

ISABELLA BANK CORP  
Form DEF 14A  
April 08, 2011

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

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )

Filed by the Registrant    
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**ISABELLA BANK CORPORATION**

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(Name of Registrant as Specified In Its Charter)

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**ISABELLA BANK CORPORATION**  
**401 N. Main St.**  
**Mt. Pleasant, Michigan 48858**

**NOTICE OF THE ANNUAL MEETING OF SHAREHOLDERS**  
**To Be Held May 3, 2011**

Notice is hereby given that the Annual Meeting of Shareholders of Isabella Bank Corporation will be held on Tuesday, May 3, 2011 at 5:00 p.m. Eastern Standard Time, at the Comfort Inn, 2424 S. Mission Street, Mt. Pleasant, Michigan. The meeting is for the purpose of considering and acting upon the following items of business:

1. The election of five directors.
2. To hold an advisory, non-binding vote on executive compensation of named executive officers.
3. To hold an advisory, non-binding vote on how frequently advisory votes on the executive compensation of named executive officers should be held.
4. To transact such other business as may properly come before the meeting, or any adjournment or adjournments thereof.

The Board of Directors has fixed April 1, 2011 as the record date for determination of shareholders entitled to notice of, and to vote at, the meeting or any adjournments thereof.

Your vote is important. Even if you plan to attend the meeting, please date and sign the enclosed proxy form, indicate your choice with respect to the matters to be voted upon, and return it promptly in the enclosed envelope. Note that if stock is held in more than one name, all parties should sign the proxy form.

By order of the Board of Directors

Debra Campbell, Secretary

Dated: April 8, 2011

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**ISABELLA BANK CORPORATION**

**401 N. Main St**

**Mt. Pleasant, Michigan 48858**

**PROXY STATEMENT**

**General Information**

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Isabella Bank Corporation (the Corporation) a Michigan financial holding company, to be voted at the Annual Meeting of Shareholders of the Corporation to be held on Tuesday, May 3, 2011 at 5:00 p.m. at the Comfort Inn, 2424 S. Mission Street, Mt. Pleasant, Michigan, or at any adjournment or adjournments thereof, for the purposes set forth in the accompanying Notice of Annual Meeting of Shareholders and in this Proxy Statement.

This Proxy Statement has been mailed on April 8, 2011 to all holders of record of common stock as of the record date. If a shareholder's shares are held in the name of a broker, bank or other nominee, then that party should give the shareholder instructions for voting the shareholder's shares.

**Voting at the Meeting**

The Board of Directors of the Corporation has fixed the close of business on April 1, 2011 as the record date for the determination of shareholders entitled to notice of, and to vote at, the Annual Meeting of Shareholders and any adjournment thereof. The Corporation has only one class of common stock and no preferred stock. As of April 1, 2011, there were 7,546,866 shares of common stock of the Corporation outstanding. Each outstanding share entitles the holder thereof to one vote on each separate matter presented for vote at the meeting. Shareholders may vote on matters that are properly presented at the meeting by either attending the meeting and casting a vote or by signing and returning the enclosed proxy. If the enclosed proxy is executed and returned, it may be revoked at any time before it is exercised at the meeting. All shareholders are encouraged to date and sign the enclosed proxy, indicate their choice with respect to the matters to be voted upon, and return it to the Corporation.

The Corporation will hold the Annual Meeting of Shareholders if holders of a majority of the Corporation's shares of common stock entitled to vote are represented in person or by proxy at the meeting. If a shareholder signs and returns the proxy, those shares will be counted to determine whether the Corporation has a quorum, even if the shareholder abstains or fails to vote on any of the proposals listed on the proxy.

A shareholder's broker may not vote on the election of directors, the advisory vote to approve the named executive officers' compensation or the advisory vote on the frequency of the vote on named executive officers' compensation if the shareholder does not furnish instructions for such proposals. A shareholder should use the voting instruction card provided by the institution that holds his or her shares to instruct the broker to vote the shares or else the shareholder's shares will be considered broker non-votes.

Broker non-votes are shares held by brokers or nominees as to which voting instructions have not been received from the beneficial owners or the persons entitled to vote those shares and the broker or nominee does not have discretionary voting power under rules applicable to broker-dealers. Under these rules, proposals one, two and three are not items on which brokerage firms may vote in their discretion on behalf of their clients if such clients have not furnished voting instructions.

At this year's annual meeting, shareholders will elect five directors to serve for a term of three years. In voting on the election of directors, a shareholder may vote in favor of the nominees, vote against or withhold votes as to all nominees, or vote against or withhold votes as to specific nominees. Directors are elected by a plurality of the votes cast at the annual meeting. This means that the nominees receiving the greatest number of votes will be elected. Shares not voted, including broker non-votes, have no effect on the election of directors.

In voting on the advisory, nonbinding proposal to approve the executive compensation described in this proxy statement, a shareholder may vote in favor of the advisory proposal, vote against the advisory proposal or abstain from voting. A majority of the shares represented at the annual meeting and entitled to vote on this advisory proposal must be voted in favor of the proposal for it to pass. While this vote is required by law, it will neither be

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binding on the Board of Directors, nor will it create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on the Board of Directors. In counting votes on the advisory, nonbinding proposal to approve executive compensation matters, abstentions will have the same effect as a vote against the proposal and broker non-votes will have no effect on the outcome of the vote.

In voting on the advisory, nonbinding proposal on how frequently a shareholder vote on executive compensation matters should be held, a shareholder may vote in favor of holding such a vote once every year, once every two years or once every three years, or may abstain from voting. Generally, approval of any proposal presented to the Corporation's shareholders requires the affirmative vote of a majority of the shares represented at the meeting and entitled to vote on the proposal. However, because this vote is advisory and nonbinding, if none of the vote frequency options receives the affirmative vote of a majority of the shares represented at the meeting and entitled to vote on the proposal, the vote frequency option receiving the greatest number of votes will be considered the frequency option recommended by the Corporation's shareholders. Even though this vote will not be binding on the Board of Directors, and it will not create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on, the Board of Directors, the Board of Directors will take into account the outcome of this vote in making a determination on the frequency that advisory votes on the Corporation's executive compensation will be included in the Corporation's proxy statements. In counting votes on the advisory, nonbinding proposal on how frequently the shareholder vote on the Corporation's executive compensation should be held, abstentions and broker non-votes will have no effect on the outcome of the vote.

### **Proposal 1-Election of Directors**

The Board of Directors currently consists of thirteen (13) members and is divided into three classes, with the directors in each class being elected for a term of three years. On December 31, 2010, in accordance with the Corporation's bylaws, William J. Strickler and Theodore W. Kortes retired as members of the Corporation's Board of Directors and the number of directors was reduced to thirteen (13). At the 2011 Annual Meeting of Shareholders five directors, Dennis P. Angner, Jeffrey J. Barnes, G. Charles Hubscher, David J. Maness, and W. Joseph Manifold, whose terms expire at the annual meeting, have been nominated for election through 2014 for the reasons described below.

Except as otherwise specified in the proxy, proxies will be voted for election of the five nominees. If a nominee becomes unable or unwilling to serve, proxies will be voted for such other person, if any, as shall be designated by the Board of Directors. However, the Corporation's management now knows of no reason to anticipate that this will occur. The five nominees for election as directors who receive the greatest number of votes cast will be elected directors. Each of the nominees has agreed to serve as a director if elected.

Nominees for election and current directors are listed below. Also shown for each nominee and each current director is his or her principal occupation for the last five or more years, age and length of service as a director of the Corporation.

**The Board of Directors unanimously recommends that shareholders vote FOR the election of each of the five director nominees nominated by the Board of Directors.**

### **Director's Qualifications**

The members of the Corporation's Board of Directors (the Board) are all well qualified to serve on the Board and represent our shareholders' best interest. As described below, under the caption "Nominating and Corporate Governance Committee" the Board and Nominating and Corporate Governance Committee (the "Nominating Committee") select nominees to the Board to establish a Board that is comprised of members who:

Have extensive business leadership

Bring a diverse perspective and experience

Are independent and collegial

Have high ethical standards and have demonstrated sound business judgment

Are willing and able to commit the significant time and effort to effectively fulfill their responsibilities

Are active in and knowledgeable of their respective communities

Each director nominee along with the other directors brings these qualifications to the Board. They provide a diverse complement of specific business skills, experience, and knowledge including extensive financial and accounting experience, knowledge of banking, small business operating experience, and specific knowledge of customer market segments, including agriculture, oil and gas, health care, food and beverage, manufacturing, and retail.

The following describes the key qualifications each director brings to the Board, in addition to the general qualifications described above and the information included in the biographical summaries provided below.

Director	Professional Expertise in Standing or Chosen Field	Audit Committee	Leadership and Team Building Skills	Diversity by Race, Gender, Cultural or Graphical Diversity	Entrepreneurial Skills	Bank Business Segment
David J. Maness	X		X	X	X	X
Dennis P. Angner	X	X	X	X	X	X
Jeffrey J. Barnes	X		X	X	X	X
Richard J. Barz	X	X	X	X	X	X
Sandra L. Caul	X		X	X	X	X
James C. Fabiano	X		X	X	X	X
G. Charles Hubscher	X	X	X	X	X	X
Thomas L. Kleinhardt	X		X	X	X	X
Joseph LaFramboise	X		X	X	X	X
W. Joseph Manifold	X	X	X	X	X	X
W. Michael McGuire	X	X	X	X	X	X
Dianne C. Morey	X		X	X	X	X
Dale D. Weburg	X		X	X	X	X

The following table identifies the individual members of our Board serving on each of these standing committees:

Director	Audit	Nominating and Corporate Governance	Compensation and Human Resource
David J. Maness	X <sub>o</sub>	X <sub>o</sub>	X <sub>c,o</sub>
Dennis P. Angner			
Jeffrey J. Barnes	X		X
Richard J. Barz			
Sandra L. Caul		X	X
James C. Fabiano		X	X
G. Charles Hubscher	X		X
Thomas L. Kleinhardt			X



Joseph LaFramboise	X		X
W. Joseph Manifold	X <sub>c</sub>	X	X
W. Michael McGuire	X	X	X
Dianne C. Morey			X
Dale D. Weburg		X <sub>c</sub>	X
C Chairperson			
O Ex-Officio			

**Director Nominees for Terms Ending in 2014**

*Dennis P. Angner* (age 55) has been a director of the Corporation and Isabella Bank (the Bank) since 2000. Mr. Angner has been principally employed by the Corporation since 1984 and has served as President of the Corporation since December 30, 2001 and CFO since January 1, 2010. Mr. Angner served as Chief Executive Officer of the Corporation from December 30, 2001 through December 31, 2009. He is the past Chair of the Michigan Bankers Association and is currently serving as vice chairman of its taxation committee, is a member of

the American Bankers Association Government Relations Council, and has served on the Central Michigan American Red Cross board for over 20 years.

*Dr. Jeffrey J. Barnes* (age 48) has been a director of the Bank since September 2007 and was appointed to the Corporation's Board of Directors effective January 1, 2010. Dr. Barnes is a physician and co-owner of Central Eye Consultants. He is a former member of the Central Michigan Community Hospital Board of Directors.

*G. Charles Hubscher* (age 57) has been a director of the Bank since May 2004 and was appointed to the Corporation's Board of Directors effective January 1, 2010. Mr. Hubscher is the President of Hubscher and Son, Inc., a sand and gravel producer. He is a director of the National Stone and Gravel Association, the Michigan Aggregates Association, serves on the Board of Trustees for the Mt. Pleasant Area Community Foundation, and is a member of the Zoning Board of Appeals for Deerfield Township.

*David J. Maness* (age 57) has been a director of the Bank since 2003 and of the Corporation since 2004. Mr. Maness was elected chairman of the board for the Corporation and the Bank in 2010. He is President of Maness Petroleum, a geological and geophysical consulting services company. Mr. Maness is currently serving as a director for the Michigan Oil & Gas Association, and he previously served on the Mt. Pleasant Public Schools Board of Education.

*W. Joseph Manifold* (age 59) has been a director of the Corporation since 2003 and of the Bank since January 1, 2010. Mr. Manifold is a Certified Public Accountant and CFO of Federal Broach Holdings LLC, a holding company which operates several manufacturing companies. Previously, he was a senior manager with Ernst & Young Certified Public Accounting firm working principally on external bank audits and was CFO of the Delfield Company. Prior to joining the Board, Mr. Manifold also served on the Isabella Community Credit Union Board and was Chairman of the Mt. Pleasant Public Schools Board of Education.

#### **Current Directors with Terms Ending in 2012**

*Richard J. Barz* (age 62) has been a director of the Bank since 2000 and of the Corporation since 2002. Mr. Barz has been employed by the Corporation since 1972 and has been Chief Executive Officer of the Corporation since January 1, 2010 and President and CEO of the Bank since December 2001. Prior to his appointment as President and CEO, he served as Executive Vice President of the Bank. Mr. Barz has been very active in community organizations and events. He is the past chairman of the Central Michigan Community Hospital Board of Directors, is the current chairman of the Middle Michigan Development Corporation Board of Directors, and serves on several boards and committees for Central Michigan University and various volunteer organizations throughout mid-Michigan.

*Sandra L. Caul* (age 67) has been a director of the Bank since 1994 and of the Corporation since 2005. Ms. Caul is Vice Chairperson of the Central Michigan Community Hospital Board of Directors, Chairperson of the Mid Michigan Community College Advisory Board and board member for Central Michigan Community Mental Health Facilities. She also sits on the board of the Central Michigan American Red Cross. Ms. Caul retired in January 2005 as a state representative of the Michigan State House of Representatives. Ms. Caul is a registered nurse.

*W. Michael McGuire* (age 61) has been a director of the Corporation since 2007 and of the Bank since January 1, 2010. He is a director of the Farwell Division of the Bank. Mr. McGuire is currently an attorney and the Director of the Office of the Corporate Secretary and Assistant Secretary of The Dow Chemical Company, a manufacturer of chemicals, plastics and agricultural products, headquartered in Midland, Michigan.

*Dianne C. Morey* (age 64) has been a director of the Bank since December 2000 and was appointed to the Corporation's Board of Directors effective January 1, 2010. Mrs. Morey is an owner of Bandit Industries, Inc., a forestry equipment manufacturer. She serves as a Trustee for the Mt. Pleasant Area Community Foundation.

**Current Directors with Terms Ending in 2013**

*James C. Fabiano* (age 67) has been a director of the Bank since 1979 and of the Corporation since 1988. He served as the Corporation's chair from 2004 to 2010. Mr. Fabiano is Chairman and CEO of Fabiano Brothers, Inc., a wholesale beverage distributor operating in several counties throughout Michigan. Mr. Fabiano is a past recipient of

the Mt. Pleasant Area Chamber of Commerce Citizen of the Year award. He is also a past Chairman of the Central Michigan University Board of Trustees.

*Thomas L. Kleinhardt* (age 56) has been a director of the Bank since October 1998 and was appointed to the Corporation's Board of Directors effective January 1, 2010. Mr. Kleinhardt is President of McGuire Chevrolet, is active in the Clare Kiwanis Club, and coaches girls Junior Varsity Basketball team at Clare High School.

*Joseph LaFramboise* (age 61) has been a director of the Bank since September 2007, and was appointed to the Corporation's Board of Directors effective January 1, 2010. He is a retired Sales and Marketing Executive of Ford Motor Company. Mr. LaFramboise is Ambassador of Eagle Village in Ewart, Michigan.

*Dale D. Weburg* (age 67) has served as a director of the Breckenridge Division of the Bank since 1987 and of the Bank and Corporation since 2000. Mr. Weburg is President of Weburg Farms, a cash crop farm operation. Mr. Weburg also serves as a trustee of the Board of Directors of Gratiot Health System.

Each of the directors has been engaged in their stated professions for more than five years.

#### **Other Named Executive Officers**

*Timothy M. Miller* (age 60), President of the Breckenridge Division of the Bank and a member of its Board of Directors, has been an employee of the Corporation since 1985. Steven D. Pung (age 61), Chief Operations Officer of the Bank and a member of the Board of Directors of Financial Group Information Services (a wholly owned subsidiary of the Corporation) has been employed by the Corporation since 1978. David J. Reetz (age 50), Senior Vice President and Chief Lending Officer of the Bank, has been employed by the Corporation since 1987.

All officers of the Corporation serve at the pleasure of the Corporation's Board of Directors.

#### **Proposal 2-Advisory Vote On Executive Compensation**

The compensation of the Corporation's principal executive officer, principal financial officer, and three other most highly compensated executive officers (named executive officers) is described below under the headings

Compensation Discussion and Analysis and Executive Officers. Shareholders are urged to read these sections of this proxy statement, which discusses the Corporation's compensation policies and procedures with respect to its named executive officers.

In accordance with recently adopted changes to Section 14A of the Securities Exchange Act of 1934 (the Exchange Act), shareholders will be asked at the annual meeting to provide their support with respect to the compensation of the Corporation's named executive officers by voting on the following advisory, non-binding resolution:

**RESOLVED, that the shareholders of Isabella Bank Corporation approve, on an advisory basis, the compensation paid to the Corporation's named executive officers, as disclosed pursuant to the compensation disclosure rules of the Securities and Exchange Commission, SEC including the Compensation Discussion and Analysis, compensation tables and narrative discussion, for purposes of Section 14A (a) of the Securities Exchange Act of 1934.**

This advisory vote, commonly referred to as a say-on-pay advisory vote, is non-binding on the Board of Directors. Although non-binding, the Board of Directors and the Compensation and Human Resource Committee value constructive dialogue on executive compensation and other important governance topics with the Corporation's shareholders and encourage all shareholders to vote their shares on this matter. The Board of Directors and the

Compensation and Human Resource Committee will review the voting results and take them into consideration when making future decisions regarding executive compensation programs. The Board believes shareholders should consider the following in determining whether to approve this proposal:

The Corporation is not required to provide any severance or termination pay or benefits to any named executive officer;

Each member of the Compensation and Human Resource Committee is independent under the applicable standards of the NASDAQ Marketplace Rules;

The Compensation and Human Resource Committee continually monitors the Corporation's performance and adjusts compensation practices accordingly; and

The Compensation and Human Resource Committee with the assistance of an independent compensation consulting firm regularly assesses the Corporation's individual and total compensation programs against peer companies, the general marketplace and other industry data points.

**Unless otherwise instructed, validly executed proxies will be voted FOR this resolution.**

**The Board of Directors unanimously recommends that shareholders vote FOR the nonbinding advisory resolution approving the executive compensation of the Corporation's named executive officers.**

### **Proposal 3-Frequency of Advisory Votes On Executive Compensation**

In accordance with recently adopted changes to Section 14A of the Exchange Act, the Corporation is providing a shareholder advisory vote to approve the compensation of our named executive officers (the say-on-pay advisory vote in Proposal 2 above) this year and will do so at least once every three years thereafter. Pursuant to recently adopted changes to Section 14A of the Exchange Act, at the 2011 Annual Meeting, the Corporation is also asking shareholders to vote on whether future say-on-pay advisory votes on executive compensation should occur every year, every two years or every three years.

After careful consideration, the Board of Directors recommends that future shareholder say-on-pay advisory votes on executive compensation be conducted every three years. Although the Board of Directors recommends a say-on-pay vote every three years, shareholders will be able to specify one of four choices for this proposal on the proxy card: one year, two years, three years or abstain. Shareholders are not voting to approve or disapprove the Board of Directors recommendation.

Although this advisory vote regarding the frequency of say-on-pay votes is non-binding on the Board of Directors, the Board of Directors and the Compensation and Human Resource Committee will review the voting results and take them into consideration when deciding how often to conduct future say-on-pay shareholder advisory votes.

**Unless otherwise instructed, validly executed proxies will be voted FOR the Three Year frequency option.**

**The Board of Directors unanimously recommends that shareholders vote FOR the Three Year frequency option.**

## **Corporate Governance**

### **Director Independence**

The Corporation has adopted the director independence standards as defined under Rule 5605(a)(2) of the NASDAQ Marketplace Rules. The Board has determined that James C. Fabiano, Dale D. Weburg, David J. Maness, W. Joseph Manifold, Sandra L. Caul, W. Michael McGuire, Thomas L. Kleinhardt, Joseph LaFramboise, Jeffrey J. Barnes, Dianne C. Morey, and G. Charles Hubscher are independent directors. Dennis P. Angner is not independent as he is employed as President and Chief Financial Officer of the Corporation. Richard J. Barz is not independent as he is

employed as Chief Executive Officer of the Corporation.

**Board Leadership Structure and Risk Oversight**

The Corporation's Governance policy provides that only directors who are deemed to be independent as set forth by NASDAQ and SEC rules are eligible to hold the office of Chairman of the Board. Additionally, the chairpersons of Board established committees must also be independent directors. It is the Board's belief that

having a separate Chairman and Chief Executive Officer best serves the interest of the shareholders. The Board of Directors elects its chairperson at the first Board meeting following the annual meeting. Independent members of the Board of Directors meet without insider directors at least twice per year.

Management is responsible for the Corporation's day to day risk management and the Board's role is to engage in informed oversight. The Board utilizes committees to oversee risks associated with compensation, financial, and governance. Financial Group Information Services, the Corporation's information processing subsidiary is responsible for overseeing risks associated with information technology. The Isabella Bank Board of Directors is responsible for overseeing credit, investment, interest rate, and trust risks. The chairpersons of the respective boards or committees report on their activities on a regular basis.

The Audit Committee is responsible for the integrity of the consolidated financial statements of the Corporation; the independent auditors' qualifications and independence; the performance of the Corporation's, and its subsidiaries' internal audit function and independent auditors; the Corporation's system of internal controls; the Corporation's financial reporting and system of disclosure controls; and the compliance by the Corporation with legal and regulatory requirements and with the Corporation's Code of Business Conduct and Ethics.

#### **Committees of the Board of Directors and Meeting Attendance**

The Board met 14 times during 2010. All incumbent directors attended 75% or more of the meetings held in 2010. The Board has an Audit Committee, a Nominating and Corporate Governance Committee, and a Compensation and Human Resource Committee.

#### ***Audit Committee***

The Audit Committee is composed of independent directors who meet the requirements for independence as defined in Rule 5605(a)(2) of the NASDAQ Marketplace Rules. Information regarding the functions performed by the Committee, its membership, and the number of meetings held during the year, is set forth in the Report of the Audit Committee included elsewhere in this annual proxy statement. The Audit Committee is governed by a written charter approved by the Board. The Audit Committee Charter is available on the Bank's website, [www.isabellabank.com](http://www.isabellabank.com), under the Investor Relations tab.

In accordance with the provisions of the Sarbanes-Oxley Act of 2002, directors Manifold and McGuire meet the requirements of Audit Committee Financial Expert and have been so designated by the Board. The Committee also consists of directors Barnes, Hubscher, LaFramboise, and Maness.

#### ***Nominating and Corporate Governance Committee***

The Corporation has a standing Nominating and Corporate Governance Committee consisting of independent directors who meet the requirements for independence as defined in Rule 5605(a)(2) of NASDAQ Marketplace Rules. The Committee consists of directors Caul, Fabiano, Maness, Manifold, McGuire, and Weburg. The Nominating and Corporate Governance Committee held one meeting in 2010, with all directors attending the meeting. The Board has approved a Nominating and Corporate Governance Committee Charter which is available on the Bank's website [www.isabellabank.com](http://www.isabellabank.com) under the Investor Relations tab.

The Nominating and Corporate Governance Committee is responsible for evaluating and recommending individuals for nomination to the Board for approval. The Committee in evaluating nominees, including incumbent directors and any nominees put forth by shareholders, considers business experience, skills, character, judgment, leadership experience, and their knowledge of the geographical markets, business segments or other criteria the Committee



deems relevant and appropriate based on the current composition of the Board. The Committee considers diversity in identifying members with respect to geographical markets served by the Corporation and the business experience of the nominee.

The Nominating and Corporate Governance Committee will consider as potential nominees, persons recommended by shareholders. Recommendations should be submitted in writing to the Secretary of the Corporation, 401 N. Main St., Mt. Pleasant, Michigan 48858 and include the shareholder's name, address and number of shares of the Corporation owned by the shareholder. The recommendation should also include the name, age, address and

qualifications of the recommended candidate for nomination. Recommendations for the 2012 Annual Meeting of Shareholders should be delivered no later than December 9, 2011. The Nominating and Corporate Governance Committee does not evaluate potential nominees for director differently based on whether they are recommended to the Nominating and Corporate Governance Committee by a shareholder or otherwise.

***Compensation and Human Resource Committee***

The Compensation and Human Resource Committee of the Corporation is responsible for reviewing and recommending to the Corporation's Board the compensation of the Chief Executive Officer and other executive officers of the Corporation, benefit plans and the overall percentage increase in salaries. The committee consists of independent directors, who meet the requirements for independence as defined in Rule 5605(a) (2) of the NASDAQ Marketplace Rules. The Committee consists of directors Maness, Barnes, Caul, Fabiano, Hubscher, Kleinhardt, LaFramboise, Manifold, McGuire, Morey, and Weburg. The Committee held one meeting during 2010 with all directors attending the meeting. This Committee is governed by a written charter approved by the Board that is available on the Bank's website [www.isabellabank.com](http://www.isabellabank.com) under the Investor Relations tab.

***Communications with the Board***

Shareholders may communicate with the Corporation's Board of Directors by sending written communications to the Corporation's Secretary, Isabella Bank Corporation, 401 N. Main St., Mt. Pleasant, Michigan 48858. Communications will be forwarded to the Board of Directors or the appropriate committee, as soon as practicable.

***Code of Ethics***

The Corporation has adopted a Code of Business Conduct and Ethics that is applicable to the Corporation's Chief Executive Officer and the Chief Financial Officer. The Corporation's Code of Business Conduct and Ethics is available on the Bank's website [www.isabellabank.com](http://www.isabellabank.com) under the Investor Relations tab.

## Report of the Audit Committee

The Audit Committee oversees the Corporation's financial reporting process on behalf of the Board. The 2010 Committee consisted of directors Barnes, Hubscher, LaFramboise, Maness, Manifold and McGuire.

The Audit Committee is responsible for pre-approving all auditing services and permitted non-audit services for the Corporation by its independent auditors or any other auditing or accounting firm if those fees are reasonably expected to exceed 5.0% of the current year agreed upon fee for independent audit services, except as noted below. The Audit Committee has established general guidelines for the permissible scope and nature of any permitted non-audit services in connection with its annual review of the audit plan and reviews the guidelines with the Board of Directors.

Management has the primary responsibility for the consolidated financial statements and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited consolidated financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the consolidated financial statements. The Audit Committee also reviewed with management and the independent auditors, management's assertion on the design and effectiveness of the Corporation's internal control over financial reporting as of December 31, 2010.

The Audit Committee reviewed with the Corporation's independent auditors, who are responsible for expressing an opinion on the conformity of those audited consolidated financial statements with accounting principles generally accepted in the United States of America, their judgments as to the quality, not just the acceptability, of the Corporation's accounting principles and such other matters as are required to be discussed with the Audit Committee by the standards of the Public Company Accounting Oversight Board (United States), including those described in AU Section 380 Communication with Audit Committees, as may be modified or supplemented. In addition, the Audit Committee has received the written disclosures and the letter from the independent accountants required by PCAOB Rule 3526, Communication with Audit Committees Concerning Independence, as may be modified or supplemented, and has discussed with the independent accountant the independent accountants' independence.

The Audit Committee discussed with the Corporation's internal and independent auditors the overall scope and plans for their respective audits. The Audit Committee meets with the internal and external independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Corporation's internal controls and the overall quality of the Corporation's financial reporting process. The Audit Committee held six meetings during 2010, and all committee members attended 75% or more of the meetings.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors (and the Board has approved) that the audited consolidated financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2010 for filing with the Securities and Exchange Commission. The Audit Committee has appointed Rehmann Robson as the independent auditors for the 2011 audit.

