

ISABELLA BANK CORP  
Form DEF 14A  
April 10, 2009

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

**SCHEDULE 14A**

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

Filed by the Registrant   
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- Definitive Proxy Statement
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**ISABELLA BANK CORPORATION**

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(Name of Registrant as Specified In Its Charter)

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

**NOTICE OF THE ANNUAL MEETING OF SHAREHOLDERS  
To Be Held May 5, 2009**

Notice is hereby given that the Annual Meeting of Shareholders of Isabella Bank Corporation will be held on Tuesday, May 5, 2009 at 5:00 p.m. Eastern Standard Time, at the Comfort Inn, 2424 S. Mission Street, Mount Pleasant, Michigan. The meeting is for the purpose of considering and acting upon the following:

1. The election of four directors.
2. Such other business as may properly come before the meeting, or any adjournment or adjournments thereof.

The Board of Directors has fixed April 1, 2009 as the record date for determination of shareholders entitled to notice of, and to vote at, the meeting or any adjournments thereof.

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

By order of the Board of Directors

Debra Campbell, Secretary

Dated: April 10, 2009

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

**PROXY STATEMENT**

**General Information**

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Isabella Bank Corporation (the Corporation) a Michigan financial holding company, to be voted at the Annual Meeting of Shareholders of the Corporation to be held on Tuesday, May 5, 2009 at 5:00 p.m. at the Comfort Inn, 2424 S. Mission Street, Mount Pleasant, Michigan, or at any adjournment or adjournments thereof, for the purposes set forth in the accompanying Notice of Annual Meeting of Shareholders and in this Proxy Statement.

This Proxy Statement has been mailed on April 10, 2009 to all holders of record of common stock as of the record date. If a shareholder's shares are held in the name of a broker, bank or other nominee, then that party should give the shareholder instructions for voting the shareholder's shares.

**Voting at the Meeting**

The Board of Directors of the Corporation has fixed the close of business on April 1, 2009 as the record date for the determination of shareholders entitled to notice of, and to vote at, the Annual Meeting of Shareholders and any adjournment thereof. The Corporation has only one class of common stock and no preferred stock. As of April 1, 2009, there were 7,531,472 shares of common stock of the Corporation outstanding. Each outstanding share entitles the holder thereof to one vote on each separate matter presented for vote at the meeting. Shareholders may vote on matters that are properly presented at the meeting by either attending the meeting and casting a vote or by signing and returning the enclosed proxy. If the enclosed proxy is executed and returned, it may be revoked at any time before it is exercised at the meeting. All shareholders are encouraged to date and sign the enclosed proxy, indicate their choice with respect to the matters to be voted upon, and return it to the Corporation.

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

If a shareholder's shares are held in the name of a nominee, and the shareholder does not tell the nominee how to vote the shares (referred to as broker non-votes), then the nominee can vote them as they see fit only on matters that are determined to be routine and not on any other proposal. Broker non-votes will be counted as present to determine if a quorum exists but will not be counted as present and entitled to vote on any non-routine proposals.

In the election of directors, director nominees receiving a plurality of votes cast at the meeting will be elected directors of the Corporation. Shares not voted, including broker non-votes, have no effect on the election of directors.

**Election of Directors**

The Board of Directors is divided into three classes, with the directors in each class being elected for a term of three years. At the Annual Meeting of Shareholders, four directors will be elected for terms ending with the annual meeting

of shareholders in 2012.

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

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

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

### **Director Nominees for Terms Ending in 2012**

*Dennis P. Angner* (age 53) has been a director of the Corporation since 2000. He also serves as an ex-officio member of all of the Corporation's subsidiary Boards of Directors and the Finance and Planning Committee. Mr. Angner also serves on the Board of Financial Group Information Services. Mr. Angner has been President and CEO of the Corporation since December 30, 2001. Prior to his appointment as President and CEO, he served as Executive Vice President of the Corporation. Mr. Angner is the past Chair of the Michigan Bankers Association and has served on the Central Michigan American Red Cross board for over 20 years.

*David J. Maness* (age 55) has been a director of the Corporation since 2004, and serves on the Audit Committee, the Compensation and Human Resource Committee and is currently Chairperson on the Finance and Planning Committee. He also serves on the Board of Directors of Isabella Bank and is Chairperson of Financial Group Information Services. He is President of Maness Petroleum, a geological and geophysical consulting services company. Mr. Maness served as a school board member of the Mount Pleasant School board.

*W. Joseph Manifold* (age 57) has been a director of the Corporation since 2003, and serves on the Nominating and Corporate Governance Committee, the Compensation and Human Resource Committee, and serves as Chairperson of the Audit Committee. Mr. Manifold is a Certified Public Accountant and CFO of Federal Broach Holdings, a manufacturing company. Previously, he was a senior auditor with Ernst & Young Certified Public Accounting firm working principally on external bank audits and was CFO of the Delfield Corporation. Prior to joining Isabella Bank Corporation Mr. Manifold also served on the Isabella Community Credit Union Board and was Chair of the Mount Pleasant School board.

*William J. Strickler* (age 68) has been a director of the Corporation since 2002, and serves on the Nominating and Corporate Governance Committee, the Finance and Planning Committee, and the Compensation and Human Resource Committee. He has been a director of Isabella Bank since 1995 and is currently serving as Chairperson. Mr. Strickler is President of Michiwest Energy, an oil and gas producer. Prior to joining the Corporation and the Bank Board he served as a director of the National City Community Bank Board.

### **Current Directors with Terms Ending in 2010**

*James C. Fabiano* (age 65) has been a director of Isabella Bank since 1979 and of the Corporation since 1988, of which he is currently serving as Chairperson and is an ex-officio member of all corporate committees. He also serves as an ex-officio member of all subsidiary Boards of Directors of the Corporation and serves as Chairperson of the Compensation and Human Resource Committee. Mr. Fabiano is Chairman and CEO of Fabiano Brothers, Inc., a wholesale beverage distributor operating in several counties throughout Michigan. Mr. Fabiano is a past recipient of the Mount Pleasant Area Chamber of Commerce Citizen of the year award. He is also a past Chairman of Central Michigan University board of trustees.

*Dale D. Weburg* (age 65) has served on the Board of the Corporation since 2000 and is a member of the Financial Group Information Services Board of Directors. He also serves as the Chairperson for the Nominating and Corporate Governance Committee, serves on the Audit Committee, and the Compensation and Human Resource Committee. He

has been a director of the Breckenridge division of Isabella Bank since 1987, of which he is currently serving as Chairperson. Mr. Weburg is President of Weburg Farms, a cash crop farm operation. Mr. Weburg also serves as a trustee of the Board of Directors of Gratiot Health System.

*Theodore W. Kortes* (age 68) was appointed director of the Corporation on January 1, 2008, and serves on the Finance and Planning Committee and the Compensation and Human Resource Committee. He is a director and Chairperson of the Greenville division of Isabella Bank. Mr. Kortes was President and CEO of Greenville Community Bank and Greenville Community Financial Corporation since its founding in 1998, until his retirement in 2007.

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**Current Directors with Terms Ending in 2011**

*Richard J. Barz* (age 60) has been a director of the Corporation since 2002. He has been a director of Isabella Bank since 2000. Mr. Barz also serves on the Board of Financial Group Information Services and is a member of the Finance and Planning Committee. Mr. Barz has been President and CEO of Isabella Bank since December 30, 2001. Prior to his appointment as President and CEO he served as Executive Vice President of Isabella Bank.

*Sandra L. Caul* (age 65) has been a director of the Corporation since 2005. She currently serves as director of Isabella Bank, and serves on the Audit Committee, the Nominating and Corporate Governance Committee, and the Compensation and Human Resource Committee. Ms. Caul is Vice Chair of Central Michigan Community Hospital Board of Directors and is Chairperson of the Central Michigan American Red Cross. Ms. Caul retired in January 2005 as a state representative of the Michigan State House of Representatives. Ms. Caul is a registered nurse.

*W. Michael McGuire* (age 59) has been a director of the Corporation since 2007, and serves on the Audit Committee, Finance and Planning Committee, and the Compensation and Human Resource Committee. He is a director of the Farwell division of Isabella Bank. Mr. McGuire is currently an attorney and the Director of the Office of the Corporate Secretary and Assistant Secretary of The Dow Chemical Company, a manufacturer of chemicals, plastics and agricultural products.

Each of the directors has been engaged in their stated professions for more than five years. The principal occupation of Dennis P. Angner is with the Corporation, and he has been employed by Isabella Bank and/or the Corporation since 1984. Other executive officers of the Corporation include: Richard J. Barz, President of Isabella Bank, an employee of Isabella Bank and/or the Corporation since 1972; Timothy M. Miller (age 58), President of the Breckenridge division of Isabella Bank, an employee of Breckenridge division and/or the Corporation since 1985; Peggy L. Wheeler (age 49), Senior Vice President and Controller of the Corporation, employed by Isabella Bank and/or the Corporation since 1977; and Steven D. Pung (age 59), Chief Operations Officer of Isabella Bank, employed by Isabella Bank and/or the Corporation since 1978. All officers of the Corporation serve at the pleasure of the Board of Directors.

**Corporate Governance**

**Director Independence**

The Corporation has adopted the director independence standards as defined in NASDAQ Marketplace Rule 4200(a)(15). The Board has determined that James C. Fabiano, Dale D. Weburg, David J. Maness, W. Joseph Manifold, William J. Strickler, Sandra L. Caul, W. Michael McGuire, and Ted W. Kortess are independent directors. Dennis P. Angner is not independent as he is employed as President and Chief Executive Officer of the Corporation. Richard J. Barz is not independent as he is employed as President and Chief Executive Officer of Isabella Bank.

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

The Board of Directors of the Corporation met 14 times during 2008. All incumbent directors attended 75% or more of the meetings held in 2008. The Board of Directors has an Audit Committee, a Nominating and Corporate Governance Committee, a Compensation and Human Resource Committee, and a Finance and Planning Committee.

***Audit Committee***

The Audit Committee is composed of independent directors who meet the requirements for independence as defined in NASDAQ Marketplace Rule 4200(a)(15). Information regarding the functions performed by the Committee, its

membership, and the number of meetings held during the year, is set forth in the Report of the Audit Committee included elsewhere in this annual proxy statement. The Audit Committee is governed by a written charter approved by the Board of Directors and was included as Appendix A to the Corporation's proxy statement for the 2008 Annual Shareholder's Meeting.

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In accordance with the provisions of the Sarbanes Oxley Act of 2002, Director Manifold meets the requirements of Audit Committee Financial Expert and has been so designated by the Board of Directors. The committee also consists of directors Caul, Fabiano, Maness, McGuire and Weburg.

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

The Corporation has a standing Nominating and Corporate Governance Committee consisting of independent directors who meet the requirements for independence as defined in NASDAQ Marketplace Rule 4200(a) (15). The Committee consists of directors Caul, Fabiano, Manifold, Strickler and Weburg. The Nominating and Corporate Governance Committee met as a full board and held two meetings in 2008, and all directors attended 75% or more of the meetings in 2008. The Board of Directors has approved a Nominating and Corporate Governance Committee Charter and it was included as Appendix B to the Corporation's proxy statement for the 2008 Annual Shareholder's Meeting. The Nominating and Corporate Governance Committee is responsible for evaluating and recommending individuals for nomination to the Board of Directors for approval. In making its selections and recommendations, the Nominating and Corporate Governance Committee considers a variety of factors, which generally include the candidate's personal and professional integrity, independence, business judgment, and communication skills.

The Nominating and Corporate Governance Committee will consider as potential nominees, persons recommended by shareholders. Recommendations should be submitted in writing to the Secretary of the Corporation, 401 N. Main St., Mount Pleasant, Michigan 48858 and include the shareholder's name, address and number of shares of the Corporation owned by the shareholder. The recommendation should also include the name, age, address and qualifications of the recommended candidate for nomination. Recommendations for the 2010 Annual Meeting of Shareholders should be delivered no later than December 11, 2009. The Nominating and Corporate Governance Committee does not evaluate potential nominees for director differently based on whether they are recommended to the Nominating and Corporate Governance Committee by a shareholder or otherwise.

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

The Compensation and Human Resource Committee of the Corporation is responsible for reviewing and recommending to the Corporation's Board of Directors the compensation of the President and executive officers of the Corporation, benefit plans and the overall percentage increase in salaries. The committee consists of all independent directors, Fabiano, Caul, Kortess, McGuire, Maness, Manifold, Strickler, and Weburg. The Committee held one meeting during 2008 with all directors attending the meeting. This committee is governed by a written charter approved by the Board of Directors that was attached as Appendix A to the Corporation's proxy statement for the 2007 Annual Shareholder's Meeting.

### ***Finance and Planning Committee***

The Finance and Planning Committee evaluates new business opportunities and business acquisitions, assists management in establishing financial goals, reviews all strategic plans of subsidiaries to assure consistency with overall corporate goals, and reviews interest rate risks, credit risks and insurance coverage. The committee consists of directors Maness, Angner, Barz, Fabiano, Kortess, McGuire, and Strickler.

### ***Communications with the Board***

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

***Code of Ethics***

The Corporation has adopted a Code of Business Conduct and Ethics that is applicable to the Corporation's principal executive officer and the principal financial officer and controller. The Corporation's Code of Business Conduct and Ethics may be obtained free of charge by sending a request to Debra Campbell, Secretary, Isabella Bank Corporation, 401 N. Main St., Mount Pleasant, Michigan 48858.

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**Report of the Audit Committee**

The Audit Committee oversees the Corporation's financial reporting process on behalf of the Board of Directors. The Committee consists of directors Fabiano, Caul, Maness, Manifold, McGuire, and Weburg.

The Audit Committee is responsible for pre-approving all auditing services and permitted non-audit services over \$5,000 for the Corporation by its independent auditors or any other auditing or accounting firm, except as noted below. The Audit Committee has established general guidelines for the permissible scope and nature of any permitted non-audit services in connection with its annual review of the audit plan and reviews the guidelines with the Board of Directors.

Management has the primary responsibility for the consolidated financial statements and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited consolidated financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the consolidated financial statements. The Audit Committee also reviewed with management and the independent auditors, management's assertion on the design and effectiveness of the Corporation's internal control over financial reporting as of December 31, 2008.

The Audit Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited consolidated financial statements with accounting principles generally accepted in the United States of America, their judgments as to the quality, not just the acceptability, of the Corporation's accounting principles and such other matters as are required to be discussed with the Audit Committee by the standards of the Public Company Accounting Oversight Board (United States), including those described in AU Section 380

Communication with Audit Committees, as may be modified or supplemented. In addition, the Audit Committee has received the written disclosures and the letter from the independent accountants required by PCAOB Rule 3526, Communication with Audit Committees Concerning Independence, as may be modified or supplemented, and has discussed with the independent accountant the independent accountants' independence.

The Audit Committee discussed with the Corporation's internal and independent auditors the overall scope and plans for their respective audits. The Audit Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Corporation's internal controls and the overall quality of the Corporation's financial reporting process. The Audit Committee held four meetings during 2008, and all directors attended 75% or more of the meetings held in 2008.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors (and the Board has approved) that the audited consolidated financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2008 for filing with the Securities and Exchange Commission. The Audit Committee has appointed Rehmann Robson as the independent auditors for the 2009 audit.

Respectfully submitted,

W. Joseph Manifold, Audit Committee Chairperson  
James C. Fabiano  
David J. Maness  
Sandra L. Caul  
W. Michael McGuire  
Dale D. Weburg



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**Compensation Discussion and Analysis**

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

**Compensation Objectives**

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

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

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

**Elements of Compensation**

The Corporation's executive compensation program has consisted primarily of base salary and benefits, annual cash bonus incentives, stock awards, and participation in the Corporation's retirement plans.

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

*Base Salary and Benefits* are set to provide competitive levels of compensation to attract and retain officers with strong motivated leadership. Each officer's performance, current compensation and responsibilities within the Corporation are considered by the Committee when establishing base salaries. The Corporation also believes it is best to pay sufficient base salary because it believes an over-reliance on equity incentive compensation could potentially skew incentives toward short-term maximization of shareholder value as opposed to building long-term shareholder value. Base salary encourages management to operate the Corporation in a safe and sound manner even when incentive goals may prove unattainable.

*Annual Performance Incentives* are used to reward executive officers for the Corporation's overall financial performance. This element of the Corporation's compensation programs is included in the overall compensation in order to reward employees above and beyond their base salaries when the Corporation's performance and profitability

exceed established annual targets. The inclusion of incentive compensation encourages management to be more creative, diligent and exhaustive in managing the Corporation to achieve specified financial goals.

*Stock Awards* are also provided as stock awards are the element of compensation that is most effective in aligning the financial interests of management with those of shareholders and because stock awards are a traditional

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and well-proven element of compensation among community banks and bank holding companies. These stock awards are granted pursuant to the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors ( Directors Plan ), under which eligible executive officers elect to defer their director fees, which deferred fees are then converted, on a quarterly basis, into shares of the Corporation s common stock. The Corporation has established a Trust to fund the Directors Plan. The directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees into the Directors Plan.

