ISABELLA BANK CORP
Form 10-Q
August 07, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended June 30, 2009

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period from __________ to __________

Commission File Number: 0-18415

Isabella Bank Corporation

(Exact name of registrant as specified in its charter)

Michigan	38-2830092
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification No.)
401 N. Main St, Mt. Pleasant, MI	48858
(Address of principal executive offices)	(Zip code)

(989) 772-9471

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock no par value, 7,510,818 as of July 31, 2009

ISABELLA BANK CORPORATION
QUARTERLY REPORT ON FORM 10-Q
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PART I FINANCIAL INFORMATION

Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands)

	June 30 2009	December 31 2008
ASSETS		
Cash and demand deposits due from banks	$ 23,063	$ 23,554
Trading securities	16,111	21,775
Available-for-sale securities (amortized cost of $220,090 in 2009; $248,741 in 2008)	216,538	246,455
Mortgage loans held for sale	2,704	898
Loans		
Agricultural	63,610	58,003
Commercial	333,911	324,806
Installment	32,852	33,179
Residential real estate mortgage	294,921	319,397
Total loans	**725,294**	**735,385**
Less allowance for loan losses	12,052	11,982
Net loans	**713,242**	**723,403**
Accrued interest receivable	5,540	6,322
Premises and equipment	23,780	23,231
Corporate-owned life insurance policies	16,465	16,152
Acquisition intangibles and goodwill, net	47,613	47,804
Equity securities without readily determinable fair values	17,756	17,345
Other assets	12,691	12,324
TOTAL ASSETS	**$ 1,095,503**	**$ 1,139,263**
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 94,427	$ 97,546
NOW accounts	114,186	113,973
Certificates of deposit and other savings	415,210	422,689
Certificates of deposit over $100,000	149,010	141,422
Total deposits	**772,833**	**775,630**
Borrowed funds ($17,913 carried at fair value in 2009; $23,130 in 2008)	178,571	222,350
Accrued interest and other liabilities	8,467	6,807
Total liabilities	**959,871**	**1,004,787**
Shareholders Equity		
Common stock no par value 15,000,000 shares authorized; outstanding 7,510,818 (including 18,029 shares to be issued) in 2009 and 7,518,856 (including 5,248 shares to be issued) in 2008	133,178	133,602

Shares to be issued for deferred compensation obligations	4,208	4,015
Retained earnings	4,074	2,428
Accumulated other comprehensive loss	(5,828)	(5,569)
Total shareholders equity	**135,632**	**134,476**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,095,503**	**$ 1,139,263**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

(Dollars in thousands except per share data)

	Common Stock Shares Outstanding	Common Stock	Shares to be issued for deferred compensation obligations	Retained Earnings	Accumulated Other Comprehensive Loss	Totals
Balances, January 1, 2008	6,364,120	$ 112,547	$ 3,772	$ 7,027	$ (266)	$ 123,080
Cumulative effect to apply EITF 06-4, net of tax				(1,571)		(1,571)
Comprehensive income				3,618	(1,041)	2,577
Common stock dividends (10%)	687,599	30,254		(30,254)		
Regulatory capital transfer		(28,000)		28,000		
Bank acquisition	514,809	22,652				22,652
Issuance of common stock	23,689	1,156				1,156
Common stock issued for deferred compensation obligations	26,427	338	(338)			
Share-based payment awards under equity compensation plan			286			286
Common stock repurchased pursuant to publically announced repurchase plan	(143,839)	(6,258)				(6,258)
Cash dividends ($0.24 per share)				(1,810)		(1,810)
Balances, June 30, 2008	7,472,805	$ 132,689	$ 3,720	$ 5,010	$ (1,307)	$ 140,112
Balances, January 1, 2009	7,518,856	$ 133,602	$ 4,015	$ 2,428	$ (5,569)	$ 134,476
Comprehensive income				3,530	(259)	3,271
Issuance of common stock	46,778	1,133				1,133
Common stock issued for deferred	10,067	274	(144)			130

compensation obligations						
Share-based payment awards under equity compensation plan			337			337
Common stock purchased for deferred compensation obligations		(488)				(488)
Common stock repurchased pursuant to publically announced repurchase plan	(64,883)	(1,343)				(1,343)
Cash dividends ($0.25 per share)				(1,884)		(1,884)
Balances, June 30, 2009	7,510,818	$ 133,178	$ 4,208	$ 4,074	$ (5,828)	$ 135,632

See notes to interim condensed consolidated financial statements.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Interest Income				
Loans, including fees	$ 12,018	$ 12,420	$ 23,916	$ 24,945
Investment securities				
Taxable	1,083	1,367	2,370	2,735
Nontaxable	1,179	1,157	2,342	2,305
Trading account securities	179	307	385	635
Federal funds sold and other	46	108	165	265
Total interest income	**14,505**	**15,359**	**29,178**	**30,885**
Interest Expense				
Deposits	3,465	5,043	7,092	10,947
Borrowings	1,561	1,336	3,162	2,514
Total interest expense	**5,026**	**6,379**	**10,254**	**13,461**
Net interest income	**9,479**	**8,980**	**18,924**	**17,424**
Provision for loan losses	1,535	1,593	3,007	2,800
Net interest income after provision for loan losses	**7,944**	**7,387**	**15,917**	**14,624**
Noninterest Income				
Service charges and fees	2,065	1,675	3,414	3,123
Gain on sale of mortgage loans	260	73	528	157
Net (loss) gain on trading securities	(57)	(485)	30	(42)
Net gain on borrowings measured at fair value	73	239	216	122
Gain on sale of investment securities	427	15	648	15
Title insurance revenue				234
Other	363	261	652	686
Total noninterest income	**3,131**	**1,778**	**5,488**	**4,295**
Noninterest Expenses				
Compensation and benefits	4,720	4,203	9,396	8,537
Occupancy	548	493	1,077	1,021
Furniture and equipment	1,013	937	2,029	1,870
FDIC insurance premiums	415	42	1,300	85
Other	1,772	1,666	3,710	3,384
Total noninterest expenses	**8,468**	**7,341**	**17,512**	**14,897**
Income before federal income tax expense	**2,607**	**1,824**	**3,893**	**4,022**
Federal income tax expense	406	133	363	404

NET INCOME	**$ 2,201**	**$ 1,691**	**$ 3,530**	**$ 3,618**
Earnings per share				
Basic	**$ 0.29**	**$ 0.23**	**$ 0.47**	**$ 0.48**
Diluted	**$ 0.29**	**$ 0.22**	**$ 0.46**	**$ 0.47**
Cash dividends per basic share	**$ 0.13**	**$ 0.12**	**$ 0.25**	**$ 0.24**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands)

	Three months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Net Income	**$ 2,201**	**$ 1,691**	**$ 3,530**	**$ 3,618**
Unrealized gains on available-for-sale securities:				
Unrealized holding losses arising during the period	(1,240)	(4,053)	(618)	(1,563)
Reclassification adjustment for net realized gains included in net income	(427)	(15)	(648)	(15)
Net unrealized losses	(1,667)	(4,068)	(1,266)	(1,578)
Tax effect	812	1,383	1,007	537
Other comprehensive loss	(855)	(2,685)	(259)	(1,041)
Comprehensive income (loss)	**$ 1,346**	**$ (994)**	**$ 3,271**	**$ 2,577**

See notes to interim condensed consolidated financial statements.

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

	Six Months Ended June 30	
	2009	2008
OPERATING ACTIVITIES		
Net income	$ 3,530	$ 3,618
Reconciliation of net income to net cash provided by operations:		
Provision for loan losses	3,007	2,800
Provision for foreclosed asset losses	34	
Depreciation	1,166	1,063
Amortization and impairment of mortgage servicing rights	483	134
Amortization of acquisition intangibles	191	211
Net amortization of available-for-sale investment securities	364	131
Realized gain on sale of available-for-sale investment securities	(648)	(15)
Unrealized (gains) losses on trading securities	(30)	42
Unrealized gains on borrowings measured at fair value	(216)	(122)
Increase in cash value of corporate owned life insurance policies	(313)	(221)
Share-based payment awards under equity compensation plan	337	286
Deferred income tax benefit		(212)
Net changes in operating assets and liabilities which provided (used) cash, net in 2008 of bank acquisition and joint venture formation:		
Trading securities	5,694	5,609
Loans held for sale	(1,806)	1,750
Accrued interest receivable	782	435
Other assets	(1,392)	(747)
Escrow funds payable		(46)
Accrued interest and other liabilities	1,660	(1,376)
Net Cash Provided By Operating Activities	**12,843**	**13,340**
INVESTING ACTIVITIES		
Activity in available-for-sale securities		
Maturities, calls, and sales	98,274	39,578
Purchases	(69,339)	(51,406)
Loan principal collections (originations), net	5,764	(23,380)
Proceeds from sales of foreclosed assets	2,494	905
Purchases of premises and equipment	(1,715)	(1,122)
Bank acquisition, net of cash acquired		(9,465)
Cash contributed to title company joint venture formation		(4,542)
Redemption of corporate owned life insurance policies		(450)
Net Cash Provided By (Used In) Investing Activities	**35,478**	**(49,882)**
FINANCING ACTIVITIES		
Net decrease in deposits	(2,797)	(14,198)
Net (decrease) increase in other borrowed funds	(43,563)	58,999
Cash dividends paid on common stock	(1,884)	(1,810)
Proceeds from issuance of common stock	989	1,156
Common stock repurchased	(1,069)	(6,258)
Common stock purchased for deferred compensation obligations	(488)	

Net Cash (Used In) Provided By Financing Activities	**(48,812)**	**37,889**
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(491)**	**1,347**
Cash and cash equivalents at beginning of period	23,554	25,583
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 23,063**	**$ 26,930**
Supplemental cash flows information:		
Interest paid	$ 10,405	$ 13,417
Transfer of loans to foreclosed assets	1,390	1,450

See notes to interim condensed consolidated financial statements.