Respectfully submitted,

W. Joseph Manifold, Audit Committee Chairperson  
Jeffrey J. Barnes  
G. Charles Hubscher  
Joseph LaFramboise  
David J. Maness  
W. Michael McGuire



## **Compensation Discussion and Analysis**

The Compensation and Human Resource Committee (the Committee) is responsible for the compensation and benefits for the Chief Executive Officer, President, and executive officers of the Corporation. The Committee evaluates and approves the executive officer and senior management compensation plans, policies and programs of the Corporation and its affiliates. The Chief Executive Officer, Richard J. Barz, conducts annual performance reviews for Named Executive Officers, excluding himself. Mr. Barz recommends an appropriate salary to the Committee based on the performance review and the officer's years of service along with competitive market data.

### **Compensation Objectives**

The Committee considers asset growth with the safety and soundness objectives and earnings per share to be the primary ratios in measuring financial performance. The Corporation's philosophy is to maximize long-term return to shareholders consistent with safe and sound banking practices, while maintaining the commitment to superior customer and community service. The Corporation believes that the performance of executive officers in managing the business should be the basis for determining overall compensation. Consideration is also given to overall economic conditions and current competitive forces in the market place. The objectives of the Committee are to effectively balance salaries and potential compensation to an officer's individual management responsibilities and encourage them to realize their potential for future contributions to the Corporation. The objectives are designed to attract and retain high performing executive officers who will lead the Corporation while attaining the Corporation's earnings and performance goals.

### **What the Compensation Programs are Designed to Reward**

The Corporation's compensation programs are designed to reward dedicated and conscientious employment with the Corporation, loyalty in terms of continued employment, attainment of job related goals and overall profitability of the Corporation. In measuring an executive officer's contributions to the Corporation, the Committee considers numerous factors including, among other things, the Corporation's growth in terms of asset size and increase in earnings per share. In rewarding loyalty and long-term service, the Corporation provides attractive retirement benefits.

### **Review of Risks Associated with Compensation Plans**

Based on an analysis conducted by management and reviewed by the Committee, management does not believe that the Corporation's compensation programs for employees are reasonably likely to have a material short or long term adverse effect on the Corporation's Results of Operation.

### **Use of Consultants**

In 2010, the Committee directly engaged the services of Blanchard Chase, an outside compensation consulting firm, to assist with a total compensation review for the top two executive officers of the Corporation (CEO and President). Blanchard Chase is an independent consulting firm and does not perform any additional services for the Corporation or senior management. In addition, Blanchard Chase does not have any other personal or business relationships with any Board member or any officer of the Corporation. The Committee is continuing to work with Blanchard Chase on proxy support in 2011. During 2009, the Committee did not employ any services of outside compensation or benefit consultants to assist it in compensation-related initiatives.

### **Elements of Compensation**

The Corporation's executive compensation program has consisted primarily of base salary and benefits, annual cash bonus incentives, director fees for insider directors, and participation in the Corporation's retirement plans.

**Why Each of the Elements of Compensation is Chosen**

*Base Salary and Benefits* are set to provide competitive levels of compensation to attract and retain officers with strong motivated leadership. Each officer's performance, current compensation, and responsibilities within the Corporation are considered by the Committee when establishing base salaries. The Corporation also believes it is best to pay sufficient base salary because it believes an over-reliance on equity incentive compensation could

potentially skew incentives toward short-term maximization of shareholder value as opposed to building long-term shareholder value. Base salary encourages management to operate the Corporation in a safe and sound manner even when incentive goals may prove unattainable.

*Annual Performance Incentives* are used to reward executive officers for the Corporation's overall financial performance. This element of the Corporation's compensation programs is included in the overall compensation in order to reward employees above and beyond their base salaries when the Corporation's performance and profitability exceed established annual targets. The inclusion of a modest incentive compensation encourages management to be more creative, diligent and exhaustive in managing the Corporation to achieve specific financial goals without incurring inordinate risks.

Performance incentives paid under the Executive Incentive Plan in 2010 were determined by reference to seven performance measures that related to services performed in 2009. The maximum award that may be granted under the Executive Incentive Plan to each eligible employee equals 10% of the employee's base salary (the Maximum Award). The payment of 35% of the Maximum Award was conditioned on the eligible employee accomplishing personal performance goals that were established by such employee's supervisor as part of the employee's annual performance review. Each of the employees who were eligible to participate in the Executive Incentive Plan in 2009 accomplished his or her personal performance goals and was accordingly paid 35% of the 2009 Maximum Award. The payment of the remaining 65% of the Maximum Award was conditioned on the achievement of Corporation-wide targets in the following six categories: (1) earnings per share (weighted 40%); (2) net operating expenses to average assets (weighted 15%); (3) Fully Taxable Equivalent FTE net interest margin, excluding loan fees (weighted 15%); (4) in-market deposit growth (weighted 10%); (5) loan growth (weighted 10%); and (6) exceeding peer group return on average assets (weighted 10%). The following chart provides the 2009 target for each of the foregoing targets that were used to determine bonus awards that were paid in 2010, as well as the performance obtained for each target.

#### Executive Incentive Plan

Target	2009 Targets				2009 Performance
	25.00%	50.00%	75.00%	100.00%	
Earning per share	\$ 0.90	\$ 0.93	\$ 0.96	\$ 0.99	\$ 1.04
Net operating expenses to average assets	1.66%	1.65%	1.64%	1.63%	1.71%
FTE Net Interest Margin	3.71%	3.73%	3.75%	3.77%	3.86%
In market deposit growth	4.50%	5.00%	5.50%	6.00%	1.87%
Loan growth	5.50%	6.00%	6.50%	7.00%	8.28%
Exceeding peer group return on average assets	-0.26%	-0.25%	-0.25%	-0.24%	0.91%

*Retirement Plans.* The Corporation's retirement plans are designed to assist executives in providing themselves with a financially secure retirement. The retirement plans include: a frozen defined benefit pension plan; a 401(k) plan; and a non-leveraged employee stock ownership plan (ESOP), which is frozen to new participants; and a retirement bonus plan.

#### How the Corporation Chose Amounts for Each Element

The Committee's approach to determining the annual base salary of executive officers is to offer competitive salaries in comparison with other comparable financial institutions. The Committee utilizes both an independent compensation

consultant, Blanchard Chase and a survey prepared by the Michigan Bankers Association of similar sized Michigan based institutions. The independent compensation consultant established a benchmark peer group of 20 mid-west financial institutions in non urban areas whose average assets size, number of branch locations, return on average assets and nonperforming assets that were comparable to Isabella Bank Corporation. The Michigan Bankers Association 2010 compensation survey was based on the compensation information provided by these organizations for 2009. Specific factors used to decide where an executive officer's salary should be within the established range include the historical financial performance, financial performance outlook, years of service, and job performance.



The annual performance incentive is based on the achievement of goals set for each individual. An analysis is conducted by the Chief Executive Officer. The Chief Executive Officer makes a recommendation to the Committee for the appropriate amount for each individual executive officer. The Committee reviews, modifies if necessary, and approves the recommendations of the Chief Executive Officer. The Committee reviews the performance of the Chief Executive Officer. The Committee uses the following factors as quantitative measures of corporate performance in determining annual cash bonus amounts to be paid:

Peer group financial performance compensation

1 and 5 year shareholder returns

Earnings per share and earnings per share growth

Budgeted as compared to actual annual operating performance

Community and industry involvement

Results of audit and regulatory exams

Other strategic goals as established by the board of directors

While no particular weight is given to any specific factor, the Committee gives at least equal weight to the subjective analyses as described above.

Total compensation in 2010 was based on the Committee targeting its Chief Executive Officer's and President & Chief Financial Officer's compensation to approximate the median of the range provided by the independent compensation consultant. Compensation for other named executive officers was based on the ranges provide by the Michigan Bankers Association surveys.

*Retirement plans.* The Corporation has a 401(k) plan in which substantially all employees are eligible to participate. Employees may contribute up to 50% of their compensation subject to certain limits based on federal tax laws. As a result of the curtailment of the defined benefit plan noted below, the Corporation increased the contributions to the 401(k) plan effective January 1, 2007. The Corporation makes a annual 3.0% safe harbor contribution for all eligible employees and matching contributions equal to 50% of the first 4.0% of an employee's compensation contributed to the Plan during the year. Employees are 100% vested in the safe harbor contributions and are 0% vested through their first two years of employment and are 100% vested after 6 years through a laddered vesting schedule of service for matching contributions.

The Corporation maintains a non-leveraged employee stock ownership plan (ESOP) which covers substantially all of its employees. The plan was frozen effective December 31, 2006 to new participants. Contributions to the plan are discretionary and approved by the Board of Directors.

The retirement bonus plan is a nonqualified plan of deferred compensation benefits for eligible employees effective January 1, 2007. An initial amount has been credited for each eligible employee as of January 1, 2007. Subsequent amounts will be credited on each allocation date thereafter as defined in the plan. The amount of the initial allocation and the annual allocation are determined pursuant to the payment schedule adopted at the sole and exclusive discretion of the Board of Directors, as set forth in the plan.

In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The effect of the curtailment was recognized in the first quarter of 2007 and the current participants' accrued benefits were frozen as of March 1, 2007. Participation in the plan was limited to eligible employees as of December 31, 2006.

*Other Benefits and Perquisites.* Executive officers are eligible for all of the benefits made available to full-time employees of the Corporation (such as the 401(k) plan, employee stock purchase plan, health insurance, group term life insurance and disability insurance) on the same basis as other full-time employees and are subject to the same sick leave and other employee policies. The Corporation also provides its executive officers with certain additional benefits and perquisites, which it believes are appropriate in order to attract and retain the proper quality of talent for these positions and to recognize that similar executive benefits and perquisites are commonly offered by comparable financial institutions.

A description and the cost to the Corporation of these perquisites are included in footnote two in the Summary Compensation Table appearing on page 14.

The Corporation believes that benefits and perquisites provided to its executive officers in 2010 represented a reasonable percentage of each executive's total compensation package and was not inconsistent, in the aggregate, with perquisites provided to executive officers of comparable competing financial institutions.

The Corporation maintains a plan for qualified officers to provide death benefits to each participant. Insurance policies, designed primarily to fund death benefits, have been purchased on the life of each participant with the Corporation as the sole owner and beneficiary of the policies.

### **How Elements Fit into Overall Compensation Objectives**

The elements of the Corporation's compensation are structured to reward past and current performance, continued service and motivate its leaders to excel in the future. The Corporation's salary compensation has generally been used to retain and attract motivated leadership. The Corporation intends to continually ensure salaries are sufficient to attract and retain exceptional officers. The Corporation's cash bonus incentive rewards current performance based upon personal and corporate goals and targets. The Corporation offers the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors' Plan) to motivate its eligible officers to enhance value for shareholders by aligning the interests of management with those of its shareholders.

As part of its goal of attracting and retaining quality team members, the Corporation has developed competitive employee benefit plans. Management feels that the combination of all of the plans listed above makes the Corporation's total compensation packages attractive.

### **Compensation and Human Resource Committee Report**

The following Report of the Compensation and Human Resource Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Corporation filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Corporation specifically incorporates this Report by reference therein.

The Compensation and Human Resource Committee, which includes all of the independent directors of the Board, has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of SEC Regulation S-K with management, and based on such review and discussion, the Compensation and Human Resource Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement and the Annual Report on Form 10-K.

Submitted by the Compensation and Human Resource Committee of Isabella Bank Corporation's Board of Directors:

David J. Maness, Chairperson  
Jeffrey J. Barnes  
Sandra L. Caul  
James C. Fabiano  
G. Charles Hubscher  
Thomas L. Kleinhardt  
Joseph LaFramboise  
W. Joseph Manifold  
W. Michael McGuire

Dianne C. Morey  
Dale D. Weburg

### Executive Officers

Executive Officers of the Corporation are compensated in accordance with their employment with the applicable entity. The following table shows information on compensation earned from the Corporation or its subsidiaries for each of the last three fiscal years ended December 31, 2010, for the Chief Executive Officer, the Chief Financial Officer, and the Corporation's three other most highly compensated executive officers.

#### Summary Compensation Table

Name and principal position	Year	Salary (\$)(1)	Bonus (\$)	Change in pension Value and Non-Qualified Deferred Compensation		All Other Compensation (\$)(3)	Total (\$)
				Earnings (\$)(2)			
Richard J. Barz CEO Isabella Bank Corporation	2010	\$ 357,600	\$ 24,706	\$ 116,364	\$ 34,856	\$ 533,526	
President and CEO Isabella Bank	2009	354,250	9,625	90,184	30,568	484,627	
Dennis P. Angner President and CFO	2008	333,275	9,100	110,559	22,697	475,631	
Isabella Bank Corporation	2010	\$ 352,600	\$ 24,706	\$ 103,340	\$ 27,922	\$ 508,568	
Timothy M. Miller President of the Breckenridge Division of Isabella Bank	2009	359,425	9,800	79,623	25,252	474,100	
Steven D. Pung Sr. Vice President and COO	2008	336,095	9,450	83,957	18,453	447,955	
Isabella Bank	2010	\$ 161,220	\$ 12,370	\$ 9,000	\$ 32,798	\$ 215,388	
David J. Reetz(4) Sr. Vice President and CLO	2009	174,600	7,319	6,000	17,323	205,242	
Isabella Bank	2008	166,860	3,200	11,000	14,127	195,187	
Isabella Bank	2010	\$ 143,632	\$ 10,572	\$ 62,288	\$ 32,886	\$ 249,378	
Isabella Bank	2009	127,100	6,003	48,518	18,468	200,089	
Isabella Bank	2008	118,225	3,785	65,111	13,169	200,290	
Isabella Bank	2010	\$ 123,910	\$ 9,165	\$ 36,429	\$ 13,694	\$ 183,198	

- (1) Includes compensation voluntarily deferred under the Corporation's 401(k) plan. Directors fees are also included, for calendar years 2010, 2009 and 2008 respectively as follows: Richard J. Barz \$52,600, \$59,250, and \$58,275; Dennis P. Angner \$52,600, \$59,425, and \$56,095; Timothy M. Miller \$11,300, \$26,900, and \$24,160; and Steven D. Pung \$900, \$900, and \$1,125.
- (2) Represents the aggregate change in the actuarial present value of the noted executive's accumulated benefit under the Isabella Bank Corporation Pension Plan and the Isabella Bank Corporation Retirement Bonus Plan.
- (3) For all noted executives all other compensation includes 401(k) matching contributions. For Richard J. Barz, Steven D. Pung, and David J. Reetz this also includes club dues and auto allowance. For Dennis P. Angner and Timothy M. Miller, this also includes auto allowance.
- (4) Not a named executive officer prior to 2010.



**2010 Pension Benefits**

The following table indicates the present value of accumulated benefits as of December 31, 2010 for each named executive in the summary compensation table.

<b>Name</b>	<b>Plan name</b>	<b>Number of Years of Vesting Service as of 01/01/11 (#)</b>	<b>Present Value of Accumulated Benefit (\$)</b>	<b>Payments During Last Fiscal Year \$</b>
Richard J. Barz	Isabella Bank Corporation Pension Plan	39	\$ 762,000	\$
	Isabella Bank Corporation Retirement Bonus Plan	39	270,931	
Dennis P. Angner	Isabella Bank Corporation Pension Plan	27	382,000	
	Isabella Bank Corporation Retirement Bonus Plan	27	275,533	
Timothy M. Miller	Isabella Bank Corporation Pension Plan	10	79,000	
Steven D. Pung	Isabella Bank Corporation Pension Plan	32	384,000	
	Isabella Bank Corporation Retirement Bonus Plan	32	145,630	
David J. Reetz	Isabella Bank Corporation Pension Plan	24	119,000	
	Isabella Bank Corporation Retirement Bonus Plan	24	90,378	

*Defined benefit pension plan.* The Corporation sponsors the Isabella Bank Corporation Pension Plan, a frozen defined benefit pension plan. In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The curtailment froze the current participant's accrued benefits as of March 1, 2007 and limited participation in the plan to eligible employees as of December 31, 2006. Due to the curtailment of the plan, the number of years of credited service was frozen. As such, the years of credited service for the plan may differ from the participant's actual years of service with the Corporation.

Annual contributions are made to the plan as required by accepted actuarial principles, applicable federal tax laws, and expenses of operating and maintaining the plan. The amount of contributions on behalf of any one participant cannot be separately or individually computed.

Pension 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, effective through December 31, 2006.

A participant may earn a benefit for up to 35 years of accredited service. Earned benefits are 100 percent vested after five years of service. Benefit payments normally start when a participant reaches age 65. A participant with more than five years of service may elect to take early retirement benefits anytime after reaching age 55. Benefits payable under

early retirement are reduced actuarially for each month prior to age 65 in which benefits begin.

Dennis P. Angner, Richard J. Barz, Timothy M. Miller, and Steven D. Pung are eligible for early retirement under the Isabella Bank Corporation Pension Plan. Under the provisions of the Plan, participants are eligible for early retirement after reaching the age of 55 with at least 5 years of service. The early retirement benefit amount is the accrued benefit payable at normal retirement date reduced by 5/9% for each of the first 60 months and 5/18% for each of the next 60 months that the benefit commencement date precedes the normal retirement date.

*Retirement bonus plan.* The Corporation sponsors the Isabella Bank Corporation Retirement Bonus Plan. The Retirement Bonus Plan is a nonqualified plan of deferred compensation benefits for eligible employees effective January 1, 2007. This plan is intended to provide eligible employees with additional retirement benefits. To be eligible, the employee needed to be employed by the Corporation on January 1, 2007, and be a participant in the Corporation's frozen Executive Supplemental Income Agreement. Participants must also be an officer of the Corporation with at least 10 years of service as of December 31, 2006. The Corporation has sole and exclusive discretion to add new participants to the plan by authorizing such participation pursuant to action of the Corporation's Board of Directors.

An initial amount has been credited for each eligible employee as of January 1, 2007. Subsequent amounts shall be credited on each allocation date thereafter as defined in the Plan. The amount of the initial allocation and the



annual allocation shall be determined pursuant to the payment schedule adopted by the sole and exclusive discretion of the Board, as set forth in the Plan.

Dennis P. Angner, Richard J. Barz, Timothy M. Miller, and Steven D. Pung are eligible for early retirement under the Isabella Bank Corporation Retirement Bonus Plan. Under the provisions of the plan, participants are eligible for early retirement upon attaining 55 years of age. There is no difference between the calculation of benefits payable upon early retirement and normal retirement.

### 2010 Nonqualified Deferred Compensation

Name	Executive Contributions in Last FY (\$)	Aggregate Earnings in Last FY (\$)	Aggregate Balance at Last FYE (\$)
Richard J. Barz	\$ 30,650	\$ 3,501	\$ 97,379
Dennis P. Angner	44,400	4,836	134,713
Timothy M. Miller	3,500	839	21,990
Steven D. Pung	900	181	4,799
David J. Reetz	N/A	N/A	N/A

The directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees into the Directors' Plan and may defer up to 100% of their earned fees based on their annual election. These amounts are reflected in the 2010 nonqualified deferred compensation table above. Under the Directors' Plan, these deferred fees are converted on a quarterly basis into shares of the Corporation's common stock based on the fair market value of shares of the Corporation's common stock at that time. Shares credited to a participant's account are eligible for stock and cash dividends as payable.

Distribution from the Directors' Plan occurs when the participant retires from the Board, attains age 70 or upon the occurrence of certain other events. Distributions must take the form of shares of the Corporation's common stock. Any Corporation common stock issued under the Directors' Plan will be considered restricted stock under the Securities Act of 1933, as amended.

### Potential Payments Upon Termination or Change in Control

The estimated payments payable to each named executive officer upon severance from employment, retirement, termination upon death or disability or termination following a change in control of the Corporation are described below. For all termination scenarios, the amounts assume such termination took place as of December 31, 2010.

#### Any Severance of Employment

Regardless of the manner in which a named executive officer's employment terminates, he or she is entitled to receive amounts earned during his or her term of employment. Such amounts include:

Amounts accrued and vested through the Defined Benefit Pension Plan.

Amounts accrued and vested through the Retirement Bonus Plan.

Amounts deferred in the Directors Plan.

Unused vacation pay.

**Retirement**

In the event of the retirement of an executive officer, the officer would receive the benefits identified above.

As of December 31, 2010, the named executive officers listed had no unused vacation days.

**Death or Disability**

In the event of death or disability of an executive officer, in addition to the benefits listed above, the executive officer will also receive payments under the Corporation's life insurance plan or benefits under the Corporation's disability plan as appropriate.

In addition to potential payments upon termination available to all employees, the estates for the executive officers listed below would receive the following payments upon death:

Name	While an Active Employee	Subsequent to Retirement
Richard J. Barz	\$ 610,000	\$ 305,000
Dennis P. Angner	600,000	300,000
Timothy M. Miller	299,800	149,900
Steven D. Pung	285,400	142,700
David J. Reetz	247,800	123,900

**Change in Control**

The Corporation currently does not have a change in control agreement with any of the executive officers; provided, however, pursuant to the Retirement Bonus Plan each participant would become 100% vested in their benefit under the plan if, following a change in control, they voluntarily terminate employment or are terminated without just cause.

**Director Compensation**

The following table summarizes the Compensation of each non-employee director who served on the Board of Directors during 2010.

Name	Fees Earned or Paid in Cash (\$)	Total (\$)
Jeffrey J. Barnes	21,000	21,000
Sandra L. Caul	35,800	35,800
James Fabiano	40,915	40,915
G. Charles Hubscher	25,950	25,950
Thomas L. Kleinhardt	29,450	29,450
Ted W. Kortes	31,100	31,100
Joseph LaFramboise	27,900	27,900
David J. Maness	52,300	52,300
W. Joseph Manifold	29,146	29,146
W. Michael McGuire	31,800	31,800
Dianne C. Morey	18,850	18,850

William J. Strickler	39,085	39,085
Dale D. Weburg	36,400	36,400

The Corporation paid a \$14,000 retainer plus \$1,350 per board meeting to external directors and a \$6,000 retainer plus \$1,350 per board meeting to inside directors during 2010. Members of the audit committee were paid \$350 per audit committee meeting attended.

Pursuant to the Directors' Plan the directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees. Under the Directors' Plan, deferred directors' fees are converted on a quarterly basis into shares of the Corporation's common stock, based on the fair market value of a share of the Corporation's

common stock at that time. Shares of stock credited to a participant's account are eligible for cash and stock dividends as payable. Directors of the Corporation deferred \$419,696 under the Directors' Plan in 2010.

Upon a participant's attainment of age 70, retirement from the Board, or the occurrence of certain other events, the participant is eligible to receive a lump-sum, in-kind distribution of all of the stock that is then credited to his or her account. The plan does not allow for cash settlement. Stock issued under the Directors' Plan is restricted stock under the Securities Act of 1933, as amended.

The Corporation established a Trust effective as of January 1, 2008 to fund the Directors' Plan. The Trust is an irrevocable grantor trust to which the Corporation may contribute assets for the limited purpose of funding a nonqualified deferred compensation plan. Although the Corporation may not reach the assets of the Trust for any purpose other than meeting its obligations under the Directors' Plan, the assets of the Trust remain subject to the claims of the Corporation's creditors. The Corporation may contribute cash or common stock to the Trust from time to time for the sole purpose of funding the Directors' Plan. The Trust will use any cash that the Corporation may contribute to purchase shares of the Corporation's common stock on the open market through the Corporation's brokerage services department.

The Corporation transferred \$492,958 to the Trust in 2010, which held 32,686 shares of the Corporation's common stock for settlement as of December 31, 2010. As of December 31, 2010, there were 191,977 shares of stock credited to participants' accounts, which credits are unfunded as of such date to the extent that they are in excess of the stock and cash that has been credited to the Trust. All amounts are unsecured claims against the Corporation's general assets. The net cost of this benefit to the Corporation was \$165,353 in 2010.

The following table displays the number of equity shares credited pursuant to the terms of the Directors' Plan as of December 31, 2010:

<b>Name</b>	<b># of Shares of Stock Credited</b>
Dennis P Angner	7,787
Jeffrey J. Barnes	31,280
Richard J. Barz	5,629
Sandra L. Caul	287,411
James Fabiano	756,559
G. Charles Hubscher	71,357
Thomas L. Kleinhardt	165,741
Ted W. Kortez	15,636
Joseph LaFramboise	36,348
David J. Maness	166,134
W. Joseph Manifold	108,959
W. Michael McGuire	84,660
Dianne C. Morey	103,849
William J. Strickler	368,446
Dale D. Weburg	200,490

**Compensation and Human Resource Committee Interlocks and Insider Participation**

The Compensation and Human Resource Committee of the Corporation is responsible for reviewing and recommending to the Corporation's Board the compensation of the Chief Executive Officer and other executive officers of the Corporation, benefit plans and the overall percentage increase in salaries. The committee consists of directors Maness, Barnes, Caul, Fabiano, Hubscher, Kleinhardt, LaFramboise, Manifold, McGuire, Morey, and Weburg.

### Indebtedness of and Transactions with Management

Certain directors and officers of the Corporation and members of their families were loan customers of Isabella Bank, or have been directors or officers of corporations, or partners of partnerships which have had transactions with the Bank. In management's opinion, all such transactions were made in the ordinary course of business and were substantially on the same terms, including collateral and interest rates, as those prevailing at the same time for comparable transactions with customers not related to the Bank. These transactions do not involve more than normal risk of collectability or present other unfavorable features. Total loans to these customers were approximately \$4,347,000 as of December 31, 2010. The Corporation addresses transactions with related parties in its *Code of Business Conduct and Ethics* policy. Conflicts of interest are prohibited as a matter of Corporation policy, except under guidelines approved by the Board of Directors or committees of the Board.

### Security Ownership of Certain Beneficial Owners and Management

As of April 1, 2011 the Corporation does not have any person who is known to the Corporation to be the beneficial owner of more than 5% of the common stock of the Corporation.

The following table sets forth certain information as of April 1, 2011 as to the common stock of the Corporation owned beneficially by each director and director nominee, by each named executive officer, and by all directors, director nominees and executive officers of the Corporation as a group. The shares to be credited under the Directors Plan are not included in the table below.

Name of Owner	Amount and Nature of Beneficial Ownership			
	Sole Voting and Investment Powers	Shared Voting or Investment Powers	Total Beneficial Ownership	Percentage of Common Stock Outstanding
Dennis P. Angner*	18,100		18,100	0.24%
Jeffrey J. Barnes		5,669	5,669	0.08%
Richard J. Barz*	20,325		20,325	0.27%
Sandra L. Caul		10,609	10,609	0.14%
James C. Fabiano	264,871	6,579	271,450	3.60%
G. Charles Hubscher	28,031	3,548	31,579	0.42%
Thomas L. Kleinhardt		31,179	31,179	0.41%
Joseph LaFramboise		910	910	0.01%
David J. Maness	466	1,135	1,601	0.02%
W. Joseph Manifold	2,089		2,089	0.03%
W. Michael McGuire	56,531		56,531	0.75%
Dianne C. Morey		40,283	40,283	0.53%
Dale D. Weburg	27,842	31,683	59,525	0.79%
Timothy M. Miller	215	3,330	3,545	0.05%
Steven D. Pung	9,422	8,236	17,658	0.23%
David J. Reetz	8,468	175	8,643	0.11%
All Directors, nominees and Executive Officers as a Group (16 persons)	436,360	143,336	579,696	7.68%

\* Trustees of the ESOP who vote ESOP stock.



### Independent Registered Public Accounting Firm

The Audit Committee has appointed Rehmann Robson as the independent auditors of the Corporation for the year ending December 31, 2011.

A representative of Rehmann Robson is expected to be present at the Annual Meeting of Shareholders to respond to appropriate questions from shareholders and to make any comments Rehmann believes is appropriate.

### Fees for Professional Services Provided by Rehmann Robson P.C.

The following table shows the aggregate fees billed by Rehmann Robson for the audit and other services provided to the Corporation for 2010 and 2009.

	2010	2009
Audit fees	\$ 252,163	\$ 291,497
Audit related fees	39,089	40,135
Tax fees	24,730	39,784
Other professional services fees		
Total	\$ 315,982	\$ 371,416

The audit fees were for performing the integrated audit of the Corporation's consolidated annual financial statements and the audit of internal control over financial reporting related to the Federal Deposit Insurance Corporation Improvement Act, review of interim quarterly financial statements included in the Corporation's Forms 10-Q, and services that are normally provided by Rehmann Robson in connection with statutory and regulatory filings or engagements. The decline in audit fees from 2009 to 2010 is primarily related to the Corporation's continued improvement in financial reporting and SOX 404 processes.