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

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

The Committee s approach to determining the annual base salary of executive officers is to offer competitive salaries in comparison with other comparable financial institutions. The Committee utilized both an independent consultant to perform a compensation survey of similar sized Michigan based institutions for 2007 and compensation information provided by the Michigan Bankers Association for banks in the State of Michigan with assets over \$500 million to provide salary ranges for its executive officers. Specific factors used to decide where an executive officer s salary should be within the established range include the historical financial performance, financial performance outlook, years of service, and job performance.

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

- peer group financial performance compensation;
- 1 and 5 year shareholder returns;
- earnings per share and earnings per share growth;
- budgeted as compared to actual annual operating performance;
- community and industry involvement;
- results of audit and regulatory exams; and
- other strategic goals as established by the board of directors

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

Stock awards are granted pursuant to the Director s Plan, under which participants elect to defer their director fees, which director fees are then converted, on a quarterly basis, into shares of the Corporation s common stock based on the fair market value of a share of the Corporation s common stock at that time. Shares of stock credited to a

participant's account under the Directors' Plan are eligible for stock and cash dividends as payable.

Total compensation in 2008 was based on the committee targeting its executive officer's compensation to approximate the median of the ranges provided by independent consultants and Michigan Bankers Association surveys.

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

The Corporation has a 401(k) plan in which substantially all employees are eligible to participate. Employees may contribute up to 100% of their compensation subject to certain limits based on federal tax laws. As a result of the curtailment of the defined benefit plan noted above, the Corporation increased the contributions to the 401(k)

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plan effective January 1, 2007. The enhancement includes a discretionary 3.0% contribution for all eligible employees and matching contributions equal to 50% of the first 4.0% of an employee's compensation contributed to the Plan during the year.

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

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

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

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

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

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

## **Compensation and Benefits Committee Report**

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

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

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

James C. Fabiano, Chairperson  
Sandra L. Caul  
Ted W. Kortes

David J. Maness  
W. Joseph Manifold  
W. Michael McGuire  
William J. Strickler  
Dale D. Weburg

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Executive Officers of the Corporation are compensated in accordance with their employment with the applicable entity. The following table shows information on compensation earned from the Corporation or its subsidiaries for each of the last three fiscal years ended December 31, 2008, by the President and Chief Executive Officer, the Principal Financial Officer, and the corporation's three most highly compensated executive officers.

**Summary Compensation Table**

| Name and principal position   | Year | Salary<br>\$(1) | Bonus<br>\$(1) | Stock<br>Awards<br>(\$) | Change in<br>Pension<br>Value and<br>Non-Qualified<br>Deferred | All<br>Other          | Total<br>(\$) |
|---|------|-----------------|----------------|-------------------------|--|-----------------------|---------------|
|   |      |                 |                |                         | Earnings<br>\$(2)  | Compensation<br>\$(3) |               |
| Dennis P. Angner<br>President and CEO<br>of Isabella Bank Corporation   | 2008 | \$ 294,670      | \$ 9,450       | \$ 41,425               | \$ 28,089  | \$ 18,453             | \$ 392,087    |
|   | 2007 | 288,101         | 8,225          | 26,280                  | (7,000)  | 18,715                | 334,321       |
|   | 2006 | 255,237         | 10,000         | 16,228                  | 70,646   | 8,233                 | 360,344       |
| Peggy L. Wheeler<br>Principal Financial Officer,<br>Sr. Vice President<br>and Controller of<br>Isabella Bank Corporation          | 2008 | 105,000         | 3,500          |                         | 13,000   | 2,216                 | 123,716       |
|   | 2007 | 100,000         | 3,000          |                         | (3,000)  | 2,023                 | 102,023       |
|   | 2006 | 88,500          |                |                         | 14,339   | 685                   | 103,524       |
| Richard J. Barz<br>Executive Vice President of<br>Isabella Bank Corporation<br>President and CEO<br>Isabella Bank                 | 2008 | 300,785         | 9,100          | 32,490                  | 72,622   | 22,697                | 437,694       |
|   | 2007 | 274,706         | 7,875          | 18,125                  |  | 23,226                | 323,932       |
|   | 2006 | 237,175         | 14,400         | 15,100                  | 134,235  | 10,948                | 411,858       |
| Timothy M. Miller<br>Vice President of<br>Isabella Bank Corporation<br>President of the Breckenridge<br>division of Isabella Bank | 2008 | 160,145         | 3,200          | 6,715                   | 3,411  | 14,127                | 187,598       |
|   | 2007 | 155,171         |                | 7,880                   | (1,000)  | 14,167                | 176,218       |
|   | 2006 | 149,117         | 3,567          | 7,223                   | 17,030   | 5,778                 | 182,715       |
| Steven D. Pung(4)<br>Sr. Vice President and COO<br>Isabella Bank  | 2008 | 117,100         | 3,785          | 1,125                   | 45,884   | 13,169                | 181,063       |
|   | 2007 | 108,100         | 3,625          | 1,800                   |  | 14,194                | 127,719       |

(1) Includes compensation voluntarily deferred under the Corporation's 401(k) plan. Directors fees paid in cash are also included, for calendar years 2008, 2007 and 2006 respectively as follows: Dennis P. Angner \$14,670, \$23,870 and \$20,237; Richard J. Barz \$25,785, \$20,475 and \$12,175; and Timothy M. Miller \$17,445, \$20,940 and \$18,117.

- (2) For 2006, approximately 75% of the change in the present value of the defined benefit is related to prior service, a decrease in the assumed discount rate, and a change in the actuarial mortality table. Amounts were determined using assumptions consistent with those used in the Corporation's consolidated financial statements. The Board of Directors approved a curtailment of this plan in December 2006 effective March 1, 2007. Assumptions were consistent with those that were presented in the consolidated financial statements.
- (3) For all noted executives all other compensation includes 401(k) matching contributions. For Richard J. Barz and Steven D. Pung this also includes club dues and auto allowance. For Dennis P. Angner and Timothy M. Miller, this also includes auto allowance.
- (4) Not a named executive officer prior to 2007.

**Table of Contents****2008 Pension Benefits**

The following table indicates the present value of accumulated benefits as of December 31, 2008 for each named executive in the summary compensation table.

| <b>Name</b>       | <b>Plan Name</b>                                | <b>Number<br/>of<br/>Years of<br/>Credited<br/>Service as<br/>of<br/>01/01/09<br/>(#)</b> | <b>Present<br/>Value of<br/>Accumulated<br/>Benefit<br/>(\$)</b> | <b>Payments<br/>During<br/>Last<br/>Fiscal Year</b> |
|-------------------|---|---|--|---|
| Dennis P. Angner  | Isabella Bank Corporation Pension Plan          | 23  | \$ 297,000   | \$  |
|                   | Isabella Bank Corporation Retirement Bonus Plan | 23  | 177,570  |   |
| Peggy L. Wheeler  | Isabella Bank Corporation Pension Plan          | 28  | 79,000   |   |
|                   | Isabella Bank Corporation Retirement Bonus Plan | 28  | 46,134   |   |
| Richard J. Barz   | Isabella Bank Corporation Pension Plan          | 35  | 625,000  |   |
|                   | Isabella Bank Corporation Retirement Bonus Plan | 35  | 201,383  |   |
| Timothy M. Miller | Isabella Bank Corporation Pension Plan          | 6   | 64,000   |   |
| Steven D. Pung    | Isabella Bank Corporation Pension Plan          | 28  | 313,000  |   |
|                   | Isabella Bank Corporation Retirement Bonus Plan | 28  | 105,824  |   |

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

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

Pension plan benefits are based on years of service and the employee's five highest consecutive years of compensation out of the last ten years of service, effective through December 31, 2006.

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

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

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

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

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

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

**2008 Nonqualified Deferred Compensation**

| <b>Name</b>       | <b>Executive<br/>Contributions<br/>in<br/>Last FY<br/>(\$)</b> | <b>Aggregate<br/>Earnings in<br/>Last FY<br/>(\$)</b> | <b>Aggregate<br/>Balance at<br/>Last FYE<br/>(\$)</b> |
|-------------------|--|---|---|
| Dennis P. Angner  | \$ 41,425  | \$ 1,269  | \$ 85,930   |
| Peggy L. Wheeler  |  |   |   |
| Richard J. Barz   | 32,490   | 987   | 67,306  |
| Timothy M. Miller | 6,715  | 352   | 22,465  |
| Steven D. Pung    | 1,125  | 98  | 6,042   |

The directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees into the Directors' Plan and may defer up to 100% of their earned fees based on their annual election. These amounts are reflected in the 2008 nonqualified deferred compensation table above. Under the Directors' Plan, these deferred fees are converted on a quarterly basis into shares of the Corporation's common stock based on the fair market value of shares of the Corporation's common stock at that time. Shares credited to a participant's account are eligible for stock and cash dividends as payable.

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

**Potential Payments Upon Termination or Change in Control**

The estimated pay outs payable to each named executive officer upon severance from employment, retirement, termination upon death or disability or termination following a change in control of the Corporation are described below. For all termination scenarios, the amounts assume such termination took place as of December 31, 2008.

**Any Severance of Employment**

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

Amounts accrued and vested through the Defined Benefit Pension Plan.

Amounts accrued and vested through the Retirement Bonus Plan.

Amounts deferred in the Directors Plan.

Unused vacation pay.

**Retirement**

In the event of the retirement of an executive officer, the officer would receive the benefits identified above. As of December 31, 2008, the named executive officers listed had no unused vacation days.

**Table of Contents****Death or Disability**

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

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

| Name              | While an<br>Active<br>Employee | Subsequent to<br>Retirement |
|-------------------|--------------------------------|-----------------------------|
| Dennis P. Angner  | \$ 560,000                     | \$ 140,000                  |
| Peggy L. Wheeler  | 210,000                        | 105,000                     |
| Richard J. Barz   | 550,000                        | 275,000                     |
| Timothy M. Miller | 285,400                        | 142,700                     |
| Steven D. Pung    | 234,200                        | 117,100                     |

**Change in Control**

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

**Director Compensation**

The following table summarizes the Compensation of each non-employee director who served on the Board of Directors during 2008.

| Name               | Fees<br>Earned or<br>Paid in<br>Cash<br>(\$) | Stock<br>Awards<br>(\$) | Change in<br>Pension<br>Value<br>and Non-<br>Qualified<br>Deferred<br>Compensation<br>Earnings<br>(\$) | Total<br>(\$) |
|--------------------|--|-------------------------|--|---------------|
| Sandra Caul        | \$   | \$ 37,450               | \$ (174,451)   | \$ (137,001)  |
| James Fabiano      |  | 47,750                  | (482,948)  | (435,198)     |
| Ted Kortez         | 18,737                                       | 12,038                  | (3,429)  | 27,346        |
| David Maness       |  | 40,325                  | (79,544)   | (39,219)      |
| W. Joseph Manifold |  | 25,350                  | (55,389)   | (30,039)      |
| W. Michael McGuire |  | 30,275                  | (34,439)   | (4,164)       |

|                   |        |           |           |
|-------------------|--------|-----------|-----------|
| William Strickler | 51,499 | (215,151) | (163,652) |
| Dale Weburg       | 32,435 | (111,175) | (78,740)  |

The Corporation paid a \$6,000 retainer plus \$950 per board meeting to its directors during 2008 and \$225 per committee meeting attended.

The Corporation sponsors a nonqualified deferred compensation plan for directors (the Directors Plan ), pursuant to which the directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees. Under the Directors Plan, deferred directors fees are converted on a quarterly basis into shares of the Corporation s common stock, based on the fair market value of a share of the Corporation s common stock at that time. Shares of stock credited to a participant s account are eligible for cash and stock dividends as payable. Participants deferred \$483,405 under the Directors Plan in 2008.

Upon a participant s attainment of age 70, retirement from the board, or the occurrence of certain other events, the participant is eligible to receive a lump-sum, in-kind distribution of all of the stock that is then credited to his or

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her account. The plan does not allow for cash settlement. Stock issued under the Directors' Plan is restricted stock under the Securities Act of 1933, as amended.

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

The Corporation transferred \$248,693 to the Rabbi Trust in 2008, which held 5,248 shares of the Corporation's common stock for settlement as of December 31, 2008. As of December 31, 2008, there were 186,766 shares of stock credited to participants' accounts as adjusted for the 10% stock dividend paid on February 29, 2008, which credits are unfunded as of such date to the extent that they are in excess of the stock and cash that has been credited to the Trust. All amounts are unsecured claims against the Corporation's general assets. The net cost of this benefit to the Corporation was \$119,616 in 2008.

The following table displays the number of equity shares granted pursuant to the terms of the Directors' Plan as of December 31, 2008:

| <b>Name</b>         | <b># of Shares<br/>of Stock<br/>Granted</b> |
|---------------------|---|
| Dennis P Angner     | 2,368                                       |
| Richard J Barz      | 1,845                                       |
| Sandra Caul         | 13,074                                      |
| James Fabiano       | 35,657                                      |
| Ted Kortez          | 338   |
| David Maness        | 6,186                                       |
| W. Joseph Manifold  | 4,142                                       |
| W. Michael McGuire  | 2,813                                       |
| William J Strickler | 16,191                                      |
| Dale Weburg         | 8,382                                       |

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

The Compensation and Human Resource Committee of the Corporation is responsible for reviewing and recommending to the Corporation's Board of Directors the compensation of the President and executive officers of the Corporation, benefit plans and the overall percentage increase in salaries. The committee consists of directors Fabiano, Caul, Kortez, McGuire, Maness, Manifold, Strickler, and Weburg.

**Indebtedness of and Transactions with Management**

Certain directors and officers of the Corporation and members of their families were loan customers of Isabella Bank, or have been directors or officers of corporations, or partners of partnerships which have had transactions with the

subsidiary Bank. In management's opinion, all such transactions are made in the ordinary course of business and are substantially on the same terms, including collateral and interest rates, as those prevailing at the same time for comparable transactions with customers not related to the Bank. These transactions do not involve more than normal risk of collectability or present other unfavorable features. Total loans to these customers were approximately \$4,011,000 as of December 31, 2008. The Corporation addresses transactions with related parties in its *Code of Business Conduct and Ethics* policy. Conflicts of interest are prohibited as a matter of Corporation policy, except under guidelines approved by the Board of Directors or committees of the Board.

**Table of Contents****Security Ownership of Certain Beneficial Owners and Management**

As of April 1, 2009 the Corporation does not have any person who is known to the Corporation to be the beneficial owner of more than 5% of the common stock of the Corporation.

The following table sets forth certain information as of April 1, 2009 as to the common stock of the Corporation owned beneficially by each director and director nominee, by each named executive officer, and by all directors, director nominees and executive officers of the Corporation as a group. The shares to be granted from stock awards are not included in the table below.

| Name of Owner  | Amount and Nature of Beneficial Ownership |                                     |                            | Percentage of Common Stock Outstanding |
|--|---|-------------------------------------|----------------------------|--|
|  | Sole Voting and Investment Powers         | Shared Voting and Investment Powers | Total Beneficial Ownership |  |
| Dennis P. Angner*  | 20,946                                    |                                     | 20,946                     | 0.28%                                  |
| Richard J Barz*  | 23,915                                    |                                     | 23,915                     | 0.32%                                  |
| Sandra L. Caul   |   | 10,242                              | 10,242                     | 0.14%                                  |
| James C. Fabiano   | 250,930                                   | 6,059                               | 256,989                    | 3.42%                                  |
| Theodore W. Kortez   |   | 15,115                              | 15,115                     | 0.20%                                  |
| W. Joseph Manifold   | 543                                       |                                     | 543                        | 0.01%                                  |
| W. Michael McGuire   | 6,177                                     |                                     | 6,177                      | 0.08%                                  |
| David J. Maness  | 429                                       | 951                                 | 1,381                      | 0.02%                                  |
| William J. Strickler   | 78,126                                    | 13,029                              | 91,154                     | 1.21%                                  |
| Dale D. Weburg   | 25,642                                    | 29,969                              | 55,611                     | 0.74%                                  |
| Timothy M. Miller  | 77  | 2,946                               | 3,024                      | 0.04%                                  |
| Steven D. Pung   | 12,752                                    | 7,160                               | 19,912                     | 0.26%                                  |
| Peggy L. Wheeler   | 5,730                                     | 2,256                               | 7,986                      | 0.11%                                  |
| All Directors, nominees and Executive Officers as a Group (13 persons) | 425,268                                   | 87,727                              | 512,995                    | 6.83%                                  |

\* Trustees of the ESOP who vote ESOP stock.

**Independent Registered Public Accounting Firm**

The Audit Committee has appointed Rehmann Robson as the independent auditors of the Corporation for the year ending December 31, 2009.

