ISABELLA BANK CORP
Form 10-K
March 16, 2009

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2008

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.)

200 East Broadway Street, Mt. Pleasant, Michigan 48858

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code (989) 772-9471

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered

Securities registered pursuant to Section 12(g) of the Act:

Common Stock No Par Value

(Title of Class)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, 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). oYes þ No

The aggregate market value of the voting stock held by non-affiliates of the registrant was $276,494,000 as of the last business day of the registrant s most recently completed second fiscal quarter.

The number of shares outstanding of the registrant s Common Stock (no par value) was 7,518,856 as of February 26, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

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

Documents	Part of Form 10-K Incorporated into
Isabella Bank Corporation Proxy Statement for its Annual Meeting of Shareholders to be held May 5, 2009	Part III

ISABELLA BANK CORPORATION
ANNUAL REPORT ON FORM 10-K
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Part I

Item 1. Business (All dollars in thousands)

General

Isabella Bank Corporation (the Corporation) is a registered financial services holding company incorporated in September 1988 under Michigan law. The Corporation has three subsidiaries: Isabella Bank (the Bank), IB&T Employee Leasing, LLC, and Financial Group Information Services. Isabella Bank has twenty four banking offices located throughout Clare, Gratiot, Isabella, Mecosta, Montcalm, and Saginaw Counties. IB & T Employee Leasing, LLC, is an employee leasing company. Financial Group Information Services renders computer services to the Corporation and its subsidiaries. All employees of the Corporation are employed by IB&T Employee Leasing and are leased to each individual subsidiary. The principal city in which the Corporation operates is Mount Pleasant, Michigan which has a population of approximately 26,000. Markets served include Isabella, Gratiot, Mecosta, southwestern Midland, western Saginaw, Montcalm, and southern Clare counties of Michigan. The area includes significant agricultural production, light manufacturing, retail, gaming and tourism, and two universities with combined enrollment of approximately 30,000 students.

On January 1, 2008, the Corporation acquired Greenville Community Financial Corporation (GCFC). This acquisition helped the Corporation expand its market area. For further discussion, see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements.

On March 1, 2008, IBT Title and Insurance Agency, Inc. (IBT Title), a wholly owned subsidiary of Isabella Bank Corporation, merged its assets and liabilities with those of Corporate Title Agency, LLC (Corporate Title), a third-party title business based in Traverse City, Michigan, to form CT/IBT Title Agency, LLC. As a result of this transaction, the Corporation became a 50 percent joint venture owner in CT/IBT Title Agency, LLC. The purpose of this joint venture was to help IBT Title and Insurance Agency, Inc. expand its service area and to take advantage of economies of scale. For further discussion, see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements.

The Bank 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 the 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 Isabella Bank Corporation. The assets of the Foundation as of December 31, 2008 were $953.

The Corporation s reportable segments are based on legal entities that account for at least 10 percent of net operating results. In April 2007, the individual bank charters of Isabella Bank and FSB Bank were consolidated into one bank charter as a part of the Corporation s strategy to increase efficiencies.

Competition

The Corporation competes with other commercial banks, many of which are subsidiaries of other bank holding companies, savings and loan associations, mortgage brokers, finance companies, credit unions, and retail brokerage firms. The Bank is a community bank with a focus on providing high-quality, personalized service at a fair price. The Bank offers a broad array of banking services to businesses, institutions, and individuals. Deposit services offered include checking accounts, savings accounts, certificates of deposit, and direct deposits. Lending activity includes loans made pursuant to lines of credit, real estate loans, consumer loans, and credit card loans. Other financial related products include trust services, stocks, investment securities, bonds, mutual fund sales, 24 hour banking service locally and nationally through shared automatic teller machines, 24 hour online banking, and safe deposit box rentals.

Lending

The Bank limits lending activities to local markets and has not purchased any loans from the secondary market. The Bank does not make loans to fund leveraged buyouts, has no foreign corporate or government loans, and has limited holdings of corporate debt securities. The general lending philosophy is to avoid concentrations to individuals and business segments. The following table sets forth the composition of the Corporation s loan portfolio as of December 31, 2008:

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LOANS BY MAJOR LENDING CATEGORY

(in thousands)	Amount	%
Residential real estate		
1 to 4 family residential	$ 302,826	41.18%
Construction and land development	16,571	2.25%
Total	319,397	43.43%
Commercial		
Real estate	200,398	27.25%
Farmland	31,656	4.30%
Agricultural production	26,347	3.58%
Commercial operating and other	124,408	16.92%
Total	382,809	52.06%
Other consumer installment	33,179	4.51%
TOTAL	$ 735,385	100.00%

There have been no significant changes in loan concentrations or underwriting standards in 2008.

First and second residential real estate mortgages are the single largest category of loans. The Corporation, through its Bank, offers 3 and 5 year fixed rate balloon mortgages with a maximum 30 year amortization, and 15 and 30 year amortized fixed rate loans. Fixed rate loans with an amortization of greater than 15 years are generally sold upon origination to the Federal Home Loan Mortgage Association. Fixed rate residential mortgage loans with an amortization of 15 years or less may be held in the Bank s portfolio, held for future sale, or sold upon origination. Factors used in determining when to sell these mortgages include management s judgment about the direction of interest rates, the Corporation s need for fixed rate assets in the management of its interest rate sensitivity, and overall loan demand.

Lending policies generally limit the maximum loan-to-value ratio on residential mortgages to 95% of the lower of the appraised value of the property or the purchase price, with the condition that private mortgage insurance is required on loans with loan-to-value ratios in excess of 80%. Substantially all loans upon origination have a loan-to-value ratio of less than 80%. Underwriting criteria for residential real estate loans include: evaluation of the borrower s ability to make monthly payments, the value of the property securing the loan, ensuring the payment of principal, interest, taxes, and hazard insurance does not exceed 28% of a borrower s gross income, all debt servicing does not exceed 36% of income, acceptable credit reports, verification of employment, income, and financial information. Appraisals are performed by independent appraisers. Escrow accounts for taxes and insurance are required on all loans with loan-to-value ratio in excess of 80%. All mortgage loan requests are reviewed by a mortgage loan committee; loans in excess of $400 require the approval of the Bank s Internal Loan Committee, Board of Directors, or its loan committee.

Construction and land development loans consist primarily of 1 to 4 family residential properties. These loans primarily have a 6 to 9 month maturity and are made using the same underwriting criteria as residential mortgages. Loan proceeds are disbursed in increments as construction progresses and inspections warrant. Construction loans are either converted to permanent loans at the completion of construction or are paid off from financing provided through another financial institution.

Commercial loans include loans for commercial real estate, farmland and agricultural production, state and political subdivisions, and commercial operating loans. Repayment of commercial loans is often dependent upon the successful operation and management of a business; thus, these loans generally involve greater risk than other types of lending. The Corporation minimizes its risk by generally limiting the amount of loans to any one borrower to $12,500. Borrowers with credit needs of more than $12,500 are serviced through the use of loan participations with other commercial banks. All commercial real estate loans require loan-to-value limits of less than 80%. Depending upon the type of loan, past credit history, and current operating results, the Corporation may require the borrower to pledge accounts receivable, inventory, and fixed assets. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and proprietorships. In addition, the Corporation requires annual financial statements, prepares cash flow analyses, and reviews credit reports as deemed necessary.

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

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Supervision and Regulation

The Corporation is subject to supervision and regulation by the Securities and Exchange Commission under the Securities Act of 1933 and the Securities Exchange Act of 1934 and by the Federal Reserve Board under the Bank Holding Company Act of 1956 as amended (BHC Act) and Financial Services Holding Company Act of 2000. A bank holding company and its subsidiaries are able to conduct only the business of commercial banking and activities closely related or incidental to it. (See Regulation below)

Isabella Bank is chartered by the State of Michigan and is a member of the Federal Reserve System. The Bank s deposits are insured by the FDIC to the extent provided by law. The Bank is a member of the Federal Home Loan Bank of Indianapolis. The Bank is supervised and regulated by the Michigan Office of Financial and Insurance Regulation (OFIR), the Federal Reserve Board, and the FDIC. (See Regulation below)

Personnel

As of December 31, 2008, the Corporation and its subsidiaries had 330 full-time equivalent leased employees. The Corporation provides group life, health, accident, disability and other insurance programs for employees and a number of other employee benefit programs. The Corporation believes its relationship with its employees to be good.

Legal Proceedings

There are various claims and lawsuits in which the Corporation and its subsidiaries are periodically involved, such as claims to enforce liens, condemnation proceedings on making and servicing of real property loans and other issues incidental to the Corporation s business. However, the Corporation and its subsidiaries are not involved in any material pending litigation.

AVAILABLE INFORMATION

The Corporation does not maintain a website. Consequently, the Corporation s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Definitive Proxy Statements, Current Reports on Form 8-K and amendments to those reports are not available on a corporate website. The Corporation will provide paper copies of its SEC reports free of charge upon request of a shareholder.

The SEC maintains an internet site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding the Corporation (CIK #0000842517) and other issuers.

REGULATION

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

The Corporation

The Corporation, as a financial services holding company, is regulated under the BHC Act, and is subject to the supervision of the Board of Governors of the Federal Reserve System (Federal Reserve Board). The Corporation is registered as a financial services holding company with the Federal Reserve Board and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board requires. The Federal Reserve Board may also make inspections and examinations of the Corporation and its subsidiaries.

Prior to March 13, 2000, a bank holding company generally was prohibited under the BHC Act from acquiring the beneficial ownership or control of more than 5% of the voting shares or substantially all the assets of any company, including a bank, without the Federal Reserve

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Board s prior approval. Also, prior to March 13, 2000, a bank holding company generally was limited to engaging in banking and such other activities as determined by the Federal Reserve Board to be closely related to banking.

Under the Gramm-Leach-Bliley Act of 1999 (GLB Act), beginning March 13, 2000, an eligible bank holding company was able to elect to become a financial holding company and thereafter affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The GLB Act defines financial in nature to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; activities that the Federal Reserve Board has determined to be closely related to banking; and other activities that the Federal Reserve Board, after consultation with the Secretary of the Treasury, determines by regulation or order to be financial in nature or incidental to a financial activity. No Federal Reserve Board approval is required for a financial holding company to acquire a company, other than a bank holding company, bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as defined in the GLB Act or as determined by the Federal Reserve Board.

A bank holding company is eligible to become a financial holding company if each of its subsidiary banks and savings associations is well capitalized under the prompt corrective action provisions of the Federal Deposit Insurance Act (FDI Act), is well managed and has a rating under the Community Reinvestment Act (CRA) of satisfactory or better. If any bank or savings association subsidiary of a financial holding company ceases to be well capitalized or well managed, the Federal Reserve Board may require the financial holding company to divest the subsidiary. Alternatively, the financial holding company may elect to conform its activities to those permissible for bank holding companies that do not elect to become financial holding companies. If any bank or savings association subsidiary of a financial holding company receives a CRA rating of less than satisfactory, the financial holding company will be prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations.

The Corporation became a financial holding company effective March 13, 2000. It continues to maintain its status as a bank holding company for purposes of other Federal Reserve Board regulations.

Under Federal Reserve Board policy, the Corporation is expected to act as a source of financial strength to its subsidiary Bank and to commit resources to support its subsidiaries. This support may be required at times when, in the absence of such Federal Reserve Board policy, the Corporation would not otherwise be required to provide it.