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ISABELLA BANK CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation s annual report for the year ended December 31, 2008.

In preparing these interim condensed consolidated financial statements, we have evaluated, for potential recognition or disclosure events or transactions subsequent to the end of the most recent quarterly period through August 7, 2009, the issuance date of these interim condensed consolidated financial statements.

All amounts other than share and per share amounts have been rounded to the nearest thousand ($000) in this report.

Effective January 1, 2008, the Corporation acquired Greenville Community Financial Corporation (GCFC). The interim condensed consolidated financial statements include the results of operations of GCFC since January 1, 2008.

Effective March 1, 2008, the Corporation entered into a joint venture with Corporate Title Agency, LLC. The investment in the joint venture is accounted for under the equity method and is included in the line item equity securities without readily determinable fair values on the consolidated balance sheets. The results of operations since the date of the joint venture are recorded in other income on the accompanying statements of income.

The accounting policies are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Corporation s annual report for the year ended December 31, 2008.

NOTE 2 COMPUTATION OF EARNINGS PER SHARE

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period, which includes shares held in the Rabbi Trust controlled by the Corporation. 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. In accordance with SFAS No. 128 (as amended), *Earnings Per Share*, the Corporation s obligations to issue shares of stock to participants in its deferred directors plan have been treated as outstanding shares of common stock in the diluted earnings per share calculation. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Corporation s Deferred Director fee plan.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Average number of common shares outstanding for basic calculation*	7,518,185	7,483,362	7,518,471	7,498,925
Potential effect of shares in the Deferred Director fee plan*	196,522	184,127	195,630	183,489
Average number of common shares outstanding used to calculate diluted earnings per common share	7,714,707	7,667,489	7,714,101	7,682,414
Net income	$ 2,201	$ 1,691	$ 3,530	$ 3,618
Earnings per share				
Basic	$ 0.29	$ 0.23	$ 0.47	$ 0.48
Diluted	$ 0.29	$ 0.22	$ 0.46	$ 0.47

* As adjusted for the 10% stock dividend paid February 29, 2008

NOTE 3 OPERATING SEGMENTS

The Corporation s reportable segments are based on legal entities that account for at least 10 percent of net operating results. As of June 30, 2009 and 2008 and each of the three and six month periods then ended, retail banking operations represented more than 90 percent of the Corporation s total assets and operating results. As such, no segment reporting is presented.

NOTE 4 DEFINED BENEFIT PENSION PLAN

The Corporation has a non-contributory defined benefit pension plan, which was curtailed effective March 1, 2007. Due to the curtailment, future salary increases are no longer considered and plan benefits are based on years of service and the employees five highest consecutive years of compensation out of the last ten years of service through March 1, 2007. As a result of the curtailment, the Corporation does not anticipate contributing to the plan in the reasonably foreseeable future.

The components of net periodic benefit cost (income) for the three and six month periods ended June 30 are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Net periodic benefit cost (income)				
Interest cost on projected benefit obligation	126	126	$ 252	$ 252
Expected return on plan assets	(131)	(165)	(262)	(330)
Amortization of unrecognized actuarial net loss	42	1	85	2
Net periodic benefit cost (income)	**$ 37**	**$ (38)**	**$ 75**	**$ (76)**

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NOTE 5 FINANCIAL INSTRUMENTS RECORDED AT 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, impaired loans, loans held for investment in foreclosed assets, 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.

Fair Value Hierarchy

Under SFAS 157, the Corporation groups assets and liabilities 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. 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 Corporation has invested $11,000 in auction rate preferred stock investment security instruments, which are classified as available-for-sale securities and reflected at fair value. Due to recent events and uncertainty in credit markets, these investments have become illiquid.

Due to the current illiquidity of these securities, these assets were classified as Level 3 during the third quarter of 2008. The fair values of these securities were estimated utilizing a discounted cash flow analysis or other type of valuation adjustment methodology as of June 30, 2009. These analyses consider, among other factors, the collateral underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, estimates of the next time the security is expected to have a successful auction, and the Corporation s ability to hold such securities until credit markets improve.

The table below represents the activity in investment securities available for sale measured with Level 3 inputs measured on a recurring basis for the three and six month periods ended June 30:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Level 3 inputs at beginning of period	$ 23,417	$ 14,862	$ 19,391	$ 12,694
Purchases			3,300	2,379
Maturities	(606)	(469)	(868)	(725)
Net unrealized gains (losses) on available-for-sale investment securities	70	(215)	1,058	(170)
Level 3 inputs June 30	$ 22,881	$ 14,178	$ 22,881	$ 14,178

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The tables below present the recorded amount of assets and liabilities measured at fair value on:

	June 30, 2009			December 31, 2008		
Description	Total	(Level 2)	(Level 3)	Total	(Level 2)	(Level 3)
Recurring Items						
Trading securities	$ 16,111	$ 16,111	$	$ 21,775	$ 21,775	$
Available-for-sale investment securities	216,538	193,657	22,881	246,455	227,064	19,391
Mortgage loans available for sale	2,704	2,704		898	898	
Borrowed funds	17,913	17,913		23,130	23,130	
Nonrecurring Items						
Impaired loans	9,097		9,097	10,014		10,014
Mortgage servicing rights	2,436	2,436		2,105	2,105	
Foreclosed assets	1,785	1,785		2,923	2,923	
	$ 266,584	$ 234,606	$ 31,978	$ 307,300	$ 277,895	$ 29,405
Percent of assets and liabilities measured at fair value		88.00%	12.00%		90.43%	9.57%

In previous Form 10-Q and Form 10-K filings the Corporation disclosed that a portion of trading securities, available-for-sale investment securities and other borrowed funds were measured at Level 1. The Corporation recently determined that documentation provided to the Corporation by its third party securities pricing vendor more closely reflects a Level 2 categorization than Level 1 as previously reported. No significant measurement methodology changes have been made by the Corporation s securities pricing vendor. As a result, $10,175 of trading securities, $89,507 of available-for-sale investment securities and $23,130 of other borrowed funds were reclassified from level 1 to level 2 classification at December 31, 2008.

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 impairment was recognized in the three and six month periods ended June 30, 2009 and 2008, are summarized as follows:

	Three Months Ended June 30					
	2009			2008		
Description	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
Recurring Items						
Trading securities	$ (57)	$	$ (57)	$ (485)	$	$ (485)
Other borrowed funds		73	73		239	239
Nonrecurring Items						
Mortgage servicing rights		205	205		30	30
Foreclosed assets		(34)	(34)			

	$ 187	$ (216)

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	Six Months Ended June 30					
	2009			2008		
Description	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
Recurring Items						
Trading securities	$ 30	$	$ 30	$ (42)	$	$ (42)
Borrowed funds		216	216		122	122
Nonrecurring Items						
Mortgage servicing rights		(8)	(8)			
Foreclosed assets		(34)	(34)			
			$ 204			$ 80

As a result of declines in the rates offered on new residential mortgage loans, the Corporation recorded impairment charges related to the carrying value of its mortgage servicing rights in the first quarter of 2009, in accordance with the provisions of SFAS No. 156. This decline in offering rates decreased the expected lives of the loans serviced and in turn decreased the value of the serving rights. During the second quarter of 2009, the Corporation reduced much of the first quarter s impairment as a result of a strong demand for new residential mortgages in the second quarter, coupled with an increased demand for refinancing. These new loans coupled with the refinancing activity increased the size and duration of the Corporation s servicing portfolio, and in turn increased the value of the servicing portfolio.
The activity in the trading portfolio of investment securities was as follows for the three and six month periods ended June 30, 2009 and 2008:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Purchases	$	$ 2,036	$	$ 9,710
Sales, calls, and maturities	(3,011)	(7,560)	(5,694)	(9,640)
Total	**$ (3,011)**	**$ (5,524)**	**$ (5,694)**	**$ 70**

During the second quarter of 2009, a $5,001 borrowing facility carried at fair market value matured. There were no changes in the level of borrowings measured at fair value; only recurring fair value adjustments occurred during the first six months of 2008.