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

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

The following table shows the aggregate fees billed by Rehmann Robson for the audit and other services provided to the Corporation for 2008 and 2007.

|                                  | <b>2008</b>       | <b>2007</b>       |
|----------------------------------|-------------------|-------------------|
| Audit Fees                       | \$ 238,275        | \$ 371,860        |
| Audit Related Fees               | 52,415            | 31,365            |
| Tax Fees                         | 65,257            | 28,750            |
| Other Professional Services Fees | 15,098            | 16,450            |
| <b>Total</b>                     | <b>\$ 371,045</b> | <b>\$ 448,425</b> |

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The audit fees were for performing the integrated audit of the Corporation's consolidated annual financial statements, and the audit of internal control over financial reporting, review of interim quarterly financial statements included in the Corporation's Forms 10-Q, auditing of the Corporation's employee benefit plans and services that are normally provided by Rehmann Robson in connection with statutory and regulatory filings or engagements. The audit fees have steadily declined over the past few years as a result of the centralization of corporate processes and diligently working on improving efficiencies related to Sarbanes Oxley (SOX) compliance.

The audit related fees for 2008 and 2007 were for regulatory filings and procedures related to the acquisition of Greenville Community Financial Corporation and for various discussions related to the adoption and interpretation of new accounting pronouncements.

The tax fees were for the preparation of the Corporation and its subsidiaries' state and federal tax returns and for consultation with the Corporation on various tax matters. The increase in the 2008 tax fees is primarily related to tax consulting for an audit conducted by the State of Michigan for Single Business Tax (SBT), the 2007 Greenville Community Financial Corporation final tax return preparation, and tax consulting related to the joint venture with CT/IBT Title (refer to Note 2 of the Corporation's consolidated financial statement).

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

## **Pre-approval Policies and Procedures**

All audit and non-audit services over \$5,000 to be performed by Rehmann Robson must be approved in advance by the Audit Committee. As permitted by the SEC's rules, the Audit Committee has authorized its Chairperson to pre-approve audit, audit-related, tax and non-audit services, provided that such approved service is reported to the full Audit Committee at its next meeting.

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

A schedule of additional services proposed to be provided by the independent auditor, or proposed revisions to services already approved, along with associated proposed fees, may be presented to the Audit Committee for their consideration and approval at any time. The schedule will be specific as to the nature of the proposed service, the proposed fee, and other details that the Audit Committee may request. The Audit Committee will by resolution authorize or decline authorization for each proposed new service.

Applicable SEC rules and regulations permit waiver of the pre-approval requirements for services other than audit, review or attest services if certain conditions are met. Out of the services characterized above as Audit-Related, Tax and Professional Services, none were billed pursuant to these provisions in 2008 and 2007 without pre-approval.

## **Shareholder Proposals**

Any proposals which shareholders of the Corporation intend to present at the next annual meeting of the Corporation must be received before December 11, 2009 to be considered for inclusion in the Corporation's proxy statement and

proxy for that meeting. Proposals should be made in accordance with Securities and Exchange Commission Rule 14a-8.

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

The Corporation's directors are encouraged to attend the annual meeting of shareholders. At the 2008 annual meeting, all directors were in attendance.

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

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

To the Corporation's knowledge, based solely on review of the copies of such reports furnished to the Corporation, during the year ended December 31, 2008 all Section 16(a) filing requirements were satisfied, with respect to the applicable officers, directors, and greater than 10 percent beneficial owners.

**Other Matters**

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

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

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

By order of the Board of Directors

Debra Campbell, Secretary

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**Isabella Bank Corporation**

**Financial Information Index**

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**Table of Contents****SUMMARY OF SELECTED FINANCIAL DATA**

|  | <b>2008</b>   | <b>2007</b> | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--|---|-------------|-------------|-------------|-------------|
|  | <b>(Dollars in thousands except per share data)</b> |             |             |             |             |
| <b>INCOME STATEMENT DATA</b>                 |   |             |             |             |             |
| 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       |
| <b>BALANCE SHEET DATA</b>                    |   |             |             |             |             |
| 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      |
| <b>PER SHARE DATA(1)</b>                     |   |             |             |             |             |
| 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       |
| <b>FINANCIAL RATIOS</b>                      |   |             |             |             |             |
| 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        |

|                                      | <b>2008</b> |            |            |            | <b>2007</b> |            |            |            |
|--------------------------------------|-------------|------------|------------|------------|-------------|------------|------------|------------|
|                                      | <b>4th</b>  | <b>3rd</b> | <b>2nd</b> | <b>1st</b> | <b>4th</b>  | <b>3rd</b> | <b>2nd</b> | <b>1st</b> |
| <b>Quarterly Operating Results:</b>  |             |            |            |            |             |            |            |            |
| Total interest income                | \$ 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      |
| <b>Per Share of Common Stock:(1)</b> |             |            |            |            |             |            |            |            |

|                             |           |         |         |         |         |         |         |         |  |
|-----------------------------|-----------|---------|---------|---------|---------|---------|---------|---------|--|
| 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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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Shareholders and Board of Directors  
Isabella Bank Corporation  
Mt. Pleasant, Michigan

We have audited the accompanying consolidated balance sheets of *Isabella Bank Corporation* as of December 31, 2008 and 2007, and the related consolidated statements of changes in shareholders' equity, income, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008. We also have audited *Isabella Bank Corporation's* internal control over financial reporting as of December 31, 2008, based on criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). *Isabella Bank Corporation's* management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the effectiveness of the *Isabella Bank Corporation's* internal control over financial reporting, based on our audits.

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

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

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

As described in Note 1 to the consolidated financial statements, effective January 1, 2008 the Corporation adopted EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. Also, as described in Notes 17 and 20 to the consolidated financial statements, effective January 1, 2007 the Corporation elected the early adoption of Statements of Financial

Accounting Standards (SFAS) No. s 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, and 157, *Fair Value Measurements*, and effective December 31, 2006 changed its method of accounting for defined benefit pension and other postretirement plans in accordance with SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans*.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Isabella Bank Corporation*** as of December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion ***Isabella Bank Corporation*** maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

Rehmann Robson, P.C.

Saginaw, Michigan  
March 6, 2009

Table of Contents**CONSOLIDATED FINANCIAL STATEMENTS****CONSOLIDATED BALANCE SHEETS**

|   | <b>December 31</b>            |                   |
|---|-------------------------------|-------------------|
|   | <b>2008</b>                   | <b>2007</b>       |
|   | <b>(Dollars in thousands)</b> |                   |
| <b>ASSETS</b>   |                               |                   |
| Cash and demand deposits due from banks   | \$ 23,554                     | \$ 25,583         |
| Trading securities  | 21,775                        | 25,064            |
| Investment securities available for sale (amortized cost of \$248,741 in 2008 and \$212,285 in 2007)                                    | 246,455                       | 213,127           |
| Mortgage loans available for sale   | 898                           | 2,214             |
| Net loans   |                               |                   |
| Loans   | 735,385                       | 612,687           |
| Less allowance for loan losses  | 11,982                        | 7,301             |
| <b>Total net loans</b>  | <b>723,403</b>                | <b>605,386</b>    |
| Premises and equipment  | 23,231                        | 22,516            |
| Corporate-owned life insurance policies   | 16,152                        | 13,195            |
| Accrued interest receivable   | 6,322                         | 5,948             |
| Acquisition intangibles and goodwill, net   | 47,804                        | 27,010            |
| Equity securities without readily determinable fair values  | 17,345                        | 7,353             |
| Other assets  | 12,324                        | 9,886             |
| <b>Total assets</b>   | <b>\$ 1,139,263</b>           | <b>\$ 957,282</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                               |                   |
| Deposits  |                               |                   |
| Noninterest bearing   | \$ 97,546                     | \$ 84,846         |
| NOW accounts  | 113,973                       | 105,526           |
| Certificates of deposit and other savings   | 422,689                       | 410,782           |
| Certificates of deposit over \$100,000  | 141,422                       | 132,319           |
| <b>Total deposits</b>   | <b>775,630</b>                | <b>733,473</b>    |
| Other borrowed funds (\$23,130 in 2008 and 7,523 in 2007 at fair value)   | 222,350                       | 92,887            |
| Escrow funds payable  |                               | 1,912             |
| Accrued interest and other liabilities  | 6,807                         | 5,930             |
| <b>Total liabilities</b>  | <b>1,004,787</b>              | <b>834,202</b>    |
| Shareholders Equity   |                               |                   |
| Common stock no par value 15,000,000 shares authorized; outstanding (including 5,248 shares to be issued) in 2008 and 6,364,120 in 2007 | 7,518,856                     | 112,547           |
| Shares to be issued for deferred compensation obligations   | 4,015                         | 3,772             |
| Retained earnings   | 2,428                         | 7,027             |

|  |                     |                   |
|--|---------------------|-------------------|
| Accumulated other comprehensive loss             | (5,569)             | (266)             |
| <b>Total shareholders equity</b>                 | <b>134,476</b>      | <b>123,080</b>    |
| <b>Total liabilities and shareholders equity</b> | <b>\$ 1,139,263</b> | <b>\$ 957,282</b> |

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

Table of Contents**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

|  | <b>Year Ended December 31</b> |                  |                  |
|--|-------------------------------|------------------|------------------|
|  | <b>2008</b>                   | <b>2007</b>      | <b>2006</b>      |
|  | <b>(Dollars in thousands)</b> |                  |                  |
| <b>Number of Shares of Common Stock Outstanding</b>  |                               |                  |                  |
| Balance at beginning of year   | 6,364,120                     | 6,335,861        | 4,974,715        |
| Common stock dividends   | 687,599                       |                  | 497,299          |
| Shares issued in exchange for bank acquisition   | 514,809                       |                  | 797,475          |
| Other issuances of common stock  | 100,664                       | 71,479           | 66,372           |
| Common stock repurchased   | (148,336)                     | (43,220)         |                  |
| <b>Balance end of year</b>   | <b>7,518,856</b>              | <b>6,364,120</b> | <b>6,335,861</b> |
| <b>Common Stock</b>  |                               |                  |                  |
| Balance at beginning of year   | \$ 112,547                    | \$ 111,648       | \$ 69,592        |
| Common stock dividends (10)%   | 30,256                        |                  | 20,887           |
| Regulatory capital transfer  | (28,000)                      |                  | (12,000)         |
| Issuances of common stock in exchange for bank acquisition   | 22,652                        |                  | 30,448           |
| Issuance of common stock   | 2,836                         | 2,780            | 2,721            |
| Common stock purchased for deferred compensation obligations   | (249)                         |                  |                  |
| Common stock repurchased   | (6,440)                       | (1,881)          |                  |
| <b>Balance end of year</b>   | <b>133,602</b>                | <b>112,547</b>   | <b>111,648</b>   |
| <b>Shares to be issued for deferred compensation obligations</b>                                     |                               |                  |                  |
| Balance at beginning of year   | 3,772                         | 3,137            | 2,704            |
| Share-based payment awards under equity compensation plan  | 603                           | 758              | 470              |
| Issuance of common stock   | (360)                         | (123)            | (37)             |
| <b>Balance end of year</b>   | <b>4,015</b>                  | <b>3,772</b>     | <b>3,137</b>     |
| <b>Retained Earnings</b>   |                               |                  |                  |
| Balance at beginning of year   | 7,027                         | 4,451            | 10,112           |
| Adjustment to initially apply FASB Statement No. 159, net of tax                                     |                               | (1,050)          |                  |
| Adjustment to initially apply EITF 06-4, net of tax  | (1,571)                       |                  |                  |
| Net income   | 4,101                         | 7,930            | 7,001            |
| Common stock dividends (10)%   | (30,256)                      |                  | (20,887)         |
| Regulatory capital transfer  | 28,000                        |                  | 12,000           |
| Cash dividends (\$0.65 per share in 2008, \$0.62 per share in 2007, \$0.58 per share in 2006)        | (4,873)                       | (4,304)          | (3,775)          |
| <b>Balance end of year</b>   | <b>2,428</b>                  | <b>7,027</b>     | <b>4,451</b>     |
| <b>Accumulated Other Comprehensive Loss</b>  |                               |                  |                  |
| Balance at beginning of year   | (266)                         | (3,487)          | (1,506)          |
| Cumulative adjustment to initially apply the fair value option of FASB Statement No. 159, net of tax |                               | 827              |                  |
| Cumulative adjustment to initially apply FASB Statement No. 158, net of tax                          |                               |                  | (2,728)          |

|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Other comprehensive (loss) income            | (5,303)           | 2,324             | 747               |
| <b>Balance end of year</b>                   | <b>(5,569)</b>    | <b>(266)</b>      | <b>(3,487)</b>    |
| <b>Total shareholders equity end of year</b> | <b>\$ 134,476</b> | <b>\$ 123,080</b> | <b>\$ 115,749</b> |

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

Table of Contents**CONSOLIDATED STATEMENTS OF INCOME**

|  | <b>Year Ended December 31</b>                           |                 |                 |
|--|---|-----------------|-----------------|
|  | <b>2008</b>   | <b>2007</b>     | <b>2006</b>     |
|  | <b>(Dollars in thousands<br/>except per share data)</b> |                 |                 |
| <b>Interest Income</b>                                     |   |                 |                 |
| Loans, including fees                                      | \$ 49,674   | \$ 43,808       | \$ 36,575       |
| Investment securities                                      |   |                 |                 |
| Taxable  | 5,433   | 3,751           | 4,948           |
| Nontaxable   | 4,642   | 3,657           | 2,797           |
| Trading account securities                                 | 1,093   | 2,097           |                 |
| Federal funds sold and other                               | 543   | 659             | 389             |
| <b>Total interest income</b>                               | <b>61,385</b>   | <b>53,972</b>   | <b>44,709</b>   |
| <b>Interest Expense</b>                                    |   |                 |                 |
| Deposits   | 19,873  | 22,605          | 17,164          |
| Borrowings   | 5,733   | 3,354           | 2,568           |
| <b>Total interest expense</b>                              | <b>25,606</b>   | <b>25,959</b>   | <b>19,732</b>   |
| <b>Net interest income</b>                                 | <b>35,779</b>   | <b>28,013</b>   | <b>24,977</b>   |
| Provision for loan losses                                  | 9,500   | 1,211           | 682             |
| <b>Net interest income after provision for loan losses</b> | <b>26,279</b>   | <b>26,802</b>   | <b>24,295</b>   |
| <b>Noninterest Income</b>                                  |   |                 |                 |
| Service charges and fees                                   | 6,370   | 5,894           | 5,490           |
| Title insurance revenue (Note 2)                           | 234   | 2,192           | 2,389           |
| Gain on sale of mortgage loans                             | 249   | 209             | 207             |
| Net gain on trading securities                             | 245   | 460             |                 |
| Other  | 704   | 1,207           | 1,012           |
| <b>Total noninterest income</b>                            | <b>7,802</b>  | <b>9,962</b>    | <b>9,098</b>    |
| <b>Noninterest Expenses</b>                                |   |                 |                 |
| Compensation and benefits                                  | 16,992  | 15,618          | 13,869          |
| Occupancy  | 2,035   | 1,766           | 1,730           |
| Furniture and equipment                                    | 3,849   | 3,297           | 2,868           |
| Other  | 7,828   | 6,548           | 6,006           |
| <b>Total noninterest expenses</b>                          | <b>30,704</b>   | <b>27,229</b>   | <b>24,473</b>   |
| <b>Income before federal income tax (benefit) expense</b>  | <b>3,377</b>  | <b>9,535</b>    | <b>8,920</b>    |
| Federal income tax (benefit) expense                       | (724)   | 1,605           | 1,919           |
| <b>Net income</b>  | <b>\$ 4,101</b>   | <b>\$ 7,930</b> | <b>\$ 7,001</b> |
| <b>Earnings per share</b>                                  |   |                 |                 |
| Basic  | <b>\$ 0.55</b>  | <b>\$ 1.14</b>  | <b>\$ 1.12</b>  |

Diluted

**\$ 0.53    \$ 1.11    \$ 1.09**

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

Table of Contents**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

|  | <b>Year Ended December 31</b> |                  |                 |
|--|-------------------------------|------------------|-----------------|
|  | <b>2008</b>                   | <b>2007</b>      | <b>2006</b>     |
|  | <b>(Dollars in thousands)</b> |                  |                 |
| <b>Net income</b>  | <b>\$ 4,101</b>               | <b>\$ 7,930</b>  | <b>\$ 7,001</b> |
| Unrealized holding gains on available-for-sale securities:                         |                               |                  |                 |
| Unrealized (losses) gains arising during the year                                  | (3,104)                       | 614              | 1,020           |
| Reclassification adjustment for net realized (gains) losses included in net income | (24)                          | 19               | 112             |
| Net unrealized (losses) gains  | (3,128)                       | 633              | 1,132           |
| Tax effect   | (643)                         | (216)            | (385)           |
| Unrealized (losses) gains, net of tax  | (3,771)                       | 417              | 747             |
| (Increase) reduction of unrecognized pension cost                                  | (2,320)                       | 2,890            |                 |
| Tax effect   | 788                           | (983)            |                 |
| Net unrealized (loss) gain on defined benefit pension plan                         | (1,532)                       | 1,907            |                 |
| <b>Other comprehensive (loss) income, net of tax</b>                               | <b>(5,303)</b>                | <b>2,324</b>     | <b>747</b>      |
| <b>Comprehensive income</b>  | <b>\$ (1,202)</b>             | <b>\$ 10,254</b> | <b>\$ 7,748</b> |

