETS					
Cash and demand deposits due from banks	$ 20,251	$ 20,251	$ 20,251	$	$
Certicates of deposit held in other financial institutions	6,880	6,906		6,906	
Mortgage loans available-for-sale	2,347	2,413		2,413	
Total loans	754,952	768,354		741,798	26,556
Less allowance for loan losses	(12,318)	(12,318)		(8,762)	(3,556)
Net loans	742,634	756,036		733,036	23,000
Accrued interest receivable	5,217	5,217	5,217		
Equity securities without readily determinable fair values (1)	17,708	17,708			
Originated mortgage servicing rights	2,424	2,424		2,424	
LIABILITIES					
Deposits without stated maturities	499,900	499,900	499,900		
Deposits with stated maturities	478,928	491,475		491,475	
Borrowed funds	234,132	240,869		240,869	
Accrued interest payable	809	809	809		

(1) Due to the characteristics of equity securities without readily determinable fair values, they are not disclosed under a specific fair value hierarchy.

Table of Contents

	December 31, 2011 Carrying Value	Estimated Fair Value
ASSETS		
Cash and demand deposits due from banks	$ 28,590	$ 28,590
Certificates of deposit held in other financial institutions	8,924	8,977
Mortgage loans available-for-sale	3,205	3,252
Total loans	750,291	769,177
Less allowance for loan losses	(12,375)	(12,375)
Net loans	737,916	756,802
Accrued interest receivable	5,848	5,848
Equity securities without readily determinable fair values	17,189	17,189
Originated mortgage servicing rights	2,374	2,374
LIABILITIES		
Deposits without stated maturities	476,627	476,627
Deposits with stated maturities	481,537	499,644
Borrowed funds	210,894	222,538
Accrued interest payable	967	967

Financial Instruments Recorded at Fair Value

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

	June 30, 2012				December 31, 2011			
Description	Total	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)
Recurring items								
Trading securities								
States and political subdivisions	$ 1,998	$	$ 1,998	$	$ 4,710	$	$ 4,710	$
Available-for-sale investment securities								
Government sponsored enterprises	2,231		2,231		397		397	
States and political subdivisions	178,654		178,654		174,938		174,938	
Auction rate money market preferred	2,574		2,574		2,049		2,049	
Preferred stocks	5,927	5,927			5,033	5,033		
Mortgage-backed securities	164,497		164,497		143,602		143,602	
Collateralized mortgage obligations	123,052		123,052		99,101		99,101	
Total available-for-sale investment securities	476,935	5,927	471,008		425,120	5,033	420,087	
Borrowed funds					5,242		5,242	
Nonrecurring items								
Impaired loans (net of the allowance for loan losses)	23,000			23,000	21,130			21,130
Originated mortgage servicing rights	2,424		2,424		2,374		2,374	
Foreclosed assets	2,362		2,362		1,876		1,876	
	$ 506,719	$ 5,927	$ 477,792	$ 23,000	$ 460,452	$ 5,033	$ 434,289	$ 21,130
		1.17%	94.29%	4.54%		1.09%	94.32%	4.59%

Percent of assets and liabilities
measured at fair value

Table of Contents

The changes in fair value of assets and liabilities recorded at fair value through earnings on a recurring basis and changes in assets and liabilities recorded at fair value on a nonrecurring basis, for which an impairment, or reduction of an impairment, was recognized in the three and six month periods ended June 30, 2012 and 2011, are summarized as follows:

	Three Months Ended June 30					
	2012			2011		
Description	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
Recurring Items						
Trading securities						