NOTE 6 FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the estimated amounts provided herein do not necessarily indicate amounts which could be realized in a current exchange. Furthermore, as the Corporation typically holds the majority of its financial instruments until maturity, it does not expect to realize all of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments, but which have

significant value. These include such items as core deposit intangibles, the future earnings of significant customer relationships and the value of other fee generating businesses. The Corporation believes the imprecision of an estimate could be significant.

The following methods and assumptions were used by the Corporation in estimating fair value disclosures for financial instruments.

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Investment securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are unavailable, fair values are based on quoted market prices of comparable instruments or other model-based valuation

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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.

Mortgage loans available for sale: Fair values of mortgage loans available for sale are based on commitments on hand from investors or prevailing market prices.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans (e.g. , real estate mortgage, agricultural, commercial, and installment) 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 declines, if any, in the credit quality of borrowers since the loans were originated. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Mortgage servicing rights: Fair value is determined using prices for similar assets with similar characteristics when applicable, or based upon discounted cash flow analyses.

Deposit liabilities: 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 discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings: The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing rates for similar types of borrowing arrangements.

Borrowings: The fair values of the Corporation s long-term borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing arrangements. The carrying amounts of federal funds purchased and borrowings under repurchase agreements approximate their fair value. The fair values of other borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Derivative financial instruments: Fair values for derivative loan commitments and forward loan sale commitments are based on fair values of the underlying mortgage loans and the probability of such commitments being exercised.

Off-balance-sheet credit-related instruments: 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.

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The following sets forth the estimated fair value and recorded carrying values of the Corporation s financial instruments as of June 30:

	2009	
	Estimated Fair Value	Carrying Value
ASSETS		
Cash and demand deposits due from banks	$ 23,063	$ 23,063
Trading securities	16,111	16,111
Investment securities available for sale	216,538	216,538
Mortgage loans available for sale	2,793	2,704
Net loans	718,942	713,242
Accrued interest receivable	5,540	5,540
Mortgage servicing rights	2,436	2,436
LIABILITIES		
Deposits with no stated maturities	381,432	381,432
Deposits with stated maturities	394,864	391,401
Borrowed funds	183,942	178,571
Accrued interest payable	1,183	1,183

NOTE 6 FEDERAL INCOME TAXES

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

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Income taxes at 34% statutory rate	$ 886	$ 620	$ 1,324	$ 1,367
Effect of nontaxable income	(491)	(503)	(980)	(984)
Effect of nondeductible expenses	11	16	19	21
Federal income tax expense	**$ 406**	**$ 133**	**$ 363**	**$ 404**

Included in other comprehensive loss for the three and six month periods ended June 30, 2009 are unrealized gains related to auction rate preferred stock investment securities of $726 and $1,696, respectively. For federal income tax purposes, these securities are considered equity investments for which no federal deferred income taxes are expected or recorded.

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NOTE 7 RECENT ACCOUNTING PRONOUNCEMENTS

On April 1, 2009 the FASB staff issued Staff Position No. FSP 141R-1 *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies.* This FASB Staff Position (FSP) amends and clarifies FASB Statement No. 141 (revised 2007), *Business Combinations,* to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FSP 141R-1 is expected to impact accounting by the Corporation of future business combinations.

On April 9, 2009 the FASB staff issued Staff Position No. FSP 157-4 *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. FSP 157-4 provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, *Fair Value Measurements,* when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4, also includes guidance on identifying circumstances that indicate a market is distressed or not orderly. The Corporation adopted this statement for the quarterly reporting period ended June 30, 2009. The adoption of this standard did not have a material impact on the Corporation s consolidated financial statements.

On April 9, 2009 the FASB staff issued Staff Position No. FSP 115-2 *Recognition and Presentation of Other-Than-Temporary Impairments.* The objective of an other-than-temporary impairment analysis under existing U.S. generally accepted accounting principles (GAAP) is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis. FSP 115-2 amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The Corporation adopted this statement for the quarterly reporting period ended June 30, 2009. The adoption of this standard did not have a material impact on the Corporation s consolidated financial statements.

On April 9, 2009 the FASB staff issued Staff Position FSP No. 107-1 and APB 28-*1 Interim Disclosures about Fair Value of Financial Instruments*. This FASB Staff Position (FSP) amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. The Corporation adopted this statement for the quarterly reporting period ended June 30, 2009. The adoption of this standard did not have a material impact on the Corporation s consolidated financial statements.

On May 28, 2009 FASB issued FASB No. 165 *Subsequent Events.* The objective is to establish general standards for disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard has been adopted for the period ended June 30, 2009 and did not have a material impact on the Corporation s consolidated financial statements.

On June 12, 2009 FASB issued FASB No. 166 *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* The objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. FASB No. 166 addresses (1) practices that have developed since the issuance of FASB Statement No. 140, that are not consistent with the original intent and key requirements of that Statement and (2) concerns of financial statement users that many of the financial assets (and related obligations) that have been derecognized should continue to be reported in the financial statements of transferors. The adoption of this standard

will be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and is not expected to have a material impact on the Corporation s consolidated financial statements.

On June 12, 2009 the FASB issued FASB No. 167 *Amendments to FASB Interpretation No. 46(R).* The objective is to improve financial reporting by enterprises involved with variable interest entities. This addresses (1) the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as a result of the elimination of the qualifying special-purpose entity concept in FASB Statement No. 166, *Accounting for Transfers of Financial Assets,* and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting

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and disclosures under the Interpretation do not always provide timely and useful information about an enterprise s involvement in a variable interest entity. The adoption of this standard will be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and the adoption of this standard is not expected to have a material impact on the Corporation s consolidated financial statements.

On June 29, 2009 the FASB issued FASB No. 168 *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162.* The *FASB Accounting Standards Codification* (Codification) will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. Following this Statement, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates. The FASB will not consider Accounting Standards Updates as authoritative in their own right. Accounting Standards Updates will serve only to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the change(s) in the Codification. This standard will be adopted for the quarter ended September 30, 2009 and the disclosures will be modified consistent with the Codification.

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Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

The following is management s discussion and analysis of the major factors that influenced Isabella Bank Corporation s financial performance. This analysis should be read in conjunction with the Corporation s 2008 annual report and with the unaudited interim condensed consolidated financial statements and notes, beginning on page 3 of this report.

CRITICAL ACCOUNTING POLICIES: A summary of the Corporation s significant accounting policies is set forth in Note 1 of the Consolidated Financial Statements included in the Corporation s Annual Report for the year ended December 31, 2008. 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 Provision for Loan Losses and Allowance for Loan Losses in the Corporation s 2008 Annual Report and herein.

United States generally accepted accounting principles require the Corporation to determine the fair value of all 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 means in determination of the fair value, including the use of discounted cash flow analysis, market comparisons, 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 which are carried at their fair value. Changes in the fair value of available-for-sale investment securities are included in other comprehensive income, while declines in the fair value of these securities below their cost that are considered to be 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.

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 fair values of investment securities with illiquid markets are estimated utilizing a discounted cash flow analysis or other type of valuation adjustment methodology. These securities are also compared, when possible, to other securities with similar characteristics.

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RESULTS OF OPERATIONS

The following table outlines the results of operations for the three and six month periods ended June 30, 2009 and 2008. Return on average assets measures the ability of the Corporation to profitably and efficiently employ its resources. Return on average equity indicates how effectively the Corporation is able to generate earnings on shareholder invested capital.

SUMMARY OF SELECTED FINANCIAL DATA

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
INCOME STATEMENT DATA				
Net interest income	$ 9,479	$ 8,980	$ 18,924	$ 17,424
Provision for loan losses	1,535	1,593	3,007	2,800
Net income	2,201	1,691	3,530	3,618
PER SHARE DATA				
Earnings per share (annualized):				
Basic	$ 0.29	$ 0.23	$ 0.47	$ 0.48
Diluted	0.29	0.22	0.46	0.47
Cash dividends per common share	0.13	0.12	0.25	0.24
Book value (at end of period)	18.06	18.75	18.06	18.75
RATIOS (annualized)				
Average primary capital to average assets	13.32%	13.71%	13.19%	13.93%
Net income to average assets	0.79	0.61	0.63	0.66
Net income to average equity	6.38	4.69	5.10	4.98
Net income to average tangible equity	9.70	7.32	7.80	7.68

Net Interest Income

Net interest income equals interest income less interest expense and is the primary source of income for Isabella Bank Corporation. Interest income includes loan fees of $538 and $988 for the three and six month periods ended June 30, 2009, respectively, as compared to $551 and $962 during the same periods 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.