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

**Table of Contents****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

|  | <b>Year Ended December 31</b> |                  |                 |
|--|-------------------------------|------------------|-----------------|
|  | <b>2008</b>                   | <b>2007</b>      | <b>2006</b>     |
|  | <b>(Dollars in thousands)</b> |                  |                 |
| <b>Operating activities</b>  |                               |                  |                 |
| Net income   | \$ 4,101                      | \$ 7,930         | \$ 7,001        |
| Reconciliation of net income to cash provided by (used in) operations:   |                               |                  |                 |
| Provision for loan losses  | 9,500                         | 1,211            | 682             |
| Provision for foreclosed asset losses  | 231                           | 109              |                 |
| Depreciation   | 2,171                         | 1,960            | 1,852           |
| Amortization and impairment of mortgage servicing rights   | 346                           | 201              | 184             |
| Amortization of acquisition intangibles  | 415                           | 278              | 160             |
| Net amortization of investment securities  | 356                           | 216              | 705             |
| Realized (gain) loss on sale of available-for-sale investment securities   | (24)                          | 19               | 112             |
| Unrealized gains on trading securities   | (245)                         | (460)            |                 |
| Unrealized losses on borrowings measured at fair value   | 641                           | 66               |                 |
| Earnings on corporate owned life insurance policies  | (616)                         | (432)            | (404)           |
| Share-based payment awards under equity compensation plan  | 603                           | 758              | 470             |
| Deferred income tax (benefit) expense  | (1,812)                       | 301              | 274             |
| Net changes in operating assets and liabilities which provided (used) cash, net in 2008 and 2006 of bank acquisitions and of the 2008 joint venture formation: |                               |                  |                 |
| Trading securities   | 8,513                         | 53,235           |                 |
| Loans held for sale  | 1,316                         | 520              | (1,990)         |
| Accrued interest receivable  | 226                           | (183)            | (626)           |
| Other assets   | (3,565)                       | (4,667)          | (1,424)         |
| Escrow funds payable   | (46)                          | (504)            | (7,407)         |
| Accrued interest and other liabilities   | (1,450)                       | (171)            | (1,378)         |
| <b>Net cash provided by (used in) operating activities</b>   | <b>20,661</b>                 | <b>60,387</b>    | <b>(1,789)</b>  |
| <b>Investing activities</b>  |                               |                  |                 |
| Activity in available-for-sale securities  |                               |                  |                 |
| Maturities, calls, and sales   | 66,387                        | 54,997           | 57,577          |
| Purchases  | (96,168)                      | (132,115)        | (70,140)        |
| Loan principal originations, net   | (42,700)                      | (24,455)         | (44,805)        |
| Proceeds from sales of foreclosed assets   | 2,310                         | 662              | 524             |
| Purchases of premises and equipment  | (2,990)                       | (3,722)          | (2,467)         |
| Bank acquisition, net of cash acquired   | (9,465)                       |                  | (2,713)         |
| Cash contributed to title company joint venture formation  | (4,542)                       |                  |                 |
| Purchase of corporate owned life insurance policies  | (1,560)                       |                  | (499)           |
| <b>Net cash used in investing activities</b>   | <b>(88,728)</b>               | <b>(104,633)</b> | <b>(62,523)</b> |
| <b>Financing activities</b>  |                               |                  |                 |
| Net (decrease) increase in deposits  | (47,892)                      | 7,633            | 60,024          |
| Net increase in other borrowed funds   | 123,016                       | 34,365           | 6,138           |
| Cash dividends paid on common stock  | (4,873)                       | (4,304)          | (3,775)         |

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|  |                  |                  |                  |
|--|------------------|------------------|------------------|
| Proceeds from issuance of common stock                       | 2,476            | 2,657            | 2,459            |
| Common stock repurchased                                     | (6,440)          | (1,881)          |                  |
| Common stock purchased for deferred compensation obligations | (249)            |                  |                  |
| <b>Net cash provided by (used in) financing activities</b>   | <b>66,038</b>    | <b>38,470</b>    | <b>64,846</b>    |
| <b>(Decrease) increase in cash and cash equivalents</b>      | <b>(2,029)</b>   | <b>(5,776)</b>   | <b>534</b>       |
| Cash and cash equivalents at beginning of year               | 25,583           | 31,359           | 30,825           |
| <b>Cash and cash equivalents at end of year</b>              | <b>\$ 23,554</b> | <b>\$ 25,583</b> | <b>\$ 31,359</b> |
| Supplemental cash flows information:                         |                  |                  |                  |
| Interest paid  | \$ 25,556        | \$ 25,872        | \$ 19,392        |
| Federal income taxes paid                                    | 1,155            | 1,776            | 1,516            |
| Transfer of loans to foreclosed assets                       | 3,398            | 1,295            | 433              |

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

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

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

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

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

***Nature of Operations:***

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

In April 2007, the Corporation consolidated the charters of FSB Bank and Isabella Bank. The consolidation into a single charter helped to further reduce operating expenses through the elimination of duplications in memberships, licensing, service contracts, compliance, computer platforms, and computer processing. The legal reorganization had no effect on the Corporation's consolidated financial statements (See Note 23 Operating Segments).

On January 1, 2008, the Corporation acquired 100 percent of Greenville Community Financial Corporation (GCFC). As a result of this acquisition, Greenville Community Bank, a wholly-owned subsidiary of GCFC, merged with and into the Bank (see Note 2 Business Combinations and Joint Venture Formation).

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 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 joint venture is accounted for as an equity investment. 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 (see Note 2 Business Combinations and Joint Venture Formation).

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

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

*Use of Estimates:*

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

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the fair value of investment securities, the valuation of real estate

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

acquired in connection with foreclosures or in satisfaction of loans, valuation of goodwill and intangible assets, determinations of assumptions in accounting for the defined benefit pension plan, and other post-retirement liabilities. In connection with the determination of the allowance for loan losses and the carrying value of foreclosed real estate, management obtains independent appraisals for significant properties.

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

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

***Cash and Cash Equivalents:***

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other deposit accounts, all of which have original maturity dates within ninety days. Generally, federal funds sold are for a one day period. The Corporation maintains deposit accounts in various financial institutions which generally exceed federally insured limits or are not insured.

***Trading Securities:***

Effective January 1, 2007, in conjunction with the early adoption of the fair value option of SFAS No. 159 (see Note 20), the Corporation engages in trading activities for its own account. Securities that are held principally for resale in the near term are recorded in the trading assets account at fair value with unrealized changes in fair value recorded in noninterest income. Interest and dividends are included in net interest income.

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

Securities classified as available-for-sale, other than money market preferred securities, are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, excluded from earnings and reported in other comprehensive income. Available-for-sale money market preferred securities are recorded at fair value, with unrealized gains and losses, considered not other-than-temporary, excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment (OTTI) losses exist, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the positive intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value (see Note 4). Realized gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

***Loans:***

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge offs, the allowance for loans losses, and any

deferred fees or costs on originated loans. Interest income on loans is accrued over the term of the loan based on the principal amount outstanding. Loan origination fees and certain direct loan origination costs are capitalized and recognized as a component of interest income over the term of the loan using the constant yield method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days or more past due unless the credit is well-secured and in the process of collection. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For loans that are placed on non-accrual status or charged-off, all interest accrued in the current calendar year, but not collected, is reversed against interest income while interest accrued in prior calendar years, but not collected is charged against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income continues to be accrued over the term of the loan based on the principal amount outstanding.

***Allowance for Loan Losses:***

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience. An unallocated component is maintained to cover uncertainties that management believes affect its estimate of probable losses based on qualitative factors. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstance surrounding the loan and the borrower, including the length of the delay, the reason for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

***Loans Held for Sale:***

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

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

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Transfers of Financial Assets:***

Transfers of financial assets, including held for sale mortgage loans, as described above, and participation loans are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is determined to be surrendered when 1) the assets have been isolated from the Bank, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets and 3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

***Servicing:***

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

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

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

***Loans Acquired Through Transfer:***

American Institute of Certified Public Accountants' Statement of Position (SOP) 03-3 requires that a valuation allowance for loans acquired in a transfer, including in a business combination, reflect only losses incurred after acquisition, and should not be recorded at acquisition. It applies to any loan acquired in a transfer that shows evidence of credit quality deterioration since it was originated. The effect on results of operations and financial position of the Corporation's acquisition of the allowance for loan losses carried over from Farwell State Savings Bank (Farwell) (see Note 2) was not material in 2006 due to the limited number of troubled loans held by Farwell. Included in the fair value adjustments of nonintangible net assets acquired from Greenville Community Financial Corporation (GCFC), was a reduction in the allowance for loan losses of \$437. The \$437 represented the identified impairments in GCFC's loan portfolio as of December 31, 2007 (see Note 2).

***Foreclosed Assets:***

Assets acquired through, or in lieu, of loan foreclosure are initially recorded at the lower of the Bank's carrying amount or fair value less estimated selling costs at the date of transfer, establishing a new cost basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new cost basis or fair value less costs to sell. Impairment losses on property to be held and used are measured at the amount by which the carrying amount of property exceeds its fair value. Costs relating to holding these assets are expensed as incurred. Valuations are

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

periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of the Bank's carrying amount or fair value less costs to sell. Foreclosed assets of \$2,923 and \$1,376 are included in Other Assets on the accompanying consolidated balance sheets at December 31, 2008 and 2007, respectively.

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

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

***Premises and Equipment:***

Land is carried at cost. Buildings and equipment are carried at cost less accumulated depreciation. Depreciation is computed principally by the straight line method based upon the useful lives of the assets which generally range from 5 to 30 years. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized.

***Equity Securities Without Readily Determinable Fair Values:***

Included in equity securities without readily determinable fair values are restricted securities of \$9,340 in 2008 and \$6,253 in 2007. Restricted securities include stock of the Federal Reserve Bank and the Federal Home Loan Bank, which are carried at cost and have no contractual maturity. Also included as of December 31, 2008 is the Corporation's investment in CT/IBT Title Agency, LLC, which was \$6,905 at that date (see Note 2 Business Combinations and Joint Venture Formation ).

***Stock Compensation Plans:***

In accordance with Statement of Financial Accounting Standard (SFAS) No. 123(revised 2004), *Share-Based Payment*, compensation costs relating to share-based payment transactions are recognized in the financial statements and the cost is measured based on the fair value of the equity or liability instruments issued. SFAS No. 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Compensation expense is based on the fair value of the awards, which is generally the market price of the stock on the measurement date and is recognized ratably over the service period of the award, which is usually the vesting period.

SFAS 123(R) applies to new awards and awards modified, repurchased, or cancelled after January 1, 2006. Compensation cost related to the non-vested portion of the awards outstanding as of December 31, 2005 was based on the grant date fair value of those awards as calculated under the original provisions of SFAS No. 123; that is, the Corporation was not required to re-measure the grant date fair value estimate of the unvested portion of awards granted prior to the effective date of SFAS No. 123(R).

***Corporate Owned Life Insurance:***

The Corporation has purchased life insurance policies on key members of management. In the event of death of one of these individuals, the Corporation would receive a specified cash payment equal to the face value of the policy. Such

policies are recorded at their cash surrender value, or the amount that can be realized on the balance sheet dates. Increases in cash surrender value in excess of single premiums paid are reported as other noninterest income.

Emerging Issues Task Force ( EITF ) Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*, ratified by the FASB in September, 2006, requires that policyholders recognize a liability for any postretirement benefits provided through

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the Corporation's program. As of December 31, 2008, the present value of the nature and amount of post retirement benefits promised by the Corporation to the covered employees is estimated to be \$2,460. The periodic policy maintenance costs were \$85 for 2008.

***Acquisition Intangibles and Goodwill:***

Isabella Bank previously acquired branch facilities and related deposits in business combinations accounted for as a purchase. During October 2006, Isabella Bank Corporation acquired Farwell State Savings Bank ( Farwell ) resulting in identified core deposit intangibles and goodwill (see Note 2). On January 1, 2008, Isabella Bank acquired Greenville Community Financial Corporation ( GCFC ) resulting in identified core deposit intangibles and goodwill (see Note 2). The acquisition of the branches included amounts related to the valuation of customer deposit relationships (core deposit intangibles). Such core deposit intangibles are included in other assets and are being amortized on the straight line basis over nine years. Core deposit intangibles arising from the acquisition of Farwell are being amortized on a 10 year sum-of-year's digits amortization schedule. Core deposit intangibles arising from the acquisition of GCFC are being amortized on a 15 year sum-of-year's digits amortization schedule. Goodwill is included in other assets and is not amortized but is evaluated for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below the carrying value.

***Federal Income Taxes:***

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax assets or liability is determined based on the tax effects of the temporary differences between the book and tax bases on the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

***Advertising Costs:***

Advertising costs are expensed as incurred (see Note 11).

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

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares issued during the period, which includes shares held in the Rabbi Trust controlled by the Corporation (see Note 17). Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Corporation's Deferred Director fee plan (see Note 17).

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

|   | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|-------------|
| Average number of common shares issued*             | 7,492,677   | 6,973,508   | 6,269,465   |
| Effect of shares in the Deferred Director fee plan* | 184,473     | 197,055     | 181,280     |

|   |           |           |           |
|---|-----------|-----------|-----------|
| Average number of common shares outstanding used to calculate diluted earnings per common share | 7,677,150 | 7,170,563 | 6,450,745 |
| Net Income  | \$ 4,101  | \$ 7,930  | \$ 7,001  |
| Earnings per share  |           |           |           |
| Basic   | \$ 0.55   | \$ 1.14   | \$ 1.12   |
| Diluted   | \$ 0.53   | \$ 1.11   | \$ 1.09   |

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

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

***Reclassifications:***

Certain amounts reported in the 2007 and 2006 consolidated financial statements have been reclassified to conform with the 2008 presentation.

***Recent Accounting Pronouncements:***

In September of 2006, EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*, was ratified by the Financial Accounting Standards Board ( FASB ). The EITF reached a consensus that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits. The Corporation has purchased corporation-owned life insurance on certain of its employees. The cash surrender value of these policies is carried as an asset on the consolidated balance sheets. These life insurance policies are generally subject to endorsement split-dollar life insurance arrangements. These arrangements were designed to provide a pre-and postretirement benefit for senior officers of the Corporation. The Corporation adopted EITF Issue No. 06-4 effective January 1, 2008 and as a result recorded an initial liability of \$2,375. To establish this liability, the Corporation recorded a one time charge of \$1,571, net of tax, directly to retained earnings at that date.

On March 19, 2008, the FASB issued Statement of Financial Accounting Standards No. 161 (SFAS No. 161) *Disclosures about Derivative Instruments and Hedging Activities*. The objective of SFAS No. 161 is to enhance disclosures about an entity's derivative and hedging activities and thereby improve the transparency of financial reporting. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 and is not expected to have a significant impact on the Corporation's consolidated financial statements.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162 (SFAS No. 162) *The Hierarchy of Generally Accepted Accounting Principles*. The objective of SFAS No. 162 is to identify the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* and is not expected to have a significant impact on the Corporation's consolidated financial statements.

In October 2008, the FASB staff issued Staff Position No. FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. FSP 157-3 clarifies the application of SFAS 157, which the Corporation adopted as of January 1, 2007, in cases where a market is not active. The Corporation has considered the guidance provided by FSP 157-3, which was effective on October 10, 2008, in its determination of estimated fair values as of December 31, 2008.

In December 2008 the FASB issued FSP No. 132(R)-1 *Employers' Disclosures about Postretirement Benefit Plan Assets*. FSP 132(R)-1 provides guidance related to an employer's disclosures about plan assets of defined benefit pension or other post-retirement benefit plans. Under FSP 132(R)-1, disclosures should provide users of financial statements with an understanding of how investment allocation decisions are made, the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the inputs and valuation

techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period and significant concentrations of risk within plan assets. The disclosures required by FSP 132(R)-1 will be included in the Corporation's financial statements beginning with the financial statements for the year-ended December 31, 2009.

On January 12, 2009 EITF Issue 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20 Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to be Held by a Transferor in Securitized Financial Assets* was ratified by the FASB. The FSP retains and emphasizes the objective of an other-than-temporary impairment assessment and the related disclosure

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requirements in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and other related guidance. EITF Issue 99-20-1 is not expected to have a significant impact on the Corporation's consolidated financial statements.

The FASB Issued EITF No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* in June 2008. FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 will be effective on January 1, 2009. All previously reported earnings per share data will be retrospectively adjusted to conform with the provisions of FSP EITF 03-6-1. FSP EITF 03-6-1 is not expected to have a significant impact on the Corporation's consolidated financial statements.