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

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

The Sarbanes-Oxley Act of 2002 (SOX) contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with Section 302(a) of SOX, a written certification by the Corporation s principal executive and financial officer is required. This certification attests that the Corporation s quarterly and annual reports filed with the SEC do not contain any untrue statement of a material fact. See the Certifications filed as Exhibits 31 (a) and (b) to this Form 10-K for such certification of the financial statements and other information for this 2008 Form 10-K. The Corporation has also implemented a program designed to comply with Section 404 of SOX, which included the identification of significant processes and accounts, documentation of the design of control effectiveness over process and entity level controls, and testing of the operating effectiveness of key controls. See Item 9A, Controls and Procedures for the Corporation s evaluation of its disclosure controls and procedures.

The Emergency Economic Stabilization Act of 2008 (EESA) was enacted in October, 2008. Pursuant to authority under EESA, the U.S. Treasury created the Troubled Asset Relief Program (TARP) Capital Purchase Program under which the U.S. Treasury will invest in senior preferred stock of U.S. banks and savings associations or their holding companies. The U.S. Treasury was initially authorized to use $250 billion for TARP Capital Purchase Program. Qualifying financial institutions may issue senior preferred stock with a value equal to not less than 1% of risk-weighted assets and not more than the lesser of $25 billion or 3% of risk-weighted assets.

In connection with the issuance of the senior preferred stock, participating institutions must issue to the U.S. Treasury immediately exercisable 10-year warrants to purchase common stock with an aggregate market price equal to 15% of the amount of senior preferred stock. The exercise price of the warrants must equal the market price of the common stock on the date of the investment.

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As the Corporation noted in its December 10, 2008, press release, the Corporation s Board of Directors, after carefully reviewing the Corporation s capital position, the cost of the federal government s capital, the terms and conditions of participating in the TARP Capital Purchase Program, and the consequences of having the U.S. Treasury as a preferred stock shareholder, decided it would not be in the best interests of the Corporation s shareholders to participate in the program.

Certain additional information concerning regulatory guidelines for capital adequacy and other regulatory matters is presented herein under the caption Capital on page 32 and in the notes to the consolidated financial statements Note 15 Commitments and Other Matters and Note 16 Minimum Regulatory Capital Requirements .

Subsidiary Bank

The Bank is subject to regulation and examination primarily by OFIR and is also subject to regulation and examination by the Federal Reserve Board.

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

The deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the Federal Deposit Insurance Corporation (FDIC) and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system that assesses insurance premiums based upon a risk matrix that takes into account a bank s capital level and supervisory rating.

On October 16, 2008, the FDIC issued a restoration plan designed to replenish the DIF and to increase the deposit insurance reserve ratio to the statutory minimum of 1.15% of insured deposits by December 31, 2013. In order to implement the restoration plan, the FDIC proposes to change both its risk-based assessment system and its base assessment rates. For the first quarter of 2009 only, the FDIC increased all FDIC deposit assessment rates by 7 basis points. These new rates range from 12-14 basis points for Risk Category I institutions to 50 basis points for Risk Category IV institutions. Under the FDIC s restoration plan, the FDIC proposes to establish new initial base assessment rates that will be subject to adjustment. On February 27, 2009, the FDIC issued proposed final rules for insurance assessments for 2009. Beginning April 1, 2009, the base assessment rates would range from 12-16 basis points for Risk Category I institutions to 45 basis points for Risk Category IV institutions. Additionally, the FDIC has called for a twenty (20) basis point special assessment on deposit balances as of June 30, 2009, and payable September 30, 2009, though the FDIC has signaled it may lower its special assessment fee to ten (10) basis points. The FDIC may impose additional special assessments of up to ten (10) basis points thereafter should the DIF reserve ratio not meet projected levels in the future. Either an increase in the risk category of Isabella Bank or adjustments to the base assessment rates would have an adverse effect on the Corporation s earnings.

The enactment of EESA temporarily raised the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. The temporary increase in deposit insurance coverage became effective on October 3, 2008. EESA provides that the basic deposit insurance limit will return to $100,000 after December 31, 2009.

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

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

The payment of dividends by the Corporation and the Bank is also affected by various regulatory requirements and policies, such as the requirement to maintain adequate capital above regulatory guidelines. Federal laws impose further restrictions on the payment of dividends by insured banks that fail to meet specified capital levels. The FDIC may prevent an insured bank from paying dividends if the bank is in default of payment of any assessment due to the FDIC. In addition, payment of dividends by a bank may be prevented by the applicable federal

regulatory authority if such payment is determined, by reason of the financial condition of such bank, to be an unsafe and unsound banking practice. The Federal Reserve Board and the FDIC have issued policy statements providing that bank holding companies and insured banks should generally pay dividends only out of current operating earnings.
The aforementioned regulations and restrictions may limit the Corporation s ability to obtain funds from its subsidiary bank for its cash needs, including payment of dividends and operating expenses.
The activities and operations of the Bank are also subject to other federal and state laws and regulations, including usury and consumer credit laws, the Federal Truth-in-Lending Act, Truth-in-Saving and Regulation Z of the Federal Reserve Board, the Federal Bank Merger Act, and the Bank Secrecy Act.

Item 1A. Risk Factors

In the normal course of business the Corporation is exposed to various risks. These risks include credit risk, interest rate risk, liquidity risk, operational risk, compliance risk, economic risk, accounting risk, and disruption of infrastructure. These risks, if not managed correctly, could have a significant impact on earnings and capital of the Corporation. Management balances the Corporation s strategic goals, including revenue and profitability objectives, with associated risks through the use of policies, systems and procedures which have been adopted to identify, assess, control, monitor, and manage in each risk area. Senior management continually reviews the adequacy and effectiveness of these policies, systems, and procedures.

Credit Risk

Credit risk is defined as the risk impacting earnings or capital due to an obligor s failure to meet the terms of a loan or an investment, or otherwise failing to perform as agreed. Credit risk occurs any time an institution relies on another party, issuer, or borrower s performance.
A volatile, illiquid market could require the Corporation to recognize an other- than-temporary impairment of the investment securities held in the portfolio. Management considers many factors in determining whether other-than-temporary impairment exists including the length of time and extent to which fair value has been less than cost, the investment credit rating, the probability the issuer will be unable to pay the amount when due and the Corporation s positive intent and ability to hold such investments to maturity or for a period of time sufficient to allow for recovery. This could lead to impairment charges that could have a material adverse effect on net income and capital levels.
To manage the credit risk arising from lending activities, the Corporation s most significant source of credit risk, management maintains what it believes are sound underwriting policies and procedures. Management continuously monitors asset quality in order to manage the Corporation s credit risk to determine the appropriateness of valuation allowances. These valuation allowances take into consideration various factors including, but not limited to, local, regional, and national economic conditions.
The Corporation maintains an allowance for probable loan losses, which is a reserve established through a provision for probable loan losses charged to expense, that represents management s best estimate of probable losses that may be incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management s continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan losses inherently involves a high degree of subjectivity and requires the Corporation to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Corporation s control, may require an increase in the allowance for possible loan losses. In addition, bank regulatory agencies periodically review the Corporation s allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. Any increases in the allowance for possible loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on the Corporation s financial condition and results of operations.

Interest Rate Risk

Interest rate risk is the timing differences in the maturity or repricing frequency of a financial institution s interest earning assets and its interest bearing liabilities. Management monitors the potential effects of changes in interest rates through rate shock and gap analyses. To help mitigate the effects of interest rate risk, management makes significant efforts to stagger projected cash flows and maturities of interest sensitive assets and liabilities.

Liquidity Risk

Liquidity risk is the risk to earnings or capital arising from the Bank s inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources, or failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value. The Corporation has significant borrowing capacity through correspondent banks as well as the ability to sell investments to fund potential cash shortages.

Operational Risk

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

To help minimize the potential losses due to operational risks, management has established an internal audit department and has retained the services of a certified public accounting firm to assist in performing such internal audit work. The focus of these internal audit procedures is to verify the validity and appropriateness of various transactions and processes. The results of these procedures are reported to the Corporation s or Bank s Audit Committee.

Compliance Risk

Compliance risk is the risk of loss from violations of, or nonconformance with laws, rules, regulations, prescribed practices, or ethical standards. This includes new or revised tax, accounting, and other laws, regulations, rules and standards that could significantly impact strategic initiatives, results of operations, and financial condition. The financial services industry is extensively regulated and must meet regulatory standards set by the FDIC, OFIR, the Federal Reserve Board, FASB, SEC, PCAOB and other regulatory bodies. Federal and state laws and regulations are designed primarily to protect the deposit insurance funds and consumers, and not necessarily to benefit the Corporation s shareholders. The nature, extent, and timing of the adoption of significant new laws, changes in existing laws, or repeal of existing laws may have a material impact on the Corporation s business, results of operations, and financial condition, the effect of which is impossible to predict at this time.

The Corporation s compliance department periodically assesses the adequacy and effectiveness of the Corporation s processes for controlling and managing its principal compliance risks.

Economic Conditions

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

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

Accounting Risk

The Corporation s consolidated financial statements conform with generally accepted accounting principles, which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. These estimates are based on information available to management at the time the estimates are made. Actual results could differ from those estimates. For further discussion regarding significant accounting estimates, see Note 1- Summary of Significant Accounting Policies in the attached Notes to the Consolidated Financial Statements.

Disruption of Infrastructure

The Corporation s operations depend upon its technological and physical infrastructure, including its equipment and facilities. Extended disruption of its vital infrastructure by fire, power loss, natural disaster, telecommunications failure, computer hacking and viruses, or other events outside of the Corporation s control, could affect the financial outcome of the Corporation or the financial services industry as a whole. The Corporation has developed disaster recovery plans, which provide detailed instructions to cover all significant aspects of the Corporation s operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Corporation s executive offices are located at 200 East Broadway, Mt. Pleasant, Michigan 48858. Isabella Bank owns 24 branches and an operations center. The Corporation s facilities current, planned, and best use is for conducting its current activities with the exception of approximately 8% of the main office and 25% of the Lake Isabella office which are leased to tenants. Management continually monitors and assesses the need for expansion and / or improvement for all facilities. In management s opinion, each facility has sufficient capacity and is in good condition.

In early spring 2009, the Corporation will be moving its executive offices to 401 N. Main Street, Mt. Pleasant, MI 48858. The future plans for 200 East Broadway are still under consideration.

Item 3. Legal Proceedings

The Corporation and its subsidiaries are not involved in any material pending legal proceedings. The Corporation, because of the nature of its business, is at times subject to numerous pending and threatened legal actions that arise out of the normal course of operating their business.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted during the fourth quarter of 2008 to a vote of security holders through the solicitation of proxies or otherwise.

Part II

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

Common Stock and Dividend Information

The Corporation s common stock is traded in the over-the-counter market. The common stock has been quoted on the Pink Sheets Electronic Quotation Service (Pink Sheets) under the symbol ISBA since August of 2008 and under the symbol IBTM prior to August of 2008. Other trades in the common stock occur in privately negotiated transactions from time to time of which the Corporation may or may not be aware.

Management has reviewed the information available to it as to the range of reported high and low bid quotations, including high and low bid information as reported by Pink Sheets and closing price information as reported by the parties to privately negotiated transactions. The following table sets forth management s compilation of that information for the periods indicated. Price information obtained from Pink Sheets reflects inter-dealer prices, without retail mark-up, mark-down or commissions and may not necessarily represent actual transactions. Price information obtained from parties to privately negotiated transactions reflects actual closing prices that were disclosed to the Corporation, which management has not independently verified. The following compiled data is provided for information purposes only and should not be viewed as indicative of the actual or market value of the Corporation s common stock. All of the information has been adjusted to reflect the 10% stock dividend, paid February 29, 2008.

