ISABELLA BANK CORP
Form 10-K
March 10, 2014
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2013
OR

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

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

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

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

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

Title of each class	Name of each exchange on which registered

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

Indicated by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes x No
Indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes x No
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check One).

Large accelerated filer ¨	Accelerated filer x

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was $190,664,000 as of the last business day of the registrant’s most recently completed second fiscal quarter.

The number of shares outstanding of the registrant’s Common Stock (no par value) was 7,725,471 as of March 7, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

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

Documents	Part of Form 10-K Incorporated into
Portions of the Isabella Bank Corporation Proxy Statement for its Annual Meeting of Shareholders to be held April 30, 2014	Part III

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Forward Looking Statements

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

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

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

FTE: Fully taxable equivalent

GAAP: U.S. generally accepted accounting principles

XBRL: eXtensible Business Reporting Language

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PART I

Item 1. Business (Dollars in thousands)

General

Isabella Bank Corporation is a registered financial services holding company incorporated in September 1988 under Michigan law. The Corporation has two subsidiaries: Isabella Bank and Financial Group Information Services. Isabella Bank has 27 banking offices located throughout Clare, Gratiot, Isabella, Mecosta, Midland, Montcalm, and Saginaw counties. The area includes significant agricultural production, light manufacturing, retail, gaming and tourism, and five colleges and universities. Financial Group Information Services renders information technology to Isabella Bank Corporation and Isabella Bank.

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

Our reportable segments are based on legal entities that account for at least 10% of net operating results. Retail banking operations for 2013, 2012, and 2011 represent approximately 90% or greater of total assets and operating results. As such, we have only one reportable segment.

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

Lending activities include loans made pursuant to commercial and agricultural operating and real estate purposes, residential real estate loans, and consumer loans. We limit lending activities primarily to local markets and have not purchased any loans from the secondary market. We do not make loans to fund leveraged buyouts, have no foreign corporate or government loans, and have limited holdings of corporate debt securities. Our general lending philosophy is to limit concentrations to individuals and business segments. For additional information related to our lending strategies and policies, see “Note 6 – Loans and ALLL” of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

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

As of December 31, 2013, we had 360 full-time equivalent employees. We provide group life, health, accident, disability, and other insurance programs as well as a number of other employee benefit programs. We believe our relationship with our employees to be good. None of our workforce is subject to collective bargaining agreements.

Available Information

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

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

Supervision and Regulation

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

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We, as a financial holding company, are regulated under the BHC Act, and are subject to the supervision of the FRB. We are registered as a financial services holding company with the FRB and are subject to annual reporting requirements and inspections and audits. Under FRB policy, we are expected to act as a source of financial strength to the Bank and to commit resources to support its subsidiaries. This support may be required at times when, in the absence of such FRB policy, it would not otherwise be required to provide support.

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

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

SOX contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with Section 302(a) of SOX, written certifications by our principal executive, financial, and accounting officers are required. These certifications attest that our quarterly and annual reports filed with the SEC do not contain any untrue statement of a material fact (see the Certifications filed as Exhibits 31 (a) and (b) to this Form 10-K for such certification of consolidated financial statements and other information for this 2013 Form 10-K). We have also implemented a program designed to comply with Section 404 of SOX, which included the identification of significant processes and accounts, documentation of the design of control effectiveness over process and entity level controls, and testing of the operating effectiveness of key controls. See Item 9A. Controls and Procedures for our evaluation of disclosure controls and procedures and internal controls over financial reporting.

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

Isabella Bank

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

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

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

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

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The payment of dividends by Isabella Bank Corporation and the Bank is also affected by various regulatory requirements and policies, such as the requirement to keep adequate capital in compliance with regulatory guidelines. Federal laws impose further restrictions on the payment of dividends by insured banks that fail to meet specified capital levels. The FDIC may prevent an insured bank from paying dividends if the bank is in default of payment of any assessment due to the FDIC. In addition, payment of dividends by a bank may be prevented by the applicable federal regulatory authority if such payment is determined, by reason of the financial condition of such bank, to be an unsafe and unsound banking practice. The FRB and the FDIC have issued policy statements providing that bank holding companies and insured banks should generally pay dividends only out of current operating earnings. Additionally, the FRB Board of Governors requires a bank holding company to notify the FRB prior to increasing its cash dividend by more than 10% over the prior year.