**Note 2 Business Combinations and Joint Venture Formation*****Farwell State Savings Bank***

On October 3, 2006, Isabella Bank (the Bank) acquired 100 percent of Farwell State Savings Bank (Farwell). As a result of this acquisition, Farwell merged with and into the Bank. Under the terms of the merger agreement, each share of Farwell common stock was automatically converted into the right to receive 3.0382 shares of Isabella Bank Corporation common stock and \$29.00 in cash. As a result of this acquisition, the Corporation issued 797,475 shares of Isabella Bank Corporation common stock valued at \$30,448 and paid a total of \$7,612 in cash to Farwell shareholders. Included in the purchase price was \$382 of transaction costs. The total consideration exchanged including the value of the common stock issued, cash paid to shareholders, plus cash paid for transaction costs resulted in a total purchase cost of \$38,442. The acquisition of Farwell has increased the overall market share for Isabella Bank Corporation in furtherance of the Bank's strategic plan.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition.

|                               | <b>Farwell<br/>October 3,<br/>2006</b> | <b>Fair Value<br/>Adjustments<br/>of<br/>Nonintangible<br/>Net Assets<br/>Acquired</b> | <b>Fair Value<br/>of Net Assets<br/>Acquired</b> |
|-------------------------------|--|--|--|
| <b>ASSETS</b>                 |  |  |  |
| Cash and cash equivalents     | \$ 5,281                               | \$   | \$ 5,281   |
| Securities available for sale | 17,166                                 |  | 17,166   |
| Loans, net                    | 63,874                                 | (470)  | 63,404   |
| Bank premises and equipment   | 307                                    | 600  | 907  |
| Other assets                  | 2,416                                  | 15   | 2,431  |
| <b>Total assets acquired</b>  | <b>89,044</b>                          | <b>145</b>   | <b>89,189</b>                                    |

**LIABILITIES AND SHAREHOLDERS EQUITY****Liabilities**

|  |                  |               |                  |
|--|------------------|---------------|------------------|
| Deposits                               | 73,731           | (393)         | 73,338           |
| Accrued interest and other liabilities | 1,114            |               | 1,114            |
| <b>Total liabilities assumed</b>       | <b>74,845</b>    | <b>(393)</b>  | <b>74,452</b>    |
| <b>Net assets acquired</b>             | <b>\$ 14,199</b> | <b>\$ 538</b> | <b>14,737</b>    |
| Core deposit intangible                |                  |               | 1,442            |
| Goodwill                               |                  |               | 22,263           |
| <b>Total consideration paid</b>        |                  |               | <b>\$ 38,442</b> |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The fair value adjustments are being amortized over two years using the straight line amortization method. The core deposit intangible is being amortized using a 10 year sum-of-the-years digits amortization schedule. Goodwill, which is not amortized, is tested for impairment at least annually. As the acquisition was considered a stock transaction, goodwill is not deductible for federal income tax purposes.

The consolidated statements of income include operating results of Farwell since the date of acquisition.

The unaudited pro forma information presented in the following table has been prepared based on Isabella Bank Corporation's historical results combined with Farwell. The information has been combined to present the results of operations as if the acquisition had occurred at the beginning of the periods presented. The pro forma results are not necessarily indicative of the results which would have actually been attained if the acquisition had been consummated in the past or what may be attained in the future and have not been adjusted for the 10% stock dividend paid February 29, 2008:

|                          | <b>Year Ended<br/>December 31<br/>2006</b> |
|--------------------------|--|
| Net interest income      | \$ 27,499                                  |
| Net income               | \$ 8,023                                   |
| Basic earnings per share | \$ 1.41                                    |

***Greenville Community Financial Corporation***

Effective on the opening of business on January 1, 2008, Isabella Bank Corporation acquired 100 percent of Greenville Community Financial Corporation (GCFC). As a result of this acquisition, Greenville Community Bank, a wholly owned subsidiary of GCFC, merged with and into the Bank. Under the terms of the merger agreement, each share of GCFC common stock was automatically converted into the right to receive 0.6659 shares of Isabella Bank Corporation common stock and \$14.70 per share in cash. Exclusive of the effects of the 10% stock dividend paid February 29, 2008, the Corporation issued 514,809 shares of Isabella Bank Corporation common stock valued at \$22,652 and paid a total of \$11,365 in cash to GCFC shareholders. The total consideration exchanged including the value of the common stock issued, cash paid to shareholders, plus cash paid for \$564 in transaction costs resulted in a total purchase price of \$34,581. The purchase price was determined using the latest Isabella Bank Corporation stock transaction price known to management as of November 27, 2007, the date of the merger agreement. The acquisition of Greenville has increased the overall market share for Isabella Bank Corporation in furtherance of the Bank's strategic plan.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the estimate of the total purchase price of the transaction as well as adjustments to allocate the purchase price based on the preliminary estimates of fair values of the assets and liabilities of GCFC.

|  | <b>Greenville<br/>January 1,<br/>2008</b> | <b>Fair Value<br/>Adjustments<br/>of<br/>Nonintangible<br/>Net Assets<br/>Acquired</b> | <b>Fair Value<br/>of Net Assets<br/>Acquired</b> |
|--|---|--|--|
| <b>ASSETS</b>                              |   |  |  |
| Cash and cash equivalents                  | \$ 2,339                                  | \$   | \$ 2,339   |
| Federal funds sold                         | 125                                       |  | 125  |
| Trading securities                         | 4,979                                     |  | 4,979  |
| Securities available for sale              | 7,007                                     |  | 7,007  |
| Loans, net                                 | 88,613                                    | (398)  | 88,215   |
| Bank premises and equipment                | 2,054                                     | 194  | 2,248  |
| Other assets                               | 2,870                                     |  | 2,870  |
| <b>Total assets acquired</b>               | <b>107,987</b>                            | <b>(204)</b>   | <b>107,783</b>                                   |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b> |   |  |  |
| <b>Liabilities</b>                         |   |  |  |
| Deposits                                   | 90,151                                    | (102)  | 90,049   |
| Other borrowed funds                       | 5,625                                     | 181  | 5,806  |
| Accrued interest and other liabilities     | 146                                       |  | 146  |
| <b>Total liabilities assumed</b>           | <b>95,922</b>                             | <b>79</b>  | <b>96,001</b>                                    |
| <b>Net assets acquired</b>                 | <b>\$ 12,065</b>                          | <b>\$ (283)</b>  | <b>11,782</b>                                    |
| Core deposit intangible                    |   |  | 1,480  |
| Goodwill                                   |   |  | 21,319   |
| <b>Total consideration paid</b>            |   |  | <b>\$ 34,581</b>                                 |

The fair value adjustments of tangible net assets acquired are being amortized over two years using the straight line amortization method. The core deposit intangible is being amortized using a 15 year sum-of-the-years digits amortization schedule. Goodwill, which is not amortized, is tested for impairment at least annually. As the acquisition was considered a stock transaction, goodwill is not deductible for federal income tax purposes.

The 2008 consolidated statements of income include the operating results of GCFC for the entire year.

The unaudited pro forma information presented in the following table has been prepared based on Isabella Bank Corporation's historical results combined with GCFC. The information has been combined to present the results of operations as if the acquisition had occurred at the beginning of the earliest period presented. The pro forma results are not necessarily indicative of the results which would have actually been attained if the acquisition had been consummated in the past or what may be attained in the future:

|                           | <b>Year Ended<br/>December 31</b> |             |
|---------------------------|-----------------------------------|-------------|
|                           | <b>2007</b>                       | <b>2006</b> |
| Net interest income       | \$ 31,579                         | \$ 28,817   |
| Net income                | \$ 8,631                          | \$ 7,992    |
| Basic earnings per share* | \$ 1.10                           | \$ 1.12     |

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

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Title Company Joint Venture Formation***

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 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 is to help IBT Title and Insurance Agency, Inc. expand its service area and to take advantage of economies of scale. As the Corporation is a 50 percent owner of this new entity, revenues and expenses will now be recorded under the equity method and, as such, our share of the net income or loss from the joint venture will be included in other noninterest income. As of December 31, 2008, the Corporation had a recorded investment of \$6,905 in the new entity, which is included in equity securities without readily determinable fair values. The following table summarizes the condensed balance sheet of IBT Title as of March 1, 2008. These amounts were excluded from the balance sheet detail of the Corporation and are now included in investment in equity securities without readily determinable fair values.

|  | <b>IBT Title<br/>March 1,<br/>2008</b> |
|--|--|
| <b>ASSETS</b>                                  |  |
| Cash and cash equivalents                      | \$ 4,542                               |
| Premises and equipment                         | 2,352                                  |
| Other assets, including intangibles of \$1,590 | 2,339                                  |
| <b>Total assets</b>                            | <b>9,233</b>                           |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>     |  |
| <b>Liabilities</b>                             |  |
| Escrow funds                                   | \$ 1,866                               |
| Other liabilities                              | 194                                    |
| <b>Total liabilities</b>                       | <b>2,060</b>                           |
| <b>Total equity</b>                            | <b>7,173</b>                           |
| <b>Total liabilities &amp; equity</b>          | <b>\$ 9,233</b>                        |

The assets of the joint venture as of December 31, 2008 were \$12,834. The total liabilities of the joint venture were \$1,287 and the equity was \$11,547 as of December 31, 2008. The Corporation's share of the joint venture's operating results for the ten-months ended December 31, 2008 was not significant.

**Note 3 Trading Securities**

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

|                                   | <b>2008</b>      | <b>2007</b>      |
|-----------------------------------|------------------|------------------|
| Government-sponsored enterprises  | \$ 4,014         | \$ 4,024         |
| States and political subdivisions | 11,556           | 10,324           |
| Corporate obligations             | 160              | 1,004            |
| Mortgage-backed                   | 6,045            | 9,712            |
| <b>Total trading securities</b>   | <b>\$ 21,775</b> | <b>\$ 25,064</b> |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 4 INVESTMENT SECURITIES**

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

|                                      | <b>2008</b>               |                                       |  |                       |
|--------------------------------------|---------------------------|---------------------------------------|--|-----------------------|
|                                      | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| Securities Available-for-Sale        |                           |                                       |  |                       |
| U.S. Government and federal agencies | \$ 3,999                  | \$ 84                                 | \$                                     | \$ 4,083              |
| Government-sponsored enterprises     | 61,919                    | 1,070                                 | 1                                      | 62,988                |
| States and political subdivisions    | 148,186                   | 1,808                                 | 671                                    | 149,323               |
| Corporate                            | 7,145                     |                                       |  | 7,145                 |
| Money market preferred               | 11,000                    |                                       | 5,021                                  | 5,979                 |
| Mortgage-backed                      | 16,492                    | 445                                   |  | 16,937                |
| <b>Total</b>                         | <b>\$ 248,741</b>         | <b>\$ 3,407</b>                       | <b>\$ 5,693</b>                        | <b>\$ 246,455</b>     |

|                                      | <b>2007</b>               |                                       |  |                       |
|--------------------------------------|---------------------------|---------------------------------------|--|-----------------------|
|                                      | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| Securities Available-for-Sale        |                           |                                       |  |                       |
| U.S. Government and federal agencies | \$ 3,983                  | \$ 75                                 | \$                                     | \$ 4,058              |
| Government-sponsored enterprises     | 49,631                    | 556                                   | 6                                      | 50,181                |
| States and political subdivisions    | 130,772                   | 611                                   | 427                                    | 130,956               |
| Corporate                            | 12,000                    |                                       |  | 12,000                |
| Money market preferred               | 12,300                    |                                       |  | 12,300                |
| Mortgage-backed                      | 3,599                     | 33                                    |  | 3,632                 |
| <b>Total</b>                         | <b>\$ 212,285</b>         | <b>\$ 1,275</b>                       | <b>\$ 433</b>                          | <b>\$ 213,127</b>     |

The Corporation had pledged investments in the following amounts as of December 31:

|   | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|
| Pledged for public deposits and for other purposes necessary or required by law | \$ 18,000   | \$ 26,289   |
| Pledged to secure repurchase agreements   | 64,876      | 16,072      |

|              |  |                  |                  |
|--------------|--|------------------|------------------|
| <b>Total</b> |  | <b>\$ 82,876</b> | <b>\$ 42,361</b> |
|--------------|--|------------------|------------------|

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The amortized cost and fair value of available-for-sale securities by contractual maturity at December 31, 2008 are as follows:

|                                | <b>Available for Sale</b> |                       |
|--------------------------------|---------------------------|-----------------------|
|                                | <b>Amortized<br/>Cost</b> | <b>Fair<br/>Value</b> |
| Within 1 year                  | \$ 32,057                 | \$ 27,163             |
| Over 1 year through 5 years    | 73,531                    | 74,888                |
| After 5 years through 10 years | 79,159                    | 80,158                |
| Over 10 years                  | 47,502                    | 47,309                |
|                                | 232,249                   | 229,518               |
| Mortgage-backed securities     | 16,492                    | 16,937                |
|                                | <b>\$ 248,741</b>         | <b>\$ 246,455</b>     |

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

Because of their variable payments, mortgage-backed securities are not reported by a specific maturity group.

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

|   | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|-------------|
| Proceeds from sales of securities       | \$ 6,096    | \$ 5,396    | \$ 15,257   |
| Gross realized gains                    | \$ 24       | \$ 12       | \$          |
| Gross realized losses                   |             | (31)        | (112)       |
| Net realized gains (losses)             | \$ 24       | \$ (19)     | \$ (112)    |
| Applicable income tax (expense) benefit | \$ (8)      | \$ 6        | \$ 38       |

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

| <b>December 31, 2008</b>           |                               |
|------------------------------------|-------------------------------|
| <b>Less Than Twelve<br/>Months</b> | <b>Over Twelve<br/>Months</b> |

|  | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Total<br/>Unrealized<br/>Losses</b> |
|--|--|-----------------------|--|-----------------------|--|
| Securities Available-for-Sale              |  |                       |  |                       |  |
| Government-sponsored enterprises           | \$ 1                                   | \$ 999                | \$                                     | \$                    | \$ 1                                   |
| States and political subdivisions          | 620                                    | 27,015                | 51                                     | 2,705                 | 671                                    |
| Money market preferred                     | 5,021                                  | 5,979                 |  |                       | 5,021                                  |
| <b>Total securities available-for-sale</b> | <b>\$ 5,642</b>                        | <b>\$ 33,993</b>      | <b>\$ 51</b>                           | <b>\$ 2,705</b>       | <b>\$ 5,693</b>                        |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

|  | <b>December 31, 2007</b>               |                       |  |                       |                              |
|--|--|-----------------------|--|-----------------------|------------------------------|
|  | <b>Less Than Twelve<br/>Months</b>     |                       | <b>Over Twelve Months</b>              |                       | <b>Total</b>                 |
|  | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| Securities Available-for-Sale              |  |                       |  |                       |                              |
| Government-sponsored enterprises           | \$ 6                                   | \$ 994                | \$                                     | \$                    | \$ 6                         |
| States and political subdivisions          | 276                                    | 32,309                | 151                                    | 17,065                | 427                          |
| <b>Total securities available-for-sale</b> | <b>\$ 282</b>                          | <b>\$ 33,303</b>      | <b>\$ 151</b>                          | <b>\$ 17,065</b>      | <b>\$ 433</b>                |

The unrealized losses in the Corporation's municipal bond portfolio are largely due 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 municipal bond portfolio has struggled to increase in value.

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 estimated fair value. Due to recent events and general uncertainty in credit markets, 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.

Due to the lack of marketability of certain investments at this time, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including money market preferred securities, should be considered other-than-temporarily-impaired (OTTI). Such analyses included, among other factors, the following criteria:

Has the value of the investment declined more than 20% based on a risk and maturity adjusted discount rate?

Is the investment credit rating below investment grade?

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

Does the Corporation have the ability and positive intent to hold the security until maturity?

Has the duration of the investment been extended by more than 7 years?

Based on the Corporation's analysis using the above criteria, and the fact that the Corporation has the positive intent and ability to hold debt securities for the reasonably foreseeable future, management does not believe that the values of these or any other securities are other-than-temporarily impaired as of December 31, 2008 or 2007.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 5 Loans**

The Bank grants commercial, agricultural, consumer and residential loans to customers situated primarily in Isabella, Gratiot, Mecosta, Southwestern Midland, Western Saginaw, Montcalm and Southern Clare counties in Michigan. The ability of the borrowers to honor their repayment obligations is often dependent upon the real estate, agricultural, and general economic conditions of this region. Substantially all of the consumer and residential mortgage loans are secured by various items of property, while commercial loans are secured primarily by real estate, business assets and personal guarantees; a portion of loans are unsecured.