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Period	Number of Sales	Number of Shares	Sale Price Low	Sale Price High
2008				
First Quarter	109	107,920	$32.73	$44.00
Second Quarter	89	50,600	39.00	44.00
Third Quarter	50	29,303	33.00	40.00
Fourth Quarter	80	71,855	22.50	36.50
	328	259,678		
2007				
First Quarter	61	65,506	38.18	40.91
Second Quarter	78	42,227	38.50	40.91
Third Quarter	66	59,752	38.41	40.45
Fourth Quarter	65	24,597	38.18	40.00
	270	192,082		

The following table sets forth the cash dividends paid for the following quarters, adjusted for the 10% stock dividend paid on February 29, 2008.

	Per Share 2008	Per Share 2007
First Quarter	$ 0.12	$ 0.11
Second Quarter	0.12	0.11
Third Quarter	0.12	0.11
Fourth Quarter	0.29	0.29
Total	$ 0.65	$ 0.62

Isabella Bank Corporation s authorized common stock consists of 15,000,000 shares, of which 7,518,856 shares are issued and outstanding as of December 31, 2008. As of that date, there were 2,979 shareholders of record.

On March 22, 2007, the Board of Directors adopted a repurchase plan which allows for the repurchase of up to 150,000 shares of the Corporation s issued and outstanding common stock. This plan was amended in May 2008 to allow for the repurchase of an additional 25,000 shares. The plan was further amended to allow for an additional 5,000 shares to be repurchased in July 2008. As shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued shares. This authorization does not have an expiration date. The following table provides information as of December 31, 2008, with respect to this plan:

	Shares Repurchased Number	Shares Repurchased Average Price Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs

Balance, September 30, 2008		1,044
October 1 - 31, 2008	$	1,044
November 1 - 30, 2008		1,044
December 1 - 31, 2008		1,044
Balance, December 31, 2008	$	1,044

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

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Stock Performance

The following graph compares the cumulative total shareholder return on Corporation common stock for the last five years with the cumulative total return on (1) the NASDAQ Stock Market Index, which is comprised of all United States common shares traded on the NASDAQ and (2) the NASDAQ Bank Stock Index, which is comprised of bank and bank holding company common shares traded on the NASDAQ over the same period. The graph assumes the value of an investment in the Corporation and each index was $100 at December 31, 2003 and all dividends are reinvested.

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

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

Year	Isabella Bank Corporation	NASDAQ	NASDAQ Banks
12/31/2003	100.0	100.0	100.0
12/31/2004	117.2	109.1	113.4
12/31/2005	124.7	111.4	111.2
12/31/2006	139.2	122.9	126.4
12/31/2007	141.4	136.0	101.6
12/31/2008	92.1	81.6	80.0

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Item 6. Selected Financial Data

RESULTS OF OPERATIONS

Two key measures of earnings performance commonly used in the banking industry are return on average assets and return on average shareholders equity. Return on average assets measures the ability of a 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
(Dollars in thousands except per share data)

	2008	2007	2006	2005	2004
INCOME STATEMENT DATA					
Total interest income	$ 61,385	$ 53,972	$ 44,709	$ 36,882	$ 33,821
Net interest income	35,779	28,013	24,977	23,909	23,364
Provision for loan losses	9,500	1,211	682	777	735
Net income	4,101	7,930	7,001	6,776	6,645
BALANCE SHEET DATA					
End of year assets	$1,139,263	$957,282	$910,127	$741,654	$678,034
Daily average assets	1,113,102	925,631	800,174	700,624	675,157
Daily average deposits	817,041	727,762	639,046	576,091	567,145
Daily average loans/net	708,434	596,739	515,539	459,310	430,854
Daily average equity	143,626	119,246	91,964	74,682	70,787
PER SHARE DATA (1)					
Earnings per share					
Basic	$ 0.55	$ 1.14	$ 1.12	$ 1.14	$ 1.13
Diluted	0.53	1.11	1.09	1.14	1.13
Cash dividends	0.65	0.62	0.58	0.55	0.52
Book value (at year end)	17.89	17.58	16.61	13.44	12.25
FINANCIAL RATIOS					
Shareholders equity to assets (at year end)	11.80%	12.86%	12.72%	10.91%	10.71%
Return on average equity	2.86	6.65	7.61	9.07	9.39
Return on average tangible equity	4.41	8.54	8.31	9.12	10.01
Cash dividend payout to net income	118.82	54.27	53.92	48.02	46.20
Return on average assets	0.37	0.86	0.87	0.97	0.98

	2008				2007			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st
Quarterly Operating Results:								
Total interest income	$ 15,099	$ 15,401	$ 15,359	$ 15,526	$ 13,747	$ 13,794	$ 13,539	$ 12,892
Interest expense	5,836	6,309	6,379	7,082	6,466	6,690	6,554	6,249
Net interest income	9,263	9,092	8,980	8,444	7,281	7,104	6,985	6,643
Provision for loan losses	5,725	975	1,593	1,207	593	268	224	126

Noninterest income	1,130	2,377	1,778	2,517	2,605	2,719	2,227	2,411
Noninterest expenses	8,377	7,430	7,341	7,556	6,597	6,995	6,833	6,804
Net (loss) income	(2,041)	2,524	1,691	1,927	2,268	2,096	1,756	1,810
Per Share of Common Stock: (1)								
Earnings (loss) per share								
Basic	$ (0.28)	$ 0.34	$ 0.23	$ 0.26	$ 0.33	$ 0.30	$ 0.25	$ 0.26
Diluted	(0.27)	0.33	0.22	0.25	0.32	0.29	0.25	0.25
Cash dividends	0.29	0.12	0.12	0.12	0.29	0.11	0.11	0.11
Book value (at quarter end)	17.89	18.78	18.75	19.07	17.58	17.38	17.04	16.77

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

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

ISABELLA BANK CORPORATION FINANCIAL REVIEW

(All dollars in thousands)

The following is management s discussion and analysis of the financial condition and results of operations for Isabella Bank Corporation (the Corporation). This discussion and analysis is intended to provide a better understanding of the consolidated financial statements and statistical data included elsewhere in the Annual Report. The Corporation s significant acquisitions of Greenville Community Financial Corporation in January 2008 and Farwell State Savings Bank in October 2006 were accounted for as purchase transactions, and as such, the related results of operations are included from the dates of acquisition. See Note 2 Business Combinations and Joint Venture Formation in the accompanying Notes to Consolidated Financial Statements included elsewhere in the report.

During 2008, as a result of a significant downturn in economy, the Corporation experienced significant increases in past due and nonaccrual loans. This increase in delinquencies has led to dramatic increases in net loans charged off as well as collection expenses. For further discussion and analysis, see below.

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

The allowance for loan losses requires management s most subjective and complex judgment. Changes in economic conditions can have a significant impact on the allowance for loan losses and, therefore, the provision for loan losses and results of operations. The Corporation has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation s assessments may be impacted in future periods by changes in economic conditions, and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation s allowance for loan losses and related matters, see the Provision for Loan Losses discussion below.

United States generally accepted accounting principles require the Corporation determine the fair value of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. The Corporation employs a variety of measures in determination of the fair value, including the use of discounted cash flow analysis, market appraisals, and projected future revenue streams. For certain items that management believes it has the appropriate expertise to determine the fair value, management may choose to use its own calculations of the value. In other cases, where the value is not easily determined, the Corporation consults with outside parties to determine the fair value of the identified asset or liability. Once valuations have been adjusted, the net difference between the price paid for the acquired entity and the value of its balance sheet, including identifiable intangibles, is recorded as goodwill. This goodwill is not amortized, but is tested for impairment on at least an annual basis.

The Corporation currently has both available-for-sale and trading investment securities that are carried at 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 other than temporary are reflected as realized losses. 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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DISTRIBUTION OF ASSETS, LIABILITIES, AND SHAREHOLDERS EQUITY
INTEREST RATE AND INTEREST DIFFERENTIAL

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

	2008			2007			2006		
	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate	Average Balance	Tax Equivalent Interest	Average Yield / Rate
INTEREST EARNING ASSETS:									
Loans	$ 717,040	$ 49,674	6.93%	$ 604,342	$ 43,808	7.25%	$ 522,726	$ 36,575	7.00%
Taxable investment securities	108,919	5,433	4.99%	68,398	3,751	5.48%	123,316	4,948	4.01%
Nontaxable investment securities	121,220	7,218	5.95%	96,789	5,726	5.92%	75,712	4,423	5.84%
Trading account securities	26,618	1,305	4.90%	50,904	2,298	4.51%			
Federal funds sold	5,198	110	2.12%	6,758	342	5.06%	2,762	139	5.03%
Other	17,600	433	2.46%	7,143	317	4.44%	5,012	250	4.99%
Total earning assets	996,595	64,173	6.44%	834,334	56,242	6.74%	729,528	46,335	6.35%
NON EARNING ASSETS:									
Allowance for loan losses	(8,606)			(7,603)			(7,187)		
Cash and due from banks	18,582			20,588			24,351		
Premises and equipment	22,905			21,507			17,690		
Accrued income and other assets	83,626			56,805			35,792		
Total assets	$ 1,113,102			$ 925,631			$ 800,174		

INTEREST BEARING LIABILITIES:

Interest bearing demand deposits	$ 114,889	813	0.71%	$ 109,370	1,880	1.72%	$ 105,476	1,664	1.58%
Savings deposits	213,410	2,439	1.14%	188,323	4,232	2.25%	158,327	2,675	1.69%
Time deposits	393,190	16,621	4.23%	349,941	16,493	4.71%	301,593	12,825	4.25%
Other borrowed funds	145,802	5,733	3.93%	68,586	3,354	4.89%	53,256	2,568	4.82%
Total interest bearing liabilities	867,291	25,606	2.95%	716,220	25,959	3.62%	618,652	19,732	3.19%
NONINTEREST BEARING LIABILITIES:									
Demand deposits	95,552			80,128			73,650		
Other	6,633			10,037			15,908		
Shareholders equity	143,626			119,246			91,964		
Total liabilities and equity	$ 1,113,102			$ 925,631			$ 800,174		
Net interest income (FTE)		$ 38,567			$ 30,283			$ 26,603	
Net yield on interest earning assets (FTE)			3.87%			3.63%			3.65%

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Net Interest Income

The Corporation derives the majority of its gross income from interest earned on loans and investments, while its most significant expense is the interest cost incurred for funds used. Net interest income is the amount by which interest income on earning assets exceeds the interest cost of deposits and borrowings. Net interest income is influenced by changes in the balance and mix of assets and liabilities and market interest rates. Management exerts some control over these factors; however, Federal Reserve monetary policy and competition have a significant impact. Interest income includes loan fees of $1,808 in 2008, $1,330 in 2007, and $1,172 in 2006. For analytical purposes, net interest income is adjusted to a taxable equivalent basis by adding the income tax savings from interest on tax-exempt loans and securities, thus making year-to-year comparisons more meaningful.