(Continued on page 21)

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AVERAGE BALANCES, INTEREST RATE, AND NET INTEREST INCOME

The following schedules present the daily average amount outstanding for each major category of interest earning assets, nonearning assets, interest bearing liabilities, and noninterest bearing liabilities. 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% 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 restricted equity holdings are included in Other.

Results for the three month periods ended June 30, 2009 and June 30, 2008 are as follows:

	Three Months Ended					
	June 30, 2009			June 30, 2008		
	Average Balance	Tax Equivalent Interest	Average Yield\ Rate	Average Balance	Tax Equivalent Interest	Average Yield\ Rate
INTEREST EARNING ASSETS:						
Loans	$ 723,854	$ 12,018	6.64%	$ 711,073	$ 12,420	6.99%
Taxable investment securities	106,912	1,083	4.05%	111,500	1,367	4.90%
Nontaxable investment securities	122,609	1,832	5.98%	121,079	1,798	5.94%
Trading account securities	17,886	225	5.03%	26,976	362	5.37%
Federal funds sold	108		0.00%	1,166	6	2.06%
Other	23,453	46	0.78%	17,665	102	2.31%
Total earning assets	994,822	15,204	6.11%	989,459	16,055	6.49%
NON EARNING ASSETS:						
Allowance for loan losses	(12,197)			(8,637)		
Cash and due from banks	21,984			17,131		
Premises and equipment	23,880			22,539		
Accrued income and other assets	86,794			84,915		
Total assets	$ 1,115,283			$ 1,105,407		
INTEREST BEARING LIABILITIES:						
Interest-bearing demand deposits	$ 117,330	30	0.10%	$ 113,844	179	0.63%
Savings deposits	181,098	96	0.21%	220,705	619	1.12%
Time deposits	390,936	3,339	3.42%	395,363	4,245	4.29%
Borrowed funds	186,994	1,561	3.34%	131,112	1,336	4.08%
	876,358	5,026	2.29%	861,024	6,379	2.96%

Total interest bearing liabilities						
NONINTEREST BEARING LIABILITIES:						
Demand deposits	93,842			93,868		
Other	7,121			6,379		
Shareholders equity	137,962			144,136		
Total liabilities and equity	$ 1,115,283			$ 1,105,407		
Net interest income (FTE)		$ 10,178			$ 9,676	
Net yield on interest earning assets (FTE)			4.09%			3.91%

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Results for the six month periods ended June 30, 2009 and June 30, 2008 are as follows:

	Six Months Ended					
	June 30, 2009			June 30, 2008		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS:						
Loans	$ 726,433	$ 23,916	6.58%	$ 705,538	$ 24,945	7.07%
Taxable investment securities	114,891	2,370	4.13%	104,348	2,735	5.24%
Nontaxable investment securities	122,102	3,641	5.96%	120,351	3,585	5.96%
Trading account securities	19,244	477	4.96%	29,595	748	5.05%
Federal funds sold	1,684	1	0.12%	3,699	55	2.97%
Other	23,824	164	1.38%	15,497	210	2.71%
Total earning assets	1,008,178	30,569	6.06%	979,028	32,278	6.59%
NON EARNING ASSETS:						
Allowance for loan losses	(12,133)			(8,668)		
Cash and due from banks	20,812			18,918		
Premises and equipment	23,764			23,170		
Accrued income and other assets	88,177			84,511		
Total assets	$ 1,128,798			$ 1,096,959		
INTEREST BEARING LIABILITIES:						
Interest bearing demand deposits	$ 118,160	63	0.11%	$ 118,825	557	0.94%
Savings deposits	180,214	198	0.22%	214,572	1,482	1.38%
Time deposits	389,061	6,831	3.51%	399,852	8,908	4.46%
Borrowed funds	202,372	3,162	3.12%	119,059	2,514	4.22%
Total interest bearing liabilities	889,807	10,254	2.30%	852,308	13,461	3.16%
NONINTEREST BEARING LIABILITIES:						
Demand deposits	93,661			92,373		
Other	6,964			6,933		
Shareholders equity	138,366			145,345		

Total liabilities and equity	$ 1,128,798		$ 1,096,959	
Net interest income (FTE)	$ 20,315		$ 18,817	
Net yield on interest earning assets (FTE)		4.03%		3.84%

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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 Variance change in volume multiplied by the previous year s rate.

Rate Variance change in the fully taxable equivalent (FTE) rate multiplied by the prior 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.

	Three Months Ended June 30, 2009 compared to June 30, 2008 Increase (Decrease) Due to			Six Months Ended June 30, 2009 compared to June 30, 2008 Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
CHANGES IN INTEREST INCOME:						
Loans	$ 220	$ (622)	$ (402)	$ 723	$ (1,752)	$ (1,029)
Taxable investment securities	(54)	(230)	(284)	257	(622)	(365)
Nontaxable investment securities	23	11	34	52	4	56
Trading account securities	(116)	(21)	(137)	(257)	(14)	(271)
Federal funds sold	(3)	(3)	(6)	(20)	(34)	(54)
Other	26	(82)	(56)	84	(130)	(46)
Total changes in interest income	96	(947)	(851)	839	(2,548)	(1,709)
CHANGES IN INTEREST EXPENSE:						
Interest bearing demand deposits	5	(154)	(149)	(3)	(491)	(494)
Savings deposits	(95)	(428)	(523)	(205)	(1,079)	(1,284)
Time deposits	281	(1,187)	(906)	(235)	(1,842)	(2,077)
Borrowed funds	497	(272)	225	1,426	(778)	648
Total changes in interest expense	688	(2,041)	(1,353)	983	(4,190)	(3,207)
Net change in interest margin (FTE)	$ (592)	$ 1,094	$ 502	$ (144)	$ 1,642	$ 1,498

Interest rates paid on interest bearing liabilities decreased faster than those earned on interest earning assets, resulting in a 0.18% and 0.19% increase in net interest margins on a tax equivalent basis when the three and six month periods ended June 30, 2009 are compared to the same periods in 2008, respectively. The Corporation anticipates that net interest margin yield will decline during 2009 due to the followings factors:

Based on the current economic conditions, management does not anticipate any changes in the target Fed Funds rate during 2009. 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, as securities with call dates during

2009 will most likely be called and the Corporation will be reinvesting those proceeds at significantly lower rates.

The recent substantial decline in residential mortgage rates has led to increases in the demand of fixed rate mortgage products resulting in the Corporation s customers refinancing three and five year balloon mortgages into fixed rate products that are sold on the secondary market. The reinvestment of these proceeds at lower interest rates will adversely impact interest income.

While the Corporation s non-accrual loans have declined since December 31, 2008, they still remain at historically high levels. The high volume is a direct result of a decline in residential housing market values, the inability of residential and commercial developers to sell and or lease property, and a significant increase in unemployment rates, and overall economic

uncertainty. These non-accrual loans will decrease 2009 interest income as the loans will no longer be accruing interest income.

The Corporation anticipates growing the balance sheet through the acquisition of investment securities in the third and fourth quarters of 2009. These investments will be funded through deposit growth and wholesale borrowings. The net interest margin generated by the purchase on these investments is anticipated to be less than 2.0%, but will provide additional net interest income.

Allowance for Loan Losses

The viability of any financial institution is ultimately determined by its management of credit risk. Total loans outstanding represent 66.2% of the Corporation s total assets and is the Corporation s single largest concentration of risk. The allowance for loan losses is management s estimation of potential future losses inherent 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 table summarizes the Corporation s charge off and recovery activity for the six month periods ended June 30, 2009 and 2008.

	Six Months Ended June 30	
	2009	2008
Allowance for loan losses January 1	$ 11,982	$ 7,301
Allowance of acquired bank		822
Loans charged off		
Commercial and agricultural	2,226	973
Real estate mortgage	1,028	1,558
Consumer	432	390
Total loans charged off	**3,686**	**2,921**
Recoveries		
Commercial and agricultural	388	56
Real estate mortgage	169	84
Consumer	192	147
Total recoveries	**749**	**287**
Net loans charged off	2,937	2,634
Provision charged to income	3,007	2,800
Allowance for loan losses June 30	**$ 12,052**	**$ 8,289**
Year to date average loans	**$ 726,433**	**$ 705,538**
Net loans charged off to average loans outstanding	**0.40%**	**0.37%**
Total amount of loans outstanding	**$ 725,294**	**$ 721,020**
Allowance for loan losses as a % of loans	**1.66%**	**1.15%**

With increases in the net loans charged off to average loans and nonperforming loans as a percentage of total loans and the declines in the credit quality of the loan portfolio, the Corporation significantly increased the provision charged to income in the second half of 2008 and into 2009. This additional provision increased the allowance for loans losses as a percentage of loans to 1.63% as of December 31, 2008 and 1.66% as of June 30, 2009.