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

|  | <b>December 31</b> |                   |
|--|--------------------|-------------------|
|  | <b>2008</b>        | <b>2007</b>       |
| Mortgage loans on real estate                  |                    |                   |
| Residential 1-4 family                         | \$ 231,705         | \$ 227,304        |
| Commercial                                     | 200,398            | 158,982           |
| Agricultural                                   | 31,656             | 19,951            |
| Construction and land development              | 16,571             | 15,060            |
| Second mortgages                               | 46,103             | 36,393            |
| Equity lines of credit                         | 25,018             | 19,180            |
| <b>Total mortgage loans</b>                    | <b>551,451</b>     | <b>476,870</b>    |
| Commercial and agricultural loans              |                    |                   |
| Commercial                                     | 124,408            | 79,324            |
| Agricultural production                        | 26,347             | 27,456            |
| <b>Total commercial and agricultural loans</b> | <b>150,755</b>     | <b>106,780</b>    |
| Consumer installment loans                     | 33,179             | 29,037            |
| <b>Total loans</b>                             | <b>735,385</b>     | <b>612,687</b>    |
| Less: allowance for loan losses                | 11,982             | 7,301             |
| <b>Loans, net</b>                              | <b>\$ 723,403</b>  | <b>\$ 605,386</b> |

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

|                              | <b>Year Ended December 31</b> |             |             |
|------------------------------|-------------------------------|-------------|-------------|
|                              | <b>2008</b>                   | <b>2007</b> | <b>2006</b> |
| Balance at beginning of year | \$ 7,301                      | \$ 7,605    | \$ 6,899    |
| Allowance of acquired bank   | 822                           |             | 726         |
| Loans charged off            | (6,325)                       | (2,146)     | (1,149)     |

|                               |                  |                 |                 |
|-------------------------------|------------------|-----------------|-----------------|
| Recoveries                    | 684              | 631             | 447             |
| Provision charged to income   | 9,500            | 1,211           | 682             |
| <b>Balance at end of year</b> | <b>\$ 11,982</b> | <b>\$ 7,301</b> | <b>\$ 7,605</b> |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

|   | 2008      | 2007     |
|---|-----------|----------|
| Impaired loans with a valuation allowance     | \$ 9,603  | \$ 3,779 |
| Impaired loans without a valuation allowance  | \$ 411    | \$       |
| Total impaired loans accruing interest        | \$ 2,796  | \$ 1,292 |
| Valuation allowance related to impaired loans | \$ 2,065  | \$ 703   |
| Total nonaccrual loans                        | \$ 11,175 | \$ 4,156 |
| Accruing loans past due 90 days or more       | \$ 1,251  | \$ 1,727 |
| Average investment in impaired loans          | \$ 6,636  | \$ 3,768 |
| Total restructured loans                      | \$ 4,550  | \$ 685   |

Interest income recognized on impaired loans was not significant during any of the three years ended December 31, 2008. No additional funds are committed to be advanced in connection with impaired loans.

**Note 6 Servicing**

Residential mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgages serviced for others was \$254,495, \$255,839, and \$255,577 at December 31, 2008, 2007, and 2006 respectively; such loans are not included in the accompanying consolidated balance sheets. The fair value of servicing rights was determined using a discount rate of 8.1%, prepayment speeds ranging from 6.0% to 25.8%, depending upon the stratification of the specific right and a weighted average default rate of 0.0%. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and foreclosure processing.

The following table summarizes the changes in each year of the carrying value of mortgage servicing rights included in other assets as of December 31:

|                                       | 2008            | 2007            | 2006            |
|---------------------------------------|-----------------|-----------------|-----------------|
| Balance at beginning of year          | \$ 2,198        | \$ 2,155        | \$ 2,125        |
| Mortgage servicing rights capitalized | 3,079           | 2,869           | 2,655           |
| Accumulated amortization              | (3,016)         | (2,785)         | (2,589)         |
| Impairment valuation allowance        | (156)           | (41)            | (36)            |
| <b>Balance at end of year</b>         | <b>\$ 2,105</b> | <b>\$ 2,198</b> | <b>\$ 2,155</b> |
| Impairment losses recognized          | \$ 115          | \$ 5            | \$ 24           |

**Note 7 Premises and Equipment**

A summary of premises and equipment at December 31 follows:

|                                    | <b>2008</b>      | <b>2007</b>      |
|------------------------------------|------------------|------------------|
| Land                               | \$ 4,665         | \$ 3,997         |
| Buildings and improvements         | 18,653           | 16,067           |
| Furniture and equipment            | 23,043           | 23,226           |
| Total                              | 46,361           | 43,290           |
| Less: Accumulated depreciation     | 23,130           | 20,774           |
| <b>Premises and equipment, net</b> | <b>\$ 23,231</b> | <b>\$ 22,516</b> |

Depreciation expense amounted to \$2,171, \$1,960 and \$1,852 in 2008, 2007, and 2006, respectively.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 8 Goodwill and Other Intangible Assets**

The change in the carrying amount of goodwill for the year is as follows:

|  | 2008             | 2007             |
|--|------------------|------------------|
| Balance January 1  | \$ 25,889        | \$ 25,889        |
| Goodwill identified in GCFC acquisition (See Note 2)   | 21,319           |                  |
| Reclassification for goodwill contributed to CT/IBT Title Agency, LLC joint venture (See Note 2) | (1,590)          |                  |
| <b>Balance at December 31</b>  | <b>\$ 45,618</b> | <b>\$ 25,889</b> |

Identifiable intangible assets at year end were as follows:

|  | 2008                          |                             |                             |
|--|-------------------------------|-----------------------------|-----------------------------|
|  | Gross<br>Intangible<br>Assets | Accumulated<br>Amortization | Net<br>Intangible<br>Assets |
| Amortizable intangible assets:   |                               |                             |                             |
| Core deposit premium resulting from the Greenville acquisition in 2008 | \$ 1,480                      | \$ 185                      | \$ 1,295                    |
| Core deposit premium resulting from the Farwell acquisition in 2006    | 1,442                         | 551                         | 891                         |
| Core deposit premium resulting from previous acquisitions              | 2,451                         | 2,451                       |                             |
| <b>Total</b>   | <b>\$ 5,373</b>               | <b>\$ 3,187</b>             | <b>\$ 2,186</b>             |

|   | 2007                          |                             |                             |
|---|-------------------------------|-----------------------------|-----------------------------|
|   | Gross<br>Intangible<br>Assets | Accumulated<br>Amortization | Net<br>Intangible<br>Assets |
| Amortizable intangible assets:                                      |                               |                             |                             |
| Core deposit premium resulting from the Farwell acquisition in 2006 | \$ 1,442                      | \$ 321                      | \$ 1,121                    |
| Core deposit premium resulting from previous acquisitions           | 2,451                         | 2,451                       |                             |
| <b>Total</b>  | <b>\$ 3,893</b>               | <b>\$ 2,772</b>             | <b>\$ 1,121</b>             |

Amortization expense associated with identifiable intangible assets was \$415, \$278, and \$160 in 2008, 2007, and 2006, respectively.

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

| <b>Year</b> | <b>Amount</b> |
|-------------|---------------|
| 2009        | \$ 376        |
| 2010        | 337           |
| 2011        | 299           |
| 2012        | 261           |
| 2013        | 221           |
| Thereafter  | 692           |
|             | \$ 2,186      |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 9 Deposits**

Scheduled maturities of time deposits for the years succeeding December 31, 2008 are as follows:

| <b>Year</b> | <b>Amount</b>     |
|-------------|-------------------|
| 2009        | \$ 240,339        |
| 2010        | 63,464            |
| 2011        | 29,771            |
| 2012        | 21,565            |
| 2013        | 24,860            |
| Thereafter  | 1,589             |
|             | <b>\$ 381,588</b> |

Interest expense on time deposits greater than \$100 was \$6,525 in 2008, \$6,649 in 2007, and \$5,195 in 2006.

**Note 10 Borrowed Funds**

Borrowed funds consist of the following obligations at December 31:

|  | <b>2008</b>       | <b>2007</b>      |
|--|-------------------|------------------|
| Federal Home Loan Bank advances  | \$ 150,220        | \$ 66,023        |
| Federal Funds purchased  | 9,700             | 15,883           |
| Securities sold under agreements to repurchase without stated maturity dates | 42,430            | 981              |
| Securities sold under agreements to repurchase with stated maturity dates    | 20,000            | 10,000           |
|  | <b>\$ 222,350</b> | <b>\$ 92,887</b> |

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

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

|                              | <b>2008</b>   |             | <b>2007</b>   |             |
|------------------------------|---------------|-------------|---------------|-------------|
|                              | <b>Amount</b> | <b>Rate</b> | <b>Amount</b> | <b>Rate</b> |
| Fixed rate advances due 2008 | \$            |             | \$ 6,131      | 4.79%       |
| Fixed rate advances due 2009 | 42,215        | 1.89%       | 11,500        | 4.95%       |

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|                                    |                   |              |                  |              |
|------------------------------------|-------------------|--------------|------------------|--------------|
| Fixed rate advances due 2010       | 29,516            | 4.58%        | 18,392           | 5.08%        |
| Fixed rate advances due 2011       | 10,225            | 3.96%        |                  |              |
| One year putable advances due 2010 | 5,000             | 5.18%        | 3,000            | 4.98%        |
| One year putable advances due 2011 | 1,000             | 4.75%        |                  |              |
| One year putable advances due 2012 | 5,000             | 4.07%        | 15,000           | 4.10%        |
| Fixed rate advances due 2012       | 17,000            | 4.19%        | 2,000            | 4.90%        |
| One year putable advances due 2013 | 10,264            | 3.66%        |                  |              |
| Fixed rate advances due 2014       | 5,000             | 4.38%        |                  |              |
| Fixed rate advances due 2015       | 25,000            | 4.63%        | 10,000           | 4.84%        |
|                                    | <b>\$ 150,220</b> | <b>3.68%</b> | <b>\$ 66,023</b> | <b>4.76%</b> |

Securities sold under agreements to repurchase are classified as secured borrowings. Securities sold under agreements to repurchase without stated maturity dates generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

connection with the transaction. The U.S. government agency securities underlying the agreements have a carrying value and a fair value of \$64,876 and \$16,072 at December 31, 2008 and 2007, respectively. Such securities remain under the control of the Corporation. The Corporation may be required to provide additional collateral based on the fair value of underlying securities.

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

|                                | 2008             |              | 2007             |              |
|--------------------------------|------------------|--------------|------------------|--------------|
|                                | Amount           | Rate         | Amount           | Rate         |
| Repurchase agreements due 2010 | \$ 5,000         | 4.00%        | \$ 5,000         | 4.00%        |
| Repurchase agreements due 2013 | 5,000            | 4.51%        | 5,000            | 4.51%        |
| Repurchase agreements due 2014 | 10,000           | 3.19%        |                  |              |
|                                | <b>\$ 20,000</b> | <b>3.72%</b> | <b>\$ 10,000</b> | <b>4.26%</b> |

**Note 11 Other Noninterest Expenses**

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

|                                     | 2008            | 2007            | 2006            |
|-------------------------------------|-----------------|-----------------|-----------------|
| Director fees                       | \$ 867          | \$ 796          | \$ 584          |
| Marketing and advertising           | 691             | 642             | 697             |
| Audit and SOX compliance fees       | 565             | 583             | 1,010           |
| Other, not individually significant | 5,705           | 4,527           | 3,715           |
|                                     | <b>\$ 7,828</b> | <b>\$ 6,548</b> | <b>\$ 6,006</b> |

**Note 12 Federal Income Taxes**

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

|   | 2008            | 2007            | 2006            |
|---|-----------------|-----------------|-----------------|
| Currently payable                           | \$ 1,088        | \$ 1,304        | \$ 1,645        |
| Deferred (benefit) expense                  | (1,812)         | 301             | 274             |
| <b>Federal income tax (benefit) expense</b> | <b>\$ (724)</b> | <b>\$ 1,605</b> | <b>\$ 1,919</b> |

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

|   | <b>2008</b>     | <b>2007</b>     | <b>2006</b>     |
|---|-----------------|-----------------|-----------------|
| Income taxes at 34% statutory rate          | \$ 1,148        | \$ 3,242        | \$ 3,033        |
| Effect of nontaxable income                 | (2,088)         | (1,782)         | (1,239)         |
| Effect of nondeductible expenses            | 216             | 145             | 125             |
| <b>Federal income tax (benefit) expense</b> | <b>\$ (724)</b> | <b>\$ 1,605</b> | <b>\$ 1,919</b> |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for federal income tax purposes. Significant components of the Corporation's deferred tax assets and liabilities, included in other assets in the accompanying consolidated balance sheets, are as follows as of December 31:

|   | <b>2008</b>     | <b>2007</b>     |
|---|-----------------|-----------------|
| <b>Deferred tax assets</b>                            |                 |                 |
| Allowance for loan losses                             | \$ 3,145        | \$ 1,658        |
| Deferred directors' fees                              | 1,930           | 1,803           |
| Employee benefit plans                                | 80              | 33              |
| Core deposit premium and acquisition expenses         | 252             | 116             |
| Net unrealized losses on trading securities           | 32              | 119             |
| Net unrecognized actuarial loss on pension plan       | 1,211           | 424             |
| Life insurance death benefit payable                  | 804             |                 |
| Other   | 860             | 209             |
| <b>Total deferred tax assets</b>                      | <b>8,314</b>    | <b>4,362</b>    |
| <b>Deferred tax liabilities</b>                       |                 |                 |
| Prepaid pension cost                                  | 951             | 899             |
| Premises and equipment                                | 620             | 606             |
| Accretion on securities                               | 45              | 47              |
| Core deposit premium and acquisition expenses         | 506             | 315             |
| Net unrealized gains on available-for-sale securities | 930             | 286             |
| Other   | 193             | 194             |
| <b>Total deferred tax liabilities</b>                 | <b>3,245</b>    | <b>2,347</b>    |
| <b>Net deferred tax assets</b>                        | <b>\$ 5,069</b> | <b>\$ 2,015</b> |

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48), an interpretation of Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*. FIN No. 48 seeks to reduce the significant diversity in practice associated with financial statement recognition and measurement in accounting for income taxes and prescribes a recognition threshold and measurement attribute for disclosure of tax positions taken or expected to be taken on an income tax return, in order for those tax provisions to be recognized in the Corporation's financial statements. During 2007, the Corporation adopted the provisions of FIN No. 48. The adoption had no effect on the Corporation's financial statements.

The Corporation and its subsidiaries are subject to U.S. federal income tax. The Corporation is no longer subject to examination by taxing authorities for years before 2005. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense. The Corporation does not have any amounts accrued for interest and penalties at December 31, 2008 and is not aware of any claims for such amounts by federal income tax authorities.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 13 Off-Balance-Sheet Activities***Credit-Related Financial Instruments*

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

|  | <b>Contract Amount</b> |             |
|--|------------------------|-------------|
|  | <b>2008</b>            | <b>2007</b> |
| Unfunded commitments under lines of credit | \$ 106,861             | \$ 87,969   |
| Commercial and standby letters of credit   | 6,429                  | 4,405       |
| Commitments to grant loans                 | 10,228                 | 1,069       |

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

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

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

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

The Corporation's exposure to credit-related loss in the event of nonperformance by the counter parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in deciding to make these commitments as

it does for extending loans to customers.

**Note 14 On-Balance Sheet Activities**

*Derivative Loan Commitments*

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

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

Outstanding derivative loan commitments expose the Corporation to the risk that the price of the loans arising from the exercise of the loan commitment might decline from the inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of undesignated interest rate lock commitments was \$334 and \$311 at December 31, 2008 and 2007, respectively.

***Forward Loan Sale Commitments***

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

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

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

The Corporation expects that these forward loan sale commitments will experience changes in fair value opposite to change in fair value of derivative loan commitments. The notional amount of undesignated forward loan sale commitments was \$1,232 and \$2,525 at December 31, 2008 and 2007, respectively.

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

**Note 15 Commitments and other Matters**

Banking regulations require banks to maintain cash reserve balances in currency or as deposits with the Federal Reserve Bank. At December 31, 2008 and 2007, the reserve balances amounted to \$700 and \$370, respectively.

Isabella 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 Isabella Bank. The Bank periodically makes charitable contributions in the form of cash transfers to the Foundation. The Foundation is administered by members of the Isabella Bank Board of Directors. The assets and transactions of the Foundation are not included in the consolidated financial statements of Isabella Bank Corporation. During 2008, 2007, and 2006, the Corporation contributed \$78 , \$0, and \$0 respectively to the Foundation. The assets of the Foundation as of December 31, 2008 and 2007 were \$953 and \$1,069, respectively.

Banking regulations limit the transfer of assets in the form of dividends, loans, or advances from the Bank to the Corporation. At December 31, 2008, substantially all of the Bank's assets were restricted from transfer to the Corporation in the form of loans or advances. Consequently, bank dividends are the principal source of funds for the

Corporation. Payment of dividends without regulatory approval is limited to the current years retained net income plus retained net income for the preceding two years, less any required transfers to common stock. At January 1, 2009, the amount available for dividends without regulatory approval was approximately \$7,831.