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

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

Item 1A. Risk Factors

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

Our enterprise risk process covers each of the following areas.

Increases to loan losses and required allowance for loan and lease losses

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

We maintain an ALLL, which is a reserve established through a provision for loan losses charged to expense. The ALLL, in our judgment, is necessary to reserve for estimated loan losses and risks within our loan portfolio. The level of the ALLL reflects our continued evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; and present economic, political and regulatory conditions. The determination of the appropriate level of the ALLL inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and economic trends, all of which may undergo material changes. In addition, bank regulatory agencies periodically review our ALLL and may require changes in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than our own.

Changes in economic conditions

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

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

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Interest rate risk

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

Liquidity risk

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

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

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

Operational risk

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

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

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

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

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

We may not adjust to changes in the financial services industry

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

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We may be required to recognize an impairment of goodwill
Goodwill represents the excess of the amounts paid to acquire subsidiaries over the fair value of their net assets at the date of acquisition. The majority of the recorded goodwill is related to acquisitions of other banks, which were subsequently merged into Isabella Bank. If it is determined that the goodwill has been impaired, we must write-down the goodwill by the amount of the impairment.
We may face increasing pressure from purchasers of our residential mortgage loans to repurchase loans sold or reimburse purchasers for losses related to such loans
We generally sell the fixed rate long term residential mortgage loans we originate to the secondary market. In response to the recent economic downturn, the purchasers of residential mortgage loans, such as government sponsored entities, increased their efforts to require sellers of residential mortgage loans to either repurchase loans previously sold, or reimburse the purchasers for losses incurred on foreclosed loans due to actual or alleged failure to strictly conform to the terms of the contract.
Consumers may decide not to use banks to complete their financial transactions
Technology and other changes are allowing customers to complete financial transactions without the involvement of banks. For example, consumers can now pay bills and transfer funds directly without banks. The process of eliminating banks as intermediaries in financial transactions could result in the loss of fee income, as well as the loss of customer deposits and income generated from those deposits.
Changes to the financial services industry as a result of regulatory changes or actions, or significant litigation
The financial services industry is extensively regulated. We are subject to extensive state and federal regulation, supervision and legislation that govern almost all aspects of our operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors, and the deposit insurance funds. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact us or our ability to increase the value of our business. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution’s ALLL. Future regulatory changes or accounting pronouncements may increase our regulatory capital requirements or adversely affect our regulatory capital levels. Additionally, actions by regulatory agencies or significant litigation against us could require the dedication of significant time and resources to defending our business and may lead to penalties.
Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of computer systems or otherwise
As part of our business, we collect and retain sensitive and confidential client and customer information on our behalf and other third parties. Despite the security measures we have in place for our facilities and systems, and the security measures of our third party service providers, we may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, human errors or other similar events. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by us or by our vendors, could severely damage our reputation, expose us to the risks of litigation and liability, disrupt our operations and have a material adverse effect on our business.
Our estimates and assumptions may be incorrect
Our consolidated financial statements conform with GAAP, which require us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. These estimates are based on information available to us at the time the estimates are made. Actual results could differ from those estimates. For further discussion regarding significant accounting estimates, see “Note 1 – Nature of Operations and Summary of Significant Accounting Policies” of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.
Disruption of infrastructure
Our operations depend upon our technological and physical infrastructure, including our equipment and facilities. Extended disruption of our vital infrastructure by fire, power loss, natural disaster, telecommunications failure, computer hacking and viruses, or other events outside of our control, could have a significant impact on our operations. We have developed disaster recovery plans, which provide detailed instructions covering all significant

aspects of our operations.

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Anti-takeover provisions

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our executive offices are located at 401 North Main Street in Mount Pleasant, Michigan. We own 27 branches, an operations center, and a mortgage operations center. Our facilities current, planned, and best use is for conducting our current activities, with the exception of approximately 75% of our previous main office location, approximately 25% of the building that houses the Lake Isabella branch, and approximately 25% of the building that houses our mortgage processing operations which are leased to non-related parties. We continually monitor and assess the need for expansion and/or improvement for all facilities. In our opinion, each facility has sufficient capacity and is in good condition.