The Corporation has also experienced an increase in foreclosed loans and an increase in loans charged off due mainly to the downturn in the residential real estate mortgage market. Of the $2,226 of total commercial and agricultural loans charged off in the six months of 2009, $1,125 related to one loan, of which $1,000 was a specific impairment allocation as of December 31, 2008.

The nationwide increase in residential mortgage loans past due and in foreclosures has received considerable attention by the Federal Government, the media, banking regulators, and industry trade groups. Based on information provided by The Mortgage Bankers Association, a substantial portion of the nationwide increases in both past dues and foreclosures are related to fixed and adjustable rate

sub-prime mortgages. While the Corporation does not hold sub-prime mortgage loans, the difficulties experienced in the sub-prime market have adversely impacted the entire market, and thus the overall credit quality of the Corporation s residential mortgage portfolio. The increase in troubled residential mortgage loans and a tightening of underwriting standards will most likely result in a continued increase in the inventory of unsold homes. The inventory of unsold homes has not reached these levels since the 1991 recession. The combination of all of these factors is expected to further reduce average home values and thus homeowner s equity on a national level.

The Corporation originates and sells fixed rate residential real estate mortgages to the Federal Home Loan Mortgage Corporation. The Corporation has not originated loans for either trading or its own portfolio that would be classified as sub prime, nor has it originated adjustable rate mortgages or financed loans for more than 80% of market value unless insured by private third party insurance.

Based on management s analysis, the allowance for loan losses of $12,052 is considered adequate as of June 30, 2009. Management will continue to closely monitor its overall credit quality during 2009 to ensure that the allowance for loan losses remains adequate.

NONPERFORMING ASSETS

	June 30 2009	December 31 2008	Change
Nonaccrual loans	$ 7,826	$ 11,175	$ (3,349)
Accruing loans past due 90 days or more	890	1,251	(361)
Total nonperforming loans	**8,716**	**12,426**	**(3,710)**
Other real estate owned (OREO)	1,694	2,770	(1,076)
Repossessed assets	91	153	(62)
Total nonperforming assets	**$ 10,501**	**$ 15,349**	**$ (4,848)**
Nonperforming loans as a % of total loans	**1.20%**	**1.69%**	**-0.49%**
Nonperforming assets as a % of total assets	**0.96%**	**1.35%**	**-0.39%**

RESTRUCTURED LOANS

	June 30 2009	December 31 2008	Change
Complying with modified terms	$ 1,407	$ 2,565	$ (1,158)
Nonaccrual	1,355	1,985	(630)
Total restructured loans	$ 2,762	$ 4,550	$ (1,788)

Residential real estate loans are placed in nonaccrual status when the foreclosure process has begun, generally after a loan is 90 days past due, unless there is an abundance of collateral. 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.

Since December 31, 2008, the Corporation s nonperforming loans have declined by $3,710. Of this decline, $1,125 is related to the charge off of one specific loan as noted above. The remainder of the decline is related to loans being removed from nonaccrual status as a result of improvements in creditworthiness and the loans being paid off. Despite

the decline in restructured loans from December 31, 2008, restructured loans remain at historically high levels as of June 30, 2009. The majority of the restructured loans are the result of the Corporation working with borrowers to develop a payment structure that will allow them to continue making payments in lieu of foreclosure.

Of the $1,076 decline in other real estate owned, $670 related to the sale of one property. Management has evaluated the properties held as other real estate owned and has adjusted the carrying value of each property to the lower of the carrying amount or fair value less costs to sell, as necessary. Management anticipates the balance of OREO to remain at historically high levels for the remainder of 2009.

Management has devoted considerable attention to identifying loans for which losses are possible and adjusting the value of these loans to their current net realizable values. 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 residential 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.

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As of June 30, 2009, there were no other interest bearing assets which required classification. Management is not aware of any recommendations by regulatory agencies that, if implemented, would have a material impact on the Corporation s liquidity, capital, or operations.

As a result of the new State of Michigan foreclosure laws, which went into effect on July 5, 2009, the time required to complete a residential mortgage foreclosure is expected to increase. Despite the increased timeline to complete the foreclosure process, the new law is not expected to have a significant impact on the Corporation s ability to foreclose.

NONINTEREST INCOME AND EXPENSES

Noninterest Income

Noninterest income consists of trust fees, deposit service charges, fees for other financial services, gains on the sale of mortgage loans, and other. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations:

	Three Months Ended June 30			
			Change	
	2009	2008	$	%
Service charges and fee income				
NSF and overdraft fees	$ 795	$ 833	$ (38)	-4.6%
Trust fees	212	227	(15)	-6.6%
Freddie Mac servicing fee	178	157	21	13.4%
ATM and debit card fees	304	266	38	14.3%
Service charges on deposit accounts	86	95	(9)	-9.5%
Net OMSR income	462	60	402	670.0%
All other	28	37	(9)	-24.3%
Total service charges and fees	**2,065**	**1,675**	**390**	**23.3%**
Gain on sale of mortgage loans	**260**	**73**	**187**	**256.2%**
Net loss on trading securities	**(57)**	**(485)**	**428**	**N/M**
Net gain on borrowings measured at fair value	**73**	**239**	**(166)**	**-69.5%**
Gain on sale of investment securities	**427**	**15**	**412**	**N/M**
Other				
Increase in cash value of corporate owned life insurance policies	148	96	52	54.2%
Brokerage and advisory fees	138	130	8	6.2%
All other	77	35	42	120.0%
Total other	**363**	**261**	**102**	**39.1%**
Total noninterest income	**$ 3,131**	**$ 1,778**	**$ 1,353**	**76.1%**

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	Six Months Ended June 30			
			Change	
	2009	2008	$	%
Service charges and fee income				
NSF and overdraft fees	$ 1,524	$ 1,608	$ (84)	-5.2%
Trust fees	409	445	(36)	-8.1%
Freddie Mac servicing fee	342	313	29	9.3%
ATM and debit card fees	579	478	101	21.1%
Service charges on deposit accounts	168	185	(17)	-9.2%
Net OMSR income	330	18	312	N/M
All other	62	76	(14)	-18.4%
Total service charges and fees	**3,414**	**3,123**	**291**	**9.3%**
Gain on sale of mortgage loans	**528**	**157**	**371**	**236.3%**
Net gain (loss) on trading securities	**30**	**(42)**	**72**	**N/M**
Net gain on borrowings measured at fair value	**216**	**122**	**94**	**77.0%**
Gain on sale of investment securities	**648**	**15**	**633**	**N/M**
Title insurance revenue		**234**	**(234)**	**-100.0%**
Other				
Earnings on corporate owned life insurance policies	324	221	103	46.6%
Brokerage and advisory fees	239	259	(20)	-7.7%
All other	89	206	(117)	-56.8%
Total other	**652**	**686**	**(34)**	**-5.0%**
Total noninterest income	**$ 5,488**	**$ 4,295**	**$ 1,193**	**27.8%**

Management continuously analyzes various fees related to deposit accounts, including service charges, NSF and overdraft fees, and ATM and debit card 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. Management does not expect significant changes to its deposit fee structure in 2009.

Trust fees fluctuate from period to period based on various factors including changes in mix of their customers portfolios and the closing of client estates (as much of their estate fees are non-recurring in nature and are based on the assets of the estate).

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 has experienced increases in Federal Home Loan Corporation (Freddie Mac) servicing fees, net originated mortgage servicing rights (OMSR), and gains from the sale of mortgage loans to the secondary market. The Corporation s servicing portfolio has increased by $40,238 since December 31, 2008. The increase in Freddie Mac servicing fees is a direct result of the increase in the volume of loans the Corporation services as the Corporation is paid 0.25% per year for each dollar of loans serviced. This increase in loans serviced, as well as recent increases in residential mortgage rates, has led to the increase in net OMSR income. As refinancing activity is expected to decline, the Corporation anticipates net OMSR income to decline throughout the remainder of the year. Gain on the sale of mortgage loans continued to grow during the three and six month periods ended June 30, 2009. The Corporation anticipates that gains from the sale of mortgage loans will remain at current levels.

Net gains from trading activities have increased significantly from last year. Fluctuations in the gains and losses related to these balances are caused by interest rate variances. Management does not anticipate any significant fluctuations in net trading activities for the remainder of the year as significant interest rate changes are not expected.
Title insurance fees have decreased as a result of a joint venture between IBT Title and Insurance Agency and Corporate Title which was formed on March 1, 2008 (see Note 1 of Notes to Interim Condensed Consolidated Financial Statements).
The current interest rate environment has created opportunities for the Corporation to take advantage of several selling opportunities from its available for sale investment portfolio which resulted in gains on the sales of these securities of $648 in the six month period ended June 30, 2009.