VOLUME AND RATE VARIANCE ANALYSIS

The following table details the dollar amount of changes in FTE net interest income for each major category of interest earning assets and interest bearing liabilities and the amount of change attributable to changes in average balances (volume) or average rates. The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	2008 Compared to 2007 Increase (Decrease) Due to			2007 Compared to 2006 Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
CHANGES IN INTEREST INCOME:						
Loans	$ 7,877	$ (2,011)	$ 5,866	$ 5,878	$ 1,355	$ 7,233
Taxable investment securities	2,048	(366)	1,682	(2,647)	1,450	(1,197)
Nontaxable investment securities	1,454	38	1,492	1,246	57	1,303
Trading account securities	(1,176)	183	(993)	2,298		2,298
Federal funds sold	(66)	(166)	(232)	202	1	203
Other	306	(190)	116	97	(30)	67
Total changes in interest income	10,443	(2,512)	7,931	7,074	2,833	9,907
CHANGES IN INTEREST EXPENSE:						
Interest bearing demand deposits	90	(1,157)	(1,067)	63	153	216
Savings deposits	505	(2,298)	(1,793)	568	989	1,557
Time deposits	1,924	(1,796)	128	2,189	1,479	3,668
Other borrowings	3,146	(767)	2,379	749	37	786
Total changes in interest expense	5,665	(6,018)	(353)	3,569	2,658	6,227
Net change in interest margin (FTE)	$ 4,778	$ 3,506	$ 8,284	$ 3,505	$ 175	$ 3,680

The Corporation, as well as all other financial institutions, has experienced dramatic changes in interest rates in the last two years. Since September of 2007, the Federal Reserve Bank (The Fed) has lowered its target Fed Funds rate from 5.25% to its current level of 0.00% 0.25%. The Fed s actions are a result of significant weakening of the Nation s economy.

The Corporation s balance sheet was well positioned to protect interest margins in this decreasing rate environment and provided strong interest margin growth in 2008. Interest margins are likely to decrease in 2009 due to the following three factors:

Based on the current economic conditions, management does not anticipate any changes in the target Fed Funds 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 will also result in movement of the Corporation s customers from its three and five year balloon mortgages to fixed rate products that are sold on the secondary market. The reinvestment of these proceeds at lower interest rates will adversely impact interest income.

The Corporation experienced a significant increase in non-accrual loans in the fourth quarter of 2008. The increase 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. The increase in non-accrual loans will decrease 2009 interest income as these loans will no longer be accruing interest income.

Net yield on interest earning assets increased by 0.24% when 2008 is compared to 2007. The primary reason for this increase was that in early 2007, the Corporation, as part of a balance sheet management strategy, extended the maturities of interest earning assets, which as interest rates declined in the latter half of 2007, had a positive impact on interest margins as the cost of funding sources decreased more rapidly than the rates earned on interest earning assets. Another contributing factor for the increase in margins was a result of the loan growth, primarily in higher yielding commercial loans.

The above mentioned balance sheet reorganization strategy was accelerated by the Corporation s election to early adopt Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, and SFAS No. 157, *Fair Value Measurements*, effective January 1, 2007. The purpose of the early adoption of these standards was to not only provide the Corporation with an opportunity to accelerate the restructuring of its balance sheet, but also to better manage interest rate risk now and in the future.

Overall FTE net interest margin increased by $8,284 for the year ended December 31, 2008 as compared to the same period in 2007. Changes in volume provided an additional $4,778 of net interest margin, while changes in interest rates, both earned and paid, provided an additional $3,506 of net interest margin. During 2008, the rates paid on interest bearing liabilities decreased by 0.67% while those earned on interest earning assets declined by only 0.30%.

Net FTE interest income increased $3,680 for the year ended December 31, 2007 when compared to the same period in 2006. The net increase from the change in volume of interest earning assets and interest bearing liabilities was $3,505 in 2007. Net interest income increased $175 as a result of interest rate changes. During 2007, the rates paid on interest bearing liabilities increased 0.43%, while those earned on interest earning assets increased 0.39%. The decline in interest rate spread is a direct result of the continued use of high cost funding sources such as certificates of deposit and other borrowed funds. The increase in the cost of these deposits in relation to other sources is a result of continued competition for retail deposits.

Provision for Loan Losses

The provision for loan losses represents the current period loan cost associated with maintaining an appropriate allowance for loan losses as determined by management. Periodic fluctuations in the provision for loan losses result from management s best estimates as to the adequacy of the allowance for loan losses to absorb probable losses within the existing loan portfolio. The provision for loan losses for each period is further dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, assessment by management, third parties and banking regulators of the quality of the loan portfolio, the value of the underlying collateral on problem loans and the general economic conditions in our market areas.

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

	Year Ended December 31,				
	2008	2007	2006	2005	2004
Allowance for loan losses January 1	$ 7,301	$ 7,605	$ 6,899	$ 6,444	$ 6,204
Allowance of acquired bank	822		726		
Loans charged off					
Commercial and agricultural	2,137	905	368	101	561
Real estate mortgage	3,334	659	252	166	
Consumer	854	582	529	376	374
Total loans charged off	**6,325**	**2,146**	**1,149**	**643**	**935**
Recoveries					
Commercial and agricultural	160	297	136	105	191
Real estate mortgage	240	49	53		62
Consumer	284	285	258	216	187
Total recoveries	**684**	**631**	**447**	**321**	**440**
Net loans charged off	5,641	1,515	702	322	495
Provision charged to income	9,500	1,211	682	777	735
Allowance for loan losses December 31	**$ 11,982**	**$ 7,301**	**$ 7,605**	**$ 6,899**	**$ 6,444**
Year to date average loans	**$ 717,040**	**$ 604,342**	**$ 522,726**	**$ 466,001**	**$ 437,438**
Net loans charged off to average loans outstanding	**0.79%**	**0.25%**	**0.13%**	**0.07%**	**0.11%**
Total amount of loans outstanding	**$ 735,385**	**$ 612,687**	**$ 591,042**	**$ 483,242**	**$ 452,895**
Allowance for loan losses as a % of loans	**1.63%**	**1.19%**	**1.29%**	**1.43%**	**1.42%**

During 2008, the Corporation experienced a significant increase in total loans charged off, primarily in the form of residential real estate mortgages; total loans charged off increased by $4,179 to $6,325. As a result of the increases in loans charged off, as well as local and regional economic uncertainties of the Corporation s loan portfolio, the Corporation recorded a provision for loan loss in the amount of $5,725 in the fourth quarter of 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 finance loans for more than 80% of market value unless insured by private third party insurance.

With increases in the net loans charged off to average loans and nonperforming loans as a percentage of total loans, the Corporation increased the provision charged to income in 2008. This additional provision increased the allowance for loans losses as a percentage of loans by 0.44% to 1.63%. The increase in the allowance as a percentage of loans is the result of increases in charge offs in the current year, an increase in nonperforming loans, and the declines in the credit quality of the loan portfolio. Management will continue to closely monitor its overall credit quality during 2009 to ensure that the allowance for loan losses remains adequate.

Based on management s analysis, the allowance for loan losses of $11,982 is considered adequate as of December 31, 2008.

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Allocation of the Allowance for Loan Losses
The allowance for loan losses has been allocated according to the amount deemed to be reasonably necessary to reflect for the probability of losses being incurred within the following categories as of December 31:

	2008		2007		2006		2005		2004	
	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans	Allowance Amount	% of Each Category to Total Loans
Commercial and agricultural	$ 3,632	50.7%	$ 2,458	46.0%	$ 2,687	43.3%	$ 2,771	46.9%	$ 2,634	42.3%
Real estate mortgage	3,832	43.4%	1,341	48.6%	1,367	50.9%	1,192	46.8%	1,463	50.5%
Consumer installment	1,736	4.5%	2,195	4.8%	2,434	5.1%	2,286	5.8%	1,606	6.6%
Impaired loans	2,065	1.4%	703	0.6%	594	0.7%	184	0.5%	304	0.6%
Unallocated	717	0.0%	604	0.0%	523	0.0%	466	0.0%	437	0.0%
Total	$ 11,982	100.0%	$ 7,301	100.0%	$ 7,605	100.0%	$ 6,899	100.0%	$ 6,444	100.0%

Management has evaluated impaired loans and believes the valuation allowance related to these loans to be adequate.

Nonperforming Assets
Loans are generally placed on nonaccrual status when they become 90 days past due, unless they are well secured and in the process of collection. When a loan is placed on nonaccrual status, any interest previously accrued and not collected is generally reversed from income or charged off against the allowance for loan losses. Loans are charged off when management determines that collection has become unlikely. Restructured loans are those where a concession has been granted on either principal or interest paid due to financial difficulties of the borrower. Other real estate owned (OREO) consists of real property acquired through foreclosure on the related collateral underlying defaulted loans.

The following table presents nonperforming assets for the past five years:

NONPERFORMING ASSETS

	Year Ended December 31,				
	2008	2007	2006	2005	2004
Nonaccrual loans	$ 11,175	$ 4,156	$ 3,444	$ 1,375	$ 1,900
Accruing loans past due 90 days or more	1,251	1,727	1,185	1,058	702
Restructured loans	4,550	685	697	725	686
Total nonperforming loans	**16,976**	**6,568**	**5,326**	**3,158**	**3,288**
Other real estate owned	2,770	1,376	562	122	40
Repossessed assets	153				
Total nonperperforming assets	**$ 19,899**	**$ 7,944**	**$ 5,888**	**$ 3,280**	**$ 3,328**

Nonperforming loans as a % of total loans	**2.31%**	**1.07%**	**0.90%**	**0.65%**	**0.73%**
Nonperforming assets as a % of total assets	**1.75%**	**0.83%**	**0.65%**	**0.44%**	**0.49%**

Due to the aforementioned residential real estate market difficulties inherent in the market, the Corporation has increased its efforts to identify potential problem loans. 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. Additionally, these loans are charged down to their estimated net realizable value when placed on nonaccrual. Historically, residential real estate loans were placed in nonaccrual status upon reaching the beginning of the legally mandated borrower redemption period, which is typically six months. Chargeoffs of any expected deficiency were recognized at the end of the six month redemption period. These efforts have had a significant impact on the increase in loans classified as nonaccrual as well as the increase in gross chargeoffs in 2008.

The increase in the Corporation s nonperforming loans is primarily related to the current market difficulties previously discussed related to real estate loans. These market difficulties have also resulted in a substantial increase in restructured loans. The majority of the increase in

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restructured loans is 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.

The increase in OREO is also related to the downturn in the residential real estate market. 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 Bank s carrying amount or fair value less costs to sell, as necessary. Management expects the balance of OREO to continue to increase throughout 2009 both as the result of increases in foreclosures as well as increases in the marketing time for home sales.

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.

As of December 31, 2008, 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.

Noninterest Income

The following table shows the changes in noninterest income between the years ended December 31, 2008, 2007, and 2006 respectively.