The Bank has obtained approval to borrow up to \$200,000 from the Federal Home Loan Bank (FHLB) of Indianapolis. Under the terms of the agreement, the Bank may obtain advances at the stated rate at the time of the borrowings. The Bank has agreed to pledge eligible mortgage loans and U.S. Treasury and governmental agencies as collateral for any such borrowings.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 16 Minimum Regulatory Capital Requirements**

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2008 and 2007, that the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2008, the most recent notifications from The Regulators categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notifications that management believes has changed the Bank's categories. The Corporation's and each Bank's actual capital amounts (in thousands) and ratios are also presented in the table.

|  | Actual    |       | Minimum Capital Requirement |       | Minimum to be Well Capitalized Under Prompt Corrective Action Provisions |       |
|--|-----------|-------|-----------------------------|-------|--|-------|
|  | Amount    | Ratio | Amount                      | Ratio | Amount   | Ratio |
| <b>December 31, 2008</b>               |           |       |                             |       |  |       |
| Total capital to risk weighted assets  |           |       |                             |       |  |       |
| Isabella Bank                          | \$ 89,192 | 12.4% | \$ 57,666                   | 8.0%  | \$ 72,082  | 10.0% |
| Consolidated                           | 98,867    | 13.5  | 58,485                      | 8.0   | N/A  | N/A   |
| Tier 1 capital to risk weighted assets |           |       |                             |       |  |       |
| Isabella Bank                          | 80,145    | 11.1  | 28,833                      | 4.0   | 43,249   | 6.0   |
| Consolidated                           | 89,694    | 12.3  | 29,242                      | 4.0   | N/A  | N/A   |
| Tier 1 capital to average assets       |           |       |                             |       |  |       |
| Isabella Bank                          | 80,145    | 7.4   | 43,069                      | 4.0   | 53,836   | 5.0   |
| Consolidated                           | 89,694    | 8.4   | 42,603                      | 4.0   | N/A  | N/A   |
| <b>December 31, 2007</b>               |           |       |                             |       |  |       |
| Total capital to risk weighted assets  |           |       |                             |       |  |       |
| Isabella Bank                          | \$ 75,769 | 12.7% | \$ 47,705                   | 8.0%  | \$ 59,632  | 10.0% |
| Consolidated                           | 103,436   | 17.0  | 48,636                      | 8.0   | N/A  | N/A   |

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|  |        |      |        |     |        |     |
|--|--------|------|--------|-----|--------|-----|
| Tier 1 capital to risk weighted assets |        |      |        |     |        |     |
| Isabella Bank                          | 68,468 | 11.5 | 23,853 | 4.0 | 35,779 | 6.0 |
| Consolidated                           | 96,135 | 15.8 | 24,318 | 4.0 | N/A    | N/A |
| Tier 1 capital to average assets       |        |      |        |     |        |     |
| Isabella Bank                          | 68,468 | 7.7  | 35,723 | 4.0 | 44,654 | 5.0 |
| Consolidated                           | 96,135 | 10.7 | 35,936 | 4.0 | N/A    | N/A |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 17 Employee Benefit Plans*****Defined Benefit Pension Plan***

The Corporation has a non-contributory defined benefit pension plan covering substantially all of its employees. In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The effect of the curtailment, which was recognized in the first quarter of 2007, suspended the current participant's accrued benefits as of March 1, 2007 and limited participation in the plan to eligible employees as of December 31, 2006. Due to the curtailment, future salary increases will not be considered and the benefits are based on years of service and the employee's five highest consecutive years of compensation out of the last ten years of service through March 1, 2007. As a result of the curtailment, the Corporation does not anticipate contributing to the plan in the near future.

The curtailment resulted in a reduction in 2007 of \$2,939 in the projected benefit obligation, which served to reduce unrecognized net actuarial loss of \$2,939, a component of accumulated other comprehensive loss.

Subsequent to the decision to curtail the defined benefit plan, the Corporation decided to increase the contributions to the Corporation's 401(k) plan effective January 1, 2007 (see Other Employee Benefit Plans on page 52).

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

|   | <b>2008</b>     | <b>2007</b>     |
|---|-----------------|-----------------|
| Change in benefit obligation                        |                 |                 |
| Benefit obligation, January 1                       | \$ 8,206        | \$ 10,996       |
| Service cost  |                 | 109             |
| Interest cost                                       | 503             | 489             |
| Actuarial loss                                      | 356             | 51              |
| Benefits paid, including plan expenses              | (629)           | (500)           |
| Plan curtailment                                    |                 | (2,939)         |
| <b>Benefit obligation, December 31</b>              | <b>8,436</b>    | <b>8,206</b>    |
| Change in plan assets                               |                 |                 |
| Fair value of plan assets, January 1                | 9,607           | 9,199           |
| Investment (loss) return                            | (1,309)         | 558             |
| Corporation contribution                            |                 | 350             |
| Benefits paid, including plan expenses              | (629)           | (500)           |
| <b>Fair value of plan assets, December 31</b>       | <b>7,669</b>    | <b>9,607</b>    |
| <b>(Deficiency in) funded status at December 31</b> | <b>\$ (767)</b> | <b>\$ 1,401</b> |

|  | 2008            | 2007            |
|--|-----------------|-----------------|
| Change in (accrued) prepaid pension benefit costs                |                 |                 |
| Prepaid (accrued) benefit cost at January 1                      | \$ 1,401        | \$ (1,797)      |
| Contributions to the plan  |                 | 350             |
| Net periodic benefit income (cost) for the year                  | 152             | (2)             |
| Plan curtailment loss  |                 | (40)            |
| Net change in unrecognized actuarial loss and prior service cost | (2,320)         | 2,890           |
| <b>(Accrued) prepaid pension benefit cost at December 31</b>     | <b>\$ (767)</b> | <b>\$ 1,401</b> |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2006, the Corporation adopted the provisions of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* ( SFAS No. 158 ) and in accordance therewith reflected the under funded status of the plan on its consolidated balance sheet at December 31, 2006. Prospectively, the Corporation adjusts the liability to reflect the current funded status of the plan. Any gains or losses that arise during the year but are not recognized as components of net periodic benefit cost are now recognized as a component of other comprehensive income (loss).

The adoption of SFAS No. 158 had no effect on the Corporation's consolidated statement of operations for the year ended December 31, 2006, and it will not affect the Corporation's operating results in future periods.

The incremental effects of applying FASB Statement No. 158 on individual line items on the consolidated statement of financial position as of the December 31, 2006 implementation date are as follows:

|  | <b>Before<br/>Application of<br/>SFAS No. 158</b> | <b>SFAS No. 158<br/>Application<br/>Adjustments</b> | <b>After<br/>Application of<br/>SFAS No. 158</b> |
|--|---|---|--|
| (Prepaid) accrued liability for pension benefits | \$ (2,337)  | \$ 4,134  | \$ 1,797   |
| Deferred income tax assets                       | 2,030   | 1,406   | 3,436  |
| Total liabilities                                | 792,581   | 1,797   | 794,378  |
| Accumulated other comprehensive loss             | (759)   | (2,728)   | (3,487)  |
| Total shareholders' equity                       | 118,477   | (2,728)   | 115,749  |

Amounts recognized as a component of accumulated other comprehensive loss consist of:

|  | <b>December 31</b> |                 |                   |
|--|--------------------|-----------------|-------------------|
|  | <b>2008</b>        | <b>2007</b>     | <b>2006</b>       |
| (Increase) reduction of unrecognized pension cost    | \$ (2,320)         | \$ 2,890        | \$                |
| Tax effect   | 788                | (983)           |                   |
| Net of tax amount                                    | (1,532)            | 1,907           |                   |
| Adjustment to initially apply FASB Statement No. 158 |                    |                 | (4,134)           |
| Tax effect   |                    |                 | 1,406             |
| Net of tax amount                                    |                    |                 | (2,728)           |
| <b>Total</b>   | <b>\$ (1,532)</b>  | <b>\$ 1,907</b> | <b>\$ (2,728)</b> |

The accumulated benefit obligation was \$8,436 and \$8,206 at December 31, 2008 and 2007, respectively. The \$4,134 adjustment to initially apply SFAS No. 158 in 2006 consisted primarily of previously unrecognized net actuarial losses.

The components of net periodic benefit cost and other pension related amounts recognized in other comprehensive income (loss) are as follows for the years ended December 31:

|   | <b>2008</b>     | <b>2007</b> | <b>2006</b>   |
|---|-----------------|-------------|---------------|
| <b>Net periodic benefit (income) cost</b>                             |                 |             |               |
| Service cost on benefits earned for services rendered during the year | \$              | \$ 109      | \$ 637        |
| Interest cost on projected benefit obligation                         | 503             | 489         | 607           |
| Expected return on plan assets  | (659)           | (628)       | (555)         |
| Amortization of unrecognized prior service cost                       |                 |             | 18            |
| Amortization of unrecognized actuarial net loss                       | 4               | 32          | 232           |
| <b>Net periodic benefit (income) cost</b>                             | <b>\$ (152)</b> | <b>\$ 2</b> | <b>\$ 939</b> |

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Accumulated other comprehensive loss at December 31, 2008 includes net unrecognized actuarial losses of \$3,564, of which \$170 is expected to be amortized into benefit cost during 2009.

Actuarial assumptions used in determining the projected benefit obligation are as follows for the year ended December 31:

|   | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|-------------|
| Weighted average discount rate          | 6.10%       | 6.44%       | 6.00%       |
| Rate of increase in future compensation | N/A         | N/A         | 4.50%       |
| Expected long-term rate of return       | 7.00%       | 7.00%       | 7.50%       |

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

|  | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|-------------|
| Discount rate                            | 6.10%       | 6.44%       | 6.00%       |
| Rate of compensation increase            | N/A         | N/A         | 4.50%       |
| Expected long-term return on plan assets | 7.00%       | 7.00%       | 7.00%       |

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

Historical longer term rates of return for broad asset classes.

Actual past rates of return achieved by the plan.

The general mix of assets held by the plan.

The stated investment policy for the plan.

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

The Corporation's actual pension plan weighted-average asset allocations by asset category are as follows at December 31:

| <b>Asset Category</b> | <b>2008</b> | <b>2007</b> |
|-----------------------|-------------|-------------|
| Money market          | 2.5%        | 4.0%        |
| Equity securities     | 52.8%       | 38.0%       |
| Debt securities       | 44.7%       | 58.0%       |

|       |         |         |
|-------|---------|---------|
| Total | 100.00% | 100.00% |
|-------|---------|---------|

As of December 31, 2008, the plan held \$188 (2.5% of total plan assets) of funds in a money market account. The remaining funds are invested in two mutual funds managed by the plan's investment advisors. These funds had \$4,050 in equity investments and \$3,431 in debt securities as of December 31, 2008.

The asset mix, the sector weighting of equity investments, and debt issues to hold are based on a third party investment advisor retained by the Corporation to manage the plan. The Corporation reviews the performance of the advisor no less than annually.

The Corporation does not expect to make contributions to the pension plan in 2009.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

| <b>Year</b>               | <b>Amount</b> |
|---------------------------|---------------|
| 2009                      | \$ 363        |
| 2010                      | 379           |
| 2011                      | 381           |
| 2012                      | 400           |
| 2013                      | 399           |
| Years 2014 - 2018 (total) | 2,753         |

***Other Employee Benefit Plans***

The Corporation maintains a nonqualified supplementary employee retirement plan (SERP) for qualified officers to provide supplemental retirement benefits to each participant. Expenses related to this program for 2008, 2007, and 2006 were \$206, \$202, and \$97, respectively, and are being recognized over the participants' expected years of service. As a result of curtailing Isabella Bank Corporation's defined benefit plan in March 2007, the Corporation established an additional SERP to maintain the benefit levels for all employees that were at least forty years old and had at least 15 years of service. The cost to provide this benefit was \$128 and \$120 for 2008 and 2007, respectively.

The Corporation maintains a non-leveraged employee stock ownership plan (ESOP) and a profit sharing plan which cover substantially all of its employees. Effective December 31, 2006, the ESOP plan was frozen to new participants. Contributions to the plans are discretionary and are approved by the Board of Directors and recorded as compensation expense. Expenses related to the plans for 2008, 2007, and 2006 were \$0, \$115, and \$13, respectively. Total allocated shares outstanding related to the ESOP at December 31, 2008, 2007, and 2006 were 271,520, 149,154, and 161,762, respectively, were included in the computation of dividends and earnings per share in each of the respective years and have not been adjusted for the 10% stock dividend paid February 29, 2008.

The Corporation maintains a self-funded medical plan under which the Corporation is responsible for the first \$50 per year of claims made by a covered family. Medical claims are subject to a lifetime maximum of \$5,000 per covered individual. Expenses are accrued based on estimates of the aggregate liability for claims incurred and the Corporation's experience. Expenses were \$2,110 in 2008, \$1,804 in 2007 and \$1,316 in 2006.

The Corporation offers dividend reinvestment, and employee and director stock purchase plans. The dividend reinvestment plan allows shareholders to purchase previously unissued Isabella Bank Corporation common shares. The stock purchase plan allows employees and directors to purchase Isabella Bank Corporation common stock through payroll deduction. The number of shares reserved for issuance under these plans are 635,000, with 314,856 shares unissued at December 31, 2008, as adjusted for the 10% stock dividend paid February 29, 2008. During 2008, 2007 and 2006, 78,994 shares were issued for \$2,879, 63,233 shares were issued for \$2,657 and 61,258 shares were issued for \$2,459, respectively, in cash pursuant to these plans, exclusive of the effects of the 10% stock dividend paid February 29, 2008.

***401(k) Plan***

The Corporation has a 401(k) plan in which substantially all employees are eligible to participate. Employees may contribute up to 100% of their compensation subject to certain limits based on federal tax laws. The Corporation began making matching contributions equal to 25% of the first 3% of an employee's compensation contributed to the plan in 2005. Employees are 0% vested through their first two years of employment and are 100% vested after 6 years of service.

As a result of the curtailment of the defined benefit plan noted above, the Corporation decided to increase the contributions to the Corporation's 401(k) plan effective January 1, 2007. The enhancement includes an automatic 3.0% contribution for all eligible employees and matching contributions equal to 50% of the first 4.0% of an

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

employee's compensation contributed to the Plan during the year. For the year ended December 31, 2008 and 2007, expenses attributable to the Plan were \$543 and \$439, respectively.

***Equity Compensation Plan***

Pursuant to the terms of the Deferred Compensation Plan for Directors, directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees to the Plan. The fees are converted to stock units based on the fair market value of a share of common stock as of the relevant valuation date. Stock credited to a participant's account is eligible for stock and cash dividends as declared. Upon retirement from the board or the occurrence of certain other events, the participant is eligible to receive a lump-sum, in-kind, distribution of all of the stock that is then in his or her account, and any unconverted cash will be converted to and rounded up to whole shares of stock and distributed, as well. The Plan as modified does not allow for cash settlement, and therefore, such share-based payment awards qualify for classification as equity. All authorized but unissued shares of common stock are eligible for issuance under this Plan. The Corporation may also purchase shares of common stock from the open market to meet its obligations under the Plan. Under the Plan, the Corporation was to issue \$3,766 in dollar value of common stock or 186,766 shares and \$3,772 or 198,939 shares as of December 31, 2008 and 2007, respectively as adjusted for the 10% stock dividend paid on February 29, 2008, pursuant to the antidilution provision required by the Plan.

On December 17, 2008, the Corporation established a Rabbi Trust effective as of July 1, 2008, to fund the Plan. A Rabbi Trust is an irrevocable grantor trust to which the Corporation may contribute assets for the limited purpose of funding a nonqualified deferred compensation plan. Although the Corporation may not reach the assets of the Rabbi Trust for any purpose other than meeting its obligations under the plan, the assets of the trust remain subject to the claims of the Corporation's creditors and are included in the consolidated financial statements. The Corporation may contribute cash or common stock to the trust from time to time for the sole purpose of funding the Plan. The trust will use any cash that the Corporation contributed to purchase shares of the Corporation's common stock on the open market through the Corporation's brokerage services department.

Since July 1, 2008, the Corporation has transferred \$249 of cash to the Rabbi Trust. As of December 31, 2008, the Trust held 5,248 shares of the Corporation's common stock for settlement.

**Note 18 Comprehensive Income (Loss)**

Comprehensive income (loss) includes net income as well as unrealized gains and losses, net of tax, on available-for-sale investment securities owned and changes in the funded status of the Corporation's defined benefit pension plan, which are excluded from net income. Unrealized investment securities gains and losses and changes in the funded status of the pension plan, net of tax, are excluded from net income, and are reflected as a direct charge or credit to shareholders' equity. Comprehensive income (loss) and the related components are disclosed in the accompanying consolidated statements of comprehensive income for each of the years ended December 31, 2008, 2007, and 2006.