Item 3. Legal Proceedings

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

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PART II

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

Common Stock and Dividend Information

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

Our authorized common stock consists of 15,000,000 shares, of which 7,723,023 shares are issued and outstanding as of December 31, 2013. As of that date, there were 3,080 shareholders of record.

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

	Number of Shares	Sale Price Low	High
2013			
First Quarter	54,741	$21.79	$25.10
Second Quarter	65,865	24.78	26.00
Third Quarter	105,540	23.49	25.50
Fourth Quarter	116,052	21.20	24.84
	342,198		
2012			
First Quarter	64,873	$22.15	$24.25
Second Quarter	63,656	23.45	24.98
Third Quarter	97,706	22.50	24.90
Fourth Quarter	87,966	21.60	23.45
	314,201		

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

	Per Share 2013	2012
First Quarter	$0.21	$0.20
Second Quarter	0.21	0.20
Third Quarter	0.21	0.20
Fourth Quarter	0.21	0.20
Total	$0.84	$0.80

We have adopted and publicly announced a common stock repurchase plan. The plan was last amended on October 23, 2013, to allow for the repurchase of an additional 150,000 shares of common stock. These authorizations do not have expiration dates. As shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued shares.

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The following table provides information for the three month period ended December 31, 2013, with respect to the common stock repurchase plan:

	Shares Repurchased		Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
	Number	Average Price Per Share		
Balance, September 30				11,441
October 1 - 23	4,400	$23.86	4,400	7,041
Additional Authorization (150,000 shares)				157,041
October 24 - 31	4,950	23.84	4,950	152,091
November 1 - 30	7,022	23.50	7,022	145,069
December 1 - 31	7,673	22.42	7,673	137,396
Balance, December 31	24,045	$23.29	24,045	137,396

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

Stock Performance

The following graph compares the cumulative total shareholder return on our common stock for the last five years with the cumulative total return on (1) NASDAQ, which is comprised of all United States common shares traded on the NASDAQ and (2) the NASDAQ Banks, which is comprised of bank and bank holding company common shares traded on the NASDAQ over the same period. The graph assumes the value of an investment in ISBA and each index was $100 at December 31, 2008 and all dividends are reinvested.

Year	ISBA	NASDAQ	NASDAQ Banks
12/31/2008	$100.00	$100.00	$100.00
12/31/2009	77.10	145.05	83.58
12/31/2010	73.40	171.14	95.29
12/31/2011	104.50	169.83	85.32
12/31/2012	99.30	199.89	101.15
12/31/2013	112.60	279.62	142.93

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Item 6. Selected Financial Data

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

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

	2013		2012		2011		2010		2009	
INCOME STATEMENT DATA										
Interest income	$54,076		$56,401		$57,905		$57,217		$58,105	
Interest expense	11,021		13,423		16,203		17,204		19,839	
Net interest income	43,055		42,978		41,702		40,013		38,266	
Provision for loan losses	1,111		2,300		3,826		4,857		6,093	
Noninterest income	10,175		11,530		8,218		9,300		10,156	
Noninterest expenses	37,413		37,639		34,530		33,807		33,683	
Federal income tax expense	2,196		2,363		1,354		1,604		846	
Net income	$12,510		$12,206		$10,210		$9,045		$7,800	
PER SHARE										
Basic earnings	$1.63		$1.61		$1.35		$1.20		$1.04	
Diluted earnings	1.59		1.56		1.31		1.17		1.01	
Dividends	0.84		0.80		0.76		0.72		0.70	
Market value*	23.85		21.75		23.70		17.30		18.95	
Tangible book value*	15.62		14.72		13.90		13.22		12.67	
BALANCE SHEET DATA										
At end of period										
Loans	$808,037		$772,753		$750,291		$735,304		$723,316	
Total assets	1,493,137		1,430,639		1,337,925		1,225,810		1,143,944	
Deposits	1,043,766		1,017,667		958,164		877,339		802,652	
Shareholders' equity	160,609		164,489		154,783		145,161		140,803	
Average balance										
Loans	$790,132		$754,304		$743,441		$725,534		$725,299	
Total assets	1,448,440		1,381,083		1,287,195		1,182,930		1,127,634	
Deposits	1,025,088		984,927		927,186		840,392		786,714	
Shareholders’ equity	163,010		160,682		151,379		145,304		137,910	
PERFORMANCE RATIOS										
Return on average total assets	0.86	%	0.88	%	0.79	%	0.76	%	0.69	%
Return on average shareholders' equity	7.67	%	7.60	%	6.74	%	6.22	%	5.66	%
Return on average tangible equity	10.71	%	11.41	%	10.30	%	9.51	%	8.53	%
Net interest margin yield (FTE)	3.50	%	3.70	%	3.87	%	4.04	%	4.06	%
Loan to deposit*	77.42	%	75.93	%	78.31	%	83.81	%	90.12	%
Nonperforming loans to total loans*	0.42	%	1.00	%	0.95	%	0.83	%	1.28	%
Nonperforming assets to total assets*	0.32	%	0.68	%	0.67	%	0.67	%	0.91	%
ALLL to nonperforming loans*	339.63	%	154.39	%	173.10	%	202.97	%	139.71	%
CAPITAL RATIOS										
Shareholders' equity to assets*	10.76	%	11.50	%	11.57	%	11.84	%	12.31	%
Tier 1 capital to average assets*	8.46	%	8.29	%	8.18	%	8.24	%	8.60	%
Tier 1 risk-based capital*	13.67	%	13.23	%	12.92	%	12.44	%	12.80	%
Total risk-based capital*	14.92	%	14.48	%	14.17	%	13.69	%	14.06	%