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Earnings on corporate owned life insurance policies have increased as a result of both increases in the number of policies owned as well as increases in the rates earned on the policies. Management anticipates that the earnings on theses policies will approximate current levels for the remainder of the year.
The fluctuations in all other income are spread throughout various categories, none of which are individually significant.

Noninterest Expenses

Noninterest expenses include compensation and benefits, occupancy, furniture and equipment, FDIC insurance premiums, and other expenses. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations:

	Three Months Ended June 30			
			Change	
	2009	2008	$	%
Compensation and benefits				
Leased employee salaries	$ 3,385	$ 3,002	$ 383	12.8%
Leased employee benefits	1,265	1,137	128	11.3%
All other	70	64	6	9.4%
Total compensation and benefits	**4,720**	**4,203**	**517**	**12.3%**
Occupancy				
Depreciation	134	124	10	8.1%
Outside services	109	120	(11)	-9.2%
Property taxes	118	113	5	4.4%
Utilities	86	85	1	1.2%
Building repairs	84	39	45	115.4%
All other	17	12	5	41.7%
Total occupancy	**548**	**493**	**55**	**11.2%**
Furniture and equipment				
Depreciation	450	409	41	10.0%
Computer / service contracts	382	379	3	0.8%
ATM and debit card expenses	161	137	24	17.5%
All other	20	12	8	66.7%
Total furniture and equipment	**1,013**	**937**	**76**	**8.1%**
FDIC insurance premiums	**415**	**42**	**373**	**N/M**
Other				
Audit and SOX compliance fees	66	75	(9)	-12.0%
Marketing	144	212	(68)	-32.1%
Directors fees	237	224	13	5.8%
Printing and supplies	86	109	(23)	-21.1%
Education and travel	78	131	(53)	-40.5%
Postage and freight	115	127	(12)	-9.4%
Legal	93	104	(11)	-10.6%
Amortization of deposit premium	96	106	(10)	-9.4%

Foreclosed assets	162	46	116	N/M
Collection	101	36	65	180.6%
Brokerage and advisory	61	59	2	3.4%
Consulting	45	55	(10)	-18.2%
All other	488	382	106	27.7%
Total other	**1,772**	**1,666**	**106**	**6.4%**
Total noninterest expenses	**$ 8,468**	**$ 7,341**	**$ 1,127**	**15.4%**

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	Six Months Ended June 30			
			Change	
	2009	2008	$	%
Compensation and benefits				
Leased employee salaries	$ 6,579	$ 6,153	$ 426	6.9%
Leased employee benefits	2,656	2,259	397	17.6%
All other	161	125	36	28.8%
Total compensation and benefits	**9,396**	**8,537**	**859**	**10.1%**
Occupancy				
Depreciation	266	252	14	5.6%
Outside services	212	239	(27)	-11.3%
Property taxes	232	231	1	0.4%
Utilities	208	190	18	9.5%
Building repairs	125	77	48	62.3%
All other	34	32	2	6.3%
Total occupancy	**1,077**	**1,021**	**56**	**5.5%**
Furniture and equipment				
Depreciation	900	811	89	11.0%
Computer / service contracts	781	761	20	2.6%
ATM and debit card expenses	305	257	48	18.7%
All other	43	41	2	4.9%
Total furniture and equipment	**2,029**	**1,870**	**159**	**8.5%**
FDIC insurance premiums	**1,300**	**85**	**1,215**	**N/M**
Other				
Audit and SOX compliance fees	253	239	14	5.9%
Marketing	271	445	(174)	-39.1%
Directors fees	458	449	9	2.0%
Printing and supplies	306	225	81	36.0%
Education and travel	152	210	(58)	-27.6%
Postage and freight	242	242		0.0%
Legal	210	191	19	9.9%
Amortization of deposit premium	191	211	(20)	-9.5%
Foreclosed assets	283	57	226	N/M
Collection	144	53	91	171.7%
Brokerage and advisory	98	110	(12)	-10.9%
Consulting	95	132	(37)	-28.0%
All other	1,007	820	187	22.8%
Total other	**3,710**	**3,384**	**326**	**9.6%**
Total noninterest expenses	**$ 17,512**	**$ 14,897**	**$ 2,615**	**17.6%**

Leased employee salaries expenses have increased due to annual merit increases and the continued growth of the Corporation as well as overtime due to the increased volume of mortgage refinancing noted earlier. The increases in leased employee benefits expenses are principally the result of continued increases in health care costs.

The increase in building repairs during the second quarter can be attributed to standard upkeep done to various branches in June of 2009.

The increases in ATM and debit card expenses are primarily the result of the increased usage of debit cards by the Bank s customers. These expenses are expected to continue to increase as the usage of debit cards increases.

FDIC insurance premium expense has increased primarily as a result of increases in the premium rates charged by the Federal Deposit Insurance Corporation. This also includes a one time assessment of $500, which is scheduled to be paid in September 2009, but is required to be accrued as of June 30, 2009. These expenses are expected to continue to decrease for the remainder of 2009 as the Corporation is not anticipating any further special assessments to be paid in 2009.

In April 2008, the Corporation unveiled a new brand for both Isabella Bank (the Bank) and Isabella Bank Corporation. As a result of the development of this brand and the corresponding marketing campaign, the Corporation incurred some significant nonrecurring marketing expenses during the first six months of 2008. For the second quarter of 2008, expenses were incurred for website development, advertisement tools and logo supplies. Marketing expenses have subsequently declined and management anticipates that marketing expenses will remain at current levels for the remainder of 2009.

As a result of increases in delinquencies and foreclosures, the Corporation has experienced significant increases in legal expenses, foreclosed asset expenses, and collection expenses. These expenses are expected to continue at current levels throughout 2009 as management anticipates that delinquency rates and foreclosures will remain historically high.

The Corporation places a strong emphasis on customer service. In June of 2008, the Corporation offered sales training to its employees. This program was designed as sales and service development for its participants.

During the first three months of 2008, the Corporation incurred consulting fees related to the formation of the joint venture between IBT Title and Insurance Agency and Corporate Title on March 1, 2008 (see Note 1 of Notes to Interim Condensed Consolidated Financial Statements). Consulting expenses are expected to approximate current levels for the remainder of the year.

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

ANALYSIS OF CHANGES IN FINANCIAL CONDITION

	June 30 2009	December 31 2008	$ Change	% Change
ASSETS				
Cash and cash equivalents	$ 23,063	$ 23,554	$ (491)	-2.08%
Trading securities	16,111	21,775	(5,664)	-26.01%
Available-for-sale securities	216,538	246,455	(29,917)	-12.14%
Mortgage loans held for sale	2,704	898	1,806	N/M
Loans	725,294	735,385	(10,091)	-1.37%
Allowance for loan losses	(12,052)	(11,982)	(70)	0.58%
Premises and equipment	23,780	23,231	549	2.36%
Acquisition intangibles and goodwill, net	47,613	47,804	(191)	-0.40%
Equity securities without readily determinable fair values	17,756	17,345	411	2.37%
Other assets	34,696	34,798	(102)	-0.29%
TOTAL ASSETS	**$ 1,095,503**	**$ 1,139,263**	**$ (43,760)**	**-3.84%**
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities				
Deposits	$ 772,833	$ 775,630	$ (2,797)	-0.36%
Borrowed funds	178,571	222,350	(43,779)	-19.69%
Accrued interest and other liabilities	8,467	6,807	1,660	24.39%
Total liabilities	**959,871**	**1,004,787**	**(44,916)**	**-4.47%**
Shareholders equity	**135,632**	**134,476**	**1,156**	**0.86%**

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,095,503**	**$ 1,139,263**	**$ (43,760)**	**-3.84%**

The increase in mortgage loans available for sale is a direct result of loans being rewritten due to low mortgage rates. The current rate environment has increased refinancing activity, which has led to increases in inventories of loans to be sold to the secondary market. This refinancing activity has, however, led to a decline in the residential real estate portfolio as customers who have traditionally utilized 3 and 5 year balloon products are refinancing into 15 and 30 year fixed rate loans, which the Corporation typically sells on the secondary market. This activity resulted in an increase of $40,238 in residential mortgage loans sold to the secondary market during the first quarter of 2009 as compared to the same period in 2008. The decline in the residential real estate portfolio was partially offset by increases in the Corporation s commercial and agricultural portfolios. The overall decline in the Corporation s loan portfolio,

coupled with the decline in the securities portfolio has allowed the Corporation to pay off $22,500 in short term borrowings as well as allowing an additional $21,279 to mature.
The current interest rate environment has encouraged bond issuers to exercise call options on debt securities. These calls have led to the decline in the Corporation s available-for-sale securities portfolio.
The following table outlines the changes in the loan portfolio:

	June 30 2009	December 31 2008	$ Change	% Change (unannualized)
Commercial	$ 333,911	$ 324,806	$ 9,105	2.80%
Agricultural	63,610	58,003	5,607	9.67%
Residential real estate mortgage	294,921	319,397	(24,476)	-7.66%
Installment	32,852	33,179	(327)	-0.99%
	$ 725,294	$ 735,385	$ (10,091)	-1.37%

The following table outlines the changes in the deposit portfolio:

	June 30 2009	December 31 2008	$ Change	% Change (unannualized)
Noninterest bearing demand deposits	$ 94,427	$ 97,546	$ (3,119)	-3.20%
Interest bearing demand deposits	114,186	113,973	213	0.19%
Savings deposits	172,819	182,523	(9,704)	-5.32%
Certificates of deposit	352,211	340,976	11,235	3.29%
Brokered certificates of deposit	29,147	28,185	962	3.41%
Internet certificates of deposit	10,043	12,427	(2,384)	-19.18%
Total	$ 772,833	$ 775,630	$ (2,797)	-0.36%

As shown in the preceding table total deposits have remained stable since year end. The decline in internet certificates of deposit has been the result of the Corporation s ability to replace these deposits with local funding.