	Year Ended December 31						
			Change			Change	
	2008	2007	$	%	2006	$	%
Service charges and fee income							
NSF and overdraft fees	$ 3,413	$ 2,961	$ 452	15.3%	$ 2,950	$ 11	0.4%
Trust fees	886	1,035	(149)	-14.4%	866	169	19.5%
Freddie Mac servicing fee	627	635	(8)	-1.3%	635		0.0%
ATM and debit card fees	1,029	737	292	39.6%	545	192	35.2%
Service charges on deposit accounts	372	328	44	13.4%	315	13	4.1%
Net OMSR (loss) income	(92)	43	(135)	N/M	30	13	43.3%
All other	135	155	(20)	-12.9%	149	6	4.0%
Total service charges and fees	**6,370**	**5,894**	**476**	**8.1%**	**5,490**	**404**	**7.4%**
Title insurance revenue	**234**	**2,192**	**(1,958)**	**-89.3%**	**2,389**	**(197)**	**-8.2%**
Gain on sale of mortgage loans	**249**	**209**	**40**	**19.1%**	**207**	**2**	**1.0%**
Net gain on trading securities	**245**	**460**	**(215)**	**-46.7%**		**460**	**N/M**
Other							
Increase in cash value of corporate owned life insurance policies	616	432	184	42.6%	404	28	6.9%
Brokerage and advisory fees	480	276	204	73.9%	213	63	29.6%
	24	(19)	43	N/M	(112)	93	83.0%

Gain (loss) on sale of investment securities							
Net loss on borrowings measured at fair value	(641)	(66)	(575)	N/M		(66)	N/M
All other	225	584	(359)	-61.5%	507	77	15.2%
Total other	**704**	**1,207**	**(503)**	**-41.7%**	**1,012**	**195**	**19.3%**
Total noninterest income	**$ 7,802**	**$ 9,962**	**$ (2,160)**	**-21.7%**	**$ 9,098**	**$ 864**	**9.5%**

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Noninterest Income (excluding the activity of GCFC since January 1, 2008 to make year to year comparisons more meaningful)

	Year Ended December 31						
			Change			Change	
	2008	2007	$	%	2006	$	%
Service charges and fee income							
NSF and overdraft fees	$ 3,094	$ 2,961	$ 133	4.5%	$ 2,950	$ 11	0.4%
Trust fees	886	1,035	(149)	-14.4%	866	169	19.5%
Freddie Mac servicing fee	626	635	(9)	-1.4%	635		0.0%
ATM and debit card fees	995	737	258	35.0%	545	192	35.2%
Service charges on deposit accounts	330	328	2	0.6%	315	13	4.1%
Net OMSR (loss) income	(92)	43	(135)	N/M	30	13	43.3%
All other	118	155	(37)	-23.9%	149	6	4.0%
Total service charges and fees	**5,957**	**5,894**	**63**	**1.1%**	**5,490**	**404**	**7.4%**
Title insurance revenue	**234**	**2,192**	**(1,958)**	**-89.3%**	**2,389**	**(197)**	**-8.2%**
Gain on sale of mortgage loans	**207**	**209**	**(2)**	**-1.0%**	**207**	**2**	**1.0%**
Net gain on trading securities	**236**	**460**	**(224)**	**-48.7%**		**460**	**N/M**
Other							
Increase in cash value of corporate owned life insurance policies	604	432	172	39.8%	404	28	6.9%
Brokerage and advisory fees	430	276	154	55.8%	213	63	29.6%
Gain (loss) on sale of investment securities	24	(19)	43	N/M	(112)	93	83.0%
Net loss on borrowings measured at fair value	(641)	(66)	(575)	N/M		(66)	N/M
All other	229	584	(355)	-60.8%	507	77	15.2%
Total other	**646**	**1,207**	**(561)**	**-46.5%**	**1,012**	**195**	**19.3%**
Total noninterest income	**$ 7,280**	**$ 9,962**	**$ (2,682)**	**-26.9%**	**$ 9,098**	**$ 864**	**9.5%**

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 the Bank s 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.

The decline in net OMSR (originated mortgage servicing rights) income was primarily due to an increase in amortization expense. The increase in amortization was the result of the estimated lives on the mortgage loans serviced decreasing, which was driven by decreases in the rates offered on new loans in December 2008. Typically as the rates on mortgages decline, there is an increase in consumer refinancing, which results in an increase in amortization of OMSR and eventually an increase in the gain on sale of mortgage loans. As the large declines in interest rates occurred so close to year end, the Corporation had not observed any large increases in the gain on sale of mortgage loans. However, the Corporation does anticipate significant increases in gains from the sales from mortgage loans in 2009.

Title insurance fees have decreased as a result of a joint venture between IBT Title and Insurance Agency and Corporate Title on March 1, 2008 (see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements).

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Net gains from trading activities have declined significantly from last year. Exclusive of the effects of the merger with GCFC, net gains on trading securities have declined by 48.7% to $236. Significant losses on trading securities were incurred in the second quarter, primarily related to municipal investment securities. The reason for the large declines in value in this sector was related to the downgrading of the two largest bond insurers from AAA to AA in June 2008. These downgrades caused the market to demand higher returns on insured bonds, which has resulted in declines in the value of the Corporation s municipal bond portfolio, as the majority of the portfolio is insured. Despite the significant declines in interest rates observed during the fourth quarter of 2008, the trading portfolio has struggled to increase in value. Typically, as market rates decline, the value of these securities will increase, while the value of borrowings carried at fair market value will decrease. However, the increases in the value of trading securities have not increased as much as the values of borrowings carried at fair market value have decreased.

Income related to the value of Corporate owned life insurance has increased as a result of the purchase of additional policies as well as transferring the management of the policies to a new investment advisor.

The year ended December 31, 2008 was a good year for brokerage and advisory services income, and one of the most productive years in the Corporation s history. These results are due to an increase in customer base and a conscious effort by management to expand the Bank s presence in the local market. The Corporation anticipates this trend to continue throughout 2009.

The increase in total noninterest income from 2006 to 2007 was partially the result of the acquisition of Farwell State Savings Bank in October 2006. Exclusive of the effects of the acquisition, total noninterest income increased 6.29%. There were no individually significant changes other than those noted above between 2007 and 2006.

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Noninterest Expenses
The following table shows the changes in noninterest expenses between the years ended December 31, 2008, 2007, and 2006 respectively.

	Year Ended December 31						
			Change			Change	
	2008	2007	$	%	2006	$	%
Compensation							
Leased employee salaries	$ 12,232	$ 11,362	$ 870	7.7%	$ 10,105	$ 1,257	12.4%
Leased employee benefits	4,502	4,096	406	9.9%	3,608	488	13.5%
All other	258	160	98	61.3%	156	4	2.6%
Total compensation	**16,992**	**15,618**	**1,374**	**8.8%**	**13,869**	**1,749**	**12.6%**
Occupancy							
Depreciation	508	448	60	13.4%	412	36	8.7%
Outside services	492	332	160	48.2%	334	(2)	-0.6%
Property taxes	411	384	27	7.0%	322	62	19.3%
Utilities	366	344	22	6.4%	320	24	7.5%
Building rent	3	72	(69)	-95.8%	163	(91)	-55.8%
Building repairs	202	147	55	37.4%	129	18	14.0%
All other	53	39	14	35.9%	50	(11)	-22.0%
Total occupancy	**2,035**	**1,766**	**269**	**15.2%**	**1,730**	**36**	**2.1%**
Furniture and equipment							
Depreciation	1,663	1,512	151	10.0%	1,440	72	5.0%
Computer / service contracts	1,526	1,254	272	21.7%	1,101	153	13.9%
ATM and debit card fees	570	433	137	31.6%	263	170	64.6%
All other	90	98	(8)	-8.2%	64	34	53.1%
Total furniture and equipment	**3,849**	**3,297**	**552**	**16.7%**	**2,868**	**429**	**15.0%**
Other							
Audit and SOX compliance fees	565	583	(18)	-3.1%	1,010	(427)	-42.3%
Marketing	691	642	49	7.6%	697	(55)	-7.9%
Directors fees	867	796	71	8.9%	584	212	36.3%
Printing and supplies	508	462	46	10.0%	377	85	22.5%
Education and travel	446	412	34	8.3%	360	52	14.4%
Postage and freight	523	459	64	13.9%	445	14	3.1%
Legal	419	296	123	41.6%	229	67	29.3%
	415	278	137	49.3%	160	118	73.8%

Amortization of deposit premium							
Foreclosed assets	419	157	262	166.9%	41	116	N/M
Collection	279	112	167	149.1%	31	81	N/M
Brokerage and advisory	205	92	113	122.8%	31	61	196.8%
FDIC Insurance	313	95	218	N/M	87	8	9.2%
Consulting	298	176	122	69.3%	208	(32)	-15.4%
All other	1,880	1,988	(108)	-5.4%	1,746	242	13.9%
Total other	**7,828**	**6,548**	**1,280**	**19.5%**	**6,006**	**542**	**9.0%**
Total noninterest expenses	**$ 30,704**	**$ 27,229**	**$ 3,475**	**12.8%**	**$ 24,473**	**$ 2,756**	**11.3%**

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Noninterest Expenses (excluding the activity of GCFC since January 1, 2008 to make year-to-year comparisons more meaningful)

	Year Ended December 31						
			Change			Change	
	2008	2007	$	%	2006	$	%
Compensation							
Leased employee salaries	$ 11,152	$ 11,362	$ (210)	-1.8%	$ 10,105	$ 1,257	12.4%
Leased employee benefits	4,144	4,096	48	1.2%	3,608	488	13.5%
All other	241	160	81	50.6%	156	4	2.6%
Total compensation	**15,537**	**15,618**	**(81)**	**-0.5%**	**13,869**	**1,749**	**12.6%**
Occupancy							
Depreciation	445	448	(3)	-0.7%	412	36	8.7%
Outside services	404	332	72	21.7%	334	(2)	-0.6%
Property taxes	388	384	4	1.0%	322	62	19.3%
Utilities	340	344	(4)	-1.2%	320	24	7.5%
Building rent	3	72	(69)	-95.8%	163	(91)	-55.8%
Building repairs	185	147	38	25.9%	129	18	14.0%
All other	49	39	10	25.6%	50	(11)	-22.0%
Total occupancy	**1,814**	**1,766**	**48**	**2.7%**	**1,730**	**36**	**2.1%**
Furniture and equipment							
Depreciation	1,557	1,512	45	3.0%	1,440	72	5.0%
Computer / service contracts	1,322	1,254	68	5.4%	1,101	153	13.9%
ATM and debit card fees	553	433	120	27.7%	263	170	64.6%
All other	80	98	(18)	-18.4%	64	34	53.1%
Total furniture and equipment	**3,512**	**3,297**	**215**	**6.5%**	**2,868**	**429**	**15.0%**
Other							
Audit and SOX compliance fees	557	583	(26)	-4.5%	1,010	(427)	-42.3%
Marketing	636	642	(6)	-0.9%	697	(55)	-7.9%
Directors fees	771	796	(25)	-3.1%	584	212	36.3%
Printing and supplies	479	462	17	3.7%	377	85	22.5%
Education and travel	401	412	(11)	-2.7%	360	52	14.4%
Postage and freight	495	459	36	7.8%	445	14	3.1%
Legal	411	296	115	38.9%	229	67	29.3%
Amortization of deposit premium	415	278	137	49.3%	160	118	73.8%
Foreclosed assets	390	157	233	148.4%	41	116	N/M

Collection	158	112	46	41.1%	31	81	N/M
Brokerage and advisory	205	92	113	122.8%	31	61	196.8%
FDIC Insurance	275	95	180	189.5%	87	8	9.2%
Consulting	269	176	93	52.8%	208	(32)	-15.4%
All other	1,531	1,988	(457)	-23.0%	1,746	242	13.9%
Total other	**6,993**	**6,548**	**445**	**6.8%**	**6,006**	**542**	**9.0%**
Total noninterest expenses	**$ 27,856**	**$ 27,229**	**$ 627**	**2.3%**	**$ 24,473**	**$ 2,756**	**11.3%**

Leased employee salaries expenses have decreased as a result of the new joint venture entered into during the first quarter of 2008 (see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements). Exclusive of the effects of this joint venture, leased employee salaries expenses have increased due to annual merit increases and the continued growth of the Corporation. Despite the reduction in salaries as a result of the above mentioned joint venture, leased employee benefits increased as a result of continued increases in health care costs.