* At end of year

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

	Quarter to Date							
	December 31 2013	September 30 2013	June 30 2013	March 31 2013	December 31 2012	September 30 2012	June 30 2012	March 31 2012
Total interest income	$13,603	$ 13,505	$13,440	$13,528	$ 13,845	$ 14,164	$14,188	$14,204
Total interest expense	2,683	2,736	2,781	2,821	3,051	3,239	3,429	3,704
Net interest income	10,920	10,769	10,659	10,707	10,794	10,925	10,759	10,500
Provision for loan losses	245	351	215	300	1,200	200	439	461
Noninterest income	2,130	2,862	2,736	2,447	2,686	2,759	2,544	3,541
Noninterest expenses	9,578	9,320	9,324	9,191	9,750	9,128	9,188	9,573
Federal income tax expense	303	674	643	576	19	899	672	773
Net income	$2,924	$ 3,286	$3,213	$3,087	$ 2,511	$ 3,457	$3,004	$3,234
PER SHARE								
Basic earnings	$0.38	$ 0.43	$0.42	$0.40	$ 0.33	$ 0.45	$0.40	$0.43
Diluted earnings	0.37	0.42	0.41	0.39	0.32	0.44	0.39	0.41
Dividends	0.21	0.21	0.21	0.21	0.20	0.20	0.20	0.20
Market value*	23.85	24.85	24.75	25.00	21.75	22.50	24.85	24.00
Tangible book value*	15.62	15.43	15.19	14.95	14.72	14.65	14.37	14.15