The audit related fees are typically for various discussions related to the adoption and interpretation of new accounting pronouncements. Also included are fees for auditing of the Corporation's employee benefit plans.

The tax fees were for the preparation of the Corporation's and its subsidiaries' state and federal tax returns and for consultation with the Corporation on various tax matters. During 2009 tax fees also included consulting related to the then new State of Michigan Business Tax (MBT).

The Audit Committee has considered whether the services provided by Rehmann Robson, P.C. other than the audit fees, are compatible with maintaining Rehmann Robson, P.C.'s independence and believes that the other services provided are compatible.

### Pre-Approval Policies and Procedures

All audit and non-audit services over \$5,000 to be performed by Rehmann Robson must be approved in advance by the Audit Committee if those fees are reasonably expected to exceed 5.0% of the current year agreed upon fee for independent audit services. As permitted by the SEC's rules, the Audit Committee has authorized its Chairperson to pre-approve audit, audit-related, tax and non-audit services, provided that such approved service is reported to the full

Audit Committee at its next meeting.

As early as practicable in each calendar year, the independent auditor provides to the Audit Committee a schedule of the audit and other services that the independent auditor expects to provide or may provide during the next twelve months. The schedule will be specific as to the nature of the proposed services, the proposed fees, timing, and other details that the Audit Committee may request. The Audit Committee will by resolution authorize or decline the proposed services. Upon approval, this schedule will serve as the budget for fees by specific activity or service for the next twelve months.

A schedule of additional services proposed to be provided by the independent auditor, or proposed revisions to services already approved, along with associated proposed fees, may be presented to the Audit Committee for their consideration and approval at any time. The schedule will be specific as to the nature of the proposed service, the

proposed fee, and other details that the Audit Committee may request. The Audit Committee will by resolution authorize or decline authorization for each proposed new service.

Applicable SEC rules and regulations permit waiver of the pre-approval requirements for services other than audit, review or attest services if certain conditions are met. Out of the services characterized above as audit-related, tax and professional services, none were billed pursuant to these provisions in 2010 and 2009 without pre-approval as required under the Corporation's policies.

### **Shareholder Proposals**

Any proposals which shareholders of the Corporation intend to present at the next annual meeting of the Corporation must be received before December 9, 2011 to be considered for inclusion in the Corporation's proxy statement and proxy for that meeting. Proposals should be made in accordance with Securities and Exchange Commission Rule 14a-8.

### **Directors Attendance at the Annual Meeting of Shareholders**

The Corporation's directors are encouraged to attend the annual meeting of shareholders. At the 2010 annual meeting, all directors were in attendance.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the Corporation's directors and certain officers and persons who own more than ten percent of the Corporation's common stock, to file with the SEC initial reports of ownership and reports of changes in ownership of the Corporation's common stock. These officers, directors, and greater than ten percent shareholders are required by SEC regulation to furnish the Corporation with copies of these reports.

To the Corporation's knowledge, based solely on review of the copies of such reports furnished to the Corporation, during the year ended December 31, 2010 all Section 16(a) filing requirements were satisfied, with respect to the applicable officers, directors, and greater than 10 percent beneficial owners.

### **Other Matters**

The cost of soliciting proxies will be borne by the Corporation. In addition to solicitation by mail, officers and other employees of the Corporation may solicit proxies by telephone or in person, without compensation other than their regular compensation.

### **As to Other Business Which May Come Before the Meeting**

Management of the Corporation does not intend to bring any other business before the meeting for action. However, if any other business should be presented for action, it is the intention of the persons named in the enclosed form of proxy to vote in accordance with their judgment on such business.

By order of the Board of Directors

Debra Campbell, Secretary

**Isabella Bank Corporation**

**Financial Information Index**

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**SUMMARY OF SELECTED FINANCIAL DATA**

	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Dollars in thousands except per share data)</b>				
<b>INCOME STATEMENT DATA</b>					
Total interest income	\$ 57,217	\$ 58,105	\$ 61,385	\$ 53,972	\$ 44,709
Net interest income	40,013	38,266	35,779	28,013	24,977
Provision for loan losses	4,857	6,093	9,500	1,211	682
Net income	9,045	7,800	4,101	7,930	7,001
<b>BALANCE SHEET DATA</b>					
End of year assets	\$ 1,225,810	\$ 1,143,944	\$ 1,139,263	\$ 957,282	\$ 910,127
Daily average assets	1,182,930	1,127,634	1,113,102	925,631	800,174
Daily average deposits	840,392	786,714	817,041	727,762	639,046
Daily average loans/net	712,272	712,965	708,434	596,739	515,539
Daily average equity	139,855	139,810	143,626	119,246	91,964
<b>PER SHARE DATA(1)</b>					
Earnings per share					
Basic	\$ 1.20	\$ 1.04	\$ 0.55	\$ 1.14	\$ 1.12
Diluted	1.17	1.01	0.53	1.11	1.09
Cash dividends	0.72	0.70	0.65	0.62	0.58
Book value (at year end)	19.23	18.69	17.89	17.58	16.61
<b>FINANCIAL RATIOS</b>					
Shareholders' equity to assets (at year end)	11.84%	12.31%	11.80%	12.86%	12.72%
Return on average equity	6.47	5.58	2.86	6.65	7.61
Return on average tangible equity	9.55	8.53	4.41	8.54	8.31
Cash dividend payout to net income	59.93	67.40	118.82	54.27	53.92
Return on average assets	0.76	0.69	0.37	0.86	0.87

	<b>2010</b>				<b>2009</b>			
	<b>4th</b>	<b>3rd</b>	<b>2nd</b>	<b>1st</b>	<b>4th</b>	<b>3rd</b>	<b>2nd</b>	<b>1st</b>
<b>Quarterly Operating Results:</b>								
Total interest income	\$ 14,540	\$ 14,306	\$ 14,272	\$ 14,099	\$ 14,411	\$ 14,516	\$ 14,505	\$ 14,673
Interest expense	4,217	4,296	4,291	4,400	4,657	4,928	5,026	5,228
Net interest income	10,323	10,010	9,981	9,699	9,754	9,588	9,479	9,445
Provision for loan losses	1,626	968	1,056	1,207	1,544	1,542	1,535	1,472

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Noninterest income	2,629	2,634	1,870	2,167	2,102	2,566	3,131	2,357
Noninterest expenses	8,558	8,620	8,275	8,354	8,176	7,995	8,468	9,044
Net income	2,318	2,553	2,151	2,023	2,073	2,197	2,201	1,329
Per Share of Common Stock:								
Earnings per share								
Basic	\$ 0.30	\$ 0.34	\$ 0.29	\$ 0.27	\$ 0.28	\$ 0.29	\$ 0.29	\$ 0.18
Diluted	0.30	0.33	0.28	0.26	0.27	0.28	0.29	0.17
Cash dividends	0.18	0.18	0.18	0.18	0.32	0.13	0.13	0.12
Book value (at quarter end)	19.23	19.59	19.39	18.89	18.69	18.97	18.06	18.01

(1) Retroactively restated for the 10% stock dividend, paid on February 29, 2008.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Shareholders and Board of Directors  
Isabella Bank Corporation  
Mount Pleasant, Michigan

We have audited the accompanying consolidated balance sheets of *Isabella Bank Corporation* as of December 31, 2010 and 2009, and the related consolidated statements of changes in shareholders' equity, income, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010. We also have audited *Isabella Bank Corporation*'s internal control over financial reporting as of December 31, 2010, based on criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). *Isabella Bank Corporation*'s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the effectiveness of *Isabella Bank Corporation*'s internal control over financial reporting, based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material misstatement exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. We believe that our audits provide a reasonable basis for our opinion.

A corporation's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. A corporation's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and directors of the corporation; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the corporation's assets that could have a material effect on the consolidated financial statements.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2008, the Corporation adopted ASC Topic 715, *Compensation - Retirement Benefits*.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of **Isabella Bank Corporation** as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion **Isabella Bank Corporation** maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

Rehmann Robson, P.C.

Saginaw, Michigan  
March 8, 2011

## CONSOLIDATED BALANCE SHEETS

	December 31	
	2010	2009
	(Dollars in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents		
Cash and demand deposits due from banks	\$ 16,978	\$ 17,342
Interest bearing balances due from banks	1,131	7,140
<b>Total cash and cash equivalents</b>	<b>18,109</b>	<b>24,482</b>
Certificates of deposit held in other financial institutions	15,808	5,380
Trading securities	5,837	13,563
Available-for-sale investment securities (amortized cost of \$329,435 in 2010 and \$258,585 in 2009)	330,724	259,066
Mortgage loans available-for-sale	1,182	2,281
Loans		
Agricultural	71,446	64,845
Commercial	348,852	340,274
Installment	30,977	32,359
Residential real estate mortgage	284,029	285,838
<b>Total loans</b>	<b>735,304</b>	<b>723,316</b>
Less allowance for loan losses	12,373	12,979
<b>Net loans</b>	<b>722,931</b>	<b>710,337</b>
Premises and equipment	24,627	23,917
Corporate owned life insurance	17,466	16,782
Accrued interest receivable	5,456	5,832
Equity securities without readily determinable fair values	17,564	17,921
Goodwill and other intangible assets	47,091	47,429
Other assets	19,015	16,954
<b>Total Assets</b>	<b>\$ 1,225,810</b>	<b>\$ 1,143,944</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Deposits		
Noninterest bearing	\$ 104,902	\$ 96,875
NOW accounts	142,259	128,111
Certificates of deposit under \$100 and other savings	425,981	389,644
Certificates of deposit over \$100	204,197	188,022
<b>Total deposits</b>	<b>877,339</b>	<b>802,652</b>

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Borrowed funds (\$10,423 in 2010 and \$17,804 in 2009 at fair value)	194,917	193,101
Accrued interest and other liabilities	8,393	7,388
<b>Total liabilities</b>	<b>1,080,649</b>	<b>1,003,141</b>
Shareholders' equity		
Common stock - no par value 15,000,000 shares authorized; issued and outstanding 7,550,074 (including 32,686 shares to be issued) in 2010 and 7,535,193 (including 30,626 shares to be issued) in 2009	133,592	133,443
Shares to be issued for deferred compensation obligations	4,682	4,507
Retained earnings	8,596	4,972
Accumulated other comprehensive loss	(1,709)	(2,119)
<b>Total shareholders' equity</b>	<b>145,161</b>	<b>140,803</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,225,810</b>	<b>\$ 1,143,944</b>

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

	<b>Common Stock Shares Outstanding</b>	<b>Common Stock (\$ in thousands)</b>	<b>Shares to be Issued for Deferred Compensation Obligations (\$ in thousands)</b>	<b>Retained Earnings (\$ in thousands)</b>	<b>Accumulated Other Comprehensive Loss (\$ in thousands)</b>	<b>Totals</b>
Balance, January 1, 2008	6,364,120	\$ 112,547	\$ 3,772	\$ 7,027	\$ (266)	\$ 123,080
Cumulative effect to apply ASC Topic 715, net of tax				(1,571)		(1,571)
Comprehensive loss				4,101	(5,303)	(1,202)
Common stock dividends (10)%	687,599	30,256		(30,256)		
Regulatory capital transfer		(28,000)		28,000		
Bank acquisition	514,809	22,652				22,652
Issuance of common stock	73,660	2,476				2,476
Common stock issued for deferred compensation obligations	27,004	360	(360)			
Share-based payment awards under equity compensation plan			603			603
Common stock purchased for deferred compensation obligations		(249)				(249)
Common stock repurchased pursuant to publicly announced repurchase plan	(148,336)	(6,440)				(6,440)
Cash dividends (\$0.65 per share)				(4,873)		(4,873)
Balance, December 31, 2008	7,518,856	133,602	4,015	2,428	(5,569)	134,476
Comprehensive income				7,800	3,450	11,250
Issuance of common stock	126,059	2,664				2,664
Common stock issued for deferred compensation obligations	12,890	331	(185)			146
Share-based payment awards under equity compensation plan			677			677
Common stock purchased for deferred compensation obligations		(767)				(767)

Common stock repurchased pursuant to publicly announced repurchase plan	(122,612)	(2,387)				(2,387)
Cash dividends (\$0.70 per share)				(5,256)		(5,256)
Balance, December 31, 2009	7,535,193	133,443	4,507	4,972	(2,119)	140,803
Comprehensive income				9,045	410	9,455
Issuance of common stock	124,953	2,683				2,683
Common stock issued for deferred compensation obligations	28,898	537	(475)			62
Share-based payment awards under equity compensation plan			650			650
Common stock purchased for deferred compensation obligations		(514)				(514)
Common stock repurchased pursuant to publicly announced repurchase plan	(138,970)	(2,557)				(2,557)
Cash dividends (\$0.72 per share)				(5,421)		(5,421)
Balance, December 31, 2010	7,550,074	\$ 133,592	\$ 4,682	\$ 8,596	\$ (1,709)	\$ 145,161

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF INCOME**

	<b>Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(Dollars in thousands except per share data)</b>		
<b>Interest income</b>			
Loans, including fees	\$ 46,794	\$ 47,706	\$ 49,674
Investment securities			
Taxable	5,271	4,712	5,433
Nontaxable	4,367	4,623	4,642
Trading account securities	306	687	1,093
Federal funds sold and other	479	377	543
<b>Total interest income</b>	<b>57,217</b>	<b>58,105</b>	<b>61,385</b>
<b>Interest expense</b>			
Deposits	11,530	13,588	19,873
Borrowings	5,674	6,251	5,733
<b>Total interest expense</b>	<b>17,204</b>	<b>19,839</b>	<b>25,606</b>
<b>Net interest income</b>	<b>40,013</b>	<b>38,266</b>	<b>35,779</b>
Provision for loan losses	4,857	6,093	9,500
<b>Net interest income after provision for loan losses</b>	<b>35,156</b>	<b>32,173</b>	<b>26,279</b>
<b>Noninterest income</b>			
Service charges and fees	6,480	6,913	6,370
Gain on sale of mortgage loans	610	886	249
Net (loss) gain on trading securities	(94)	80	245
Net gain (loss) on borrowings measured at fair value	227	289	(641)
Gain on sale of available-for-sale investment securities	348	648	24
Other	1,729	1,340	1,555
<b>Total noninterest income</b>	<b>9,300</b>	<b>10,156</b>	<b>7,802</b>
<b>Noninterest expenses</b>			
Compensation and benefits	18,552	18,258	16,992
Occupancy	2,351	2,170	2,035
Furniture and equipment	4,344	4,146	3,849
FDIC insurance premiums	1,254	1,730	313
Other	7,306	7,379	7,515
<b>Total noninterest expenses</b>	<b>33,807</b>	<b>33,683</b>	<b>30,704</b>
<b>Income before federal income tax expense (benefit)</b>	<b>10,649</b>	<b>8,646</b>	<b>3,377</b>
Federal income tax expense (benefit)	1,604	846	(724)
<b>Net income</b>	<b>\$ 9,045</b>	<b>\$ 7,800</b>	<b>\$ 4,101</b>

**Earnings per share**

Basic	\$	1.20	\$	1.04	\$	0.55
Diluted	\$	1.17	\$	1.01	\$	0.53
<b>Cash dividends per basic share</b>	\$	<b>0.72</b>	\$	<b>0.70</b>	\$	<b>0.65</b>

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(Dollars in thousands)</b>		
<b>Net income</b>	<b>\$ 9,045</b>	<b>\$ 7,800</b>	<b>\$ 4,101</b>
Unrealized holding gains (losses) on available-for-sale securities:			
Unrealized gains (losses) arising during the year	1,156	3,415	(3,104)
Reclassification adjustment for net realized gains included in net income	(348)	(648)	(24)
Net unrealized gains (losses)	808	2,767	(3,128)
Tax effect	(351)	436	(643)
Unrealized gains (losses), net of tax	457	3,203	(3,771)
(Increase) reduction of unrecognized pension costs	(72)	374	(2,320)
Tax effect	25	(127)	788
Net unrealized (loss) gain on defined benefit pension plan	(47)	247	(1,532)
<b>Other comprehensive income (loss), net of tax</b>	<b>410</b>	<b>3,450</b>	<b>(5,303)</b>
<b>Comprehensive income (loss)</b>	<b>\$ 9,455</b>	<b>\$ 11,250</b>	<b>\$ (1,202)</b>

The accompanying notes are an integral part of these consolidated financial statements.



**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(Dollars in thousands)</b>		
	<b>(Unaudited)</b>		
<b>Operating activities</b>			
Net income	\$ 9,045	\$ 7,800	\$ 4,101
Reconciliation of net income to net cash provided by operations:			
Provision for loan losses	4,857	6,093	9,500
Impairment of foreclosed assets	180	157	231
Depreciation	2,522	2,349	2,171
Amortization and impairment of originated mortgage servicing rights	543	683	346
Amortization of acquisition intangibles	338	375	415
Net amortization of available-for-sale investment securities	1,153	741	356
Realized gain on sale of available-for-sale investment securities	(348)	(648)	(24)
Net unrealized losses (gains) on trading securities	94	(80)	(245)
Net gain on sale of mortgage loans	(610)	(886)	(249)
Net unrealized (gains) losses on borrowings measured at fair value	(227)	(289)	641
Increase in cash value of corporate owned life insurance	(642)	(641)	(616)
Realized gain on redemption of corporate owned life insurance	(21)		
Share-based payment awards under equity compensation plan	650	677	603
Deferred income tax expense (benefit)	179	(641)	(1,812)
Origination of loans held for sale	(72,106)	(153,388)	(33,353)
Proceeds from loan sales	73,815	152,891	34,918
Net changes in operating assets and liabilities which provided (used) cash:			
Trading securities	7,632	8,292	8,513
Accrued interest receivable	376	490	226
Other assets	(1,914)	(6,331)	(3,565)
Accrued interest and other liabilities	1,005	581	(1,496)
<b>Net cash provided by operating activities</b>	<b>26,521</b>	<b>18,225</b>	<b>20,661</b>
<b>Investing activities</b>			
Net change in certificates of deposit held in other financial institutions	(10,428)	(4,805)	882
Activity in available-for-sale securities			
Maturities, calls, and sales	85,273	130,580	66,387
Purchases	(156,928)	(140,517)	(96,168)
Loan principal (originations) collections, net	(21,319)	4,437	(42,700)
Proceeds from sales of foreclosed assets	2,778	4,145	2,310
Purchases of premises and equipment	(3,232)	(3,035)	(2,990)
Bank acquisition, net of cash acquired			(9,465)
Cash contributed to title company joint venture formation			(4,542)
Purchases of corporate owned life insurance	(175)		(1,560)
Proceeds from the redemption of corporate owned life insurance	154	11	
<b>Net cash used in investing activities</b>	<b>(103,877)</b>	<b>(9,184)</b>	<b>(87,846)</b>

**Financing activities**

Acceptances and withdrawals of deposits, net	74,687	27,022	(47,892)
Advances (repayments) of borrowed funds	2,043	(28,960)	123,016
Cash dividends paid on common stock	(5,421)	(5,256)	(4,873)
Proceeds from issuance of common stock	2,208	2,479	2,476
Common stock repurchased	(2,020)	(2,056)	(6,440)
Common stock purchased for deferred compensation obligations	(514)	(767)	(249)

**Net cash provided by (used in) financing activities** **70,983** **(7,538)** **66,038**

**(Decrease) increase in cash and cash equivalents** **(6,373)** **1,503** **(1,147)**

Cash and cash equivalents at beginning of year 24,482 22,979 24,126

**Cash and cash equivalents at end of year** **\$ 18,109** **\$ 24,482** **\$ 22,979**

## Supplemental cash flows information:

Interest paid \$ 17,344 \$ 20,030 \$ 25,556

Federal income taxes paid 1,261 2,237 1,155

## Supplemental noncash information:

Transfers of loans to foreclosed assets \$ 3,868 \$ 2,536 \$ 3,398

Common stock issued for deferred compensation obligations 475 185 360

Common stock repurchased from an associated grantor trust (Rabbi Trust) (537) (331) (360)

The accompanying notes are an integral part of these consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in thousands except per share amounts)**

**NOTE 1 Nature of Operations and Summary of Significant Accounting Policies**

***Basis of Presentation and Consolidation:***

The consolidated financial statements include the accounts of Isabella Bank Corporation (the Corporation), a financial services holding company, and its wholly owned subsidiaries, Isabella Bank (the Bank), Financial Group Information Services, and IB&T Employee Leasing, LLC. All intercompany balances and accounts have been eliminated in consolidation.

***Nature of Operations:***

Isabella Bank Corporation is a financial services holding company offering a wide array of financial products and services in several mid-Michigan counties. Its banking subsidiary, Isabella Bank, offers banking services through 25 locations, 24 hour banking services locally and nationally through shared automatic teller machines, 24 hour online banking, and direct deposits to businesses, institutions, and individuals. Lending services offered include commercial loans, agricultural loans, residential real estate loans, consumer loans, student loans, and credit cards. Deposit services include interest and noninterest bearing checking accounts, savings accounts, money market accounts, and certificates of deposit. Other related financial products include trust and investment services, safe deposit box rentals, and credit life insurance. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of the Corporation's principal markets. The Corporation's results of operations can be significantly affected by changes in interest rates or changes in the local economic environment.

Financial Group Information Services provides information technology services to Isabella Bank Corporation and its subsidiaries.

IB&T Employee Leasing provides payroll services, benefit administration, and other human resource services to Isabella Bank Corporation and its subsidiaries.

***Use of Estimates:***

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the fair value of certain available-for-sale investment securities, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, valuation of goodwill and other intangible assets, and determinations of assumptions in accounting for the defined benefit pension plan. In connection with the determination of the allowance for loan losses and the carrying value of foreclosed real estate, management obtains independent appraisals for significant properties.

***Fair Value Measurements:***

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, such as the reporting entity's own data. The Corporation may choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, allowing the Corporation to record identical financial assets and liabilities at fair value or by another

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

measurement basis permitted under generally accepted accounting principles, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments.

For assets and liabilities recorded at fair value, it is the Corporation's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements for those financial instruments for which there is an active market. In cases where the market for a financial asset or liability is not active, the Corporation includes appropriate risk adjustments that market participants would make for nonperformance and liquidity risks when developing fair value measurements. Fair value measurements for assets and liabilities for which limited or no observable market data exists are accordingly based primarily upon estimates, are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values.

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Investment securities available-for-sale, trading securities, and certain liabilities are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record other assets at fair value on a nonrecurring basis, such as mortgage loans available-for-sale, impaired loans, foreclosed assets, originated mortgage servicing rights, goodwill, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

### *Fair Value Hierarchy*

Under fair value measurement and disclosure authoritative guidance, the Corporation groups assets and liabilities measured at fair value into three levels, based on the markets in which the assets and liabilities are traded, and the reliability of the assumptions used to determine fair value, based on the prioritization of inputs in the valuation techniques. These levels are:

*Level 1:* Valuation is based upon quoted prices for identical instruments traded in active markets.

*Level 2:* Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model based valuation techniques for which all significant assumptions are observable in the market.

*Level 3:* Valuation is generated from model based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

For a further discussion of fair value considerations, refer to Notes 19 to the consolidated financial statements.

### *Significant Group Concentrations of Credit Risk:*

Most of the Corporation's activities conducted are with customers located within the central Michigan area. A significant amount of its outstanding loans are secured by commercial and residential real estate. Other than these types of loans, there is no significant concentration to any other industry or any one customer.

***Cash and Cash Equivalents:***

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other deposit accounts. Generally, federal funds sold are for a one day

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

period. The Corporation maintains deposit accounts in various financial institutions which generally exceed federally insured limits or are not insured. Management does not believe the Company is exposed to any significant interest, credit or other financial risk as a result of these deposits.

### *Certificates of Deposit Held in Other Financial Institutions:*

Certificates of deposits held in other financial institutions consist of interest bearing certificates of deposit that mature within 3 years and are carried at cost.

### *Trading Securities:*

The Corporation engages in trading activities of its own accounts. Securities that are held principally for resale in the near term are recorded in the trading assets account at fair value with changes in fair value recorded in noninterest income. Interest income is included in net interest income.

### *Available-For-Sale Investment Securities:*

All purchases of investment securities are generally classified as available-for-sale. However, classification of investment securities as either held to maturity or trading may be elected by management of the Corporation. Securities classified as available-for-sale are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, excluded from earnings and reported in other comprehensive income. Auction rate money market preferred securities and preferred stocks are considered equity securities for federal income tax purposes, as such, no estimated federal income tax impact is expected or recorded. Auction rate money market preferred securities and preferred stock are recorded at fair value, with unrealized gains and losses, considered not other-than-temporary, excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses on the sale of available-for-sale investment securities are determined using the specific identification method.

Investment securities are reviewed quarterly for possible other-than-temporary impairment (OTTI). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Corporation must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For debt securities that do not meet the above criteria, and the Corporation does not expect to recover the security's amortized cost basis, the security is considered other-than-temporarily impaired. For these debt securities, the Corporation separates the total impairment into the credit risk loss component and the amount of the loss related to market and other risk factors. In order to determine the amount of the credit loss for a debt security, the Corporation calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Available-for-sale equity securities are reviewed for other-than-temporary impairment at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and management's ability and intent to hold the securities until fair value recovers. If it is determined that management does not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

not recover in value then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income. No such losses were recognized in 2010, 2009, or 2008.

***Loans:***

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loans losses, and any deferred fees or costs on originated loans. 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 constant yield method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days or more past due unless the credit is well-secured and in the process of collection. Credit card loans and other personal 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 non-accrual 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 returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. 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.

***Allowance for Loan Losses:***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's 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 allowance consists of specific, general and unallocated components. The specific component relates to loans that are deemed to be impaired. For such loans that are also analyzed for specific allowance allocations, an allowance is established when the discounted cash flows or collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non classified loans and is based on historical loss experience. An unallocated component is maintained to cover uncertainties that management believes affect its 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.

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;
2. The loan has been classified as a troubled debt restructuring; or
3. The loan is in nonaccrual status.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Impairment is measured on a loan by loan basis for commercial and commercial 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. Accordingly, the Corporation does not separately identify individual consumer loans for impairment allocations and related disclosures.

### *Loans Held for Sale:*

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value as determined by aggregating outstanding commitments from investors or current investor yield requirements. Net unrealized losses, if any, are recognized through a valuation allowance of which the provision is accounted for in other noninterest expenses in the consolidated statements of income.

Mortgage loans held for sale are sold with the mortgage servicing rights retained by the Corporation. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

### *Transfers of Financial Assets:*

Transfers of financial assets, including sold mortgage loans and mortgage loans held for sale, as described above, and participation loans are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is determined to be surrendered when 1) the assets have been legally isolated from the Corporation, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets and 3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 5, the Corporation has no substantive continuing involvement related to these loans. Servicing fee earned on such loans was \$760, \$724, and \$627 for 2010, 2009, and 2008, respectively, and is included in other noninterest income.

### *Servicing:*

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. The Corporation has no purchased servicing rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the valuation allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets and are amortized into

noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Servicing fee income is recorded for fees earned for servicing loans for others. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned.

### ***Loans Acquired Through Transfer:***

Authoritative accounting guidance related to acquired loans requires that a valuation allowance for loans acquired in a transfer, including in a business combination, reflect only losses incurred after acquisition, and should not be recorded at acquisition. This standard applies to any loan acquired in a transfer that shows evidence of credit quality deterioration since it was originated.

### ***Foreclosed Assets:***

Assets acquired through, or in lieu, of loan foreclosure are held for sale and are initially recorded at the lower of the Corporation's carrying amount or fair value less estimated selling costs at the date of transfer, establishing a new cost basis. Any write downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new cost basis or fair value less costs to sell. Impairment losses on property to be held and used are measured at the amount by which the carrying amount of property exceeds its fair value. Costs relating to holding these assets are expensed as incurred. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of the Corporation's carrying amount or fair value less costs to sell. Foreclosed assets of \$2,067 and \$1,157 are included in Other Assets on the accompanying consolidated balance sheets.