A significant portion of the increase in occupancy and equipment is related to additional expenses incurred for snowplowing during the fourth quarter of 2008. This increase was offset by a decline in building rent, due to the new joint venture.

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The increase in furniture and equipment expense in 2008 was primarily the result of increases in ATM and debit card expenses. These increases were the result of increased usage of debit cards by the Bank s customers, as the Bank incurs a fee each time a card is used.

Management has been diligently working to decrease audit and Sarbanes Oxley (SOX) compliance fees through improved efficiencies. These fees have steadily declined over the past few years as a result of the centralization of corporate processes.

The increases in director fees in 2007 were the result of additional meetings related to ongoing strategic planning, which was partially related to the acquisition of Greenville Community Financial Corporation and the joint venture with Corporate Title, LLC (see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements).

The Corporation places a strong emphasis on continuing education. These educational programs help provide team members with a competitive edge in the market place. Over the past three years, the Corporation offered structured leadership training to its employees. This program is designed to help develop and optimize the communication skills of its participants. Management feels that this investment in its employees today will pay dividends for years to come.

The increase in the amortization of deposit premium is related to the January 2008 acquisition of GCFC.

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

FDIC insurance expense has increased not only as a result of growth of the Corporation, but primarily as a result of increases in the premium rates charged by the Federal Deposit Insurance Corporation. These expenses are expected to significantly increase in 2009 as a result of further premium increases.

Consulting fees increased in 2008 primarily as a result of a potential new branch location study that was performed.

All other expenses include title insurance expenses as well as other miscellaneous expenses. All other expenses decreased by $222 as a result of the new joint venture (see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements). The main reasons for the increase in this line item in 2007 were related to expenses of approximately $130 incurred to convert the Farwell Division to Isabella Bank s core banking platform in August of 2007. The remaining changes in other expenses are individually not significant.

The increase in total noninterest expenses from 2006 to 2007 was partially the result of the acquisition of Farwell State Savings Bank in October 2006. Exclusive of the effects of the acquisition, total noninterest expenses increased 4.9%, with no individually significant changes when comparing 2007 to 2006.

Federal Income Taxes

Federal income tax (benefit) expense for 2008 was ($724) or (21.4%) of pre-tax income compared to $1,605 or 16.8% of pre-tax income in 2007 and $1,919 or 21.5% in 2006. The primary factor behind the reduction in the effective rate in 2008 and 2007 is related to the increase in tax exempt income as a percentage of net income. A reconcilement of actual federal income tax expense reported and the amount computed at the federal statutory rate of 34% is found in Note 12, Federal Income Taxes , of Notes to Consolidated Financial Statements.

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ANALYSIS OF CHANGES IN FINANCIAL CONDITION

As shown in the following tables, the Corporation experienced another year of solid asset growth. This growth has been the result of the Corporation s continued growth strategies, including the GCFC acquisition. See below for further discussion.

	December 31			
	2008	2007	$ Change	% Change
ASSETS				
Cash and cash equivalents	$ 23,554	$ 25,583	$ (2,029)	-7.93%
Trading account securities	21,775	25,064	(3,289)	-13.12%
Securities available for sale	246,455	213,127	33,328	15.64%
Mortgage loans available for sale	898	2,214	(1,316)	-59.44%
Loans	735,385	612,687	122,698	20.03%
Allowance for loan losses	(11,982)	(7,301)	(4,681)	64.11%
Bank premises and equipment	23,231	22,516	715	3.18%
Acquisition intangibles, net	47,804	27,010	20,794	76.99%
Equity securities without readily determinable fair values	17,345	7,353	9,992	135.89%
Other assets	34,798	29,029	5,769	19.87%
TOTAL ASSETS	**$ 1,139,263**	**$ 957,282**	**$ 181,981**	**19.01%**
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities				
Deposits	$ 775,630	$ 733,473	$ 42,157	5.75%
Other borrowed funds	222,350	92,887	129,463	139.38%
Escrow funds payable		1,912	(1,912)	-100.00%
Accrued interest and other liabilities	6,807	5,930	877	14.79%
Total liabilities	**1,004,787**	**834,202**	**170,585**	**20.45%**
Shareholders equity	**134,476**	**123,080**	**11,396**	**9.26%**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,139,263**	**$ 957,282**	**$ 181,981**	**19.01%**

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Analysis of changes in financial condition (excluding the effects of the acquisition of GCFC on January 1, 2008 to make the year-to-year comparisons more useful)

	December 31			
	2008	2007	$ Change	% Change
ASSETS				
Cash and cash equivalents	$ 21,090	$ 25,583	$ (4,493)	-17.56%
Trading account securities	16,796	25,064	(8,268)	-32.99%
Securities available for sale	239,448	213,127	26,321	12.35%
Mortgage loans available for sale	898	2,214	(1,316)	-59.44%
Loans	646,772	612,687	34,085	5.56%
Allowance for loan losses	(11,982)	(7,301)	(4,681)	64.11%
Bank premises and equipment	21,177	22,516	(1,339)	-5.95%
Acquisition intangibles, net	47,804	27,010	20,794	76.99%
Equity securities without readily determinable fair values	16,937	7,353	9,584	130.34%
Other assets	32,336	29,029	3,307	11.39%
TOTAL ASSETS	**$ 1,031,276**	**$ 957,282**	**$ 73,994**	**7.73%**
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities				
Deposits	$ 685,479	$ 733,473	$ (47,994)	-6.54%
Other borrowed funds	216,725	92,887	123,838	133.32%
Escrow funds payable		1,912	(1,912)	-100.00%
Accrued interest and other liabilities	6,661	5,930	731	12.33%
Total liabilities	**908,865**	**834,202**	**74,663**	**8.95%**
Shareholders equity	**122,411**	**123,080**	**(669)**	**-0.54%**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,031,276**	**$ 957,282**	**$ 73,994**	**7.73%**

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

Trading account securities

As previously mentioned, the Corporation commenced a balance sheet reorganization strategy in 2007 which resulted in a transfer of available-for-sale securities to trading securities. The Corporation s overall intent was to maintain a trading portfolio to enhance the ongoing restructuring of assets and liabilities as part of our interest rate risk management objectives (See Note 3 of the Consolidated Financial Statements).

Available-for-sale Investment Securities

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

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

		December 31	
	2008	2007	2006
Available-for-sale			
U.S. Government and federal agencies	$ 67,071	$ 54,239	$ 69,020
States and political subdivisions	149,323	130,956	112,754
Corporate	7,145	12,000	11,053
Money market preferred securities	5,979	12,300	
Mortgage-backed	16,937	3,632	20,623
Total	$ 246,455	$ 213,127	$ 213,450

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

	December 31	
	2008	2007
Trading Securities		
U.S. Government and federal agencies	$ 4,014	$ 4,024
States and political subdivisions	11,556	10,324
Corporate	160	1,004
Mortgage-backed	6,045	9,712
Total	$ 21,775	$ 25,064

Excluding those holdings of the investment portfolio in U.S. Government and federal agencies, there were no investments in securities of any one issuer that exceeded 10% of shareholders equity. The Corporation has a policy prohibiting investments in securities that it deems are unsuitable due to their inherent credit or market risks. Prohibited investments include stripped mortgage backed securities, zero coupon bonds, nongovernment agency asset backed securities, and structured notes.

The Corporation has invested $11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at fair value. Due to recent events, the credit markets for these investments have become illiquid.

Due to the current illiquidity of these securities, the fair values were estimated utilizing a discounted cash flow analysis or other type of valuation adjustment methodology as of December 31, 2008. 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 positive intent and ability to hold such securities until credit markets improve. These securities were also compared, when possible, to other securities with similar characteristics (see Note 4 of Notes to Consolidated Financial Statements).

The following is a schedule of maturities of available for sale investment securities (at carrying value) and their weighted average yield as of December 31, 2008. Weighted average yields have been computed on a fully taxable-equivalent basis using a tax rate of 34%. Mortgage-backed securities and collateralized mortgage obligations are included in maturity categories based on their stated maturity date. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Trading securities have been excluded as they are not expected to be held to maturity.

	Maturing							
	Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years		After Ten Years	
	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)	Amount	Yield (%)
Available-for-sale								
U.S. Government and federal agencies	$ 4,083	3.29	$ 37,324	4.40	$ 25,664	4.82	$	
States and political subdivisions	9,956	5.14	37,564	5.59	54,494	5.70	47,309	4.92
Mortgage-backed	25	2.79	361	5.33	2,459	5.34	14,092	4.86
Money market preferred securities	5,979	4.12						
Corporate	7,145	5.67						
Total	**$ 27,188**	**4.76**	**$ 75,249**	**5.00**	**$ 82,617**	**5.41**	**$ 61,401**	**4.90**

Loans

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

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

	2008	2007	2006	2005	2004
Commercial	$ 324,806	$ 238,306	$ 212,701	$ 179,541	$ 146,152
Agricultural	58,003	47,407	47,302	49,424	49,179
Residential real estate mortgage	319,397	297,937	300,650	226,251	227,421
Installment	33,179	29,037	30,389	28,026	30,143
	$ 735,385	$ 612,687	$ 591,042	$ 483,242	$ 452,895

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

	2008		2007		2006	
	$ Change	% Change	$Change	% Change	$ Change	% Change
Commercial	$ 86,500	36.3%	$ 25,605	12.0%	$ 33,160	18.5%
Agricultural	10,596	22.4%	105	0.2%	(2,122)	-4.3%
Residential real estate mortgage	21,460	7.2%	(2,713)	-0.9%	74,399	32.9%
Installment	4,142	14.3%	(1,352)	-4.4%	2,363	8.4%

	$ 122,698	20.0%	$ 21,645	3.7%	$ 107,800	22.3%

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The following table presents the change in loan categories between December 31, 2008 and December 31, 2007, excluding the loans acquired from GCFC:

	Consolidated 12/31/08	Less loans acquired from GCFC	Adjusted Consolidated 12/31/08	Consolidated 12/31/07	$ Change	% Change
Commercial	$ 324,806	$ 44,605	$ 280,201	$ 238,306	$ 41,895	17.6%
Agricultural	58,003		58,003	47,407	10,596	22.4%
Residential real estate mortgage	319,397	37,142	282,255	297,937	(15,682)	-5.3%
Installment	33,179	6,866	26,313	29,037	(2,724)	-9.4%
	$ 735,385	$ 88,613	$ 646,772	$ 612,687	$ 34,085	5.6%

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

Excluding the effects of the Greenville acquisition, residential mortgage loans declined during 2008 as a result of a shift in demand from balloon mortgages to long term fixed rate (typically 30 year) mortgage products. This triggered a decrease in residential mortgage loans as loans with maturity dates greater than 15 years are typically sold to the Federal Home Loan Mortgage Corporation (Freddie Mac). Installment loans have been steadily decreasing over the past few years. This is a result of the increased competition from credit unions and financing offered from other non traditional financial institutions. Management expects both residential mortgages and installment loans to decrease during 2009.

A substantial portion of the increase in total loans when December 31, 2006 is compared to 2005, most notably the increase in residential real estate mortgages, was the result of the acquisition of the Farwell State Savings Bank in October 2006. Pursuant to the acquisition, the Corporation purchased gross loans totaling $64,600.

Bank Premises and Equipment

Exclusive of the effects of the GCFC acquisition, Bank premises and equipment and escrow funds payable have declined as a result of the merger of assets and liabilities between IBT Title and Insurance Agency and Corporate Title Agency, LLC through a joint venture transaction (see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements), resulting in a reduction in such assets and liabilities.