* At end of period

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
ISABELLA BANK CORPORATION FINANCIAL REVIEW
(Dollars in thousands except per share amounts)
The following is management’s discussion and analysis of the financial condition and results of our operations. This discussion and analysis is intended to provide a better understanding of the consolidated financial statements and statistical data included elsewhere in this Annual Report on Form 10-K.
Executive Summary
During 2013, we earned a record $12,510, which was an increase of $304 from 2012. We enjoyed loan growth of $35,284 and an improvement in credit quality indicators. As of December 31, 2013, our total assets were $1.49 billion, and assets under management - which included loans sold and serviced, and assets managed by our Investment and Trust Services Department of $645.09 million - were $2.14 billion, which was a 4.13% increase in assets under management from December 31, 2012.
While competition for high quality loans has been intense, we have not relaxed our underwriting standards and we remain committed to core community banking principles and long term sustainable growth. This focus has enabled us to continue to meet the needs of the communities we serve, which translates into increased shareholder value. Our loan quality remains sound as evidenced by the relatively low percentage of loans classified as nonperforming. As of December 31, 2013, our ratio of nonperforming loans to total loans was 0.42%. In comparison, the average percentage for all bank holding companies in our peer group was 1.71% as of September 30, 2013 (peer group ratios are not yet available for December 31, 2013). In addition, our risk based capital to risk adjusted total assets ratio of 14.92% as of December 31, 2013 compares favorably to the 8.00% ratio required to be classified as adequately capitalized under the Federal Reserve Board's risk based capital rules.
In August 2013, we opened our latest branch in Big Rapids, Michigan. We are excited about our newest branch's growth potential and the new relationships that we have established. The new location has complemented our existing Big Rapids office and will provide additional shareholder value for years to come.
In order to preserve our culture and provide strong leadership for the future we emphasize succession planning. We have made significant investments in employee development and as a result, we have a tremendous amount of leadership and professional strength throughout our organization. The selection of Jae A. Evans, previously Isabella Bank's Chief Operations Officer, as Richard J. Barz's successor as CEO of Isabella Bank Corporation effective January 1, 2014 was no exception to this commitment. Mr. Evans has been with the Bank since 2008 and has more than 36 years of banking experience. Prior to his position as Chief Operations Officer, Mr. Evans served as the president of the Greenville Division of Isabella Bank. Mr. Barz continues to serve on the Board of Directors for both Isabella Bank and Isabella Bank Corporation.
Recent Legislation
The Health Care and Education Act of 2010, the Patient Protection and Affordable Care Act, the Dodd-Frank Act, and the JOBS Act, have already had, and are expected to continue to have, a negative impact on our operating results. Of these four acts, the Dodd-Frank Act has had the most significant impact. The Dodd-Frank Act established the CFPB which has made significant changes in the regulation of financial institutions aimed at strengthening the oversight of the federal government over the operation of the financial services sector and increasing the protection of consumers. As a result of the implementation of some of the provisions, we have had increases in operational costs and this trend is expected to continue.
The CFPB has begun to issue substantial proposed and final rules regarding consumer lending, including residential mortgage lending. These rules will likely further increase our compensation and outside advisor costs to ensure our compliance with the new regulations. In addition to increased costs, we anticipate that residential mortgage volume will likely decline in 2014 due to the strict underwriting standards that have removed business judgment from the underwriting process.
On July 2, 2013, the FRB published revised BASEL III Capital standards for banks. The rules redefine what is included or deducted from equity capital, changes risk weighting for certain on and off-balance sheet assets, increases the minimum required equity capital to be considered well capitalized, and introduces a capital cushion buffer. The rules, which will be gradually phased in between 2015 and 2019, are not expected to have a material impact on the

Corporation.

Other

We have not received any notices of regulatory actions as of February 28, 2014.

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CRITICAL ACCOUNTING POLICIES

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

The ALLL requires our most subjective and complex judgment. Changes in economic conditions can have a significant impact on the ALLL and, therefore, the provision for loan losses and results of operations. We have developed policies and procedures for assessing the appropriateness of the ALLL, recognizing that this process requires a number of assumptions and estimates with respect to our loan portfolio. Our assessments may be impacted in future periods by changes in economic conditions, and the discovery of information with respect to borrowers which is not known to us at the time of the issuance of the consolidated financial statements. For additional discussion concerning our ALLL and related matters, see the detailed discussion to follow under the caption “Allowance for Loan and Lease Losses” and “Note 6 – Loans and ALLL” of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

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

We currently have both AFS and trading investment securities that are carried at fair value. Changes in the fair value of AFS 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. We evaluate AFS securities for indications of losses that are considered other-than-temporary, if any, on a regular basis. The market values for AFS and trading investment securities are typically obtained from outside sources and applied to individual securities within the portfolio.

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Distribution of Assets, Liabilities, and Shareholders' Equity; Interest Rates 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. These schedules also present an analysis of interest income and interest expense for the years indicated. All interest income is reported on a 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. FRB and FHLB restricted equity holdings are included in accrued income and other assets.