Capital

The capital of the Corporation consists solely of common stock, capital surplus, retained earnings, and accumulated other comprehensive loss. The Corporation offers dividend reinvestment and employee and director stock purchase plans. Under the provisions of these plans, the Corporation issued 46,512 shares or $907 of common stock during the first six months of 2009, as compared to 50,116 shares or $1,156 of common stock during the same period in 2008.
The Corporation also offers share-based payment awards through its equity compensation plan. Pursuant to this plan, the Corporation increased common stock by $337 and $286 during the six month periods ended June 30, 2009 and 2008, respectively.
The Board of Directors has adopted a common stock repurchase plan. This plan was last amended in February 2009 to enable the Corporation to repurchase an additional 100,000 shares of the Corporation s common stock for reissuance to the dividend reinvestment plan, the employee stock purchase plan and for distributions of share based payment awards. As of June 30, 2009, the Corporation was authorized to repurchase up to an additional 36,161 shares of common stock. During the first six months of 2009 and 2008, pursuant to this plan, the Corporation repurchased 64,883 shares of common stock at an average price of $20.70 and 143,839 shares of common stock at an average price of $43.51, respectively.
Accumulated other comprehensive loss increased $259 for the six month period ended June 30, 2009, net of tax, and is a result of unrealized losses on available-for-sale investment securities. Management has reviewed the credit quality

of its bond portfolio and believes that there are no losses that are other than temporary.

There are no significant regulatory constraints placed on the Corporation s capital. The Federal Reserve Board s current recommended minimum primary capital to assets requirement is 6.0%. The Corporation s primary capital to adjusted average assets, which consists of shareholders equity plus the allowance for loan losses less acquisition intangibles, was 9.26% as of June 30, 2009.

There are no commitments for significant capital expenditures for the remainder of 2009.
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 June 30, 2009:

Percentage of Capital to Risk Adjusted Assets

	Isabella Bank Corporation June 30, 2009	
	Required	Actual
Equity Capital	4.00%	12.65%
Secondary Capital	4.00%	1.25%
Total Capital	8.00%	13.90%

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 and FDIC also prescribe minimum capital requirements for the Corporation s subsidiary Bank. At June 30, 2009, the Bank exceeded these minimum capital requirements. On October 14, 2008, the U.S. Treasury Department (the Treasury) announced a Capital Purchase Program and encouraged non troubled financial institutions to participate. Under the Treasury s proposal, the participating institutions would issue 5.0% senior preferred stock, which the Treasury would buy. The Treasury feels that this program will increase banks abilities to lend to consumers, as well as each other. The Corporation has elected not to participate in the program.

Liquidity

The primary sources of the Corporation s liquidity are cash and demand deposits due from banks, trading securities, and available-for-sale securities, excluding money market preferred securities and preferred stocks due to their illiquidity as of June 30, 2009 and December 31, 2008. These categories totaled $248,037 or 22.6% of assets as of June 30, 2009 as compared to $286,764 or 25.2% as of December 31, 2008. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests and various other commitments including expansion of operations, investment opportunities, and payment of cash dividends. On a daily basis, liquidity varies significantly, based on customer activity.
Historically, the primary source of funds for the Bank has been deposits. The Bank emphasizes interest-bearing time deposits as part of its funding strategy. The Bank also seeks noninterest bearing deposits, or checking accounts, which reduce the Bank s cost of funds in an effort to expand the customer base. However, as the competition for core deposits continues to increase, the Corporation has become more dependent on borrowings and other noncore funding sources to fund its growth.
In addition to these primary sources of liquidity, the Corporation has the ability to borrow in the federal funds market at both the Federal Reserve Bank and the Federal Home Loan Bank, some obligations of which have been reported at fair value to mitigate the Corporation s interest rate risk. The Corporation s liquidity is considered adequate by the management of the Corporation.
Operating activities provided $12,843 of cash in the first six months of 2009, as compared to $13,340 during the same period in 2008. The Corporation s investing activities provided $35,478 of cash in the first six months of 2009 as compared to using $49,882 of cash during the same period in 2008. This fluctuation was a result of declines in the Corporation s loan portfolio, and more specifically in the residential mortgage portfolio due to the current interest rate environment, as well as the volume of available-for-sale securities called in 2009 compared to the same period in 2008. Financing activities used $48,812 in cash in the first six months of 2009 as compared to providing $37,889 of cash in the same period in 2008. This reduction was primarily the result of the Corporation reducing its borrowings by

$43,563 during the first six months of 2009. The accumulated effect of the Corporation s operating, investing, and financing activities used cash aggregating $491 and provided cash of $1,347 during the six month periods ended June 30, 2009 and 2008, respectively.

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FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET ARRANGEMENTS

The Corporation is party to financial instruments with off-balance-sheet risk. These 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 instruments.

The Corporation s exposure to credit loss in the event of nonperformance by the other party 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.

Commitments to extend credit, which include unfunded commitments to grant loans and unfunded commitments under lines of credit, totaled $141,044 at June 30, 2009. Commitments generally have variable interest rates, fixed expiration dates, or other termination clauses and may require the payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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. At June 30, 2009, the Corporation had a total of $6,824 in outstanding standby letters of credit.

Generally, 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. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and other income producing commercial properties.

Isabella Bank, a subsidiary of the Corporation, sponsors the IBT Foundation (the Foundation), which is a nonprofit entity formed for the purpose of distributing charitable donations to recipient organizations generally located in the communities serviced by Isabella Bank. The Bank periodically makes charitable contributions in the form of cash transfers to the Foundation. The Foundation is administered by members of the Corporation s Board of Directors. The assets and transactions of the Foundation are not included in the consolidated financial statements of the Corporation. The assets of the Foundation as of June 30, 2009 were $942.

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 Litigation 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 its 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 and the Federal Reserve Board, 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 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.

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Item 3 Quantitative and Qualitative Disclosures about Market Risk

The Corporation s primary market risks are interest rate risk and, to a lesser extent, liquidity risk. The Corporation has very limited foreign exchange risk and does not utilize interest rate swaps or derivatives in the management of its interest rate risk. The Corporation does have a significant amount of loans extended to borrowers involved in agricultural production. Cash flow and ability to service debt of such customers is largely dependent on growing conditions and the commodity prices for corn, soybeans, sugar beets, milk, beef and a variety of dry beans. 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 to 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. Interest rate risk is the fundamental method by which financial institutions earn income and create shareholder value. Excessive exposure to interest rate risk could pose a significant risk to the Corporation s earnings and capital.

The Federal Reserve, 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 two main techniques to manage interest rate risk. 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. These assets have imbedded options that allow the borrower to repay the balance prior to maturity without penalty. The amount of prepayments is dependent upon many factors, including the interest rate of a given loan in comparison to the current interest rates; 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. 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 flow from these deposits is estimated based on historical experience. Time deposits have penalties which discourage early withdrawals. Cash flows may vary based on current offering rates, competition, customer need for deposits, and overall economic activity. The Corporation has reclassified a portion of its investment portfolio and its borrowings into trading accounts. Management feels that these practices help it mitigate the volatility of the current interest rate environment.

The second technique used in the management of interest rate risk is to combine the projected cash flows and repricing characteristics generated by the gap analysis and the interest rates associated with those cash flows and projected 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.

The following table provides information about the Corporation s assets and liabilities that are sensitive to changes in interest rates as of June 30, 2009. The Corporation has no interest rate swaps, futures contracts, or other derivative financial options, except for derivative loan commitments, which are not significant. 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.