### ***Premises and Equipment:***

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

### ***Fdic Insurance Premium:***

In 2009, the Corporation was required to prepay quarterly FDIC risk-based assessments for the fourth quarter of 2009 and each of the quarters in the years ending December 31, 2010, 2011 and 2012. The assessments for 2010 through 2012, which had a carrying balance of \$3,586 and \$4,737 as of December 31, 2010 and 2009, respectively, have been recorded as a prepaid asset in the accompanying consolidated balance sheets in Other Assets, and will be expensed on a ratable basis quarterly through December 31, 2012.

### ***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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Equity securities without readily determinable fair values consist of the following as of December 31:

	2010	2009
Federal Home Loan Bank Stock	\$ 7,596	\$ 7,960
Investment in Corporate Settlement Solutions	6,793	6,782
Federal Reserve Bank Stock	1,879	1,879
Investment in Valley Financial Corporation	1,000	1,000
Other	296	300
Total	\$ 17,564	\$ 17,921

***Stock Compensation Plans:***

At December 31, 2010, the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan ) had 224,663 shares to be issued to participants, for which an associated grantor trust (Rabbi Trust) held 32,686 shares. The Corporation had 216,905 shares to be issued in 2009, with 30,626 shares held in the Rabbi Trust. Compensation costs relating to share based payment transactions are recognized in the consolidated financial statements and the cost is measured based on the fair value of the equity or liability instruments issued. The Corporation has no other share based compensation plans.

***Corporate Owned Life Insurance:***

The Corporation has purchased life insurance policies on key members of management. In the event of death of one of these individuals, the Corporation would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be realized on the balance sheet dates. Increases in cash surrender value in excess of single premiums paid are reported as Other Noninterest Income.

ASC Topic 715 was amended to require that the Corporation recognize a liability for any post retirement benefits provided by the Corporation, beginning January 1, 2008. As a result of the adoption of the new authoritative guidance, the Corporation recognized a liability of \$1,571 as of January 1, 2008. As of December 31, 2010 and 2009, the present value of the post retirement benefits promised by the Corporation to the covered employees was estimated to be \$2,573 and \$2,505, respectively, and is included in Accrued Interest and Other Liabilities on the consolidated balance sheets. The periodic policy maintenance costs were \$68 and \$45 for 2010 and 2009, respectively.

***Acquisition Intangibles and Goodwill:***

The Corporation previously acquired branch facilities and related deposits in business combinations accounted for as a purchase. The acquisitions included amounts related to the valuation of customer deposit relationships (core deposit intangibles). Core deposit intangibles arising from acquisitions are included in Other Assets and are being amortized over their estimated lives. Goodwill, which is included in Other Assets, represents the excess of purchase price over identifiable assets, is not amortized but is evaluated for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below the carrying value.

***Off Balance Sheet Credit Related Financial Instruments:***

In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under credit card arrangements, home equity lines of credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded only when funded.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Federal Income Taxes:***

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax assets or liability is determined based on the tax effects of the temporary differences between the book and tax bases on the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Valuations allowances are established, where necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

The Corporation analyzes its filing positions in the jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Corporation has also elected to retain its existing accounting policy with respect to the treatment of interest and penalties attributable to income taxes, and continues to reflect any charges for such, to the extent they arise, as a component of its noninterest expenses

***Marketing Costs:***

Marketing costs are expensed as incurred (see Note 10).

***Computation of Earnings Per Share:***

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares issued 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 by the Corporation relate solely to outstanding shares in the Corporation's Directors Plan (see Note 16).

Earnings per common share have been computed based on the following:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Average number of common shares outstanding for basic calculation	7,541,676	7,517,276	7,492,677
Average potential effect of shares in the Deferred Director fee plan(1)	187,744	181,319	184,473
Average number of common shares outstanding used to calculate diluted earnings per common share	7,729,420	7,698,595	7,677,150
Net income	\$ 9,045	\$ 7,800	\$ 4,101
<b>Earnings per share</b>			
<b>Basic</b>	<b>\$ 1.20</b>	<b>\$ 1.04</b>	<b>\$ 0.55</b>
<b>Diluted</b>	<b>\$ 1.17</b>	<b>\$ 1.01</b>	<b>\$ 0.53</b>



(1) Exclusive of shares held in the Rabbi Trust

***Reclassifications:***

Certain amounts reported in the 2009 and 2008 consolidated financial statements have been reclassified to conform with the 2010 presentation.

***Recent Accounting Pronouncements:***

FASB ASC Topic 310, Receivables. In April 2010, ASC Topic 310 was amended by Accounting Standards Update (ASU) No. 2010-18, *Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset* (a consensus of the FASB Emerging Issues Task ), to clarify that individual loans accounted for

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

within pools are not to be removed from the pool solely as a result of modifications to the loan (including troubled debt restructurings). The new guidance was effective for interim and annual periods ending on or after July 15, 2010 and did not have a significant impact on the Corporation's consolidated financial statements.

In July 2010, ASC Topic 310 was amended by ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* to provide financial statement users greater transparency about the Corporation's allowance for loan losses and the credit quality of its financing receivables. Existing disclosures are amended that required the Corporation to provide the following disclosure about its loan portfolio on a disaggregated basis: (1) a rollforward schedule of the allowance for loan losses from the beginning of the reporting period to the end of a reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method, (2) for each disaggregated ending balance in item (1), the related recorded investment in loans, (3) the nonaccrual status of loans by class of loans, and (4) impaired loans by class of loans.

The amendments in this update required the Corporation to provide the following additional disclosures about its loans: (1) credit quality indicators of financing receivables at the end of the reporting period by class of loans, (2) the aging of past due loans at the end of the reporting period by class of loans, (3) the nature and extent of troubled debt restructurings that occurred during the period by class of loans and their effect on the allowance for loan losses, (4) the nature and extent of financing receivables modified within the previous 12 months that defaulted during the period by class of financing receivables and their effect on the allowance for loan losses and (5) significant purchases and sales of loans during the period disaggregated by portfolio segment. The new disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010, with the exception of the new disclosures related to troubled debt restructurings which are not required to be reported until the second quarter of 2011. The new disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The new guidance has significantly expanded the Corporation's consolidated financial statement disclosures. (See Note 4)

FASB ASC Topic 350, Intangibles - Goodwill and Other. In December 2010, ASC Topic 350 was amended by ASU No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)*, to address questions related to the testing for goodwill impairments for entities with goodwill with zero or negative carrying amounts. The new guidance is effective for interim and annual periods beginning after December 15, 2010 and is not anticipated to have any impact on the Corporation's consolidated financial statements.

FASB ASC Topic 715, Compensation - Retirement Benefits. In January 2010, ASC Topic 715 was amended by ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements*, to change the terminology for major categories of assets to classes of assets to correspond with the amendments to ASC Topic 820 (see below). The new guidance was effective for interim and annual periods ending on or after January 1, 2010 and had no impact on the Corporation's consolidated financial statements.

FASB ASC Topic 805, Business Combinations. In December 2010, ASC Topic 805 was amended by ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations (a consensus of the FASB Emerging Issues Task Force)*, to address diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The new guidance is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2010 and is not anticipated to impact the Corporation's consolidated financial statements.

FASB ASC Topic 810. Consolidation. New authoritative accounting guidance under ASC Topic 810 amends prior guidance to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other factors, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. The new authoritative accounting guidance requires additional disclosures about the reporting entity's involvement with

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

variable interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity's financial statements. The new authoritative accounting guidance under ASC Topic 810 was effective January 1, 2010 and had no impact on the Corporation's consolidated financial statements.

**FASB ASC Topic 820. Fair Value Measurements and Disclosures.** In January 2010, ASC Topic 820 was amended by ASU No. 2010-06, to add new disclosures for: (1) significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers and (2) presenting separately information about purchases, sales, issuances and settlements for Level 3 fair value instruments (as opposed to reporting activity as net).

ASU No. 2010-06 also clarifies existing disclosures by requiring reporting entities to provide fair value measurement disclosures for each class of assets and liabilities and to provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The new authoritative guidance was effective for interim and annual reporting periods beginning January 1, 2010 except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements, which will be effective January 1, 2011. The new guidance did not, and is not anticipated to, have a significant impact on the Corporation's consolidated financial statements.

**FASB ASC Topic 860. Transfers and Servicing.** New authoritative accounting guidance under ASC Topic 860 amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a qualifying special purpose entity and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC Topic 860 was effective January 1, 2010 and had no significant impact on the Corporation's consolidated financial statements.

**NOTE 2 Trading Securities**

Trading securities, at fair value, consist of the following investments at December 31:

	<b>2010</b>	<b>2009</b>
States and political subdivisions	\$ 5,837	\$ 9,962
Mortgage-backed		3,601
<b>Total</b>	<b>\$ 5,837</b>	<b>\$ 13,563</b>

Included in the net trading losses of \$94 during 2010, were \$74 of net trading losses on securities that relate to the Corporation's trading portfolio as of December 31, 2010. Included in net trading gains of \$80 during 2009, were \$38 of net trading gains on securities that relate to the Corporation's trading portfolio as of December 31, 2009.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 3 Available-for-Sale Investment Securities

The amortized cost and fair value of available-for-sale investment securities, with gross unrealized gains and losses, are as follows as of December 31:

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	\$ 5,394	\$ 10	\$	\$ 5,404
States and political subdivisions	167,328	3,349	960	169,717
Auction rate money market preferred	3,200		335	2,865
Preferred stocks	7,800		864	6,936
Mortgage-backed	101,096	1,633	514	102,215
Collateralized mortgage obligations	44,617	103	1,133	43,587
<b>Total</b>	<b>\$ 329,435</b>	<b>\$ 5,095</b>	<b>\$ 3,806</b>	<b>\$ 330,724</b>

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	\$ 19,386	\$ 127	\$ 42	\$ 19,471
States and political subdivisions	150,688	3,632	2,590	151,730
Auction rate money market preferred	3,200		227	2,973
Preferred stocks	7,800		746	7,054
Mortgage-backed	67,215	638	119	67,734
Collateralized mortgage obligations	10,296		192	10,104
<b>Total</b>	<b>\$ 258,585</b>	<b>\$ 4,397</b>	<b>\$ 3,916</b>	<b>\$ 259,066</b>

The Corporation had pledged available-for-sale and trading securities in the following amounts as of December 31:

	2010	2009
Pledged to secure borrowed funds	\$ 86,788	\$ 41,612
Pledged to secure repurchase agreements	86,381	74,605
Pledged for public deposits and for other purposes necessary or required by law	14,626	20,054
<b>Total</b>	<b>\$ 187,795</b>	<b>\$ 136,271</b>

While borrowed funds increased \$1,816 since December 31, 2009, the Corporation increased the level of securities pledged to secure other borrowed funds and repurchase agreements by \$51,524 in the same period. The additional pledging has enhanced the Corporation's liquidity position as it allows for an increased availability of borrowed funds.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The amortized cost and fair value of available-for-sale securities by contractual maturity at December 31, 2010 are as follows:

	Due in One Year or Less	Maturing After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	Securities With Variable Monthly Payments	Total
Government sponsored enterprises	\$	\$ 5,000	\$ 394	\$	\$	\$ 5,394
States and political subdivisions	14,061	33,702	85,757	33,808		167,328
Auction rate money market preferred					3,200	3,200
Preferred stocks					7,800	7,800
Mortgage-backed Collateralized mortgage obligations					101,096	101,096
					44,617	44,617
<b>Total amortized cost</b>	<b>\$ 14,061</b>	<b>\$ 38,702</b>	<b>\$ 86,151</b>	<b>\$ 33,808</b>	<b>\$ 156,713</b>	<b>\$ 329,435</b>
<b>Fair value</b>	<b>\$ 14,132</b>	<b>\$ 39,844</b>	<b>\$ 87,660</b>	<b>\$ 43,286</b>	<b>\$ 145,802</b>	<b>\$ 330,724</b>

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, auction rate money market preferreds, preferred stocks, mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group.

A summary of the activity related to the sale of available-for-sale debt securities is as follows during the years ended December 31:

	2010	2009	2008
Proceeds from sales of securities	\$ 18,303	\$ 32,204	\$ 6,096
Gross realized gains	\$ 351	\$ 648	\$ 24
Gross realized losses	(3)		
Net realized gains	\$ 348	\$ 648	\$ 24

Applicable income tax expense	\$	118	\$	220	\$	8
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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.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Information pertaining to available-for-sale securities with gross unrealized losses at December 31 aggregated by investment category and length of time that individual securities have been in continuous loss position, follows:

	<b>December 31, 2010</b>				
	<b>Less Than Twelve Months</b>		<b>Over Twelve Months</b>		<b>Total Unrealized Losses</b>
	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	
States and political subdivisions	\$ 960	\$ 29,409	\$	\$	
Auction rate money market preferred			335	2,865	335
Preferred stock			864	2,936	864
Mortgage-backed	514	38,734			514
Collateralized mortgage obligations	1,133	33,880			1,133
<b>Total</b>	<b>\$ 2,607</b>	<b>\$ 102,023</b>	<b>\$ 1,199</b>	<b>\$ 5,801</b>	<b>\$ 3,806</b>

<b>Number of securities in an unrealized loss position:</b>	<b>82</b>	<b>4</b>	<b>86</b>
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	<b>December 31, 2009</b>				
	<b>Less Than Twelve Months</b>		<b>Over Twelve Months</b>		<b>Total Unrealized Losses</b>
	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	
Government sponsored enterprises	\$ 42	\$ 7,960	\$	\$	
States and political subdivisions	2,536	11,459	54	2,267	2,590
Auction rate money market preferred			227	2,973	227
Preferred stocks			746	3,054	746
Mortgage-backed	119	25,395			119
Collateralized mortgage obligations	192	10,104			192
<b>Total</b>	<b>\$ 2,889</b>	<b>\$ 54,918</b>	<b>\$ 1,027</b>	<b>\$ 8,294</b>	<b>\$ 3,916</b>

<b>Number of securities in an unrealized loss position:</b>	<b>39</b>	<b>8</b>	<b>47</b>
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The Corporation invested \$11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, \$7,800 converted to

preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a discounted cash flow analysis as of December 31, 2010 and December 31, 2009. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, and the current volume of trading activity. As of December 31, 2010, the Corporation held an auction rate money market preferred security and preferred stock which declined in fair value as a result of the securities interest rates, they are currently lower than the offering rates of securities with similar characteristics. Despite the limited trading of these securities, management has 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 these securities are deemed to be below investment grade, and management does not intend to sell the securities in an unrealized loss position, and it is more likely than not that the Corporation will not have to sell the securities before recovery of their cost basis. As a result, the Corporation has not recognized an other-than-temporary impairment related to these declines in fair value.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of December 31, 2010 and December 31, 2009, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including auction rate money market preferred securities and preferred stocks, should be considered other-than-temporarily-impaired (OTTI). Such analyses considered, among other factors, the following criteria:

Has the value of the investment declined more than what is deemed to be reasonable based on a risk and maturity adjusted discount rate?

Is the investment credit rating below investment grade?

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

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

Has the duration of the investment been extended?

Based on the Corporation's analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2010 or 2009.

**NOTE 4 Loans and Allowance for Loan Losses**

The Corporation grants commercial, agricultural, consumer and residential loans to customers situated primarily in Isabella, Gratiot, Mecosta, Midland, Western Saginaw, Montcalm and Southern Clare 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 mortgage 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.

A summary of the major classifications of loans is as follows as of December 31:

	<b>2010</b>	<b>2009</b>
Mortgage loans on real estate		
Residential 1-4 family	\$ 207,749	\$ 207,560
Commercial	239,810	224,176
Agricultural	44,246	38,236
Construction and land development	12,250	13,268
Second mortgages	26,712	34,255
Equity lines of credit	37,318	30,755
Total mortgage loans	568,085	548,250
Commercial and agricultural loans		
Commercial	109,042	116,098

Agricultural production	27,200	26,609
Total commercial and agricultural loans	136,242	142,707
Consumer installment loans	30,977	32,359
Total loans	735,304	723,316
Less: allowance for loan losses	12,373	12,979
<b>Net loans</b>	<b>\$ 722,931</b>	<b>\$ 710,337</b>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A summary of changes in the allowance for loan losses by loan segments follows:

**Allowance for Credit Losses and Recorded Investment in Financing Receivables  
For the Year Ended December 31, 2010**

	<b>Commercial</b>	<b>Agricultural</b>	<b>Residential Real Estate</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance for loan losses</b>						
January 1, 2010	\$ 5,531	\$ 731	\$ 3,590	\$ 626	\$ 2,501	\$ 12,979
Loans charged off	(3,731)		(2,524)	(596)		(6,851)
Recoveries	452	1	638	297		1,388
Provision for loan losses	3,796	301	1,494	278	(1,012)	4,857
<b>December 31, 2010</b>	<b>\$ 6,048</b>	<b>\$ 1,033</b>	<b>\$ 3,198</b>	<b>\$ 605</b>	<b>\$ 1,489</b>	<b>\$ 12,373</b>
<b>Allowance for loan losses as of December 31, 2010</b>						
Individually evaluated for impairment	\$ 490	\$ 558	\$ 732	\$	\$	\$ 1,780
Collectively evaluated for impairment	5,558	475	2,466	605	1,489	10,593
<b>Total</b>	<b>\$ 6,048</b>	<b>\$ 1,033</b>	<b>\$ 3,198</b>	<b>\$ 605</b>	<b>\$ 1,489</b>	<b>\$ 12,373</b>
<b>Loans as of December 31, 2010</b>						
Individually evaluated for impairment	\$ 4,890	\$ 2,629	\$ 4,866	\$		\$ 12,385
Collectively evaluated for impairment	343,962	68,817	279,163	30,977		722,919
<b>Total</b>	<b>\$ 348,852</b>	<b>\$ 71,446</b>	<b>\$ 284,029</b>	<b>\$ 30,977</b>		<b>\$ 735,304</b>

Following is a summary of changes in the allowance for loan losses for the years ended December 31:

	<b>2009</b>	<b>2008</b>
Balance at beginning of year	\$ 11,982	\$ 7,301
Allowance of acquired bank		822
Loans charged off	(6,642)	(6,325)
Recoveries	1,546	684
Provision charged to income	6,093	9,500

**Balance at end of year** **\$ 12,979**    **\$ 11,982**

The primary factors behind the determination of the level of the allowance for loan losses (ALLL) are specific allocations for impaired loans, historical loss percentages, as well as current economic conditions. Specific allocations for impaired loans are primarily determined based on the difference between the net realizable value of the loans underlying collateral or the net present value of the projected payment stream and its recorded investment. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio over the preceding three years.

Commercial loans include loans for commercial real estate, farmland and agricultural production, state and political subdivisions, and commercial operating loans. The largest concentration of commercial loans is

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

commercial real estate. Repayment of commercial 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. The Corporation minimizes its 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. All commercial real estate loans require loan to value limits of less than 80%. Depending upon the type of loan, past credit history, and current operating results, the Corporation may require the borrower to pledge accounts receivable, inventory, and fixed assets. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and proprietorships. In addition, the Corporation requires annual financial statements, prepares cash flow analyses, and reviews credit reports as deemed necessary.

First and second residential real estate mortgages are the single largest category of loans. The Corporation offers adjustable rate mortgages, fixed rate balloon mortgages, 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 the Federal Home Loan Mortgage Association. Fixed rate residential mortgage loans with an amortization of 15 years or less may be held in the Corporation's portfolio, held for future sale, or sold upon origination. Factors used in determining when to sell these mortgages include management's judgment about the direction of interest rates, the Corporation's need for fixed rate assets in the management of its interest rate sensitivity, and overall loan demand.

Construction and land development loans consist primarily of 1 to 4 family residential properties. These loans primarily have a 6 to 9 month maturity and are made using the same underwriting criteria as residential mortgages. Loan proceeds are disbursed in increments as construction progresses and inspections warrant. Construction loans are typically converted to permanent loans at the completion of construction.

Lending policies generally limit the maximum loan to value ratio on residential mortgages 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. All mortgage loan requests are reviewed by a mortgage loan committee or through a secondary market automated underwriting system; loans in excess of \$400 require the approval of the Bank's Internal Loan Committee, Board of Directors, or its loan committee.

Consumer loans granted include automobile loans, secured and unsecured personal loans, credit cards, student 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 ability to pay rather than collateral value. No consumer loans are sold to the secondary market.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Credit Quality Indicators  
As of December 31, 2010

## Commercial and Agricultural Credit Exposure

## Credit Risk Profile by Internally Assigned Credit Rating

Rating	Commercial			Agricultural		
	Real Estate	Other	Total	Real Estate	Other	Total
2 High quality	\$ 10,995	\$ 13,525	\$ 24,520	\$ 3,792	\$ 1,134	\$ 4,926
3 High satisfactory	74,912	30,322	105,234	11,247	3,235	14,482
4 Low satisfactory	119,912	57,403	177,315	22,384	14,862	37,246
5 Special mention	19,560	6,507	26,067	4,169	3,356	7,525
6 Substandard	10,234	1,104	11,338	2,654	4,613	7,267
7 Vulnerable	3,339	54	3,393			
8 Doubtful	858	127	985			
<b>Total</b>	<b>\$ 239,810</b>	<b>\$ 109,042</b>	<b>\$ 348,852</b>	<b>\$ 44,246</b>	<b>\$ 27,200</b>	<b>\$ 71,446</b>

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**

Loans to borrowers with a 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**

Loans to borrowers with a sound financial condition and 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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. HIGH SATISFACTORY Reasonable Risk**

Loans to borrowers with a 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**

Loans to borrowers which are considered Bankable risks, although some signs of weaknesses are shown:

Would include most start-up businesses.

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

Management abilities 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**

These borrowers constitute 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.

Loan may need to be restructured to improve collateral position or reduce payments.

Collateral / guaranty offers limited protection.

Negative debt service coverage however well collateralized and payments current.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. SUBSTANDARD Classified**

A substandard loan is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged. There is a distinct possibility that the Corporation will implement collection procedures if the loan deficiencies are not corrected. In addition, the following characteristics may apply:

Sustained losses have severely eroded the equity and cash flow.

Deteriorating liquidity.

Serious management problems or internal fraud.

Original repayment terms liberalized.

Likelihood of bankruptcy.

Inability to access other funding sources.

Reliance on secondary source of repayment.

Litigation filed against borrower.

Collateral provides little or no value.

Requires excessive attention of the loan officer.

Borrower is uncooperative with loan officer.

**7. VULNERABLE Classified**

This classification includes substandard loans that warrant 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**

A doubtful loan 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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. LOSS Charge off**

Loans classified loss 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.

The Corporation's primary credit quality indicators for residential real estate and consumer loans is the individual loan's past due aging.

**Age Analysis of Past Due Loans  
As of December 31, 2010**

	<b>Accruing Interest and Past Due:</b>		<b>Nonaccrual</b>	<b>Total Past Due and Current</b>		<b>Total</b>
	<b>30-89 Days</b>	<b>90 Days or More</b>		<b>Nonaccrual</b>	<b>Current</b>	
Commercial						
Commercial real estate	\$ 4,814	\$ 125	\$ 4,001	\$ 8,940	\$ 230,870	\$ 239,810
Commercial other	381		139	520	108,522	109,042
Total commercial	5,195	125	4,140	9,460	339,392	348,852
Agricultural						
Agricultural real estate	92			92	44,154	44,246
Agricultural other	4	50		54	27,146	27,200
Total agricultural	96	50		146	71,300	71,446
Residential mortgage						
Senior liens	5,265	310	1,421	6,996	213,003	219,999
Junior liens	476		49	525	26,187	26,712
Home equity lines of credit	598			598	36,720	37,318
Total residential mortgage	6,339	310	1,470	8,119	275,910	284,029

Consumer						
Secured	298			298	24,781	25,079
Unsecured	10	1		11	5,887	5,898
Total consumer	308	1		309	30,668	30,977
<b>Total</b>	\$ 11,938	\$ 486	\$ 5,610	\$ 18,034	\$ 717,270	\$ 735,304
<b>December 31, 2009</b>	\$ 10,305	\$ 768	\$ 8,522	\$ 19,595	\$ 703,721	\$ 723,316
<b>December 31, 2008</b>	\$ 14,906	\$ 1,251	\$ 11,175	\$ 27,332	\$ 708,053	\$ 735,385

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of information pertaining to impaired loans as of, and for the year, ended December 31, 2010:

	December 31, 2010			2010 Year to Date	
	Outstanding	Unpaid	Valuation	Average	Interest
	Balance	Principal	Allowance	Outstanding	Income
		Balance		Balance	Recognized
<b>Impaired loans with a valuation allowance</b>					
Commercial real estate	\$ 3,010	\$ 4,110	\$ 472	\$ 2,482	\$ 90
Commercial other	18	18	18	259	1
Agricultural other	2,196	2,196	558	1,098	143
Residential mortgage senior liens	4,292	5,236	698	5,045	187
Residential mortgage junior liens	172	250	34	205	7
Consumer				12	
<b>Total impaired loans with a valuation allowance</b>	<b>\$ 9,688</b>	<b>\$ 11,810</b>	<b>\$ 1,780</b>	<b>\$ 9,101</b>	<b>\$ 428</b>
<b>Impaired loans without a valuation allowance</b>					
Commercial real estate	\$ 1,742	\$ 2,669		\$ 2,738	\$ 147
Commercial other	169	269		145	20
Agricultural real estate				106	
Residential mortgage senior liens	401	501		201	26
Home equity lines of credit				8	
Consumer secured	48	85		55	5
<b>Total impaired loans without a valuation allowance</b>	<b>\$ 2,360</b>	<b>\$ 3,524</b>		<b>\$ 3,253</b>	<b>\$ 198</b>
<b>Impaired loans</b>					
Commercial	\$ 4,939	\$ 7,066	\$ 490	\$ 5,624	\$ 258
Agricultural	2,196	2,196	558	1,204	143
Residential mortgage	4,865	5,987	732	5,459	220
Consumer	48	85		67	5
<b>Total impaired loans</b>	<b>\$ 12,048</b>	<b>\$ 15,334</b>	<b>\$ 1,780</b>	<b>\$ 12,354</b>	<b>\$ 626</b>

The following is a summary of information pertaining to impaired loans as of, and for the years ended, December 31:

2009 2008



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Impaired loans with a valuation allowance	\$ 3,757	\$ 7,378
Impaired loans without a valuation allowance	8,897	6,465
Total impaired loans	\$ 12,654	\$ 13,843
Valuation allowance related to impaired loans	\$ 612	\$ 1,413
Year to date average outstanding balance of impaired loans	\$ 13,249	\$ 9,342
Year to date interest income recognized on impaired loans	\$ 340	\$ 171

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following is a summary of restructured loans as of December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Total restructured loans	5,763	\$ 4,977	\$ 4,550

No additional funds are committed to be advanced in connection with impaired loans, which includes restructured loans.

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 it is earned according to the terms of the loan agreement.

**NOTE 5 Servicing**

Residential mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgages serviced for others was \$309,882 and \$307,656 at December 31, 2010 and 2009, respectively. The fair value of servicing rights was determined using discount rates ranging from 7.50% to 9.00%, prepayment speeds ranging from 6.00% to 48.72%, depending upon the stratification of the specific right and a weighted average default rate of 0.4%. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and foreclosure processing.

The following table summarizes the carrying value and changes therein of mortgage servicing rights included in Other Assets as of December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Balance at beginning of year	\$ 2,620	\$ 2,105	\$ 2,198
Mortgage servicing rights capitalized	4,445	4,370	3,079
Accumulated amortization	(4,250)	(3,706)	(3,016)
Impairment valuation allowance	(148)	(149)	(156)
<b>Balance at end of year</b>	<b>\$ 2,667</b>	<b>\$ 2,620</b>	<b>\$ 2,105</b>
Impairment losses (reversed) recognized	\$ (1)	\$ (7)	\$ 115

The Corporation recorded servicing fee revenue of \$760, \$724, and \$627 related to residential mortgage loans serviced for others during the years ended December 31, 2010, 2009, and 2008, respectively.