	Year Ended December 31								
	2013			2012			2011		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS									
Loans	$790,132	$41,233	5.22 %	$754,304	$43,396	5.75 %	$743,441	$45,463	6.12 %
Taxable investment securities	335,575	7,228	2.15 %	309,681	7,555	2.44 %	235,437	6,941	2.95 %
Nontaxable investment securities	165,774	8,294	5.00 %	145,502	7,941	5.46 %	136,356	7,847	5.75 %
Trading account securities	1,071	55	5.14 %	2,624	142	5.41 %	5,087	286	5.62 %
Other	27,235	447	1.64 %	33,359	486	1.46 %	37,539	506	1.35 %
Total earning assets	1,319,787	57,257	4.34 %	1,245,470	59,520	4.78 %	1,157,860	61,043	5.27 %
NONEARNING ASSETS									
ALLL	(11,877)			(12,408)			(12,522)		
Cash and demand deposits due from banks	18,162			19,409			20,195		
Premises and equipment	25,993			25,244			24,397		
Accrued income and other assets	96,375			103,368			97,265		
Total assets	$1,448,440			$1,381,083			$1,287,195		
INTEREST BEARING LIABILITIES									
Interest bearing demand deposits	$183,665	161	0.09 %	$170,851	204	0.12 %	$152,530	189	0.12 %
Savings deposits	242,777	366	0.15 %	214,958	451	0.21 %	192,999	488	0.25 %
Time deposits	456,774	6,613	1.45 %	473,675	8,476	1.79 %	467,931	10,258	2.19 %
Borrowed funds	251,590	3,881	1.54 %	225,689	4,292	1.90 %	198,828	5,268	2.65 %
Total interest bearing liabilities	1,134,806	11,021	0.97 %	1,085,173	13,423	1.24 %	1,012,288	16,203	1.60 %

NONINTEREST BEARING LIABILITIES									
Demand deposits	141,872			125,443			113,726		
Other	8,752			9,785			9,802		
Shareholders' equity	163,010			160,682			151,379		
Total liabilities and shareholders' equity	$1,448,440			$1,381,083			$1,287,195		
Net interest income (FTE)		$46,236			$46,097			$44,840	
Net yield on interest earning assets (FTE)			3.50 %			3.70 %			3.87 %

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Net Interest Income

Net interest income is the amount by which interest income on earning assets exceeds the interest expenses on interest bearing liabilities. Net interest income is influenced by changes in the balance and mix of assets and liabilities and market interest rates. We exert some control over these factors; however, FRB monetary policy and competition have a significant impact. Interest income includes loan fees of $3,182 in 2013, $3,178 in 2012, and $2,385 in 2011. For analytical purposes, net interest income is adjusted to an FTE basis by adding the income tax savings from interest on tax exempt loans, AFS securities, and trading securities, thus making year to year comparisons more meaningful.

Volume and Rate Variance Analysis

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

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

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

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

	2013 Compared to 2012 Increase (Decrease) Due to			2012 Compared to 2011 Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
Changes in interest income						
Loans	$1,996	$(4,159)	$(2,163)	$656	$(2,723)	$(2,067)
Taxable AFS securities	601	(928)	(327)	1,945	(1,331)	614
Nontaxable AFS securities	1,049	(696)	353	511	(417)	94
Trading securities	(80)	(7)	(87)	(134)	(10)	(144)
Other	(96)	57	(39)	(59)	39	(20)
Total changes in interest income	3,470	(5,733)	(2,263)	2,919	(4,442)	(1,523)
Changes in interest expense						
Interest bearing demand deposits	14	(57)	(43)	22	(7)	15
Savings deposits	53	(138)	(85)	52	(89)	(37)
Time deposits	(293)	(1,570)	(1,863)	124	(1,906)	(1,782)
Borrowed funds	457	(868)	(411)	647	(1,623)	(976)
Total changes in interest expense	231	(2,633)	(2,402)	845	(3,625)	(2,780)
Net change in interest margin (FTE)	$3,239	$(3,100)	$139	$2,074	$(817)	$1,257

As shown in the following table, we experienced significant downward pressure on our net yield on interest earning assets over the past 12 months. This pressure is a direct result of FRB monetary policy which has reduced yields on interest earning assets more than rates on interest bearing liabilities. The persistent low interest rate environment coupled with an increase in the concentration of AFS securities and trading securities as a percentage of earnings assets has also placed downward pressure on net interest margin yield.