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(dollars in thousands)	June 30, 2009							Fair Value
	2010	2011	2012	2013	2014	Thereafter	Total	06/30/09
Rate sensitive assets								
Other interest bearing assets	$ 5,027	$	$	$	$	$	$ 5,027	$ 5,027
Average interest rates	1.57%						1.57%	
Trading securities	$ 8,623	$ 2,962	$ 2,546	$ 1,040	$ 940	$	$ 16,111	$ 16,111
Average interest rates	2.03%	2.03%	2.27%	2.27%	2.56%		2.11%	
Fixed interest rate securities	$ 60,145	$ 25,497	$ 20,555	$17,015	$15,205	$78,121	$216,538	$216,538
Average interest rates	4.66%	3.99%	3.88%	3.67%	3.77%	3.52%	3.96%	
Fixed interest rate loans	$131,242	$107,264	$110,466	$79,953	$88,390	$48,781	$566,096	$571,796
Average interest rates	6.88%	6.81%	6.90%	6.84%	6.38%	6.13%	6.72%	
Variable interest rate loans	$ 76,403	$ 16,814	$ 22,677	$17,755	$10,824	$14,725	$159,198	$159,198
Average interest rates	4.62%	5.21%	5.33%	4.60%	5.46%	6.05%	4.97%	
Rate sensitive liabilities								
Borrowed funds	$ 60,380	$ 21,191	$ 35,000	$17,000	$10,000	$35,000	$178,571	$183,942
Average interest rates	1.96%	4.68%	3.55%	3.74%	4.45%	4.22%	3.35%	
Savings and NOW accounts	$127,047	$ 88,116	$ 54,639	$15,599	$ 1,604	$	$287,005	$287,005
Average interest rates	0.21%	0.13%	0.08%	0.13%	0.17%		0.16%	
Fixed interest rate time deposits	$263,847	$ 46,475	$ 31,732	$29,673	$16,634	$ 1,264	$389,625	$393,088
Average interest rates	2.94%	4.16%	4.42%	4.22%	3.44%	3.16%	3.33%	
Variable interest rate time deposits	$ 1,200	$ 576	$	$	$	$	$ 1,776	$ 1,776
Average interest rates	1.64%	1.44%					1.58%	

	June 30, 2008							Fair Value
	2009	2010	2011	2012	2013	Thereafter	Total	06/30/08
Rate sensitive assets								
Other interest bearing assets	$ 1,363	$	$	$	$	$	$ 1,363	$ 1,363
Average interest rates	2.87%						2.87%	
Trading securities	$ 6,389	$ 4,213	$ 3,742	$ 2,805	$ 3,435	$ 4,508	$ 25,092	$ 25,092
Average interest rates	4.46%	4.00%	3.90%	3.53%	4.02%	3.46%	3.96%	
Fixed interest rate securities	$ 71,322	$ 25,009	$ 14,106	$14,390	$19,348	$85,393	$229,568	$229,568
Average interest rates	5.15%	5.03%	4.29%	4.09%	3.89%	3.93%	4.46%	
	$136,998	$111,417	$103,864	$75,469	$72,417	$65,784	$565,949	$567,191

Fixed interest rate loans								
Average interest rates	6.69%	6.86%	6.83%	7.27%	6.86%	6.23%	6.79%	
Variable interest rate loans	$ 64,051	$ 28,036	$ 15,208	$ 7,994	$20,719	$19,063	$155,071	$155,071
Average interest rates	5.76%	5.62%	6.29%	6.53%	5.83%	6.78%	5.96%	
Rate sensitive liabilities								
Borrowed funds	$ 50,845	$ 23,500	$ 16,225	$15,000	$17,000	$35,000	$157,570	$156,104
Average interest rates	3.05%	4.55%	4.98%	4.30%	3.74%	4.21%	3.92%	
Savings and NOW accounts	$148,435	$ 69,962	$ 72,743	$23,200	$ 4,940	$	$319,280	$319,280
Average interest rates	1.48%	0.47%	0.36%	0.34%	0.53%		0.91%	
Fixed interest rate time deposits	$241,212	$ 64,630	$ 37,010	$26,458	$19,359	$ 987	$389,656	$388,589
Average interest rates	3.86%	4.31%	4.57%	4.75%	4.32%	3.80%	4.09%	
Variable interest rate time deposits	$ 1,343	$ 533	$ 4	$	$	$	$ 1,880	$ 1,880
Average interest rates	2.94%	2.41%	2.37%				2.79%	

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Item 4 Controls and Procedures

DISCLOSURE CONTROLS AND PROCEDURES

The Corporation s management carried out an evaluation, under the supervision and with the participation of the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Corporation s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of June 30, 2009, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Corporation s disclosure controls and procedures as of June 30, 2009, were effective to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the most recent fiscal quarter, no change occurred in the Corporation s internal control over financial reporting that materially affected, or is likely to materially effect, the Corporation s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1 Legal Proceedings

The Corporation is not involved in any material legal proceedings. The Corporation and the Bank are involved in ordinary, routine litigation incidental to its business; however, no such routine proceedings are expected to result in any material adverse effect on operations, earnings, or financial condition.

Item 1A Risk Factors

In addition to the risk factors previously disclosed in ITEM 1A. RISK FACTORS of Part I of the Corporation s 2008 Form 10-K, the Corporation has identified the risk factor below as one that could materially affect the Corporation s business, financial condition or future operating results.

Increases in FDIC Insurance Premiums.

The recent upsurge in the number of bank failures has increased resolution costs of the Federal Deposit Insurance Corporation (FDIC) and depleted the Deposit Insurance Fund. In addition, the FDIC implemented two temporary programs in 2008 to further insure customer deposits at FDIC-member banks through December 31, 2009: deposit accounts are now insured up to $250,000 per customer and non-interest bearing transactional accounts are fully insured. These programs have placed additional stress on the Deposit Insurance Fund. On May 20, 2009, the FDIC extended the $250,000 per customer insurance limit through December 31, 2013. On January 1, 2014, the standard insurance amount will return to $100,000 per depositor for all accounts except for certain retirement accounts which will remain insured up to $250,000 per depositor.

In order to preserve a strong funding position and restore reserve ratios of the Deposit Insurance Fund, the FDIC raised assessment rates of insured institutions by 7 cents for every $100 of deposits beginning with the first quarter of 2009. In addition, on May 22, 2009, the FDIC adopted a final rule that imposed a special assessment on all insured depository institutions, which will be collected on September 30, 2009. The final rule also permits the FDIC to impose additional special assessments after June 30, 2009, if necessary to maintain public confidence in federal deposit insurance. The latest possible date for imposing additional special assessments under the final rule would be December 31, 2009, with collection on March 30, 2010.

The Corporation is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures, the Corporation may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases in FDIC insurance premiums may materially adversely affect the Corporation s results of operations, financial condition and ability to continue to pay dividends on its common shares at the current rate.

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Item 2 Unregistered Sales of Equity Securities and Use of Proceeds
(A) None

(B) None

(C) Repurchases of Common Stock
The Board of Directors has adopted a common stock repurchase plan. This plan, which was last amended in February 2009 to enable the Corporation to repurchase an additional 100,000 shares of the Corporation s common stock, the Corporation is authorized to repurchase up to 36,161 shares as of June 30, 2009. 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. The following table provides information for the three month period ended June 30, 2009, with respect to this plan:

	Shares Repurchased		Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the
	Number	Average Price Per Share	or Program	Plans or Programs
Balance, March 31, 2009				76,616
April 1 30, 2009	9,300	$ 19.62	9,300	67,316
May 1 31, 2009	9,710	18.98	9,710	57,606
June 1 30, 2009	21,445	19.06	21,445	36,161
Balance, June 30, 2009	40,455	$ 19.17	40,455	36,161

Item 4 Submission of Matters to a Vote of Security Holders
The registrant s annual meeting of shareholders was held on May 5, 2009. At the meeting the shareholders voted upon the election of Directors to terms ending in 2012.

	For	Witheld
Dennis P. Angner	4,163,794	177,560
David J. Maness	4,165,187	176,167
W. Joseph Manifold	4,142,738	198,616
William J. Strickler	4,168,885	172,469

The terms of the following directors continued after the meeting:

James C. Fabiano
Richard J. Barz
Sanda L. Caul
Ted W. Kortes
W. Michael McGuire
Dale Weburg

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Item 6 Exhibits

(a) Exhibits

31(a)	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Executive Officer
31(b)	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Financial Officer
32	Section 1350 Certification of Principal Executive Officer and Principal Financial Officer

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Isabella Bank Corporation

Date: July 31, 2009

/s/ Dennis P. Angner
Dennis P. Angner
Chief Executive Officer

/s/ Peggy L. Wheeler
Peggy L. Wheeler
Principal Financial Officer

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