**NOTE 6 Premises and Equipment**

A summary of premises and equipment at December 31 follows:

	<b>2010</b>	<b>2009</b>
Land	\$ 4,694	\$ 4,614
Buildings and improvements	21,502	20,478
Furniture and equipment	25,822	24,284
Total	52,018	49,376
Less: accumulated depreciation	27,391	25,459
<b>Premises and equipment, net</b>	<b>\$ 24,627</b>	<b>\$ 23,917</b>

Depreciation expense amounted to \$2,522, \$2,349 and \$2,171 in 2010, 2009, and 2008, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 7 Goodwill and Other Intangible Assets**

The carrying amount of goodwill was \$45,618 at December 31, 2010 and 2009.

Identifiable intangible assets at year end were as follows:

	<b>Gross Intangible Assets</b>	<b>2010 Accumulated Amortization</b>	<b>Net Intangible Assets</b>
Core deposit premium resulting from acquisitions	5,373	3,900	1,473
<b>Total</b>	<b>\$ 5,373</b>	<b>\$ 3,900</b>	<b>\$ 1,473</b>

	<b>Gross Intangible Assets</b>	<b>2009 Accumulated Amortization</b>	<b>Net Intangible Assets</b>
Core deposit premium resulting from acquisitions	5,373	3,562	1,811
<b>Total</b>	<b>\$ 5,373</b>	<b>\$ 3,562</b>	<b>\$ 1,811</b>

Amortization expense associated with identifiable intangible assets was \$338, \$375, and \$415 in 2010, 2009, and 2008, respectively.

Estimated amortization expense associated with identifiable intangibles for each of the next five years succeeding December 31, 2010, and thereafter is as follows:

<b>Year</b>	<b>Amount</b>
2011	\$ 299
2012	260
2013	221
2014	183
2015	145
Thereafter	365
	<b>\$ 1,473</b>

**NOTE 8 Deposits**

Scheduled maturities of time deposits for the next five years, and thereafter, are as follows:

<b>Year</b>	<b>Amount</b>
2011	\$ 216,927
2012	113,999
2013	44,269
2014	31,414
2015	39,474
Thereafter	6,278
	\$ 452,361

Interest expense on time deposits greater than \$100 was \$4,427 in 2010, \$5,246 in 2009, and \$6,525 in 2008.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 9 Borrowed Funds

Borrowed funds consist of the following obligations at December 31:

	2010		2009	
	Amount	Rate	Amount	Rate
Federal Home Loan Bank advances	\$ 113,423	3.64%	\$ 127,804	4.11%
Securities sold under agreements to repurchase without stated maturity dates	45,871	0.25%	37,797	0.30%
Securities sold under agreements to repurchase with stated maturity dates	19,623	3.01%	20,000	3.72%
Federal funds purchased	16,000	0.60%		
Federal Reserve Bank discount window advance			7,500	0.75%
<b>Total</b>	<b>\$ 194,917</b>	<b>2.53%</b>	<b>\$ 193,101</b>	<b>3.19%</b>

The Federal Home Loan Bank borrowings are collateralized by a blanket lien on all qualified 1-to-4 family mortgage loans and U.S. government and federal agency securities. Advances are also secured by FHLB stock owned by the Corporation.

The Corporation had the ability to borrow up to an additional \$122,960, based on the assets currently pledged as collateral. The Corporation has pledged eligible mortgage loans and investment securities as collateral for any such borrowings.

The maturity and weighted average interest rates of FHLB advances are as follows as of December 31:

	2010		2009	
	Amount	Rate	Amount	Rate
Fixed rate advances due 2010	\$		\$ 28,320	4.52%
One year putable advances due 2010			6,000	5.31%
Fixed rate advances due 2011	10,086	3.96%	10,206	3.96%
One year putable advances due 2011	1,000	4.75%	1,000	4.75%
Fixed rate advances due 2012	17,000	2.97%	17,000	2.97%
One year putable advances due 2012	15,000	4.10%	15,000	4.10%
Fixed rate advances due 2013	5,337	4.14%	5,278	4.14%
One year putable advances due 2013	5,000	3.15%	5,000	3.15%
Fixed rate advances due 2014	25,000	3.16%	15,000	3.63%
Fixed rate advances due 2015	25,000	4.63%	25,000	4.63%
Fixed rate advances due 2017	10,000	2.35%		
<b>Total</b>	<b>\$ 113,423</b>	<b>3.64%</b>	<b>\$ 127,804</b>	<b>4.11%</b>



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The maturity and weighted average interest rates of securities sold under agreements to repurchase with stated maturity dates are as follows at December 31:

	2010		2009	
	Amount	Rate	Amount	Rate
Repurchase agreements due 2010	\$		\$ 5,000	4.00%
Repurchase agreements due 2011	858	1.51%		
Repurchase agreements due 2012	1,013	2.21%		
Repurchase agreements due 2013	5,127	4.45%	5,000	4.51%
Repurchase agreements due 2014	12,087	3.00%	10,000	3.19%
Repurchase agreements due 2015	538	3.25%		
<b>Total</b>	<b>\$ 19,623</b>	<b>3.01%</b>	<b>\$ 20,000</b>	<b>3.72%</b>

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 \$86,381 and \$74,605 at December 31, 2010 and 2009, respectively. Such securities remain under the control of the Corporation. The Corporation may be required to provide additional collateral based on the fair value of underlying securities.

Securities sold under repurchase agreements without stated maturity dates, federal funds purchased, and Federal Reserve Bank discount window advances generally mature within one to four days from the transaction date. The following table provides a summary of short term borrowings for the years ended December 31:

	2010			2009		
	Maximum Month-End Balance	YTD Average Balance	Weighted Average Interest Rate During the Year	Maximum Month-End Balance	YTD Average Balance	Weighted Average Interest Rate During the Year
Securities sold under agreements to repurchase without stated maturity dates	\$ 56,410	\$ 44,974	0.29%	\$ 51,269	\$ 38,590	0.32%
Federal funds purchased	16,000	333	0.60%	13,200	1,635	0.50%
Federal Reserve Bank discount window advance	7,500	103	0.75	7,500	41	0.75



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 Other Noninterest Expenses**

A summary of expenses included in Other Noninterest Expenses are as follows for the year ended December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Marketing and community relations	\$ 1,093	\$ 894	\$ 921
Foreclosed asset and collection	710	546	565
Directors fees	887	923	867
Audit and SOX compliance fees	916	831	698
Education and travel	499	395	491
Printing and supplies	420	529	508
Postage and freight	382	415	419
Legal fees	338	375	415
Amortization of deposit premium	395	472	523
Consulting fees	167	201	298
All other	1,499	1,798	1,810
<b>Total other</b>	<b>\$ 7,306</b>	<b>\$ 7,379</b>	<b>\$ 7,515</b>

**NOTE 11 Federal Income Taxes**

Components of the consolidated provision (benefit) for income taxes are as follows for the year ended December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Currently payable	\$ 1,425	\$ 1,487	\$ 1,088
Deferred expense (benefit)	179	(641)	(1,812)
<b>Income tax expense (benefit)</b>	<b>\$ 1,604</b>	<b>\$ 846</b>	<b>\$ (724)</b>

The reconciliation of the provision (benefit) for federal income taxes and the amount computed at the federal statutory tax rate of 34% of income before federal income taxes is as follows for the years ended December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Income taxes at 34% statutory rate	\$ 3,621	\$ 2,940	\$ 1,148
Effect of nontaxable income			
Interest income on tax exempt municipal bonds	(1,565)	(1,680)	(1,713)
Earnings on corporate owned life insurance	(225)	(218)	(106)
Other	(395)	(383)	(269)

Total effect of nontaxable income	(2,185)	(2,281)	(2,088)
Effect of nondeductible expenses	168	187	216
<b>Income tax expense (benefit)</b>	<b>\$ 1,604</b>	<b>\$ 846</b>	<b>\$ (724)</b>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for federal income tax purposes.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Significant components of the Corporation's deferred tax assets and liabilities, included in other assets in the accompanying consolidated balance sheets, are as follows as of December 31:

	<b>2010</b>	<b>2009</b>
<b>Deferred tax assets</b>		
Allowance for loan losses	\$ 3,270	\$ 3,482
Deferred directors' fees	2,364	2,251
Employee benefit plans	122	132
Core deposit premium and acquisition expenses	694	310
Net unrealized losses on trading securities	400	23
Net unrecognized actuarial loss on pension plan	1,109	1,084
Life insurance death benefit payable	804	804
Alternative minimum tax	686	619
Other	219	504
<b>Total deferred tax assets</b>	<b>9,668</b>	<b>9,209</b>
<b>Deferred tax liabilities</b>		
Prepaid pension cost	851	900
Premises and equipment	902	665
Accretion on securities	36	54
Core deposit premium and acquisition expenses	1,000	642
Net unrealized gains on available-for-sale securities	847	494
Other	518	435
<b>Total deferred tax liabilities</b>	<b>4,154</b>	<b>3,190</b>
<b>Net deferred tax assets</b>	<b>\$ 5,514</b>	<b>\$ 6,019</b>

The Corporation and its subsidiaries are subject to U.S. federal income tax. The Corporation is no longer subject to examination by taxing authorities for years before 2007. There are no material uncertain tax positions requiring recognition in the Company's consolidated financial statements. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense. The Corporation does not have any amounts accrued for interest and penalties at December 31, 2010 and is not aware of any claims for such amounts by federal income tax authorities.

Included in other comprehensive income for the years ended December 31, 2010 and 2009 are the changes in unrealized losses of \$226 and unrealized gains of \$4,048, respectively, related to auction rate money market securities and preferred stock. For federal income tax purposes, these securities are considered equity investments for which no federal deferred income taxes are expected or recorded.

**NOTE 12 Off-Balance-Sheet Activities**

***Credit-Related Financial Instruments***

The Corporation is party to credit related financial instruments with off-balance-sheet risk. These financial instruments are entered into in the normal course of business to meet the financing needs of its customers. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of these instruments reflect the extent of involvement the Corporation has in a particular class of financial instrument.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	<b>Contract Amount</b>	
	<b>2010</b>	<b>2009</b>
Unfunded commitments under lines of credit	\$ 110,201	\$ 111,711
Commercial and standby letters of credit	4,881	6,509
Commitments to grant loans	13,382	9,645

Unfunded commitments under commercial lines of credit, revolving credit home equity lines of credit and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Corporation is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

Commercial and standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements, including commercial paper, bond financing, and similar transactions.

These commitments to extend credit and letters of credit mature within one year. The credit risk involved in these transactions is essentially the same as that involved in extending loans to customers. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon the extension of credit, is based on management's credit evaluation of the borrower. While the Corporation considers standby letters of credit to be guarantees, the amount of the liability related to such guarantees on the commitment date is not significant and a liability related to such guarantees is not recorded on the consolidated balance sheets.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Corporation, is based on management's credit evaluation of the customer.

The Corporation's exposure to credit-related loss in the event of nonperformance by the counter parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in deciding to make these commitments as it does for extending loans to customers. No significant losses are anticipated as a result of these commitments.

**NOTE 13 On-Balance Sheet Activities*****Derivative Loan Commitments***

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Corporation enters into commitments to fund residential mortgage loans at specific times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Corporation to lend funds to a potential borrower at a specified interest rate within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Corporation to the risk that the price of the loans arising from the exercise of the loan commitment might decline from the inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of undesignated interest rate lock commitments was \$547 and \$760 at December 31, 2010 and 2009, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### *Forward Loan Sale Commitments*

To protect against the price risk inherent in derivative loan commitments, the Corporation utilizes both mandatory delivery and best efforts forward loan sale commitments to mitigate the risk of potential decreases in the values of loan that would result from the exercise of the derivative loan commitments.

With a mandatory delivery contract, the Corporation commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Corporation fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a pair-off fee, based on then current market prices, to the investor to compensate the investor for the shortfall.

With a best efforts contract, the Corporation commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g. on the same day the lender commits to lend funds to a potential borrower).

The Corporation expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of undesignated forward loan sale commitments was \$1,729 and \$3,041 at December 31, 2010 and 2009, respectively.

The fair values of the rate lock loan commitments related to the origination of mortgage loans that will be held for sale and the forward loan sale commitments are deemed insignificant by management and, accordingly, are not recorded in the accompanying consolidated financial statements.

### **NOTE 14 Commitments and Other Matters**

Banking regulations require the Bank to maintain cash reserve balances in currency or as deposits with the Federal Reserve Bank. At December 31, 2010 and 2009, the reserve balances amounted to \$470 and \$687, respectively.

Banking regulations limit the transfer of assets in the form of dividends, loans, or advances from the Bank to the Corporation. At December 31, 2010, substantially all of the Bank's assets were restricted from transfer to the Corporation in the form of loans or advances. Consequently, bank dividends are the principal source of funds for the Corporation. Payment of dividends without regulatory approval is limited to the current years retained net income plus retained net income for the preceding two years, less any required transfers to common stock. At January 1, 2011, the amount available for dividends without regulatory approval was approximately \$8,435.

### **Note 15 Minimum Regulatory Capital Requirements**

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Bank and the Federal Deposit Insurance Corporation (The Regulators). Failure to meet minimum capital requirements can initiate mandatory and possibly additional discretionary actions by The Regulators that if undertaken, could have a material effect on the Corporation's and Bank's financial statements. Under regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that include quantitative measures of their assets, liabilities, capital, and certain off-balance-sheet items, as calculated under regulatory accounting standards. The Bank's capital amounts and classifications are also subject to qualitative judgments by The Regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital to average assets (as defined).



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Management believes, as of December 31, 2010 and 2009, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2010, the most recent notifications from The Regulators categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notifications that management believes has changed the Bank's categories. The Corporation's and the Bank's actual capital amounts (in thousands) and ratios are also presented in the table.

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2010</b>						
Total capital to risk weighted assets						
Isabella Bank	\$ 98,566	12.8%	\$ 61,642	8.0%	\$ 77,053	10.0%
Consolidated	106,826	13.7	62,423	8.0	N/A	N/A
Tier 1 capital to risk weighted assets						
Isabella Bank	88,901	11.5	30,821	4.0	46,232	6.0
Consolidated	97,040	12.4	31,212	4.0	N/A	N/A
Tier 1 capital to average assets						
Isabella Bank	88,901	7.6	46,653	4.0	58,316	5.0
Consolidated	97,040	8.2	47,116	4.0	N/A	N/A
	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2009</b>						
Total capital to risk weighted assets						
Isabella Bank	\$ 93,079	12.9%	\$ 57,713	8.0%	\$ 72,141	10.0%
Consolidated	102,285	14.1	58,213	8.0	N/A	N/A
Tier 1 capital to risk weighted assets						
Isabella Bank	84,012	11.6	28,856	4.0	43,285	6.0
Consolidated	93,141	12.8	29,106	4.0	N/A	N/A
Tier 1 capital to average assets						
Isabella Bank	84,012	7.8	42,813	4.0	53,516	5.0
Consolidated	93,141	8.6	43,326	4.0	N/A	N/A

**Note 16 Benefit Plans**

***401(k) Plan***

The Corporation has a 401(k) plan in which substantially all employees are eligible to participate. Employees may contribute up to 50% of their compensation subject to certain limits based on federal tax laws. The Corporation makes a 3.0% safe harbor contribution for all eligible employees and matching contributions equal to 50% of the first 4.0% of an employee's compensation contributed to the Plan during the year. Employees are 100% vested in the safe harbor contributions and are 0% vested through their first two years of employment and are 100% vested after

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

6 years of service for matching contributions. For the year ended December 31, 2010, 2009 and 2008, expenses attributable to the Plan were \$625, \$617, and \$543 respectively.

***Defined Benefit Pension Plan***

The Corporation has a non-contributory defined benefit pension plan which was curtailed in 2007. Due to the curtailment, future salary increases will not be considered and the benefits are based on years of service and the employees' five highest consecutive years of compensation out of the last ten years of service rendered through March 1, 2007.

Changes in the projected benefit obligation and plan assets during each year, the funded status of the plan, and the net amount recognized on the Corporation's consolidated balance sheets using an actuarial measurement date of December 31, are summarized as follows during the years ended December 31:

	<b>2010</b>	<b>2009</b>
Change in benefit obligation		
Benefit obligation, January 1	\$ 8,897	\$ 8,436
Interest cost	531	504
Actuarial loss	679	392
Benefits paid, including plan expenses	(447)	(435)
<b>Benefit obligation, December 31</b>	<b>9,660</b>	<b>8,897</b>
Change in plan assets		
Fair value of plan assets, January 1	8,355	7,669
Investment return	945	1,121
Contributions	47	
Benefits paid, including plan expenses	(447)	(435)
<b>Fair value of plan assets, December 31</b>	<b>8,900</b>	<b>8,355</b>
<b>Deficiency in funded status at December 31, included on the consolidated balance sheets in accrued interest and other liabilities</b>	<b>\$ (760)</b>	<b>\$ (542)</b>
Change in accrued pension benefit costs		
Accrued benefit cost at January 1	\$ (542)	\$ (767)
Contributions	47	
Net periodic cost for the year	(193)	(149)
Net change in unrecognized actuarial loss and prior service cost	(72)	374
<b>Accrued pension benefit cost at December 31</b>	<b>\$ (760)</b>	<b>\$ (542)</b>

Amounts recognized as a component of other comprehensive loss consist of the following amounts during the years ended December 31 :

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Change in unrecognized pension cost	\$ (72)	\$ 374	\$ (2,320)
Tax effect	25	(127)	788
<b>Net</b>	<b>\$ (47)</b>	<b>\$ 247</b>	<b>\$ (1,532)</b>

The accumulated benefit obligation was \$9,660 and \$8,897 at December 31, 2010 and 2009, respectively.

The Company has recorded the funded status of the Plan in its consolidated balance sheets. The Company adjusts the underfunded status in a liability account to reflect the current funded status of the plan. Any gains or

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

losses that arise during the period but are not recognized as components of net periodic benefit cost will be recognized as a component of other comprehensive income (loss). The components of net periodic benefit cost are as follows for the years ended December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Net periodic benefit cost (income)</b>			
Interest cost on projected benefit obligation	\$ 531	\$ 504	\$ 503
Expected return on plan assets	(491)	(524)	(659)
Amortization of unrecognized actuarial net loss	153	169	4
<b>Net periodic benefit cost (income)</b>	<b>\$ 193</b>	<b>\$ 149</b>	<b>\$ (152)</b>

Accumulated other comprehensive loss at December 31, 2010 includes net unrecognized actuarial losses before income taxes of \$3,262, of which \$138 is expected to be amortized into benefit cost during 2011.

The actuarial assumptions used in determining the projected benefit obligation and the actual weighted average assumptions used in determining the net periodic pension costs are as follows for the year ended December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Discount rate	6.10%	5.87%	6.10%
Expected long-term rate of return	6.00%	6.00%	7.00%

As a result of the curtailment of the Plan, there is no rate of compensation increase considered in the above assumptions.

The expected long term rate of return is an estimate of anticipated future long term rates of return on plan assets as measured on a market value basis. Factors considered in arriving at this assumption include:

Historical longer term rates of return for broad asset classes.

Actual past rates of return achieved by the plan.

The general mix of assets held by the plan.

The stated investment policy for the plan.

The selected rate of return is net of anticipated investment related expenses.

***Plan Assets***

The Corporation's overall investment strategy is to moderately grow the portfolio by investing 50% of the portfolio in equity securities and 50% in fixed income securities. This strategy is designed to generate a long term rate of return of

8.7%. Equity securities primarily consist of the S&P 500 Index with a smaller allocation to the Small Cap and International Index. Fixed income securities are invested in the Bond Market Index. The Plan has appropriate assets invested in short term investments to meet near-term benefit payments.

The asset mix and the sector weighting of the investments are determined by the pension committee, which is comprised of members of management of the Corporation. Consultations are held with a third party investment advisor retained by the Corporation to manage the Plan. The Corporation reviews the performance of the advisor no less than annually.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The fair values of the Corporation's pension plan assets by asset category were as follows as of December 31:

<b>Description</b>	<b>2010</b>		<b>2009</b>	
	<b>Total</b>	<b>(Level 2)</b>	<b>Total</b>	<b>(Level 2)</b>
Asset Category				
Short-term investments	\$ 108	\$ 108	\$ 70	\$ 70
Common collective trusts				
Fixed income	4,470	4,470	4,826	4,826
Equity investments	4,322	4,322	3,459	3,459
	\$ 8,900	\$ 8,900	\$ 8,355	\$ 8,355

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2010 and 2009:

*Short-term investments:* Shares of a money market portfolio, which is valued using amortized cost, which approximates fair value.

*Common collective trusts:* These investments are public investment securities valued using the net asset value ( NAV ) provided by a third party investment advisor. The NAV is quoted on a private market that is not active; however, the unit price is based on underlying investments which are traded on an active market.

The Corporation does not anticipate making any contributions to the plan in 2011.

Estimated future benefit payments are as follows for the next ten years:

<b>Year</b>	<b>Amount</b>
2011	\$ 393
2012	406
2013	404
2014	497
2015	542
Years 2016 - 2020	3,038

The components of projected net periodic benefit cost are as follows for the year ended December 31:

	<b>2011</b>
Interest cost on projected benefit obligation	507
Expected return on plan assets	(522)
Amortization of unrecognized actuarial net loss	153

**Net periodic benefit cost****\$ 138*****Equity Compensation Plan***

Pursuant to the terms of the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan ), directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees into the Directors Plan. The fees are converted on a quarterly basis into the Corporation's common stock based on the fair market value of a share of common stock as of the relevant valuation date. Stock credited to a participant's account is eligible for stock and cash dividends as declared. Upon retirement from the board or the occurrence of certain other events, the participant is eligible to receive a lump-sum, in-kind, distribution of all of the stock that is then in his or her account, and any unconverted cash will be converted to and rounded up to whole shares of stock and distributed, as well. The Directors Plan does not allow for cash settlement, and therefore, such share based payment awards qualify for classification as equity. All authorized but unissued



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

shares of common stock are eligible for issuance under the Directors Plan. The Corporation may also purchase shares of common stock on the open market to meet its obligations under the Directors Plan.

In 2008, the Corporation established a Rabbi Trust effective as of July 1, 2008, to fund the Directors Plan. A Rabbi Trust is an irrevocable grantor trust to which the Corporation may contribute assets for the limited purpose of funding a nonqualified deferred compensation plan. Although the Corporation may not reach the assets of the Rabbi Trust ( Trust ) for any purpose other than meeting its obligations under the Directors Plan, the assets of the Trust remain subject to the claims of the Corporation's creditors and are included in the consolidated financial statements. The Corporation may contribute cash or common stock to the Trust from time to time for the sole purpose of funding the Directors Plan. The Trust will use any cash that the Corporation contributed to purchase shares of the Corporation's common stock on the open market through the Corporation's brokerage services department.

The components of shares eligible to be issued under the Directors Plan were as follows as of December 31:

	2010		2009	
	Eligible Shares	Market Value	Eligible Shares	Market Value
Unissued	191,977	\$ 3,321	186,279	\$ 3,530
Shares held in Rabbi Trust	32,686	565	30,626	580
<b>Total</b>	<b>224,663</b>	<b>\$ 3,886</b>	<b>216,905</b>	<b>\$ 4,110</b>

***Other Employee Benefit Plans***

The Corporation maintains a nonqualified supplementary employee retirement plan ( SERP ) for qualified officers to provide supplemental retirement benefits to each participant. Expenses related to this program for 2010, 2009, and 2008 were \$218, \$219, and \$206, respectively, and are being recognized over the participants' expected years of service. As a result of curtailing the Corporation's defined benefit plan, the Corporation established an additional SERP to maintain the benefit levels for all employees that were at least forty years old and had at least 15 years of service. The cost to provide this benefit was \$145, \$124 and \$128 for 2010, 2009 and 2008, respectively.

The Corporation maintains a non leveraged employee stock ownership plan (ESOP) and a profit sharing plan which cover substantially all of its employees. Effective December 31, 2006, the ESOP was frozen to new participants. Contributions to the plans are discretionary and are approved by the Board of Directors and recorded as compensation expense. During 2009, the Board of Directors approved a contribution of \$50 to the plan. Expenses related to the plans for 2010, 2009, and 2008 were \$0, \$50, and \$0, respectively. Total allocated shares outstanding related to the ESOP at December 31, 2010, 2009, and 2008 were 246,419, 271,421, and 271,520, respectively. Such shares are included in the computation of dividends and earnings per share in each of the respective years.

The Corporation maintains a self funded medical plan under which the Corporation is responsible for the first \$50 per year of claims made by a covered family. Medical claims are subject to a lifetime maximum of \$5,000 per covered individual. Expenses are accrued based on estimates of the aggregate liability for claims incurred and the Corporation's experience. Expenses were \$2,101 in 2010, \$2,155 in 2009 and \$2,110 in 2008.

The Corporation maintains the Isabella Bank Corporation Stockholder Dividend Reinvestment Plan and Employee Stock Purchase Plan (the Dividend Reinvestment Plan ). The dividend reinvestment feature of the Dividend Reinvestment Plan allows shareholders to purchase previously unissued Isabella Bank Corporation common shares using dividends paid on shares held in the plan. The employee stock purchase feature of the Dividend Reinvestment Plan allows employees and directors to purchase Isabella Bank Corporation common stock through payroll deduction. The shareholder stock purchase feature of the Dividend Reinvestment Plan enables existing shareholders to purchase additional shares of the Corporation s stock directly from the Corporation. The number of shares reserved for issuance under this plan are 885,000, with 313,078 shares unissued at December 31, 2010. During 2010, 2009 and 2008, 124,904 shares were issued for \$2,203, 126,874 shares were issued for \$2,396 and 78,994 shares were issued for \$2,879, respectively, in cash pursuant to these plans.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 17 Accumulated Other Comprehensive Loss**

Comprehensive loss includes net income as well as unrealized gains and losses, net of tax, on available-for-sale investment securities owned and changes in the funded status of the Corporation's defined benefit pension plan, which are excluded from net income. Unrealized investment securities gains and losses and changes in the funded status of the pension plan, net of tax, are excluded from net income, and are reflected as a direct charge or credit to shareholders' equity. Comprehensive income (loss) and the related components are disclosed in the accompanying consolidated statements of comprehensive income for each of the years ended December 31, 2010, 2009, and 2008.

The following is a summary of the components comprising the balance of accumulated other comprehensive loss reported on the consolidated balance sheets as of December 31 (presented net of tax):

	<b>2010</b>	<b>2009</b>
Unrealized gains (losses) on available-for-sale investment securities	\$ 444	\$ (13)
Unrecognized pension costs	(2,153)	(2,106)
<b>Accumulated other comprehensive loss</b>	<b>\$ (1,709)</b>	<b>\$ (2,119)</b>

**Note 18 Related Party Transactions**

In the ordinary course of business, the Corporation grants loans to principal officers and directors and their affiliates (including their families and companies in which they have 10% or more ownership). Annual activity during the years ended December 31 consisted of the following:

	<b>2010</b>	<b>2009</b>
Balance, beginning of year	\$ 4,142	\$ 4,011
New loans	3,038	5,033
Repayments	(2,833)	(4,902)
Balance, ending of year	\$ 4,347	\$ 4,142

Total deposits of these principal officers and directors and their affiliates amounted to \$11,556 and \$7,090 at December 31, 2010 and 2009, respectively. In addition, Isabella Bank Corporation's Employee Stock Ownership Plan held deposits with the Bank aggregating \$254 and \$219, respectively, at December 31, 2010 and 2009.