	Average Yield / Rate for the Three Month Periods Ended:				
	December 31 2013	September 30 2013	June 30 2013	March 31 2013	December 31 2012
Total earning assets	4.30 %	4.31 %	4.35 %	4.41 %	4.61 %
Total interest bearing liabilities	0.94 %	0.96 %	0.99 %	1.01 %	1.12 %
Net yield on interest earning assets (FTE)	3.50 %	3.48 %	3.50 %	3.54 %	3.65 %

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While there have been increases in long term interest rates, short and medium term interest rates continue to be at historically low levels. We do not anticipate any significant changes in net interest margin yield in the near future. Despite the challenging current interest rate environment, we anticipate net interest income and the net yield on interest earning assets (FTE) will modestly increase as most interest earning assets have already repriced at lower rates while some interest bearing liabilities will likely reprice at lower interest rates in coming periods. As shown in in the following table net interest income in the fourth quarter of 2013 exceeded net interest income in each of the previous four quarters.

	Quarter to Date Net Interest Income				
	December 31 2013	September 30 2013	June 30 2013	March 31 2013	December 31 2012
Total interest income	$13,603	$ 13,505	$13,440	$13,528	$13,845
Total interest expense	2,683	2,736	2,781	2,821	3,051
Net interest income	$10,920	$ 10,769	$10,659	$10,707	$10,794

Allowance for Loan and Lease Losses

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

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

	2013	2012	2011	2010	2009
ALLL at beginning of period	$11,936	$12,375	$12,373	$12,979	$11,982
Loans charged-off					
Commercial and agricultural	907	1,672	1,984	3,731	3,081
Residential real estate	1,004	1,142	2,240	2,524	2,627
Consumer	429	542	552	596	934
Total loans charged-off	2,340	3,356	4,776	6,851	6,642
Recoveries					
Commercial and agricultural	363	240	461	453	623
Residential real estate	181	122	177	638	546
Consumer	249	255	314	297	377
Total recoveries	793	617	952	1,388	1,546
Provision for loan losses	1,111	2,300	3,826	4,857	6,093
ALLL at end of period	$11,500	$11,936	$12,375	$12,373	$12,979
Net loans charged-off	$1,547	$2,739	$3,824	$5,463	$5,096
Net loans charged-off to average loans outstanding	0.20 %	0.36 %	0.51 %	0.75 %	0.70 %
ALLL as a % of loans at end of period	1.42 %	1.54 %	1.65 %	1.68 %	1.79 %

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The following table summarizes our charge-off and recovery activity for the three months ended:

	December 31 2013		September 30 2013		June 30 2013		March 31 2013		December 31 2012	
Total loans charged-off	$497		$602		$719		$522		$1,469	
Total recoveries	152		151		295		195		143	
Net loans charged-off	345		451		424		327		1,326	
Net loans charged-off to average loans outstanding	0.04	%	0.06	%	0.05	%	0.04	%	0.17	%
Provision for loan losses	$245		$351		$215		$300		$1,200	

As the level of net loans charged-off has continued to decline since 2008, we have been able to gradually reduce the ALLL in both amount and as a percentage of loans. We anticipate 2014 net loans charged-off to approximate 2013 levels and, as such, we anticipate that the ALLL will approximate current levels. While overall net loans charged-off is likely to remain at current levels in the near future, charge-offs on residential real estate loans are anticipated to increase slightly as a percentage of net loans charged-off due to increased foreclosures as a result of the impact of the CFPB ability to repay rules. For further discussion of the allocation of the ALLL, see “Note 6 – Loans and ALLL” of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

Loans Past Due and Loans in Nonaccrual Status

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

	Total Past Due and Nonaccrual				
	December 31 2013	September 30 2013	June 30 2013	March 31 2013	December 31 2012
Commercial and agricultural	$3,621	$5,371	$4,962	$8,713	$7,271
Residential real estate	7,008	6,339	5,080	4,077	5,431
Consumer	259	152	104	212	199
Total	$10,888	$11,862	$10,146	$13,002	$12,901

	Total Past Due and Nonaccrual as of December 31				
	2013	2012	2011	2011	2009
Commercial and agricultural	$3,621	$7,271	$7,420	$9,606	$8,839
Residential real estate	7,008	5,431	5,297	8,119	10,296
Consumer	259	199	186	309	460
Total	$10,888	$12,901	$12,903	$18,034	$19,595

A summary of loans past due and in nonaccrual status, including the composition of the ending balance of nonaccrual loans by type, is included in “Note 6 – Loans and ALLL” of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