Equity securities without readily determinable fair values

Equity securities without readily determinable fair values includes Federal Home Loan Bank Stock and Federal Reserve Bank Stock. The Corporation has purchased additional shares of stock in 2008 as a result of the consolidation of the Bank s charter as well as to fulfill stock requirements to borrow additional funds from the Federal Home Loan Bank. Also included in the increase is the Corporation s investment in the joint venture between IBT Title and Insurance Agency and Corporate Title Agency, LLC, which is accounted for under the equity method of accounting (see Note 2 Business Combinations and Joint Venture Formation of Notes to Consolidated Financial Statements).

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Deposits

The main source of funds for the Corporation is deposits. The deposit portfolio represents various types of non transaction accounts as well as savings accounts and time deposits.

The following table presents the composition of our deposit portfolio as of December 31:

	2008	2007	2006	2005	2004
Noninterest bearing demand deposits	$ 97,546	$ 84,846	$ 83,902	$ 73,839	$ 65,736
Interest bearing demand deposits	113,973	105,526	111,406	104,251	101,362
Savings deposits	182,523	196,682	178,001	153,397	162,516
Certificates of deposit	340,976	311,976	320,226	250,246	234,262
Brokered certificates of deposit	28,185	28,197	27,446	7,076	
Internet certificates of deposit	12,427	6,246	4,859	3,669	
Total	$ 775,630	$ 733,473	$ 725,840	$ 592,478	$ 563,876

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

	2008		2007		2006	
	$ Change	% Change	$ Change	% Change	$ Change	% Change
Noninterest bearing demand deposits	$ 12,700	15.0%	$ 944	1.1%	$ 10,063	13.6%
Interest bearing demand deposits	8,447	8.0%	(5,880)	-5.3%	7,155	6.9%
Savings deposits	(14,159)	-7.2%	18,681	10.5%	24,604	16.0%
Certificates of deposit	29,000	9.3%	(8,250)	-2.6%	69,980	28.0%
Brokered certificates of deposit	(12)	0.0%	751	2.7%	20,370	100.0%
Internet certificates of deposit	6,181	99.0%	1,387	28.5%	1,190	100.0%
Total	$ 42,157	5.7%	$ 7,633	1.1%	$ 133,362	22.5%

The following table presents the change in deposit categories between December 31, 2008 and 2007, excluding the deposits acquired from GCFC:

	Consolidated 12/31/08	Less deposits acquired from GCFC	Adjusted Consolidated 12/31/08	Consolidated 12/31/07	$ Change	% Change
Noninterest bearing demand deposits	$ 97,546	$ 10,251	$ 87,295	$ 84,846	$ 2,449	2.9%
Interest bearing demand deposits	113,973	12,236	101,737	105,526	(3,789)	-3.6%
Savings deposits	182,523	10,735	171,788	196,682	(24,894)	-12.7%
Certificates of deposit	340,976	39,911	301,065	311,976	(10,911)	-3.5%
Brokered certificates of deposit	28,185	8,976	19,209	28,197	(8,988)	-31.9%

Internet certificates of deposit	12,427	8,042	4,385	6,246	(1,861)	-29.8%
Total	$ 775,630	$ 90,151	$ 685,479	$ 733,473	$ (47,994)	-6.5%

As shown in the preceding table, exclusive of the effects of the GCFC acquisition, the Corporation has observed a decline in deposits during 2008. This decline has been the result of increased competition with other depository institutions as well as declines in brokered certificates of deposit and internet certificates of deposit. Deposits also declined due to well publicized bank failures, the collapse of the investment banking industry, and uncertainty of the public in the financial condition of banks in general. The decrease in savings accounts is the result of large deposit customers looking for a secure investment that is fully insured. As a result, the Corporation expanded its repurchase sweep products to meet customers needs. Since December 31, 2007, these repurchase agreements have increased by $41,449; due to the nature of these accounts, they are classified as borrowings.

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

	2008		2007		2006	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand deposits	$ 95,552		$ 80,128		$ 73,650	
Interest bearing demand deposits	114,889	0.71%	109,370	1.72%	105,476	1.58%
Savings deposits	213,410	1.14%	188,323	2.25%	158,327	1.69%
Time deposits	393,190	4.23%	349,941	4.71%	301,593	4.25%
Total	$ 817,041		$ 727,762		$ 639,046	

The time remaining until maturity of time certificates and other time deposits of $100 or more at December 31, 2008 was as follows:

Maturity	
Within 3 months	$ 36,650
Within 3 to 6 months	15,550
Within 6 to 12 months	37,207
Over 12 months	52,015
Total	**$ 141,422**

Borrowed Funds

As a result of the Corporation s recent loan growth, the desire to increase its investment in high quality tax exempt municipal bonds, and the increased level of competition for deposits, the Corporation has increased its other borrowings significantly over the past year. Included in the increase in other borrowed funds is an increase of $41,449 in repurchase agreements (see deposit discussion above). Management does anticipate that the Corporation will continue to increase its borrowings throughout 2009 (See Note 10 of Notes to Consolidated Financial Statements).

Capital

The capital of the Corporation consists solely of common stock, retained earnings, and accumulated other comprehensive income / (loss). The Corporation offers dividend reinvestment and employee and director stock purchase plans. Under the provisions of these Plans, the Corporation issued 78,994 shares of common stock generating $2,879 of capital during 2008, and 63,233 shares of common stock generating $2,657 of capital in 2007. The Corporation also offers share-based payment awards through its equity compensation plan (See Note 17 of Notes to Consolidated Financial Statements). Pursuant to this plan, the Corporation generated $603 and $758 of capital in 2008 and 2007, respectively.

In October 2002, the Board of Directors authorized management to repurchase up to $2,000 in dollar value of the Corporation s common stock. In March 2007, the Board of Directors amended this plan which allowed for the repurchase of up to 150,000 of additional shares. In May and July 2008 they further amended the plan to allow for the repurchase of an additional 25,000 and 5,000 shares, respectively. During 2008 and 2007, the Corporation repurchased 148,336 shares of common stock at an average price of $43.41 and 43,220 shares of common stock at an average price of $43.51, respectively. There were no shares repurchased in 2006.

Accumulated other comprehensive loss increased $5,303 in 2008 and consists of a $3,771 increase in unrealized loss on available-for-sale investment securities and a $1,532 increase in unrecognized pension cost of the defined benefit pension plan. These amounts are net of tax.

The Federal Reserve Board s current recommended minimum primary capital to assets requirement is 6.0%. The Corporation s primary capital to average assets ratio, which consists of shareholders equity plus the allowance for loan losses less acquisition intangibles, was 9.26% at year end 2008. There are no commitments for significant capital expenditures.

The Federal Reserve Board has established a minimum risk based capital standard. Under this standard, a framework has been established that assigns risk weights to each category of on and off-balance-sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum standard to determine whether a corporation has adequate capital. The minimum standard is 8%, of which at least 4% must consist of equity capital net of goodwill. The following table sets forth the percentages required under the Risk Based Capital guidelines and the Corporation s values at December 31, 2008:
Percentage of Capital to Risk Adjusted Assets:

	Isabella Bank Corporation December 31, 2008	
	Required	Actual
Equity Capital	4.00%	12.27%
Secondary Capital	4.00%	1.25%
Total Capital	8.00%	13.52%

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 also prescribes minimum capital requirements for the Corporation s subsidiary Bank. At December 31, 2008, the Bank exceeded these minimums. For further information regarding the Bank s capital requirements, refer to Note 16 of the Consolidated Financial Statements, Minimum Regulatory Capital Requirements .

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, 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.

Following is a description of the valuation methodologies used for assets and liabilities recorded at fair value.
Investment Securities: Investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets, mortgage-backed securities issued by government-sponsored entities and money market funds. Level 2 securities include municipal bonds and corporate

debt securities in

active markets. Securities classified as Level 3 include securities in less liquid markets, including illiquid markets in some instances, and include certain municipal securities and money market preferred auction rate securities.

The Corporation has invested $11,000 in auction rate money market preferred 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 2008. The fair values of these securities were estimated utilizing a discounted cash flow analysis or other type of valuation adjustment methodology as of December 31, 2008. 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 positive intent and ability to hold such securities until credit markets improve, as further described in Note 4 of Notes to Consolidated Financial Statements.

Loans Available-for-Sale: Loans available for sale are carried at the lower of cost or market value. The fair value of loans held-for-sale is based on what price secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies loans subjected to nonrecurring fair value adjustments as Level 2.

Loans: The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2008, impaired loans were evaluated based on the fair value of the collateral or based on the net present value of their expected cash flows. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or the impairment is determined using the net present value of the expected cash flows, the Corporation classifies the impaired loan as nonrecurring Level 3.

Foreclosed Assets: Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management s estimation of the value of the collateral. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation classifies the foreclosed asset as nonrecurring Level 3.

Equity Securities Without Readily Determinable Fair Values: The Corporation has investments in equity securities without readily determinable fair values as well as an investment in a joint venture. The assets are individually reviewed for impairment on an annual basis by comparing the carrying value to the estimated fair value. The lack of an independent source to validate fair value estimates, including the impact of future capital calls and transfer restrictions, is an inherent limitation in the valuation process. The Corporation classifies nonmarketable equity securities and its investment in a joint venture subjected to nonrecurring fair value adjustments as Level 3. During 2008 and 2007, there were no impairments recorded on equity securities without readily determinable fair values.

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

Goodwill and Other Intangible Assets: Goodwill and identified intangible assets are subject to impairment testing. A projected cash flow valuation method is used in the completion of impairment testing. This valuation method requires a significant degree of management judgment. In the event the projected undiscounted net operating cash flows are less than the carrying value, the asset is recorded at fair value as determined by the valuation model. If the testing resulted in impairment, the Corporation would classify goodwill and other intangible assets subjected to nonrecurring fair value adjustments as Level 3. During 2008 and 2007, there were no impairments recorded on goodwill and other intangible assets.

Other Borrowed Funds: The Corporation has elected to measure a portion of other borrowed funds at their fair value. These borrowings are recorded at fair value on a recurring basis, with the fair value measurement being based upon quoted prices. Changes in the fair value of these borrowings are included in noninterest income. As such, the Corporation classifies other borrowed funds as Level 2.

During 2008, primarily as a result of declines in the rates offered on new residential mortgage loans, the Corporation recorded impairment charges of $115 related to the carrying value of its mortgage servicing rights, 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.

The impairment charges to foreclosed assets were the result of the real estate held declining in value subsequent to the properties being transferred to other real estate.

Liquidity

The primary sources of the Corporation s liquidity are cash and cash equivalents, trading securities, and available-for-sale investment securities, excluding money market preferred securities in 2008 due to their illiquidity as of December 31, 2008. These categories totaled $285,805 or 25.0% of assets as of December 31, 2008 as compared to $263,774 or 27.6% in 2007. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests and various other commitments discussed in the accompanying notes to consolidated financial statements. Liquidity varies significantly daily, based on customer activity.

Operating activities provided $20,661 of cash in 2008 as compared to $60,387 in 2007. The reduction in net cash provided by operating activities was the result of the Corporation reducing its trading portfolio by $8,513 in 2008 as compared to $53,235 in 2007. Net cash provided by financing activities equaled $66,038 in 2008 and $38,470 in 2007, and was primarily the result of increases in other borrowed funds during 2008. The Corporation s investing activities used cash amounting to $88,728 in 2008 and $104,633 in 2007. The accumulated effect of the Corporation s operating, investing, and financing activities used $2,029 and $5,776 of cash in 2008 and 2007, respectively.