**Note 19 Fair Value*****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, the Corporation uses

present value techniques and other valuation methods to estimate the fair values of its 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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on the Corporation's consolidated balance sheets are as follows as of December 31:

	2010		2009	
	Estimated Fair Value	Carrying Value	Estimated Fair Value	Carrying Value
<b>ASSETS</b>				
Cash and demand deposits due from banks	\$ 18,109	\$ 18,109	\$ 24,482	\$ 24,482
Certificates of deposit held in other financial institutions	15,908	15,808	5,380	5,380
Mortgage loans available-for-sale	1,182	1,182	2,294	2,281
Net loans	734,634	722,931	719,604	710,337
Accrued interest receivable	5,456	5,456	5,832	5,832
Equity securities without readily determinable fair values	17,564	17,564	17,921	17,921
Originated mortgage servicing rights	2,673	2,667	2,620	2,620
<b>LIABILITIES</b>				
Deposits with no stated maturities	424,978	424,978	382,006	382,006
Deposits with stated maturities	454,332	452,361	424,048	420,646
Borrowed funds	190,180	184,494	177,375	175,297
Accrued interest payable	1,003	1,003	1,143	1,143

***Financial Instruments Recorded at Fair Value***

The table below presents the recorded amount of assets and liabilities measured at fair value on December 31:

Description	Total	2010		Total	2009	
		(Level 2)	(Level 3)		(Level 2)	(Level 3)
<b>Recurring items</b>						
Trading securities						
States and political subdivisions	\$ 5,837	\$ 5,837	\$	\$ 9,962	\$ 9,962	\$
Mortgage-backed				3,601	3,601	
Total trading securities	5,837	5,837		13,563	13,563	
Available-for-sale investment securities						
Government-sponsored enterprises	5,404	5,404		19,471	19,471	
States and political subdivisions	169,717	169,717		151,730	151,730	
Auction rate money market preferred	2,865		2,865	2,973		2,973
Preferred stock	6,936		6,936	7,054		7,054

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Mortgage-backed	102,215	102,215		67,734	67,734	
Collateralized mortgage obligations	43,587	43,587		10,104	10,104	
Total available-for-sale investment securities	330,724	320,923	9,801	259,066	249,039	10,027
Borrowed funds	10,423	10,423		17,804	17,804	
<b>Nonrecurring items</b>						
Mortgage loans available-for-sale	1,182	1,182		2,281	2,281	
Impaired loans	12,048		12,048	12,654		12,654
Originated mortgage servicing rights	2,667	2,667		2,620	2,620	
Foreclosed assets	2,067	2,067		1,157	1,157	
	\$ 364,948	\$ 343,099	\$ 21,849	\$ 309,145	\$ 286,464	\$ 22,681
Percent of assets and liabilities measured at fair value		94.01%	5.99%		92.66%	7.34%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2010 and 2009, the Corporation had no assets or liabilities measured utilizing Level 1 valuation techniques.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, as well as a description of the methods and significant assumptions used to estimate fair value disclosures for financial instruments not recorded at fair value in their entirety on a recurring basis. For financial assets and liabilities recorded at fair value, the description includes 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.

### ***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.

### ***Investment securities:***

Investment securities are recorded at fair value on a recurring basis. Level 2 fair value measurement is based upon quoted prices, if available. 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. Level 2 securities include bonds issued by government sponsored enterprises, states and political subdivisions, mortgage-backed securities, and collateralized mortgage obligations issued by government sponsored enterprises.

Securities classified as Level 3 include securities in less liquid markets and include auction rate money market preferred securities and preferred stocks. Due to the limited trading activity of these securities, the fair values were estimated utilizing a discounted cash flow analysis as of December 31, 2010 and 2009. These analyses considered creditworthiness of the counterparty, the investment grade, the timing of expected future cash flows, and the current volume of trading activity. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The Corporation calculated the present value assuming a 30 year nonamortizing balloon using weighted average discount rates between 3.88% and 6.87% as of December 31, 2010.

### ***Mortgage loans available-for-sale:***

Mortgage loans available-for-sale are carried at the lower of cost or market 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, the Corporation classifies 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.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered 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, management measures 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.

The Corporation reviews 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. The Corporation uses this valuation to determine if any charge offs or specific reserves are necessary. The Corporation 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, the Corporation records the loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value collateral is further impaired below the appraised value, the Corporation records the impaired loans as nonrecurring Level 3.

### ***Accrued interest:***

The carrying amounts of accrued interest approximate fair value.

### ***Goodwill and other intangible assets:***

Acquisition intangibles and goodwill are subject to impairment testing. A projected cash flow valuation method is used in the completion of impairment testing. This valuation method requires a significant degree of management judgment. In the event the projected undiscounted net operating cash flows 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, the Corporation would classify goodwill and other acquisition intangibles subjected to nonrecurring fair value adjustments as Level 3. During 2010 and 2009, there were no impairments recorded on goodwill and other acquisition intangibles.

### ***Equity securities without readily determinable fair values:***

The Corporation has 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 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. The Corporation classifies nonmarketable equity securities and its investments in joint ventures subjected to nonrecurring fair value adjustments as Level 3. During 2010 and 2009, there were no impairments recorded on equity securities without readily determinable fair values.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***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, the Corporation classifies foreclosed assets as a nonrecurring Level 2. When management determines that the net realizable value of the collateral is further impaired below the appraised value but there is no observable market price, the Corporation records the foreclosed asset as nonrecurring Level 3.

***Originated mortgage servicing rights:***

Originated mortgage servicing rights are 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, the Corporation classifies loan servicing rights subject to nonrecurring fair value adjustments as Level 2.

***Deposits:***

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). 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.

***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 the Corporation's other borrowed funds are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing arrangements.

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

***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. The Corporation does not charge fees for lending commitments; thus 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 the Corporation believes its 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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The table below represents the activity in available-for-sale investment securities measured with Level 3 inputs on a recurring basis for the years ended December 31:

	<b>2010</b>	<b>2009</b>
Level 3 inputs January 1	\$ 10,027	\$ 5,979
Net unrealized (losses) gains on available-for-sale investment securities	(226)	4,048
Level 3 inputs December 31	\$ 9,801	\$ 10,027

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 2010 and 2009, are summarized as follows:

Description	Year Ended December 31					
	2010			2009		
	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
<b>Recurring items</b>						
Trading securities	\$ (94)	\$	\$ (94)	\$ 80	\$	\$ 80
Borrowed funds		227	227		289	289
<b>Nonrecurring items</b>						
Foreclosed assets		(180)	(180)		(157)	(157)
Originated mortgage servicing rights		1	1		7	7
<b>Total</b>	<b>\$ (94)</b>	<b>\$ 48</b>	<b>\$ (46)</b>	<b>\$ 80</b>	<b>\$ 139</b>	<b>\$ 219</b>

The activity in borrowings which the Corporation has elected to carry at fair value was as follows for the years ended December 31:

	<b>2010</b>	<b>2009</b>
Borrowings carried at fair value January 1	\$ 17,804	\$ 23,130
Paydowns and maturities	(7,154)	(5,037)
Net change in fair value	(227)	(289)
<b>Borrowings carried at fair value December 31</b>	<b>\$ 10,423</b>	<b>\$ 17,804</b>

<b>Unpaid principal balance</b>	<b>December 31</b>	<b>\$ 10,000</b>	<b>\$ 17,154</b>
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 20 Parent Company Only Financial Information

## Condensed Balance Sheets

	December 31	
	2010	2009
<b>ASSETS</b>		
Cash on deposit at subsidiary Bank	\$ 301	\$ 172
Securities available for sale	1,929	2,073
Investments in subsidiaries	94,668	89,405
Premises and equipment	1,952	2,346
Other assets	53,481	53,644
<b>Total Assets</b>	<b>\$ 152,331</b>	<b>\$ 147,640</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Other liabilities	\$ 7,170	\$ 6,837
Shareholders' equity	145,161	140,803
<b>Total Liabilities And Shareholders' Equity</b>	<b>\$ 152,331</b>	<b>\$ 147,640</b>

## Condensed Statements of Income

	Year Ended December 31		
	2010	2009	2008
Income			
Dividends from subsidiaries	\$ 6,250	\$ 6,100	\$ 5,800
Interest income	72	77	88
Management fee and other	1,340	993	1,011
<b>Total income</b>	<b>7,662</b>	<b>7,170</b>	<b>6,899</b>
Expenses			
Salaries and benefits	2,286	2,112	1,819
Occupancy and equipment	356	430	435
Audit and SOX compliance fees	476	291	376
Other	932	1,074	1,359
<b>Total expenses</b>	<b>4,050</b>	<b>3,907</b>	<b>3,989</b>
Income before income tax benefit and equity in undistributed earnings of subsidiaries	3,612	3,263	2,910

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Federal income tax benefit	896	976	905
	4,508	4,239	3,815
Undistributed earnings of subsidiaries	4,537	3,561	286
<b>Net income</b>	<b>\$ 9,045</b>	<b>\$ 7,800</b>	<b>\$ 4,101</b>



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Statements of Cash Flows**

	<b>Year Ended December 31</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Operating Activities</b>			
Net income	\$ 9,045	\$ 7,800	\$ 4,101
Adjustments to reconcile net income to cash provided by operations			
Undistributed earnings of subsidiaries	(4,537)	(3,561)	(286)
Share based payment awards	650	677	603
Depreciation	147	163	294
Net amortization of investment securities	5	6	5
Deferred income tax (benefit) expense	(172)	(570)	162
Changes in operating assets and liabilities which provided (used) cash			
Other assets	298	(748)	(816)
Accrued interest and other liabilities	1,883	517	583
<b>Net Cash Provided by Operating Activities</b>	<b>7,319</b>	<b>4,284</b>	<b>4,646</b>
<b>Investing Activities</b>			
Activity in available-for-sale securities			
Maturities, calls, and sales	110	110	110
Sales (purchases) of equipment and premises	247	(466)	1,300
Advances to subsidiaries	(250)		(11,927)
<b>Net Cash Provided by (Used in) Investing Activities</b>	<b>107</b>	<b>(356)</b>	<b>(10,517)</b>
<b>Financing Activities</b>			
Net (decrease) increase in other borrowed funds	(1,550)	700	1,836
Cash dividends paid on common stock	(5,421)	(5,256)	(4,873)
Proceeds from the issuance of common stock	2,208	2,479	2,476
Common stock repurchased	(2,020)	(2,056)	(6,440)
Common stock purchased for deferred compensation obligations	(514)	(767)	(249)
<b>Net Cash Used in Financing Activities</b>	<b>(7,297)</b>	<b>(4,900)</b>	<b>(7,250)</b>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	<b>129</b>	<b>(972)</b>	<b>(13,121)</b>
Cash and cash equivalents at beginning of year	172	1,144	14,265
<b>Cash And Cash Equivalents at End of Year</b>	<b>\$ 301</b>	<b>\$ 172</b>	<b>\$ 1,144</b>

**Note 21 Operating Segments**

The Corporation's reportable segments are based on legal entities that account for at least 10 percent of net operating results. Retail banking operations for 2010, 2009, and 2008 represent approximately 90% or greater of the Corporation's total assets and operating results. As such, no additional segment information is presented.



## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **ISABELLA BANK CORPORATION FINANCIAL REVIEW**

**(All dollars in thousands)**

The following is management's discussion and analysis of the financial condition and results of operations for Isabella Bank Corporation. This discussion and analysis is intended to provide a better understanding of the consolidated financial statements and statistical data included elsewhere in the Annual Report.

#### ***Executive Summary***

Isabella Bank Corporation, as well as all other financial institutions in Michigan and across the entire country, continues to experience the negative impacts on its operations from the recent economic recession and the subsequent recovery. This recession, which began in the fourth quarter of 2008, has resulted in historically high levels of loan delinquencies and nonaccrual loans, which have translated into increases in net loans charged off and foreclosed asset and collection expenses. Additionally, there have been announcements by several large banks stating that they have halted foreclosures due to a failure to properly prepare the documents to complete the foreclosure process. Isabella Bank Corporation has, to its knowledge, materially complied with all laws governing foreclosures.

Despite the recent economic downturn, the Corporation continues to be profitable, with net income of \$9,045 for the year ended December 31, 2010. The Corporation's nonperforming loans represented 0.83% of total loans as of December 31, 2010 which declined from 1.28% as of December 31, 2009. The ratio of nonperforming loans to total loans for all banks in the Corporation's peer group was 3.71% as of September 30, 2010 (December 31, 2010 peer group ratios are not yet available). The Corporation's interest margins also continue to be strong, as the net yield on interest earning assets (on a fully tax equivalent basis) was 4.04% for the year ended December 31, 2010.

#### ***New Branch Office***

As part of the Corporation's effort to expand its market area, the Corporation opened a new branch in Midland, Michigan in the third quarter of 2010. The new full service office will expand the Corporation's presence in the Midland area as a source for both commercial and consumer loans and deposits.

#### ***Recent Legislation***

The recently passed Health Care and Education Act of 2010 and the Patient Protection and Affordable Care Act could have a significant impact on the Corporation's operating results in future periods. Aside from the potential increases in the Corporation's health care costs, the implementation of the new rules and requirements is likely to require a substantial commitment from the Corporation's management.

The recently enacted Dodd-Frank Act is very broad and complex legislation that puts in place a sweeping new financial services framework that is likely to have significant regulatory and legal consequences and will likely impact the Corporation's future operating results. Implementation of the Act will require compliance with numerous new regulations, which will increase compliance and documentation costs. For more information, see the summary of the Dodd-Frank Act under the heading "Regulation" in Item 1, included in the Corporation's 2010 annual report on Form 10-K.

In September 2010, Congress passed and the President signed into law the Small Business Lending Bill which includes access to capital for community banks. The Corporation continues to be well capitalized and profitable and is not expecting to participate in the program.

***Shareholder Stock Purchase Program***

The Corporation recently amended its Dividend Reinvestment and Employee Stock Purchase Plan to allow for any current shareholders to purchase additional shares of the Corporation's stock directly from the Corporation beginning in the fourth quarter of 2010. For more information regarding that amendment, see the Form S-3D that the Corporation filed with the SEC on October 1, 2010.

***Other***

The Corporation has not received any notices of regulatory actions as of February 28, 2011.

***Critical Accounting Policies:***

The Corporation's significant accounting policies are set forth in Note 1 of the Consolidated Financial Statements. Of these significant accounting policies, the Corporation considers its policies regarding the allowance for loan losses, acquisition intangibles, and the determination of the fair value of investment securities to be its most critical accounting policies.

The allowance for loan losses requires management's most subjective and complex judgment. Changes in economic conditions can have a significant impact on the allowance for loan losses and, therefore, the provision for loan losses and results of operations. The Corporation has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation's 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 management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation's allowance for loan losses and related matters, see the detailed discussion to follow.

United States generally accepted accounting principles require that the Corporation determine the fair value of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. The Corporation employs 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 management believes it has the appropriate expertise to determine the fair value, management may choose to use its own calculations of the value. In other cases, where the value is not easily determined, the Corporation consults 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 value of its balance sheet, including identifiable intangibles, is recorded as goodwill. This goodwill is not amortized, but is tested for impairment on at least an annual basis.

The Corporation currently has both available-for-sale and trading investment securities that are carried at fair value. Changes in the fair value of available-for-sale investment securities are included as a component of other comprehensive income, while declines in the fair value of these securities below their cost that are other-than-temporary are reflected as realized losses in the consolidated statements of income. The change in value of trading investment securities is included in current earnings. Management evaluates securities for indications of losses that are considered other-than-temporary, if any, on a regular basis. The market values for available-for-sale and trading investment securities are typically obtained from outside sources and applied to individual securities within the portfolio.

The Corporation invested \$11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, \$7,800 converted to preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a discounted cash flow analysis as of December 31, 2010 and December 31, 2009. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, and the current volume of trading activity. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The Corporation calculated the present value assuming a 30 year nonamortizing balloon using weighted average discount rates between 3.88% and 6.87% as of December 31, 2010.

As of December 31, 2010, the Corporation held an auction rate money market preferred security and preferred stock which declined in fair value as a result of the securities' interest rates, as they are currently lower than the offering rates of securities with similar characteristics. Despite the limited trading of these securities, management has 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 these securities are deemed to be below investment grade, and management does not intend to sell the securities in an unrealized loss position, and it is more likely than not that the Corporation will not have to sell the securities before recovery of their cost basis. As

a result, the Corporation has not recognized an other-than-temporary impairment related to these declines in fair value.

**DISTRIBUTION OF ASSETS, LIABILITIES, AND SHAREHOLDERS' EQUITY**  
**INTEREST RATE AND INTEREST DIFFERENTIAL**

The following schedules present the daily average amount outstanding for each major category of interest earning assets, nonearning assets, interest bearing liabilities, and noninterest bearing liabilities for the last three years. This schedule also presents an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a fully taxable equivalent (FTE) basis using a 34% federal income tax rate. Nonaccruing loans, for the purpose of the following computations, are included in the average loan amounts outstanding. Federal Reserve and Federal Home Loan Bank stock holdings which are restricted are included in Other Assets.

	December 31, 2010			Year Ended December 31, 2009			December 31, 2008		
	Average Balance	Tax Equivalent Interest	Average Yield/ Rate	Average Balance	Tax Equivalent Interest	Average Yield/ Rate	Average Balance	Tax Equivalent Interest	Average Yield/ Rate
<b>INTEREST EARNING ASSETS</b>									
Loans	\$ 725,534	\$ 46,794	6.45%	\$ 725,299	\$ 47,706	6.58%	\$ 717,040	\$ 49,674	6.93%
Available investment securities	160,514	5,271	3.28%	119,063	4,712	3.96%	108,919	5,433	4.99%
Non-taxable investment securities	120,999	7,095	5.86%	121,676	7,217	5.93%	121,220	7,218	5.95%
Money market account securities	8,097	436	5.38%	17,279	856	4.95%	26,618	1,305	4.90%
Other funds sold				842	1	0.12%	5,198	110	2.12%
Other	45,509	479	1.05%	27,433	376	1.37%	17,600	433	2.46%
<b>Total earning assets</b>	<b>1,060,653</b>	<b>60,075</b>	<b>5.66%</b>	<b>1,011,592</b>	<b>60,868</b>	<b>6.02%</b>	<b>996,595</b>	<b>64,173</b>	<b>6.44%</b>
<b>NON EARNING ASSETS</b>									
Allowance for loan losses	(13,262)			(12,334)			(8,606)		
Time and demand deposits due from banks	18,070			18,190			18,582		
Prepaid expenses and equipment	24,624			23,810			22,905		
Accrued income and other assets	92,845			86,376			83,626		
<b>Total assets</b>	<b>\$ 1,182,930</b>			<b>\$ 1,127,634</b>			<b>\$ 1,113,102</b>		

<b>INTEREST EARNING LIABILITIES</b>									
Interest bearing									
Demand deposits	\$ 137,109	151	0.11%	\$ 116,412	146	0.13%	\$ 114,889	813	0.71%
Time deposits	169,579	391	0.23%	177,538	399	0.22%	213,410	2,439	1.14%
Other deposits	430,892	10,988	2.55%	398,356	13,043	3.27%	393,190	16,621	4.23%
Borrowed funds	188,512	5,674	3.01%	193,922	6,251	3.22%	145,802	5,733	3.93%
<b>Total interest earning liabilities</b>	<b>926,092</b>	<b>17,204</b>	<b>1.86%</b>	<b>886,228</b>	<b>19,839</b>	<b>2.24%</b>	<b>867,291</b>	<b>25,606</b>	<b>2.95%</b>
<b>NONINTEREST EARNING LIABILITIES</b>									
Demand deposits	102,812			94,408			95,552		
Other	14,171			7,188			6,633		
Shareholders' equity	139,855			139,810			143,626		
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,182,930</b>			<b>\$ 1,127,634</b>			<b>\$ 1,113,102</b>		
<b>Net interest income (FTE)</b>		<b>\$ 42,871</b>			<b>\$ 41,029</b>			<b>\$ 38,567</b>	
<b>Net yield on interest earning assets (FTE)</b>			<b>4.04%</b>			<b>4.06%</b>			<b>3.87%</b>



**Net Interest Income**

The Corporation derives the majority of its gross income from interest earned on loans and investments, while its most significant expense is the interest cost incurred for funds used. Net interest income is the amount by which interest income on earning assets exceeds the interest cost of deposits and borrowings. Net interest income is influenced by changes in the balance and mix of assets and liabilities and market interest rates. Management exerts some control over these factors; however, Federal Reserve monetary policy and competition have a significant impact. Interest income includes loan fees of \$2,196, in 2010, \$1,963 in 2009, and \$1,808 in 2008. For analytical purposes, net interest income is adjusted to a taxable equivalent basis by adding the income tax savings from interest on tax exempt loans and securities, thus making year to year comparisons more meaningful.

**VOLUME AND RATE VARIANCE ANALYSIS**

The following table details the dollar amount of changes in FTE net interest income for each major category of interest earning assets and interest bearing liabilities and the amount of change attributable to changes in average balances (volume) or average rates. 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.

	<b>2010 Compared to 2009</b>			<b>2009 Compared to 2008</b>		
	<b>Increase (Decrease) Due to</b>	<b>Increase (Decrease) Due to</b>	<b>Increase (Decrease) Due to</b>	<b>Increase (Decrease) Due to</b>	<b>Increase (Decrease) Due to</b>	<b>Increase (Decrease) Due to</b>
	<b>Volume</b>	<b>Rate</b>	<b>Net</b>	<b>Volume</b>	<b>Rate</b>	<b>Net</b>
<b>CHANGES IN INTEREST INCOME:</b>						
Loans	\$ 15	\$ (927)	\$ (912)	\$ 567	\$ (2,535)	\$ (1,968)
Taxable investment securities	1,453	(894)	559	474	(1,195)	(721)
Nontaxable investment securities	(40)	(82)	(122)	27	(28)	(1)
Trading account securities	(489)	69	(420)	(463)	14	(449)
Federal funds sold	(1)		(1)	(51)	(58)	(109)
Other	205	(102)	103	182	(239)	(57)
<b>Total changes in interest income</b>	<b>1,143</b>	<b>(1,936)</b>	<b>(793)</b>	<b>736</b>	<b>(4,041)</b>	<b>(3,305)</b>
<b>CHANGES IN INTEREST EXPENSE:</b>						
Interest bearing demand deposits	24	(19)	5	11	(678)	(667)
Savings deposits	(18)	10	(8)	(353)	(1,687)	(2,040)
Time deposits	1,002	(3,057)	(2,055)	216	(3,794)	(3,578)
Borrowed funds	(171)	(406)	(577)	1,672	(1,154)	518
<b>Total changes in interest expense</b>	<b>837</b>	<b>(3,472)</b>	<b>(2,635)</b>	<b>1,546</b>	<b>(7,313)</b>	<b>(5,767)</b>
<b>Net change in interest margin (FTE)</b>	<b>\$ 306</b>	<b>\$ 1,536</b>	<b>\$ 1,842</b>	<b>\$ (810)</b>	<b>\$ 3,272</b>	<b>\$ 2,462</b>

Despite a \$49,061 increase in interest earning assets in 2010, the \$1,842 increase in FTE net interest income was primarily the result of interest rates on interest bearing liabilities decreasing faster than rates earned on interest earning assets. The Corporation anticipates that net interest margin yield will decline slightly during 2011 due to the following factors:

While the Corporation's liability sensitive balance sheet has allowed it to benefit from decreases in interest rates, it also makes the Corporation sensitive to increases in deposit and borrowing rates. As part of the Corporation's goal to minimize the potential negative impacts of possible increases in future interest rates, management is actively working to lengthen the terms of its interest bearing liabilities. This lengthening has increased the Corporation's cost of funding, reducing net interest income in the short term.

Based on the current economic conditions, management does not anticipate any changes in the target Fed funds rate in the foreseeable future. As such, the Corporation does not anticipate significant, if any, changes in market rates. However, there is the potential for declines in rates earned on interest earning assets. Most of the potential declines would arise out of the Corporation's investment portfolio, due to securities which may be called or will mature in 2011, as these funds will likely be reinvested at significantly lower rates.

Interest rates on residential mortgage loans remain at or near historical lows. This rate environment has led to strong consumer demand for fixed rate mortgage products which are generally sold to the secondary market. As a result, there has been a significant decline in three and five year balloon mortgages, which are held on the Corporation's balance sheet. As these balloon mortgages have paid off, the proceeds from these loans have been reinvested (typically in the form of available-for-sale investment securities) at lower interest rates which has adversely impacted interest income.

Loan growth has been minimal during 2010. As a result, funds were reinvested from higher yielding loans into lower yielding investments.

The interest rates on many types of loans including home equity lines of credit, residential balloon mortgages, variable rate commercial lines of credit, and investment securities with acceptable credit and interest rate risks are currently priced at or below the Corporation's current net yield on interest earning assets. In order to earn additional net interest income, the Corporation is continuing to extend loans and purchase investments that will increase net income but decrease net interest margin yield.

## ALLOWANCE FOR LOAN LOSSES

The viability of any financial institution is ultimately determined by its management of credit risk. Loans outstanding represent the Corporation's single largest concentration of risk. The allowance for loan losses ( ALLL ) is management's estimation of losses in the existing loan portfolio. Factors used to evaluate the loan portfolio, and thus to determine the current charge to expense, include recent loan loss history, financial condition of borrowers, amount of nonperforming and impaired loans, overall economic conditions, and other factors.

The following schedule shows the composition of the provision for loan losses and the allowance for loan losses.

	Year Ended December 31				
	2010	2009	2008	2007	2006
Allowance for loan losses January 1	\$ 12,979	\$ 11,982	\$ 7,301	\$ 7,605	\$ 6,899
Allowance of acquired bank			822		726
Loans charged off					
Commercial and agricultural	3,731	3,081	2,137	905	368
Real estate mortgage	2,524	2,627	3,334	659	252
Consumer	596	934	854	582	529
<b>Total loans charged off</b>	<b>6,851</b>	<b>6,642</b>	<b>6,325</b>	<b>2,146</b>	<b>1,149</b>
Recoveries					
Commercial and agricultural	453	623	160	297	136
Real estate mortgage	638	546	240	49	53
Consumer	297	377	284	285	258
<b>Total recoveries</b>	<b>1,388</b>	<b>1,546</b>	<b>684</b>	<b>631</b>	<b>447</b>
Net loans charged off	5,463	5,096	5,641	1,515	702
Provision charged to income	4,857	6,093	9,500	1,211	682

<b>Allowance for loan losses December 31</b>	<b>\$ 12,373</b>	<b>\$ 12,979</b>	<b>\$ 11,982</b>	<b>\$ 7,301</b>	<b>\$ 7,605</b>
<b>Year to date average loans</b>	<b>\$ 725,534</b>	<b>\$ 725,299</b>	<b>\$ 717,040</b>	<b>\$ 604,342</b>	<b>\$ 522,726</b>
<b>Net loans charged off to average loans outstanding</b>	<b>0.75%</b>	<b>0.70%</b>	<b>0.79%</b>	<b>0.25%</b>	<b>0.13%</b>
<b>Total amount of loans outstanding</b>	<b>\$ 735,304</b>	<b>\$ 723,316</b>	<b>\$ 735,385</b>	<b>\$ 612,687</b>	<b>\$ 591,042</b>
<b>Allowance for loan losses as a % of loans</b>	<b>1.68%</b>	<b>1.79%</b>	<b>1.63%</b>	<b>1.19%</b>	<b>1.29%</b>

As a result of the recent economic recession, residential real estate values in the Corporation's market areas have declined. These declines are the result of increases in the inventory of unsold homes. This increased inventory is partially the result of the inability of potential home buyers to obtain financing due to the tightening of loan underwriting criteria by many financial institutions, brokers and government sponsored agencies and uncertainties associated with industry wide concerns over the foreclosure process. While the Corporation has maintained traditional lending standards, the decline in real estate values has had an adverse impact on customers who are experiencing financial difficulties. Historically, customers who experienced difficulties were able to sell their properties for more than the loan balance owed. The steep decline in real estate values has diminished homeowner equity and led borrowers who are experiencing financial difficulties to default on their mortgage loans.

The Corporation originates and sells fixed rate residential real estate mortgages to the Federal Home Loan Mortgage Corporation (Freddie Mac). The Corporation has not originated loans either for trading or its own portfolio that would be classified as subprime or financed loans for more than 80% of market value unless insured by private third party insurance.

As shown in the preceding table, when comparing 2010 to 2009, net loans charged off increased by \$367. This increase is primarily related to one loan, for which a charge off of \$1,000 was recorded in the fourth quarter of 2010. Despite the increase in net loans charged off, the overall improvement in the credit quality of the Corporation's loan portfolio has allowed the Corporation to reduce its provision for loan losses in 2010 when compared to 2009.

The Corporation allocates the allowance throughout its loan portfolio based on management's assessment of the underlying risks associated with each loan segment. Management's assessments include allocations based on specific impairment allocations, historical loss histories, internally assigned credit ratings, and past due and nonaccrual balances. A portion of the allowance for loan losses is not allocated to any one loan segment, but is instead a reflection of other qualitative risks within the Corporation's loan portfolio.