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Troubled Debt Restructurings

We have taken a proactive approach to avoid foreclosures on borrowers who are willing to work with us in modifying their loans, thus making them more affordable. While this approach has allowed certain borrowers to develop a payment structure that will allow them to continue making payments in lieu of foreclosure, it has contributed to a significant increase in the level of loans classified as TDRs. The implementation of ASU No. 2011-02 “A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring” has also contributed to the increased level of TDRs. The modifications have been successful for us and our customers as very few of the modified loans have resulted in foreclosures. At the time of the TDR, the loan is reviewed to determine whether or not to classify the loan as accrual or nonaccrual. The majority of new modifications result in terms that satisfy our criteria for continued interest accrual. TDRs that have been placed in nonaccrual status may be placed back on accrual status after six months of continued performance.

We restructure debt with borrowers who due to temporary financial difficulties are unable to service their debt under the original terms. We may extend the amortization period, reduce interest rates, forgive principal, or a combination of these modifications. Typically, the modifications are for a period of five years or less. There were no TDRs that were Government sponsored as of December 31, 2013 or December 31, 2012.

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

The following table provides a roll-forward of TDRs for the years ended December 31, 2012 and 2013:

	Accruing Interest		Nonaccrual		Total	
	Number of Loans	Balance	Number of Loans	Balance	Number of Loans	Balance
January 1, 2012	112	$17,739	12	$1,017	124	$18,756
New modifications	58	10,149	9	1,217	67	11,366
Principal payments	—	(1,578)	—	(287)	—	(1,865)
Loans paid-off	(40)	(7,719)	(4)	(158)	(44)	(7,877)
Partial charge-off	—	(231)	—	(40)	—	(271)
Balances charged-off	(2)	(140)	(4)	(100)	(6)	(240)
Transfers to OREO	(2)	(134)	(5)	(380)	(7)	(514)
Transfers to accrual status	2	131	(2)	(131)	—	—
Transfers to nonaccrual status	(13)	(1,686)	13	1,686	—	—
December 31, 2012	115	16,531	19	2,824	134	19,355
New modifications	76	12,192	5	424	81	12,616
Principal payments	—	(891)	—	(292)	—	(1,183)
Loans paid-off	(17)	(2,844)	(6)	(800)	(23)	(3,644)
Partial charge-off	—	(79)	—	(477)	—	(556)
Balances charged-off	(3)	(167)	(1)	(27)	(4)	(194)
Transfers to OREO	(1)	(33)	(7)	(496)	(8)	(529)
Transfers to accrual status	2	133	(2)	(133)	—	—
Transfers to nonaccrual status	(7)	(419)	7	419	—	—
December 31, 2013	165	$24,423	15	$1,442	180	$25,865

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The following table summarizes our TDRs as of December 31:

	2013			2012			2011		
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total
Current	$21,690	$ 1,189	$22,879	$16,301	$ 941	$17,242	$16,125	$ 514	$16,639
Past due 30-59 days	2,158	37	2,195	158	561	719	1,564	344	1,908
Past due 60-89 days	575	—	575	72	41	113	50	85	135
Past due 90 days or more	—	216	216	—	1,281	1,281	—	74	74
Total	$24,423	$ 1,442	$25,865	$16,531	$ 2,824	$19,355	$17,739	$ 1,017	$18,756

	2010			2009		
	Accruing Interest	Nonaccrual	Total	Accruing Interest	Nonaccrual	Total
Current	$4,798	$ 499	$5,297	$2,754	$ 786	$3,540
Past due 30-59 days	175	26	201	107	80	187
Past due 60-89 days	102	—	102	—	824	824
Past due 90 days or more	—	163	163	—	426	426
Total	$5,075	$ 688	$5,763	$2,861	$ 2,116	$4,977

Additional disclosures about TDRs are included in “Note 6 – Loans and ALLL” of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

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Impaired Loans

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

	2013			2012		
	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance	Outstanding Balance	Unpaid Principal Balance	Valuation Allowance
TDRs						
Commercial real estate	$10,663	$11,193	$1,585	$9,227	$9,640	$1,333
Commercial other	1,310	1,340	62	1,167	1,197	38
Agricultural real estate	1,459	1,459	30	91		