The primary source of funds for the Bank is deposits. The Bank emphasizes interest-bearing time deposits as part of their 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.

In recent periods, the Corporation has experienced some competitive challenges in obtaining additional deposits to fuel growth. As depositors continue to have wider access to the Internet and other real-time interest rate monitoring resources, deposit sourcing and pricing has become more competitive. Deposit growth is achievable, but at a competitive price. As a result of this increased competition, the Corporation (as discussed above) has begun to rely more and more on brokered, internet deposits, and other borrowed funds as a key funding source.

In addition to these primary sources of liquidity, the Corporation has the ability to borrow from the Federal Home Loan Bank, the Federal Reserve Bank, and through various correspondent banks as fed funds. As of December 31, 2008, the Corporation had the capacity to borrow up to $50,809 from the Federal Home Loan Bank based upon the current Board of Director approved limits.. The Corporation s liquidity is considered adequate by the management of the Corporation.

Interest Rate Sensitivity

Interest rate sensitivity is determined by the amount of earning assets and interest bearing liabilities repricing within a specific time period, and their relative sensitivity to a change in interest rates. Management also strives to achieve reasonable stability in the net interest margin through periods of changing interest rates. One tool used by management to measure interest rate sensitivity is gap analysis. As shown in the following table, the gap analysis depicts the Corporation s position for specific time periods and the cumulative gap as a percentage of total assets. Investment securities and other investments are scheduled according to their contractual maturity. Fixed rate loans are included in the appropriate time frame based on their scheduled amortization. Variable rate loans are included in the time frame of their earliest repricing. Of the $735,385 in total loans, $156,389 are variable rate loans. Time deposit liabilities are scheduled based on their contractual maturity except for variable rate time deposits in the amount of $1,813 that are included in the 0 to 3 month time frame.

Savings, NOW accounts, and money market accounts have no contractual maturity date and are believed to be predominantly noninterest rate sensitive by management. These accounts have been classified in the gap table according to their estimated withdrawal rates based upon management s analysis of deposit runoff over the past five years. Management believes this runoff experience is consistent with its expectation for the future. As of December 31, 2008, the Corporation had $69,230 more liabilities than assets maturing within one year. A negative gap position results when more liabilities, within a specified time frame, mature or reprice than assets.

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INTEREST RATE SENSITIVITY

The following table shows the time periods and the amount of assets and liabilities available for interest rate repricing as of December 31, 2008. The interest rate sensitivity information for investment securities is based on the expected prepayments and call dates versus stated maturities. For purposes of this analysis, nonaccrual loans and the allowance for loan losses are excluded.

	0 to 3 Months	4 to 12 Months	1 to 5 Years	Over 5 Years
Interest Sensitive Assets				
Trading securities	$ 21,775	$	$	$
Investment securities	32,312	50,540	57,075	106,528
Loans	187,926	94,142	384,450	57,692
Total	**$ 242,013**	**$ 144,682**	**$ 441,525**	**$ 164,220**
Interest Sensitive Liabilities				
Borrowed funds	$ 55,659	$ 39,500	$ 97,191	$ 30,000
Time deposits	79,488	161,477	139,034	1,589
Savings	36,670	35,706	110,147	
Interest bearing demand	28,114	19,311	66,548	
Total	**$ 199,931**	**$ 255,994**	**$ 412,920**	**$ 31,589**
Cumulative gap (deficiency)	$ 42,082	$ (69,230)	$ (40,625)	$ 92,006
Cumulative gap (deficiency) as a % of assets	3.69%	(6.08)%	(3.57)%	8.08%

The following table shows the maturity of commercial and agricultural loans outstanding at December 31, 2008. Also provided are the amounts due after one year, classified according to the sensitivity to changes in interest rates.

	Due in			
	1 Year or Less	1 to 5 Years	Over 5 Years	Total
Commercial and agricultural	$ 95,292	$ 262,546	$ 24,971	$ 382,809
Interest Sensitivity				
Loans maturing after one year that have:				
Fixed interest rates		$ 223,957	$ 23,425	
Variable interest rates		38,589	1,546	
Total		$ 262,546	$ 24,971	

Item 7 A. Quantitative and Qualitative Disclosures about Market Risk

The Corporation s primary market risks are interest rate risk and liquidity risk. The Corporation has no significant foreign exchange risk, holds limited loans outstanding to oil and gas concerns, and does not utilize interest rate swaps or derivatives, except for interest rate locks, in the management of its interest rate risk. Any changes in foreign exchange rates or commodity prices would have an insignificant impact, if any, on the Corporation s interest income and cash flows. The Corporation does have a significant amount of loans extended to borrowers in agricultural production. The cash flow of such borrowers and ability to service debt is largely dependent on 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 of the Corporation s net interest income, its primary source of income, to changes in interest rates. IRR results from the difference in the maturity or repricing frequency of a financial institution s interest earning assets and its interest bearing liabilities. IRR is the fundamental method in which financial institutions earn income and create shareholder value. Excessive exposure to IRR could pose a significant risk to the Corporation s earnings and capital.

The Federal Reserve Board, the Corporation s primary Federal regulator, has adopted a policy requiring the Board of Directors and senior management to effectively manage the various risks that can have a material impact on the safety and soundness of the Corporation. The risks include credit, interest rate, liquidity, operational, and reputational. The Corporation has policies, procedures and internal controls for measuring and managing these risks. Specifically, the IRR policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to the Board of Directors.

The Corporation uses several techniques to manage IRR. The first method is gap analysis. Gap analysis measures the cash flows and/or the earliest repricing of the Corporation s interest bearing assets and liabilities. This analysis is useful for measuring trends in the repricing characteristics of the balance sheet. Significant assumptions are required in this process because of the imbedded repricing options contained in assets and liabilities. A substantial portion of the Corporation s assets are invested in loans and investment securities with issuer call options. Loans 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 rate for residential mortgages, the level of sales of used homes, and the overall availability of credit in the market place. Generally, a decrease in interest rates will result in an increase in the Corporation s cash flows from these assets. A significant portion of the Corporation s securities are callable. The call option is more likely to be exercised in a period of decreasing interest rates. Investment securities, other than those that are callable, do not have any significant imbedded options. Savings and checking deposits may generally be withdrawn on request without prior notice. The timing of cash flows from these deposits is estimated based on historical experience. Time deposits have penalties that discourage early withdrawals.

The second technique used in the management of IRR is to combine the projected cash flows and repricing characteristics generated by the gap analysis and the interest rates associated with those cash flows to project future interest income. By changing the amount and timing of the cash flows and the repricing interest rates of those cash flows, the Corporation can project the effect of changing interest rates on its interest income. Based on the projections prepared for the year ended December 31, 2008, the Corporation s net interest income would increase during a period of decreasing interest rates.

The following tables provide information about the Corporation s assets and liabilities that are sensitive to changes in interest rates as of December 31, 2008 and 2007. The Corporation has no interest rate swaps, futures contracts, or other derivative financial options. The principal amounts of assets and time deposits maturing were calculated based on the contractual maturity dates. Savings and NOW accounts are based on management s estimate of their future cash flows.

(dollars in thousands)	December 31, 2008 2009	2010	2011	2012	2013	Thereafter	Total	Fair Value 12/31/08
Rate sensitive assets								
Other interest bearing assets	$ 575	$	$	$	$	$	$ 575	$ 575
Average interest rates	0.21%						0.21%	
Trading securities	$ 7,867	$ 4,902	$ 3,181	$ 2,937	$ 1,089	$ 1,799	$ 21,775	$ 21,775
Average interest rates	3.89%	3.57%	3.47%	2.74%	2.90%	3.11%	3.49%	
Fixed interest rate securities	$ 82,852	$ 13,043	$ 12,494	$11,247	$20,291	$106,528	$246,455	$246,455
Average interest rates	4.68%	4.78%	4.25%	4.20%	3.74%	3.69%	4.15%	
Fixed interest rate loans	$136,854	$105,529	$110,218	$80,163	$88,540	$ 57,692	$578,996	$598,703
Average interest rates	6.73%	6.78%	6.90%	7.20%	6.86%	6.34%	6.82%	
Variable interest rate loans	$ 61,795	$ 25,166	$ 16,524	$ 8,049	$27,505	$ 17,350	$156,389	$156,389
Average interest rates	5.32%	4.75%	5.27%	5.34%	4.45%	5.90%	5.14%	
Rate sensitive liabilities								
Borrowed funds	$ 95,159	$ 39,191	$ 21,000	$22,000	$15,000	$ 30,000	$222,350	$230,130
Average interest rates	1.11%	4.57%	3.63%	4.17%	3.93%	4.59%	2.92%	
Savings and NOW accounts	$119,801	$ 79,465	$ 63,274	$25,140	$ 8,816	$	$296,496	$296,496
Average interest rates	0.12%	0.27%	0.26%	0.20%	0.34%		0.20%	
Fixed interest rate time deposits	$239,152	$ 62,838	$ 29,771	$21,565	$24,860	$ 1,589	$379,775	$385,478
Average interest rates	3.47%	4.29%	4.55%	4.61%	4.18%	4.57%	3.81%	
Variable interest rate time deposits	$ 1,187	$ 626	$	$	$	$	$ 1,813	$ 1,813
Average interest rates	1.90%	1.67%					1.82%	

	December 31, 2007 2008	2009	2010	2011	2012	Thereafter	Total	Fair Value 12/31/07
Rate sensitive assets								
Other interest bearing assets	$ 1,457	$	$	$	$	$	$ 1,457	$ 1,457
Average interest rates	3.21%						3.21%	
	$ 9,342	$ 2,213	$ 3,269	$ 2,750	$ 2,820	$ 4,670	$ 25,064	$ 25,064

Trading securities								
Average interest rates	4.86%	4.86%	4.20%	4.34%	3.50%	6.98%	4.96%	
Fixed interest rate securities	$ 74,950	$24,122	$ 8,450	$ 8,082	$ 2,826	$94,697	$213,127	$213,127
Average interest rates	5.54%	4.98%	4.57%	3.99%	4.13%	3.94%	4.65%	
Fixed interest rate loans	$124,447	$99,132	$98,275	$78,152	$63,957	$58,037	$522,000	$523,454
Average interest rates	6.72%	6.65%	6.87%	7.25%	7.28%	6.50%	6.86%	
Variable interest rate loans	$ 41,596	$14,613	$18,792	$ 4,796	$ 6,435	$ 4,455	$ 90,687	$ 90,687
Average interest rates	7.94%	7.67%	7.66%	7.52%	7.31%	7.56%	7.75%	
Rate sensitive liabilities								
Borrowed funds	$ 30,387	$ 6,500	$24,000	$	$17,000	$15,000	$ 92,887	$ 91,897
Average interest rates	4.77%	4.34%	4.69%		4.19%	4.73%	4.61%	
Savings and NOW accounts	$132,008	$71,320	$69,183	$23,972	$ 5,725	$	$302,208	$302,208
Average interest rates	2.61%	1.15%	0.62%	0.59%	0.86%		1.62%	
Fixed interest rate time deposits	$226,090	$33,477	$42,835	$23,067	$18,853	$ 137	$344,459	$346,528
Average interest rates	4.61%	4.42%	4.53%	4.81%	4.63%	4.40%	4.60%	
Variable interest rate time deposits	$ 1,375	$ 585	$	$	$	$	$ 1,960	$ 1,960
Average interest rates	4.09%	4.10%					4.09%	

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Forward Looking Statements

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

Item 8. Financial Statements and Supplementary Data

The following consolidated financial statements of the