For further discussion on the allocation of the allowance for loan losses, see Note 4 Loans and Allowance for Loan Losses to the Corporation's consolidated financial statements.

#### **Loans Past Due and Loans in Nonaccrual Status**

Increases in past due and nonaccrual loans can have a significant impact on the ALLL. To determine the potential impact, and corresponding estimated losses, management analyzes its historical loss trends on loans past due 30-89 days, 90 days or more, and nonaccrual loans.

The following tables summarize the Corporation's past due and nonaccrual loans as of December 31:

		<b>Total Past Due and Nonaccrual</b>			
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Commercial and agricultural	\$ 9,606	\$ 8,839	\$ 13,958	\$ 8,746	\$ 7,213
Residential mortgage	8,119	10,296	12,418	8,357	4,631
Consumer installment	309	460	956	617	360
	\$ 18,034	\$ 19,595	\$ 27,332	\$ 17,720	\$ 12,204

	<b>2010</b>			
	<b>Accruing Loans Past Due</b>			<b>Total Past Due and</b>
	<b>30-89 Days</b>	<b>Greater Than 90 Days</b>	<b>Nonaccrual</b>	<b>Nonaccrual</b>
Commercial and agricultural	5,291	175	4,140	\$ 9,606
Residential mortgage	6,339	310	1,470	8,119
Consumer installment	308	1		309
	\$ 11,938	\$ 486	\$ 5,610	\$ 18,034

	2009			
	Accruing Loans Past Due			Total Past Due and Nonaccrual
	30-89 Days	Greater Than 90 Days	Nonaccrual	
Commercial and agricultural	2,567	462	5,810	\$ 8,839
Residential mortgage	7,352	287	2,657	10,296
Consumer installment	386	19	55	460
	<b>\$ 10,305</b>	<b>\$ 768</b>	<b>\$ 8,522</b>	<b>\$ 19,595</b>

### Restructured Loans

The following table summarizes the Corporation's restructured loans as of December 31:

	2010			2009			2008			2007	2006
	Accruing Interest	Non- accrual	Total	Accruing Interest	Non- accrual	Total	Accruing Interest	Non- accrual	Total	Accruing Interest	Accruing Interest
Current	\$ 4,798	\$ 499	\$ 5,297	\$ 2,754	\$ 786	\$ 3,540	\$ 2,297	\$ 1,355	\$ 3,652	\$ 517	\$ 640
Past due 30-89 days	277	26	303	107	904	1,011	268		268	115	57
Past due 90 days or more		163	163		426	426		630	630	53	
<b>Total</b>	<b>\$ 5,075</b>	<b>\$ 688</b>	<b>\$ 5,763</b>	<b>\$ 2,861</b>	<b>\$ 2,116</b>	<b>\$ 4,977</b>	<b>\$ 2,565</b>	<b>\$ 1,985</b>	<b>\$ 4,550</b>	<b>\$ 685</b>	<b>\$ 697</b>

The Corporation had no restructured loans in nonaccrual status as of December 31, 2007 or 2006.

The Corporation has taken aggressive actions to avoid foreclosures on borrowers who are willing to work with the Corporation in modifying their loans, thus making them more affordable. These loan restructurings have allowed borrowers to develop a payment structure that will allow them to continue making payments in lieu of foreclosure. Restructured loans that have been placed in nonaccrual status may be placed back on accrual status after six months of continuous performance.

To be classified as a restructured loan, the concessions granted to a customer who is experiencing financial difficulty must meet one of the following criteria:

1. Reduction of the stated interest rate related to the sole purpose of providing payment and relief for the remaining original life of the debt.

2. Extension of the amortization period beyond typical lending guidelines.
3. Forbearance of principal.
4. Forbearance of accrued interest.

The following table displays the results of the Corporation's efforts related to loans restructured since December 31, 2008:

	Successful		Unsuccessful		Total	
	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans	Number of Loans	Amount of Loans
Reduction in interest rate	2	\$ 275	1	\$ 132	3	\$ 407
Extension of amortization	29	6,235	2	68	31	6,303
Reduction in interest rate and extension of amortization	33	4,196			33	4,196
	<b>64</b>	<b>\$ 10,706</b>	<b>3</b>	<b>\$ 200</b>	<b>67</b>	<b>\$ 10,906</b>

Since December 31, 2008, the Corporation has not restructured any loans as a result of a forbearance of principal or accrued interest.



The Corporation has restructured \$10,906 of loans since December 31, 2008 and had \$5,763 of loans classified as restructured as of December 31, 2010. While the number of loans restructured has increased in 2010, it is a reflection of the Corporation's efforts to work with customers to modify the terms of their loan agreements and an indicator that the local economy remains under stress.

### Nonperforming Assets

The following table summarizes the Corporation's nonperforming assets as of December 31:

	2010	2009	2008	2007	2006
Nonaccrual loans	\$ 5,610	\$ 8,522	\$ 11,175	\$ 4,156	\$ 3,444
Accruing loans past due 90 days or more	486	768	1,251	1,727	1,185
<b>Total nonperforming loans</b>	<b>6,096</b>	<b>9,290</b>	<b>12,426</b>	<b>5,883</b>	<b>4,629</b>
Other real estate owned	2,039	1,141	2,770	1,376	562
Reposessed assets	28	16	153		
<b>Total nonperforming assets</b>	<b>\$ 8,163</b>	<b>\$ 10,447</b>	<b>\$ 15,349</b>	<b>\$ 7,259</b>	<b>\$ 5,191</b>
<b>Nonperforming loans as a % of total loans</b>	<b>0.83%</b>	<b>1.28%</b>	<b>1.69%</b>	<b>0.96%</b>	<b>0.78%</b>
<b>Nonperforming assets as a % of total assets</b>	<b>0.67%</b>	<b>0.91%</b>	<b>1.35%</b>	<b>0.76%</b>	<b>0.57%</b>

Loans are placed in nonaccrual status when the foreclosure process has begun, generally after a loan is 90 days past due, unless such loan is well secured and in the process of collection. Upon transferring the loans to nonaccrual status, an evaluation to determine the net realizable value of the underlying collateral is performed. This evaluation is used to help determine if any charge downs are necessary. Loans may be placed back on accrual status after six months of continued performance.

The following table summarizes the Corporation's nonaccrual loan balances by type as of December 31:

	2010	2009	2008	2007	2006
Commercial and agricultural	\$ 4,140	\$ 5,810	\$ 8,059	\$ 1,959	\$ 2,887
Residential mortgage	1,470	2,657	3,092	2,185	557
Consumer installment		55	24	12	
	<b>\$ 5,610</b>	<b>\$ 8,522</b>	<b>\$ 11,175</b>	<b>\$ 4,156</b>	<b>\$ 3,444</b>

Included in nonaccrual commercial and agricultural loans was one credit with a balance of \$2,679 as of December 31, 2010. This credit is secured by unsold condominiums and undeveloped commercial real estate for which there has been a specific allocation established in the amount of \$345. Commercial and agricultural nonaccrual loans included

one credit with a balance of \$1,800 as of December 31, 2009 which was subsequently transferred to other real estate owned in the third quarter of 2010. There were no other individually significant credits included in nonaccrual loans as of December 31, 2010, 2009, 2008, 2007, or 2006.

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

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Commercial and agricultural	\$ 115	\$ 1,692	\$ 1,985
Residential mortgage	573	424	
	<b>\$ 688</b>	<b>\$ 2,116</b>	<b>\$ 1,985</b>

The Corporation had no restructured loans in nonaccrual status as of December 31, 2007 or 2006.

The Corporation has devoted considerable attention to identifying impaired loans and adjusting the net carrying value of these loans to their current net realizable values through the establishment of a specific reserve or

the recording of a charge off. To management's knowledge, there are no other loans which cause management to have serious doubts as to the ability of a borrower to comply with their loan repayment terms. A continued decline in real estate values may require further write downs of loans in foreclosure and other real estate owned and could potentially have an adverse impact on the Corporation's financial performance.

Based on management's analysis, the allowance for loan losses is considered appropriate as of December 31, 2010. Management will continue to closely monitor its overall credit quality during 2011 to ensure that the allowance for loan losses remains appropriate.

### Noninterest Income

The following table shows the changes in noninterest income between the years ended December 31, 2010, 2009, and 2008 respectively.

	2010	2009	Year Ended December 31		2008	Change	
			\$	%		\$	%
Service charges and fees							
NSF and overdraft fees	\$ 2,809	\$ 3,187	\$ (378)	-11.9%	\$ 3,413	\$ (226)	-6.6%
ATM and debit card fees	1,492	1,218	274	22.5%	1,029	189	18.4%
Trust fees	896	814	82	10.1%	886	(72)	-8.1%
Freddie Mac servicing fee	760	724	36	5.0%	627	97	15.5%
Service charges on deposit accounts	333	344	(11)	-3.2%	372	(28)	-7.5%
Net originated mortgage servicing rights income (loss)	47	514	(467)	-90.9%	(92)	606	N/M
All other	143	112	31	27.7%	135	(23)	-17.0%
<b>Total service charges and fees</b>	<b>6,480</b>	<b>6,913</b>	<b>(433)</b>	<b>-6.3%</b>	<b>6,370</b>	<b>543</b>	<b>8.5%</b>
Gain on sale of mortgage loans	610	886	(276)	-31.2%	249	637	N/M
Net (loss) gain on trading securities	(94)	80	(174)	N/M	245	(165)	-67.3%
Net gain (loss) on borrowings measured at fair value	227	289	(62)	-21.5%	(641)	930	N/M
Gain on sale of available-for-sale investment securities	348	648	(300)	-46.3%	24	624	N/M
Other							
Earnings on corporate owned life insurance policies	663	641	22	3.4%	616	25	4.1%
Brokerage and advisory fees	573	521	52	10.0%	480	41	8.5%
All other	493	178	315	177.0%	459	(281)	-61.2%

<b>Total other</b>	<b>1,729</b>	<b>1,340</b>	<b>389</b>	<b>29.0%</b>	<b>1,555</b>	<b>(215)</b>	<b>-13.8%</b>
<b>Total noninterest income</b>	<b>\$ 9,300</b>	<b>\$ 10,156</b>	<b>\$ (856)</b>	<b>-8.4%</b>	<b>\$ 7,802</b>	<b>\$ 2,354</b>	<b>30.2%</b>

Significant changes in noninterest income are detailed below:

Management continuously analyzes various fees related to deposit accounts including: service charges and NSF and overdraft fees. Based on these analyses, the Corporation makes any necessary adjustments to ensure that its fee structure is within the range of its competitors, while at the same time making sure that the fees remain fair to deposit customers. NSF and overdraft fees have been declining over the past two years, and declined further in the third quarter and fourth quarters of 2010 as a result of new regulatory rules issued by the Federal Reserve Bank being implemented related to NSF and overdraft fees. The Corporation anticipates that NSF and overdraft fees will decline further in 2011 as a result of this recent rule making.

The increases in ATM and debit card fees are primarily the result of the increased usage of debit cards by customers. As management does not anticipate any significant changes to the ATM and debit card fee structures, these fees are expected to continue to increase as the usage of debit cards increases.

As a result of lower than normal residential mortgage rates, the Corporation experienced increases in the volume of loans sold to Freddie Mac beginning in the fourth quarter of 2008. This high volume led to increases in gains from the sale of mortgage loans in 2009. The volume of new mortgage activity has returned to more normal levels in 2010, leading to a decline in the gain on sale of mortgage loans. Despite the increase in the balance of serviced loans, the Corporation recorded only modest increases in the value of its originated mortgage servicing rights ( OMSR ) portfolio in 2010 as rates remained at historically low levels. As interest rates are expected to increase, the Corporation anticipates that Freddie Mac servicing fees and net OMSR income will increase in 2011, while the gains from the sale of mortgage loans will likely decline.

Fluctuations in the gains and losses related to trading securities and borrowings carried at fair value are caused by interest rate variances. Management does not anticipate any significant fluctuations in net trading activities in 2011 as significant interest rate changes are not expected.

The Corporation does not anticipate any significant sales of available-for-sale investment securities in 2011.

Fees generated from brokerage and advisory services have been steadily increasing for the past few years. This has been the result of staff additions as well as a conscious effort by management to expand the Corporation's presence in its local market. Management anticipates brokerage and advisory fees to increase further in 2011.

The fluctuation in all other income in 2010 is due partially to a \$133 increase in earnings from the Corporation's investment in Corporate Settlement Solutions. The remainder of the difference is spread throughout the various categories, none of which are individually significant.

**Noninterest Expenses**

The following table shows the changes in noninterest expenses between the years ended December 31, 2010, 2009, and 2008 respectively.

	Year Ended December 31						
	2010	2009	Change		2008	Change	
			\$	%		\$	%
<b>Compensation and benefits</b>							
Leased employee salaries	\$ 13,697	\$ 13,494	\$ 203	1.5%	\$ 12,465	\$ 1,029	8.3%
Leased employee benefits	4,837	4,745	92	1.9%	4,502	243	5.4%
All other	18	19	(1)	-5.3%	25	(6)	-24.0%
<b>Total compensation and benefits</b>	<b>18,552</b>	<b>18,258</b>	<b>294</b>	<b>1.6%</b>	<b>16,992</b>	<b>1,266</b>	<b>7.5%</b>
Occupancy							
Depreciation	584	546	38	7.0%	508	38	7.5%
Outside services	524	433	91	21.0%	492	(59)	-12.0%
Property taxes	505	439	66	15.0%	411	28	6.8%
Utilities	423	393	30	7.6%	366	27	7.4%
Building repairs	243	288	(45)	-15.6%	202	86	42.6%
All other	72	71	1	1.4%	56	15	26.8%
<b>Total occupancy</b>	<b>2,351</b>	<b>2,170</b>	<b>181</b>	<b>8.3%</b>	<b>2,035</b>	<b>135</b>	<b>6.6%</b>
Furniture and equipment							
Depreciation	1,938	1,803	135	7.5%	1,663	140	8.4%
Computer/service contracts	1,779	1,676	103	6.1%	1,565	111	7.1%
ATM and debit card fees	595	621	(26)	-4.2%	570	51	8.9%
All other	32	46	(14)	-30.4%	51	(5)	-9.8%
<b>Total furniture and equipment</b>	<b>4,344</b>	<b>4,146</b>	<b>198</b>	<b>4.8%</b>	<b>3,849</b>	<b>297</b>	<b>7.7%</b>
<b>FDIC insurance premiums</b>	<b>1,254</b>	<b>1,730</b>	<b>(476)</b>	<b>-27.5%</b>	<b>313</b>	<b>1,417</b>	<b>N/M</b>
Other							
Marketing and community relations	1,093	894	199	22.3%	921	(27)	-2.9%
Foreclosed asset and collection	710	546	164	30.0%	565	(19)	-3.4%
Directors fees	887	923	(36)	-3.9%	867	56	6.5%
Audit and SOX compliance fees	916	831	85	10.2%	698	133	19.1%
Education and travel	499	395	104	26.3%	491	(96)	-19.6%

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Printing and supplies	420	529	(109)	-20.6%	508	21	4.1%
Postage and freight	382	415	(33)	-8.0%	419	(4)	-1.0%
Legal fees	338	375	(37)	-9.9%	415	(40)	-9.6%
Amortization of deposit premium	395	472	(77)	-16.3%	523	(51)	-9.8%
Consulting fees	167	201	(34)	-16.9%	298	(97)	-32.6%
All other	1,499	1,798	(299)	-16.6%	1,810	(12)	-0.7%
<b>Total other</b>	<b>7,306</b>	<b>7,379</b>	<b>(73)</b>	<b>-1.0%</b>	<b>7,515</b>	<b>(136)</b>	<b>-1.8%</b>
<b>Total noninterest expenses</b>	<b>\$ 33,807</b>	<b>\$ 33,683</b>	<b>\$ 124</b>	<b>0.4%</b>	<b>\$ 30,704</b>	<b>\$ 2,979</b>	<b>9.7%</b>

Significant changes in noninterest expenses are detailed below:

Leased employee salaries have remained essentially unchanged from 2009. During 2009, the Corporation incurred increased overtime costs related to the large volume of mortgage refinancing activity. While the demand for mortgage refinancing has reduced, the reduction in overtime has been offset by annual merit increases and the continued growth of the Corporation. Leased employee benefits fluctuate from period to period primarily as a result of changes in health care related expenses. The Corporation does not anticipate any significant changes in leased employee salaries or benefit expenses in 2011.

FDIC insurance premium expense decreased primarily when the year ended December 31, 2010 is compared to the same period in 2009 as a result of an FDIC special assessment of \$479, which was paid in September 2009. Management expects FDIC insurance premiums to approximate current levels for 2011.

The increase in marketing and community relations expenses in 2010 is primarily related to the Corporation making a contribution of \$250 to the IBT Foundation, compared to \$140 in 2009 and \$0 in 2008.

Audit and SOX compliance fees fluctuate due to the timing of the performance of recurring audit procedures.

Director fees declined in 2010 due to Corporation implementing a policy whereby the membership on the Isabella Bank and Isabella Bank Corporation's board of directors is identical; no significant change is expected in 2011.

Printing and supplies expenses were historically high in the first three months of 2009 as a result of the Corporation increasing inventories of various supplies. Printing and supplies expenses are expected to approximate current levels in 2011.

The Corporation places a strong emphasis on customer service. In February 2010, all of the Corporation's employees attended a special customer service seminar. This seminar coupled with increases in expenditures for executive leadership training led to increases in education expenses during 2010. Management expects that education related expenses may decline slightly in 2011.

Postage and freight expenses have declined, and are expected to continue to decline, as a result of fewer special mailings as well as an increase in the Corporation's customers usage of electronic statements.

The Corporation's legal expenses can fluctuate from period to period based on the volume of foreclosures as well as expenses related to the Corporation's ongoing operations, including regulatory compliance. At this time, the Corporation is not aware of any significant legal matters, and as such expects that legal expenses should approximate current levels in 2011.

The fluctuations in all other expenses are spread throughout various categories, none of which are individually significant.

### **Federal Income Taxes**

Federal income tax expense (benefit) for 2010 was \$1,604 or 15.1% of pre-tax income compared to \$846 or 9.8% of income in 2009 and (\$724) or (21.4%) in 2008. The primary factor behind the effective rate in 2008 is related to the increase in tax exempt income as a percentage of net income. A reconciliation of actual federal income tax expense reported and the amount computed at the federal statutory rate of 34% is found in Note 11, Federal Income Taxes of Notes to Consolidated Financial Statements.





**ANALYSIS OF CHANGES IN FINANCIAL CONDITION**

	<b>December 31</b>			
	<b>2010</b>	<b>2009</b>	<b>\$ Change</b>	<b>% Change</b>
<b>ASSETS</b>				
Cash and cash equivalents	\$ 18,109	\$ 24,482	\$ (6,373)	-26.03%
Certificates of deposit held in other financial institutions	15,808	5,380	10,428	193.83%
Trading securities	5,837	13,563	(7,726)	-56.96%
Available-for-sale investment securities	330,724	259,066	71,658	27.66%
Mortgage loans available-for-sale	1,182	2,281	(1,099)	-48.18%
Loans	735,304	723,316	11,988	1.66%
Allowance for loan losses	(12,373)	(12,979)	606	-4.67%
Premises and equipment	24,627	23,917	710	2.97%
Goodwill and other intangible assets	47,091	47,429	(338)	-0.71%
Equity securities without readily determinable fair values	17,564	17,921	(357)	-1.99%
Other assets	41,937	39,568	2,369	5.99%
<b>Total Assets</b>	<b>\$ 1,225,810</b>	<b>\$ 1,143,944</b>	<b>\$ 81,866</b>	<b>7.16%</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>				
<b>Liabilities</b>				
Deposits	\$ 877,339	\$ 802,652	\$ 74,687	9.31%
Borrowed funds	194,917	193,101	1,816	0.94%
Accrued interest and other liabilities	8,393	7,388	1,005	13.60%
<b>Total liabilities</b>	<b>1,080,649</b>	<b>1,003,141</b>	<b>77,508</b>	<b>7.73%</b>
<b>Shareholders equity</b>	<b>145,161</b>	<b>140,803</b>	<b>4,358</b>	<b>3.10%</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 1,225,810</b>	<b>\$ 1,143,944</b>	<b>\$ 81,866</b>	<b>7.16%</b>

As shown above, the Corporation has intentionally increased its balance sheet through the acquisition of available-for-sale investment securities and certificates of deposit held in other financial institutions, which is consistent with its plan to increase net interest income. These purchases were funded primarily with retail deposit growth. Available-for-sale investment securities are expected to continue to increase in 2011. Overall changes in deposit accounts and demand for loans are the primary reasons for fluctuations in cash and cash equivalents. As the Corporation has increased its investment securities, it has reduced its interest bearing balances, which is included in cash and cash equivalents.

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

**Trading securities**

Trading securities are carried at fair value. The Corporation's overall intent is to maintain a trading portfolio to enhance the ongoing restructuring of assets and liabilities as part of our interest rate risk management objectives (See Note 2 Trading Securities of the Consolidated Financial Statements). Due to the current interest rate environment, the Corporation has allowed this balance to decline.

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

	<b>2010</b>	<b>2009</b>	<b>2008</b>
Government sponsored enterprises	\$	\$	\$ 4,014
States and political subdivisions	5,837	9,962	11,556
Corporate			160
Mortgage-backed		3,601	6,045
<b>Total</b>	<b>\$ 5,837</b>	<b>\$ 13,563</b>	<b>\$ 21,775</b>

#### Available-for-sale investment securities

The primary objective of the Corporation's investing activities is to provide for safety of the principal invested. Secondary considerations include the need for earnings, liquidity, and the Corporation's overall exposure to changes in interest rates. Securities currently classified as available-for-sale are stated at fair value.

The following is a schedule of the carrying value of investment securities available-for-sale as of December 31:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
U.S. Government and federal agencies	\$	\$	\$ 4,083
Government sponsored enterprises	5,404	19,471	62,988
States and political subdivisions	169,717	151,730	149,323
Corporate			7,145
Auction rate money market preferred	2,865	2,973	5,979
Preferred stocks	6,936	7,054	
Mortgage-backed	102,215	67,734	16,937
Collateralized mortgage obligations	43,587	10,104	
<b>Total</b>	<b>\$ 330,724</b>	<b>\$ 259,066</b>	<b>\$ 246,455</b>

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

The following is a schedule of maturities of available-for-sale investment securities (at carrying value) and their weighted average yield as of December 31, 2010. Weighted average yields have been computed on a fully taxable-equivalent basis using a tax rate of 34%. Mortgage-backed securities and collateralized mortgage obligations are included in maturity categories based on their stated maturity date. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Trading securities have been

excluded as they are not expected to be held to maturity. Included in the contractual maturity distribution in the following table are auction rate money market preferred securities and preferred stock. Auction rate debt and auction rate preferred securities are long term floating rate instruments for which interest rates are set at periodic auctions. At each successful auction, the Corporation has the option to sell the security at par value. Additionally,

the issuers of auction rate securities generally have the right to redeem or refinance the debt. As a result, the expected life of auction rate securities may differ significantly from the contractual term.

	Within One Year		After One Year But Within Five Years		Maturing After Five Years But Within Ten Years		After Ten Years		Securities with Variable Payments	
	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)
Government sponsored enterprises	\$		\$ 5,007	2.02	\$ 397	7.91	\$		\$	
States and political subdivisions	14,132	3.51	34,837	3.73	87,263	3.74	33,485	2.09		
Mortgage-backed Collateralized mortgage obligations					53,738	2.54	48,477	2.66	43,587	2.59
Auction rate money market preferred									2,865	4.86
Preferred stocks									6,936	4.60
<b>Total</b>	<b>\$ 14,132</b>	<b>3.51</b>	<b>\$ 39,844</b>	<b>3.53</b>	<b>\$ 141,398</b>	<b>3.29</b>	<b>\$ 81,962</b>	<b>2.43</b>	<b>\$ 53,388</b>	<b>2.98</b>

## Loans

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

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

	2010	2009	2008	2007	2006
Commercial	\$ 348,852	\$ 340,274	\$ 324,806	\$ 238,306	\$ 212,701
Agricultural	71,446	64,845	58,003	47,407	47,302
Residential real estate mortgage	284,029	285,838	319,397	297,937	300,650
Installment	30,977	32,359	33,179	29,037	30,389

**\$ 735,304    \$ 723,316    \$ 735,385    \$ 612,687    \$ 591,042**

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

	2010		2009		2008	
	\$ Change	% Change	\$ Change	% Change	\$ Change	% Change
Commercial	\$ 8,578	2.5%	\$ 15,468	4.8%	\$ 86,500	36.3%
Agricultural	6,601	10.2%	6,842	11.8%	10,596	22.4%
Residential real estate mortgage	(1,809)	-0.6%	(33,559)	-10.5%	21,460	7.2%
Installment	(1,382)	-4.3%	(820)	-2.5%	4,142	14.3%
	<b>\$ 11,988</b>	<b>1.7%</b>	<b>\$ (12,069)</b>	<b>-1.6%</b>	<b>\$ 122,698</b>	<b>20.0%</b>

The growth in commercial and agricultural loans is a result of the Corporation's efforts to increase these segments of the loan portfolio as a percentage of total loans. A significant portion of this growth has been driven by the Corporation's new business development team.

As rates in 2010 on residential mortgages were comparable to the rates in 2009, residential mortgage refinancing activity stabilized which resulted in a decrease in loans sold to the secondary market. As a result of this decline in loans sold, the residential real estate portfolio remained stable in 2010 as compared to the significant

declines noted in 2009. Refinancing activity resulted in a net increase of \$2,226 in the balance of residential mortgage loans sold to the secondary market in 2010 compared to a net increase of \$53,161 in 2009.

A substantial portion of the increase in total loans as of December 31, 2008 compared to December 31, 2007 was a result of the acquisition of Greenville Financial Corporation in January 2008. Pursuant to the acquisition, the Corporation purchased gross loans totaling \$88,613.

#### 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 December 31:

	2010	2009
Federal Home Loan Bank Stock	\$ 7,596	\$ 7,960
Investment in Corporate Settlement Solutions	6,793	6,782
Federal Reserve Bank Stock	1,879	1,879
Investment in Valley Financial Corporation	1,000	1,000
Other	296	300
<b>Total</b>	<b>\$ 17,564</b>	<b>\$ 17,921</b>

#### Deposits

The main source of funds for the Corporation is deposits. The following table presents the composition of the deposit portfolio as of December 31:

	2010	2009	2008	2007	2006
Noninterest bearing deposits	\$ 104,902	\$ 96,875	\$ 97,546	\$ 84,846	\$ 83,902
Interest bearing demand deposits	142,259	128,111	113,973	105,526	111,406
Savings deposits	177,817	157,020	182,523	196,682	178,001
Certificates of deposit	386,435	356,594	340,976	311,976	320,226
Brokered certificates of deposit	53,748	50,933	28,185	28,197	27,446
Internet certificates of deposit	12,178	13,119	12,427	6,246	4,859
<b>Total</b>	<b>\$ 877,339</b>	<b>\$ 802,652</b>	<b>\$ 775,630</b>	<b>\$ 733,473</b>	<b>\$ 725,840</b>

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

2010	2009	2008
	\$ Change	\$ Change



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	\$ Change	% Change		% Change		% Change
Noninterest bearing deposits	\$ 8,027	8.3%	\$ (671)	-0.7%	\$ 12,700	15.0%
Interest bearing demand deposits	14,148	11.0%	14,138	12.4%	8,447	8.0%
Savings deposits	20,797	13.2%	(25,503)	-14.0%	(14,159)	-7.2%
Certificates of deposit	29,841	8.4%	15,618	4.6%	29,000	9.3%
Brokered certificates of deposit	2,815	5.5%	22,748	80.7%	(12)	0.0%
Internet certificates of deposit	(941)	-7.2%	692	5.6%	6,181	99.0%
<b>Total</b>	<b>\$ 74,687</b>	<b>9.3%</b>	<b>\$ 27,022</b>	<b>3.5%</b>	<b>\$ 42,157</b>	<b>5.7%</b>

As shown in the preceding table, the Corporation has enjoyed strong deposit growth during 2010. This growth was the result of the Corporation offering products with competitive rates and terms, as well as focused marketing efforts to increase deposit market share in the communities served. Management anticipates that deposits will continue to grow in 2011.

A substantial portion of the increase in total deposits as of December 31, 2008 compared to December 31, 2007 was a result of the acquisition of Greenville Community Financial Corporation (GCFC) in January 2008. Pursuant to the acquisition, the Corporation purchased deposits totaling \$90,151. Exclusive of the GCFC acquisition, deposits decreased \$47,994 when December 31, 2008 is compared to December 31, 2007. This decline was the result of increased competition with other depository institutions as well as declines in brokered certificates of deposit and internet certificates of deposit.

The following table shows the average balances and corresponding interest rates paid on deposit accounts as of December 31:

	2010		2009		2008	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand deposits	\$ 102,812		\$ 94,408		\$ 95,552	
Interest bearing demand deposits	137,109	0.11%	116,412	0.13%	114,889	0.71%
Savings deposits	169,579	0.23%	177,538	0.22%	213,410	1.14%
Time deposits	430,892	2.55%	398,356	3.27%	393,190	4.23%
<b>Total</b>	<b>\$ 840,392</b>		<b>\$ 786,714</b>		<b>\$ 817,041</b>	

The remaining maturity of time certificates and other time deposits of \$100 or more as of December 31, 2010 was as follows:

Maturity	
Within 3 months	\$ 35,935
Within 3 to 6 months	20,695
Within 6 to 12 months	49,207
Over 12 months	98,360
<b>Total</b>	<b>\$ 204,197</b>

### Borrowed Funds

The following table summarizes the Corporation's borrowings as of December 31:

	2010		2009	
	Amount	Rate	Amount	Rate
Federal Home Loan Bank advances	\$ 113,423	3.64%	\$ 127,804	4.11%
Securities sold under agreements to repurchase without stated maturity dates	45,871	0.25%	37,797	0.30%
Securities sold under agreements to repurchase with stated maturity dates	19,623	3.01%	20,000	3.72%
Federal funds purchased	16,000	0.60%		

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Federal Reserve Bank discount window advance			7,500	0.75%
<b>Total</b>	<b>\$ 194,917</b>	<b>2.53%</b>	<b>\$ 193,101</b>	<b>3.19%</b>

The maturity and weighted average interest rates of FHLB advances are as follows as of December 31:

	2010		2009	
	Amount	Rate	Amount	Rate
Fixed rate advances due 2010	\$		\$ 28,320	4.52%
One year putable advances due 2010			6,000	5.31%
Fixed rate advances due 2011	10,086	3.96%	10,206	3.96%
One year putable advances due 2011	1,000	4.75%	1,000	4.75%
Fixed rate advances due 2012	17,000	2.97%	17,000	2.97%
One year putable advances due 2012	15,000	4.10%	15,000	4.10%
Fixed rate advances due 2013	5,337	4.14%	5,278	4.14%
One year putable advances due 2013	5,000	3.15%	5,000	3.15%
Fixed rate advances due 2014	25,000	3.16%	15,000	3.63%
Fixed rate advances due 2015	25,000	4.63%	25,000	4.63%
Fixed rate advances due 2017	10,000	2.35%		
<b>Total</b>	<b>\$ 113,423</b>	<b>3.64%</b>	<b>\$ 127,804</b>	<b>4.11%</b>

The maturity and weighted average interest rates of securities sold under agreements to repurchase with stated maturity dates are as follows at December 31:

	2010		2009	
	Amount	Rate	Amount	Rate
Repurchase agreements due 2010	\$		\$ 5,000	4.00%
Repurchase agreements due 2011	858	1.51%		
Repurchase agreements due 2012	1,013	2.21%		
Repurchase agreements due 2013	5,127	4.45%	5,000	4.51%
Repurchase agreements due 2014	12,087	3.00%	10,000	3.19%
Repurchase agreements due 2015	538	3.25%		
<b>Total</b>	<b>\$ 19,623</b>	<b>3.01%</b>	<b>\$ 20,000</b>	<b>3.72%</b>

### Contractual Obligations and Loan Commitments

The Corporation has various financial obligations, including contractual obligations and commitments, which may require future cash payments. The following schedule summarizes the Corporation's non cancelable obligations and future minimum payments as of December 31, 2010:

Due in	Minimum Payments Due by Period	
	After One Year But	After Three Year But

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	<b>One Year or Less</b>	<b>Within Three Years</b>	<b>Within Five Years</b>	<b>After Five Years</b>	<b>Total</b>
Deposits with no stated maturity	\$ 424,978	\$	\$	\$	\$ 424,978
Certificates of deposit with stated maturities	216,927	158,268	70,888	6,278	452,361
Borrowed funds					
Short term borrowings	61,871				61,871
Long term borrowings	11,944	48,477	62,625	10,000	133,046
Total borrowed funds	73,815	48,477	62,625	10,000	194,917
<b>Total contractual obligations</b>	<b>\$ 715,720</b>	<b>\$ 206,745</b>	<b>\$ 133,513</b>	<b>\$ 16,278</b>	<b>\$ 1,072,256</b>

The Corporation also has loan commitments that may impact liquidity. The following schedule summarizes the Corporation's loan commitments and expiration dates by period as of December 31, 2010. Since many of these commitments historically have expired without being drawn upon, the total amount of these commitments does not necessarily represent future cash requirements of the Corporation.

	<b>Expiration Dates by Period</b>				<b>Total</b>
	<b>Due in One Year or Less</b>	<b>After One Year But Within Three Years</b>	<b>After Three Year But Within Five Years</b>	<b>After Five Years</b>	
Unused commitments to extend credit	\$ 65,717	\$ 24,364	\$ 14,847	\$ 5,273	\$ 110,201
Undisbursed loans	13,382				13,382
Standby letters of credit	4,881				4,881
<b>Total loan commitments</b>	<b>\$ 83,980</b>	<b>\$ 24,364</b>	<b>\$ 14,847</b>	<b>\$ 5,273</b>	<b>\$ 128,464</b>

## Capital

The capital of the Corporation consists primarily of common stock, including shares to be issued, retained earnings, and accumulated other comprehensive loss. The Corporation offers dividend reinvestment and employee, director, and shareholder stock purchase plans. Under the provisions of these plans, the Corporation issued 122,113 shares of common stock generating \$2,164 of capital during 2010, and 126,874 shares of common stock generating \$2,396 of capital in 2009. The Corporation also generates capital through the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan), its equity compensation plan (See Note 16 Benefit Plans of Notes to Consolidated Financial Statements). Pursuant to this plan, the Corporation generated \$650 and \$677 of capital in 2010 and 2009, respectively.

The Board of Directors has adopted a common stock repurchase plan. This plan was approved to enable the Corporation to repurchase the Corporation's common stock for reissuance to the dividend reinvestment plan, the employee stock purchase plan and for distributions from the Directors Plan. During 2010 and 2009 the Corporation repurchased 138,970 shares of common stock at an average price of \$18.40 and 122,612 shares of common stock at an average price of \$19.47, respectively.

Accumulated other comprehensive loss decreased \$410 in 2010 and consists of \$457 of unrealized gains on available-for-sale investment securities which was offset by a \$47 increase in unrecognized pension cost. These amounts are net of tax.

The Federal Reserve Board's current recommended minimum primary capital to assets requirement is 6.0%. The Corporation's primary capital to average assets ratio, which consists of shareholders' equity plus the allowance for loan losses less acquisition intangibles, was 8.24% at year end 2010. There are no commitments for significant capital expenditures.

The Federal Reserve Board has established a minimum risk based capital standard. Under this standard, a framework has been established that assigns risk weights to each category of on and off-balance-sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum standard to determine whether a corporation has adequate capital. The minimum standard is 8%, of which at least 4% must consist of equity capital net of goodwill. The following table sets forth the percentages required under the Risk Based Capital guidelines and the Corporation's values at:

	<b>2010</b>	<b>December 31 2009</b>	<b>Required</b>
Equity Capital	12.44%	12.80%	4.00%
Secondary Capital	1.25%	1.25%	4.00%
<b>Total Capital</b>	<b>13.69%</b>	<b>14.05%</b>	<b>8.00%</b>

Isabella Bank Corporation's secondary capital includes only the allowance for loan losses. The percentage for the secondary capital under the required column is the maximum amount allowed from all sources.

The Federal Reserve Board also prescribes minimum capital requirements for the Corporation's subsidiary Bank. At December 31, 2010, the Bank exceeded these minimums. For further information regarding the Bank's capital requirements, refer to Note 15 Minimum Regulatory Capital Requirements of the Notes to Consolidated Financial Statements,

### Fair Value

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale, trading securities, and certain liabilities are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans held-for-sale, foreclosed assets, originated mortgage servicing rights, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

The table below represents the activity in Level 3 inputs measured on a recurring basis for the year ended December 31:

	2010	2009
Level 3 inputs January 1	\$ 10,027	\$ 5,979
Net unrealized (losses) gains on available-for-sale investment securities	(226)	4,048
Level 3 inputs December 31	\$ 9,801	\$ 10,027

For further information regarding fair value measurements see Note 1, Nature of Operations and Summary of Significant Accounting Policies and Note 19, Fair Value of the Consolidated Financial Statements.

### Interest Rate Sensitivity

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

Trading securities are included in the 0 to 3 month time frame due to their repricing characteristics. Fixed interest rate investment securities are scheduled according to their contractual maturity. Fixed rate loans are included in the appropriate time frame based on their scheduled amortization. Variable rate loans, which totaled \$143,572 as of December 31, 2010, are included in the time frame of their earliest repricing. Time deposit liabilities are scheduled based on their contractual maturity except for variable rate time deposits in the amount of \$1,940 that are included in the 0 to 3 month time frame.

Savings, NOW accounts, and money market accounts have no contractual maturity date and are believed to be predominantly noninterest rate sensitive by management. These accounts have been classified in the gap table according to their estimated withdrawal rates based upon management's analysis of deposit runoff over the past five years. Management believes this runoff experience is consistent with its expectation for the future. As of December 31, 2010, the Corporation had a negative cumulative gap within one year. A negative gap position results



when more liabilities, within a specified time frame, mature or reprice than assets.

The following table shows the time periods and the amount of assets and liabilities available for interest rate repricing as of December 31, 2010. The interest rate sensitivity information for investment securities is based on the

expected prepayments and call dates versus stated maturities. For purposes of this analysis, nonaccrual loans and the allowance for loan losses are excluded.

	<b>0 to 3 Months</b>	<b>4 to 12 Months</b>	<b>1 to 5 Years</b>	<b>Over 5 Years</b>
<b>Interest Sensitive Assets</b>				
Trading securities	\$ 5,837	\$	\$	\$
Investment securities	17,405	47,247	129,688	136,384
Loans	168,790	94,739	401,106	65,059
<b>Total</b>	<b>\$ 192,032</b>	<b>\$ 141,986</b>	<b>\$ 530,794</b>	<b>\$ 201,443</b>
<b>Interest Sensitive Liabilities</b>				
Borrowed funds	\$ 63,421	\$ 10,730	\$ 110,766	\$ 10,000
Time deposits	67,036	150,552	228,495	6,278
Savings	10,770	33,671	107,557	25,819
Interest bearing demand	7,432	22,405	79,827	32,595
<b>Total</b>	<b>\$ 148,659</b>	<b>\$ 217,358</b>	<b>\$ 526,645</b>	<b>\$ 74,692</b>
Cumulative gap (deficiency)	\$ 43,373	\$ (31,999)	\$ (27,850)	\$ 98,901
Cumulative gap (deficiency) as a % of assets	3.54%	(2.61)%	(2.27) %	8.07%

The following table shows the maturity of commercial and agricultural loans outstanding at December 31, 2010. Also provided are the amounts due after one year, classified according to the sensitivity to changes in interest rates.

	<b>1 Year or Less</b>	<b>1 to 5 Years</b>	<b>Over 5 Years</b>	<b>Total</b>
Commercial and agricultural	\$ 102,027	\$ 296,042	\$ 22,229	\$ 420,298
<b>Interest Sensitivity</b>				
Loans maturing after one year that have:				
Fixed interest rates		\$ 253,106	\$ 20,346	
Variable interest rates		42,936	1,883	
<b>Total</b>		<b>\$ 296,042</b>	<b>\$ 22,229</b>	

### Liquidity

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

The primary sources of the Corporation's liquidity are cash and cash equivalents, trading securities, and available-for-sale investment securities, excluding auction rate money market preferred securities and preferred stock due to their illiquidity. These categories totaled \$360,677 or 29.4% of assets as of December 31, 2010 as compared to \$292,464 or 25.6% in 2009. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests, and various other commitments discussed in the accompanying notes to consolidated financial statements. Liquidity varies significantly daily, based on customer activity.

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

	2010	2009	\$ Variance
Net cash provided by operating activities	\$ 26,521	\$ 18,225	\$ 8,296
Net cash used in investing activities	(103,877)	(9,184)	(94,693)
Net cash provided by (used in) financing activities	70,983	(7,538)	78,521
(Decrease) Increase in cash and cash equivalents	(6,373)	1,503	(7,876)
Cash and cash equivalents January 1	24,482	22,979	1,503
Cash and cash equivalents December 31	\$ 18,109	\$ 24,482	\$ (6,373)

The primary source of funds for the Corporation is deposits. The Corporation emphasizes interest bearing time deposits as part of its funding strategy. The Corporation also seeks noninterest bearing deposits, or checking accounts, to expand its customer base, while reducing the Corporation's cost of funds.

The Corporation has the ability to borrow from the Federal Home Loan Bank, the Federal Reserve Bank, and through various correspondent banks as federal funds. These funding methods typically carry a higher interest rate than traditional market deposit accounts. Some borrowed funds, including Federal Home Loan Bank Advances, Federal Reserve Bank Discount Window Advances, and repurchase agreements, require the Corporation to pledge assets, typically in the form of investment securities or loans, as collateral.

The Corporation had the ability to borrow up to an additional \$122,960, based on the assets currently pledged as collateral. The Corporation has pledged eligible mortgage loans and investment securities as collateral for any such borrowings.

### **Quantitative and Qualitative Disclosures about Market Risk**

The Corporation's primary market risks are interest rate risk and liquidity risk. The Corporation has no significant foreign exchange risk, holds limited loans outstanding, and does not utilize interest rate swaps or derivatives, except for interest rate locks and forward loan commitments, in the management of its interest rate risk. Any changes in foreign exchange rates or commodity prices would have an insignificant impact on the Corporation's interest income and cash flows. The Corporation does have a significant amount of loans extended to borrowers in agricultural production. The cash flow of such borrowers and ability to service debt is largely dependent on commodity prices. The Corporation mitigates these risks by using conservative price and production yields when calculating a borrower's available cash flow to service their debt.

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

The Federal Reserve Board, the Corporation's primary Federal regulator, has adopted a policy requiring the Board of Directors and senior management to effectively manage the various risks that can have a material impact on the safety and soundness of the Corporation. The risks include credit, interest rate, liquidity, operational, and reputational. The

Corporation has policies, procedures and internal controls for measuring and managing these risks. Specifically, the IRR policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to the Board of Directors.

The Corporation uses several techniques to manage IRR. The first method is gap analysis. Gap analysis measures the cash flows and/or the earliest repricing of the Corporation's interest bearing assets and liabilities. This analysis is useful for measuring trends in the repricing characteristics of the balance sheet. Significant assumptions are required in this process because of the imbedded repricing options contained in assets and liabilities. A substantial portion of the Corporation's assets are invested in loans and investment securities with issuer call options. Residential real estate and other consumer loans have imbedded options that allow the borrower to repay

the balance prior to maturity without penalty, while commercial and agricultural loans have prepayment penalties. The amount of prepayments is dependent upon many factors, including the interest rate of a given loan in comparison to the current interest rate for residential mortgages, the level of sales of used homes, and the overall availability of credit in the market place. Generally, a decrease in interest rates will result in an increase in the Corporation's cash flows from these assets. A significant portion of the Corporation's securities are callable or subject to prepayment. The call option is more likely to be exercised in a period of decreasing interest rates. Investment securities, other than those that are callable, do not have any significant imbedded options. Savings and checking deposits may generally be withdrawn on request without prior notice. The timing of cash flows from these deposits is estimated based on historical experience. Time deposits have penalties that discourage early withdrawals.

The second technique used in the management of IRR is to combine the projected cash flows and repricing characteristics generated by the gap analysis and the interest rates associated with those cash flows to project future interest income. By changing the amount and timing of the cash flows and the repricing interest rates of those cash flows, the Corporation can project the effect of changing interest rates on its interest income. Based on the projections prepared for the year ended December 31, 2010, the Corporation's net interest income would decrease during a period of increasing interest rates.

The following tables provide information about the Corporation's assets and liabilities that are sensitive to changes in interest rates as of December 31, 2010 and 2009. The Corporation has no interest rate swaps, futures contracts, or other derivative financial options. The principal amounts of assets and time deposits maturing were calculated based on the contractual maturity dates. Savings and NOW accounts are based on management's estimate of their future cash flows.

	2011	2012	December 31, 2010				Total	Fair Value
			2013	2014	2015	Thereafter		12/31/10
	(Dollars in thousands)							
Rate sensitive assets								
Other interest bearing assets	\$ 10,550	\$ 5,429	\$ 960	\$	\$	\$	\$ 16,939	\$ 17,039
Average interest rates	0.96%	1.82%	2.16%				1.30%	
Trading securities	\$ 1,918	\$ 2,366	\$ 1,031	\$ 522	\$	\$	\$ 5,837	\$ 5,837
Average interest rates	3.46%	2.31%	2.42%	2.47%			2.72%	
Fixed interest rate securities	\$ 64,652	\$ 42,984	\$ 32,871	\$ 29,395	\$ 24,438	\$ 136,384	\$ 330,724	\$ 330,724
Average interest rates	3.68%	3.42%	3.30%	3.33%	3.28%	3.13%	3.32%	
Fixed interest rate loans	\$ 128,277	\$ 121,434	\$ 140,019	\$ 67,423	\$ 68,569	\$ 66,010	\$ 591,732	\$ 603,435
Average interest rates	6.80%	6.63%	6.26%	6.47%	6.08%	5.83%	6.41%	
Variable interest rate loans	\$ 59,536	\$ 17,306	\$ 22,523	\$ 15,118	\$ 18,830	\$ 10,259	\$ 143,572	\$ 143,572
	4.94%	4.76%	4.27%	3.78%	3.69%	5.21%	4.55%	

average interest rates								
rate sensitive liabilities								
borrowed funds	\$ 74,151	\$ 33,013	\$ 15,127	\$ 37,087	\$ 25,539	\$ 10,000	\$ 194,917	\$ 200,603
average interest rates	0.62%	3.46%	2.55%	3.11%	4.60%	2.35%	2.33%	
savings and NOW accounts	\$ 74,278	\$ 73,818	\$ 53,174	\$ 35,872	\$ 24,520	\$ 58,414	\$ 320,076	\$ 320,076
average interest rates	0.21%	0.21%	0.20%	0.19%	0.18%	0.15%	0.19%	
fixed interest rate time deposits	\$ 215,648	\$ 113,338	\$ 44,269	\$ 31,414	\$ 39,474	\$ 6,278	\$ 450,421	\$ 452,392
average interest rates	1.79%	2.67%	3.35%	2.86%	2.97%	3.26%	2.36%	
variable interest rate time deposits	\$ 1,279	\$ 661	\$	\$	\$	\$	\$ 1,940	\$ 1,940
average interest rates	1.21%	1.06%					1.16%	

	December 31, 2009						Total	Fair Value 12/31/09
	2010	2011	2012	2013	2014	Thereafter		
Rate sensitive assets								
Other interest bearing assets	\$ 10,360	\$ 960	\$ 1,200	\$	\$	\$	\$ 12,520	\$ 12,520
Average interest rates	1.13%	2.29%	2.64%				1.36%	
Trading securities	\$ 7,139	\$ 2,043	\$ 2,546	\$ 1,094	\$ 570	\$ 171	\$ 13,563	\$ 13,563
Average interest rates	2.84%	2.42%	2.28%	2.53%	2.66%	4.86%	2.66%	
Fixed interest rate securities	\$ 68,078	\$ 35,401	\$ 21,540	\$ 20,369	\$ 20,431	\$ 93,247	\$ 259,066	\$ 259,066
Average interest rates	3.53%	3.51%	3.59%	3.65%	3.63%	3.58%	3.57%	
Fixed interest rate loans	\$ 133,703	\$ 111,981	\$ 118,749	\$ 109,754	\$ 62,280	\$ 48,764	\$ 585,231	\$ 594,498
Average interest rates	6.64%	6.85%	6.72%	6.50%	6.61%	6.01%	6.61%	
Variable interest rate loans	\$ 60,727	\$ 17,695	\$ 13,799	\$ 16,357	\$ 16,940	\$ 12,567	\$ 138,085	\$ 138,085
Average interest rates	5.00%	4.69%	4.79%	3.83%	3.74%	5.35%	4.68%	
Rate sensitive liabilities								
Borrowed funds	\$ 85,101	\$ 11,000	\$ 32,000	\$ 15,000	\$ 5,000	\$ 45,000	\$ 193,101	\$ 195,179
Average interest rates	2.28%	4.04%	3.50%	3.93%	4.38%	4.01%	3.17%	
Savings and NOW accounts	\$ 78,383	\$ 65,107	\$ 44,439	\$ 30,095	\$ 20,609	\$ 46,498	\$ 285,131	\$ 285,131
Average interest rates	0.15%	0.15%	0.15%	0.14%	0.15%	0.13%	0.15%	
Fixed interest rate time deposits	\$ 268,005	\$ 46,484	\$ 53,054	\$ 32,959	\$ 16,273	\$ 2,050	\$ 418,825	\$ 422,227
Average interest rates	2.26%	3.59%	3.47%	3.83%	3.09%	3.35%	2.72%	
Variable interest rate time deposits	\$ 1,252	\$ 569	\$	\$	\$	\$	\$ 1,821	\$ 1,821
Average interest rates	1.56%	1.40%					1.51%	

### 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. The Corporation intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained



in the Private Securities Reform Act of 1995, and is including 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 of the Corporation, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Corporation's 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 of the Corporation and the subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government including policies of the U.S. Treasury, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Corporation's 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 the Corporation and its business, including additional factors that could materially affect the Corporation's financial results, is included in the Corporation's filings with the Securities and Exchange Commission.

### **COMMON STOCK AND DIVIDEND INFORMATION**

The Corporation's common stock is traded in the over the counter ( OTC ) market. The common stock has been quoted on the OTC Pink market tier of the OTC Markets Group, Inc.'s electronic quotation system (the Pink Sheets ) under the symbol ISBA since August of 2008 and under the symbol IBTM prior to August of 2008. Other trades in the common stock occur in privately negotiated transactions from time to time of which the Corporation may have little or no information.

Management has reviewed the information available as to the range of reported high and low bid quotations, including high and low bid information as reported by Pink Sheets and closing price information as reported by the parties to privately negotiated transactions. The following table sets forth management's compilation of that information for the periods indicated. Price information obtained from Pink Sheets reflects inter dealer prices, without retail mark up, mark down or commissions and may not necessarily represent actual transactions. Price information obtained from parties to privately negotiated transactions reflects actual closing prices that were

disclosed to the Corporation, which management has not independently verified. The following compiled data is provided for information purposes only and should not be viewed as indicative of the actual or market value of the Corporation's common stock.

Period	Number of Shares	Sale Price	
		Low	High
2010			
First Quarter	45,695	\$ 16.75	\$ 19.00
Second Quarter	64,290	17.00	18.50
Third Quarter	53,897	16.05	17.99
Fourth Quarter	56,534	16.57	18.30
	<b>220,416</b>		
2009			
First Quarter	61,987	14.99	25.51
Second Quarter	91,184	15.85	20.75
Third Quarter	66,399	17.50	19.50
Fourth Quarter	76,985	14.00	19.25
	<b>296,555</b>		

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

	Per Share	
	2010	2009
First Quarter	\$ 0.18	\$ 0.12
Second Quarter	0.18	0.13
Third Quarter	0.18	0.13
Fourth Quarter	0.18	0.32
<b>Total</b>	<b>\$ 0.72</b>	<b>\$ 0.70</b>

Isabella Bank Corporation's authorized common stock consists of 15,000,000 shares, of which 7,550,074 shares are issued and outstanding as of December 31, 2010. As of that date, there were 3,011 shareholders of record.

The Board of Directors has adopted a common stock repurchase plan. On June 23, 2010, the Board of Directors amended the plan to allow for the repurchase of an additional 100,000 shares of the Corporation's common stock. These authorizations do not have expiration dates. As shares are repurchased under this plan, they revert back to the status of authorized, but unissued shares.

The following table provides information for the three month period ended December 31, 2010, with respect to this plan:

	<b>Shares Repurchased</b>		<b>Total Number of</b>	<b>Maximum Number</b>
	<b>Number</b>	<b>Average</b>	<b>Shares</b>	<b>of</b>
		<b>Price</b>	<b>Purchased</b>	<b>Shares That May Yet</b>
		<b>Per Share</b>	<b>as Part of</b>	<b>Be</b>
			<b>Publicly</b>	<b>Purchased Under the</b>
			<b>Announced Plan</b>	<b>Plans or Programs</b>
			<b>or Program</b>	
Balance, September 30, 2010				59,131
October 1 - 31, 2010	5,224	\$ 17.23	5,224	53,907
November 1 - 30, 2010	7,773	17.37	7,773	46,134
December 1 - 31, 2010	6,697	16.87	6,697	39,437
<b>Balance, December 31, 2010</b>	<b>19,694</b>	<b>\$ 17.16</b>	<b>19,694</b>	<b>39,437</b>

Information concerning Securities Authorized for Issuance Under Equity Compensation Plans appears under Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters included in the Corporation's 2010 annual report on Form 10-K.

### Stock Performance

The following graph compares the cumulative total shareholder return on Corporation common stock for the last five years with the cumulative total return on (1) the NASDAQ Stock Market Index, which is comprised of all United States common shares traded on the NASDAQ and (2) the NASDAQ Bank Stock Index, 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 and each index was \$100 at December 31, 2005 and all dividends are reinvested.

### Stock Performance Five-Year Total Return

The dollar values for total shareholder return plotted in the graph above are shown in the table below:

#### Comparison of Five Year Cumulative Among Isabella Bank Corporation, NASDAQ Stock Market, and NASDAQ Bank Stock

Year	Isabella Bank Corporation	NASDAQ	NASDAQ Banks
12/31/2005	100.0	100.0	100.0
12/31/2006	111.6	110.3	113.6
12/31/2007	113.3	122.1	91.4
12/31/2008	73.8	73.5	72.0
12/31/2009	56.9	106.6	60.2
12/31/2010	54.2	125.8	68.6

## **SHAREHOLDERS INFORMATION**

### **Annual Meeting**

The Annual Meeting of Shareholders will be held at 5:00 p.m., Tuesday, May 3, 2011, Comfort Inn, 2424 S. Mission Street, Mt. Pleasant, Michigan.

### **Financial Information and Form 10-K**

Copies of the 2010 Annual Report, Isabella Bank Corporation Form 10-K, and other financial information not contained herein are available on the Bank's website ([www.isabellabank.com](http://www.isabellabank.com)) under the Investor Relations tab, or may be obtained, without charge, by writing to:

Debra Campbell  
Secretary  
Isabella Bank Corporation  
401 N. Main St.  
Mt. Pleasant, Michigan 48858

### **Mission Statement**

To create an operating environment that will provide shareholders with sustained growth in their investment while maintaining our independence and subsidiaries' autonomy.

### **Equal Employment Opportunity**

The equal employment opportunity clauses in Section 202 of the Executive Order 11246, as amended; 38 USC 2012, Vietnam Era Veterans Readjustment Act of 1974; Section 503 of the Rehabilitation Act of 1973, as amended; relative to equal employment opportunity and implementing rules and regulations of the Secretary of Labor are adhered to and supported by Isabella Bank Corporation, and its subsidiaries.