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

|  | 2008 | 2007 |
|--|------|------|
|--|------|------|

|  |                   |                 |
|--|-------------------|-----------------|
| Unrealized gains on available-for-sale investment securities | \$ (3,216)        | \$ 555          |
| Unrecognized pension costs                                   | (2,353)           | (821)           |
| <b>Accumulated other comprehensive loss</b>                  | <b>\$ (5,569)</b> | <b>\$ (266)</b> |

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 19 Related Party Transactions**

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

|                   | <b>2008</b> | <b>2007</b> |
|-------------------|-------------|-------------|
| Beginning balance | \$ 10,461   | \$ 10,749   |
| New loans         | 3,488       | 8,720       |
| Repayments        | (9,938)     | (9,008)     |
| Ending Balance    | \$ 4,011    | \$ 10,461   |

Total deposits of these principal officers and directors and their affiliates amounted to \$8,317 and \$10,526 at December 31, 2008 and 2007, respectively. In addition, Isabella Bank Corporation's Employee Stock Ownership Plan (Note 17) held deposits with the Bank aggregating \$370 and \$928, respectively, at December 31, 2008 and 2007.

**Note 20 Financial Instruments Recorded at Fair Value**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS No. 159, the Corporation may elect to measure many financial instruments and certain other assets and liabilities at fair value ( fair value option FVO). The fair value measurement option is not allowable for deposit or withdrawable on demand liabilities. If the use of fair value is elected, any upfront costs and fees related to the instrument must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and is generally made on an instrument-by-instrument basis, even if the Corporation has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings as of January 1, 2007. Subsequent to the adoption of SFAS No. 159, changes in fair value are recognized in earnings. Although SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and would have been required to be adopted by Isabella Bank Corporation in the first quarter of fiscal 2008, Isabella Bank Corporation elected to early adopt SFAS No. 159 effective January 1, 2007, the impact of which is detailed in the table below.

As shown in the following table, the Corporation elected to transfer \$77,839 of its \$213,450 available-for-sale securities investment portfolio to trading status to facilitate more active trading of these securities. In determining which available-for-sale securities to transfer, the Corporation considered interest rates, duration, marketability, and balance sheet management strategies. The securities transferred included obligations of US Government Agencies, variable rate Federal National Mortgage Association and Federal Home Loan Mortgage Corporation mortgage backed securities, taxable municipal bonds, and a limited number of tax exempt bonds.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Corporation also elected to report \$7,256 of long-term, relatively high interest rate, Federal Home Loan Bank advances at their fair value upon the early adoption of SFAS No. 159 to provide a hedge against significant movement in interest rates.

|   | <b>Balance Sheet<br/>1/1/2007 Prior<br/>to<br/>Adoption of<br/>FVO</b> | <b>Net Gain/<br/>(Loss ) Upon<br/>Adoption of<br/>FVO</b> | <b>Balance Sheet<br/>1/1/2007 After<br/>Adoption of<br/>FVO</b> |
|---|--|---|---|
| Investment securities   | \$ 79,198  | \$ (1,359)  | \$ 77,839   |
| FHLB borrowings included in other borrowed funds  | (7,256)  | (232)   | (7,488)   |
| Pretax cumulative loss effect of adoption of the fair value option  |  | (1,591)   |   |
| Increase in deferred tax asset  |  | 541   |   |
| Cumulative loss effect of adoption of the fair value option (charged as a reduction to retained earnings as of January 1, 2007) |  | \$ (1,050)  |   |

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, derivatives 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,

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

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 described in Note 4.

***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.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****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 1.

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

|   | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|
| Level 3 inputs January 1  | \$ 12,694   | \$ 13,723   |
| Purchases   | 2,307       |             |
| Maturities  | (1,255)     | (1,029)     |
| Transfers of securities into level 3 due to changes in the observability of significant inputs (illiquid markets) | 11,000      |             |
| Net unrealized losses on available-for-sale investment securities   | (5,355)     |             |
| Level 3 inputs December 31  | \$ 19,391   | \$ 12,694   |

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

| <b>Description</b> | <b>Total</b> | <b>2008</b>      |                  |                  |
|--------------------|--------------|------------------|------------------|------------------|
|                    |              | <b>(Level 1)</b> | <b>(Level 2)</b> | <b>(Level 3)</b> |

**Recurring Items**

|  |           |           |           |        |
|--|-----------|-----------|-----------|--------|
| Trading securities                       | \$ 21,775 | \$ 10,175 | \$ 11,600 | \$     |
| Investment securities available for sale | 246,455   | 89,507    | 137,557   | 19,391 |
| Mortgage loans available for sale        | 898       |           | 898       |        |
| Other borrowed funds                     | 23,130    | 23,130    |           |        |

**Nonrecurring Items**

|                           |        |  |       |        |
|---------------------------|--------|--|-------|--------|
| Impaired loans            | 10,014 |  |       | 10,014 |
| Mortgage servicing rights | 2,105  |  | 2,105 |        |
| Foreclosed assets         | 2,923  |  | 2,923 |        |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

| Description                              | Total     | 2007      |           | (Level 3) |
|--|-----------|-----------|-----------|-----------|
|  |           | (Level 1) | (Level 2) |           |
| <b>Recurring Items</b>                   |           |           |           |           |
| Trading securities                       | \$ 25,064 | \$ 14,741 | \$ 10,323 | \$        |
| Investment securities available for sale | 213,127   | 57,871    | 142,562   | 12,694    |
| Mortgage loans available for sale        | 2,214     |           | 2,214     |           |
| Other borrowed funds                     | 7,523     | 7,523     |           |           |
| <b>Nonrecurring Items</b>                |           |           |           |           |
| Impaired loans                           | 3,779     |           |           | 3,779     |
| Mortgage servicing rights                | 2,198     |           | 2,198     |           |
| Foreclosed assets                        | 1,376     |           | 1,376     |           |

The Corporation had 10.8% and 6.5% of Level 3 assets as a percentage of total assets and liabilities measured at fair value as of December 31, 2008 and 2007, respectively.

The changes in fair value of assets and liabilities recorded at fair value through earnings on a recurring basis and changes in assets and liabilities recorded at fair value on a nonrecurring basis, for which impairment was recognized in the years ended December 31, 2008 and 2007, are summarized as follows:

| Description               | Year Ended December 31              |   |          |                                     |   |        |
|---------------------------|-------------------------------------|---|----------|-------------------------------------|---|--------|
|                           | Trading<br>Gains<br>and<br>(Losses) | 2008<br>Other<br>Gains<br>and<br>(Losses) | Total    | Trading<br>Gains<br>and<br>(Losses) | 2007<br>Other<br>Gains<br>and<br>(Losses) | Total  |
| <b>Recurring Items</b>    |                                     |   |          |                                     |   |        |
| Trading securities        | \$ 245                              | \$  | \$ 245   | \$ 460                              | \$  | \$ 460 |
| Other borrowed funds      |                                     | (641)                                     | (641)    |                                     | (66)                                      | (66)   |
| <b>Nonrecurring Items</b> |                                     |   |          |                                     |   |        |
| Impaired loans            |                                     | (71)                                      | (71)     |                                     |   |        |
| Mortgage servicing rights |                                     | (115)                                     | (115)    |                                     | (5)                                       | (5)    |
| Foreclosed assets         |                                     | (231)                                     | (231)    |                                     | (109)                                     | (109)  |
|                           |                                     |   | \$ (813) |                                     |   | \$ 280 |

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.

The activity in the trading portfolio of investment securities was as follows for the years ended December 31, 2008 and 2007:

|                              | <b>2008</b>       | <b>2007</b>        |
|------------------------------|-------------------|--------------------|
| Purchases                    | \$ 11,010         | \$ 7,654           |
| Sales, calls, and maturities | (14,544)          | (62,248)           |
| <b>Total</b>                 | <b>\$ (3,534)</b> | <b>\$ (54,594)</b> |

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The net loss on trading securities represents mark-to-market adjustments. Included in the net trading losses of \$245 during 2008, was \$262 of net trading gains on securities that were held in the Corporation's trading portfolio as of December 31, 2008.

The activity in borrowings carried at fair value was as follows for years ended December 31, 2008 and 2007:

|                              | <b>2008</b>      | <b>2007</b>    |
|------------------------------|------------------|----------------|
| Issuances                    | \$ 15,000        | \$             |
| Sales, calls, and maturities | (34)             | (31)           |
| <b>Total</b>                 | <b>\$ 14,966</b> | <b>\$ (31)</b> |

**Note 21 Fair Values of Financial Instruments**

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

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

***Cash and cash equivalents:***

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

***Investment securities:***

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are unavailable, fair values are based on quoted market prices of comparable instruments or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions.

***Mortgage loans available for sale:***

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

***Loans receivable:***

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans (e.g. , real estate mortgage, agricultural, commercial, and installment) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The resulting amounts are adjusted to estimate the effect of declines, if any, in the credit quality of borrowers since the loans were originated. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

***Mortgage servicing rights:***

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

***Deposit liabilities:***

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

***Short-term borrowings:***

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

***Borrowings:***

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

***Accrued interest:***

The carrying amounts of accrued interest approximate fair value.

***Derivative financial instruments:***

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

***Off-balance-sheet credit-related instruments:***

Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the counterparties' credit standings. The Corporation does not charge fees for lending commitments; thus it is not practicable to estimate the fair value of these instruments.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following sets forth the estimated fair value and recorded carrying values of the Corporation's financial instruments as of December 31:

|  | <b>2008</b>                         |                           | <b>2007</b>                         |                           |
|--|-------------------------------------|---------------------------|-------------------------------------|---------------------------|
|  | <b>Estimated<br/>Fair<br/>Value</b> | <b>Carrying<br/>Value</b> | <b>Estimated<br/>Fair<br/>Value</b> | <b>Carrying<br/>Value</b> |
| <b>ASSETS</b>                            |                                     |                           |                                     |                           |
| Cash and demand deposits due from banks  | \$ 23,554                           | \$ 23,554                 | \$ 25,583                           | \$ 25,583                 |
| Trading securities                       | 21,775                              | 21,775                    | 25,064                              | 25,064                    |
| Investment securities available for sale | 246,455                             | 246,455                   | 213,127                             | 213,127                   |
| Mortgage loans available for sale        | 905                                 | 898                       | 2,228                               | 2,214                     |
| Net loans                                | 743,110                             | 723,403                   | 606,840                             | 605,386                   |
| Accrued interest receivable              | 6,322                               | 6,322                     | 5,948                               | 5,948                     |
| Mortgage servicing rights                | 2,105                               | 2,105                     | 2,198                               | 2,198                     |
| <b>LIABILITIES</b>                       |                                     |                           |                                     |                           |
| Deposits with no stated maturities       | 394,042                             | 394,042                   | 387,054                             | 387,054                   |
| Deposits with stated maturities          | 387,291                             | 381,588                   | 348,488                             | 346,419                   |
| Borrowed funds                           | 230,130                             | 222,350                   | 91,897                              | 92,887                    |
| Accrued interest payable                 | 1,334                               | 1,334                     | 1,284                               | 1,284                     |

**Note 22 Parent Company Only Financial Information (Unaudited)****Condensed Balance Sheets**

|  | <b>December 31</b> |                   |
|--|--------------------|-------------------|
|  | <b>2008</b>        | <b>2007</b>       |
| <b>ASSETS</b>                              |                    |                   |
| Cash on deposit at subsidiary Bank         | \$ 1,144           | \$ 14,265         |
| Securities available for sale              | 2,140              | 2,210             |
| Investments in subsidiaries                | 82,673             | 77,486            |
| Premises and equipment                     | 2,043              | 3,637             |
| Other assets                               | 52,096             | 26,309            |
| <b>Total Assets</b>                        | <b>\$ 140,096</b>  | <b>\$ 123,907</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b> |                    |                   |
| Other liabilities                          | \$ 5,620           | \$ 827            |
| Shareholders' equity                       | 134,476            | 123,080           |

|  |                   |                   |
|--|-------------------|-------------------|
| <b>Total Liabilities and Shareholders Equity</b> | <b>\$ 140,096</b> | <b>\$ 123,907</b> |
|--|-------------------|-------------------|

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Statements of Income**

|   | <b>Year Ended December 31</b> |                 |                 |
|---|-------------------------------|-----------------|-----------------|
|   | <b>2008</b>                   | <b>2007</b>     | <b>2006</b>     |
| Income  |                               |                 |                 |
| Dividends from subsidiaries   | \$ 5,800                      | \$ 15,975       | \$ 4,025        |
| Interest income   | 88                            | 177             | 305             |
| Management fee and other  | 1,011                         | 1,517           | 1,280           |
| <b>Total income</b>   | <b>6,899</b>                  | <b>17,669</b>   | <b>5,610</b>    |
| Expenses  | 3,989                         | 3,890           | 3,872           |
| Income before income tax benefit and equity in undistributed earnings of subsidiaries | 2,910                         | 13,779          | 1,738           |
| Federal income tax benefit  | 905                           | 773             | 825             |
|   | 3,815                         | 14,552          | 2,563           |
| Undistributed earnings (distributions in excess of earnings) of subsidiaries          | 286                           | (6,622)         | 4,438           |
| <b>Net income</b>   | <b>\$ 4,101</b>               | <b>\$ 7,930</b> | <b>\$ 7,001</b> |

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

|  | <b>Year Ended December 31</b> |                  |                 |
|--|-------------------------------|------------------|-----------------|
|  | <b>2008</b>                   | <b>2007</b>      | <b>2006</b>     |
| <b>Operating Activities</b>  |                               |                  |                 |
| Net income   | \$ 4,101                      | \$ 7,930         | \$ 7,001        |
| Adjustments to reconcile net income to cash provided by operations     |                               |                  |                 |
| Undistributed earnings of subsidiaries                                 | (286)                         | 6,622            | (4,438)         |
| Share based payment awards   | 603                           | 758              | 470             |
| Depreciation   | 294                           | 592              | 591             |
| Net amortization of investment securities                              | 5                             | 4                | 21              |
| Realized loss on sale of investment securities                         |                               |                  | 8               |
| Deferred income taxes (benefit)  | 162                           | (165)            | 128             |
| Changes in operating assets and liabilities which provided (used) cash |                               |                  |                 |
| Interest receivable  | 1                             | (2)              | 29              |
| Other assets   | (817)                         | (776)            | (522)           |
| Accrued interest and other expenses                                    | 583                           | (389)            | 138             |
| <b>Net Cash Provided by Operating Activities</b>                       | <b>4,646</b>                  | <b>14,574</b>    | <b>3,426</b>    |
| <b>Investing Activities</b>  |                               |                  |                 |
| Activity in available-for-sale securities                              |                               |                  |                 |
| Maturities, calls, and sales   | 110                           | 595              | 6,650           |
| Purchases  |                               | (266)            | (4,380)         |
| Sales (purchases) of equipment and premises                            | 1,300                         | (1,135)          | (660)           |
| Advances to subsidiaries   | (11,927)                      | (50)             | (8,394)         |
| <b>Net Cash Used in Investing Activities</b>                           | <b>(10,517)</b>               | <b>(856)</b>     | <b>(6,784)</b>  |
| <b>Financing Activities</b>  |                               |                  |                 |
| Net increase in other borrowed funds                                   | 1,836                         |                  |                 |
| Cash dividends paid on common stock                                    | (4,873)                       | (4,304)          | (3,775)         |
| Proceeds from the issuance of common stock                             | 2,476                         | 2,657            | 2,459           |
| Common stock repurchased   | (6,440)                       | (1,881)          |                 |
| Common stock purchased for deferred compensation obligations           | (249)                         |                  |                 |
| <b>Net Cash Used in Financing Activities</b>                           | <b>(7,250)</b>                | <b>(3,528)</b>   | <b>(1,316)</b>  |
| <b>(Decrease) Increase in Cash and Cash Equivalents</b>                | <b>(13,121)</b>               | <b>10,190</b>    | <b>(4,674)</b>  |
| Cash and cash equivalents at beginning of year                         | 14,265                        | 4,075            | 8,749           |
| <b>Cash and Cash Equivalents at End of Year</b>                        | <b>\$ 1,144</b>               | <b>\$ 14,265</b> | <b>\$ 4,075</b> |

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

**Note 23 Operating Segments**

In prior years, the Corporation's reportable segments were based on legal entities that account for at least 10% of 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. Retail banking operations for 2008, 2007, and 2006 represent approximately 90% or greater of the Corporation's total assets and operating results. As such, no additional segment information is presented.

**Note 24 Adjustments Affecting Fourth Quarter Results of Operations**

In the fourth quarter of 2008, due to the increased deterioration of the overall credit quality of the Corporation's loan portfolio as well as the increased uncertainty related to the overall stability of the economy, the Corporation recorded a provision for loan losses in the amount of \$5,725, which contributed to a net operating loss of \$2,041 for the three months ended December 31, 2008. Management does not believe this adjustment is attributable to conditions that were apparent in previous quarters. The aggregate effect of the \$5,725 provision for loan losses (\$3,779 net of tax) was to reduce net income per share by \$0.50.

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**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.

**Table of Contents****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             | Tax           | Average      | Average           | Tax           | Average      | Average           | Tax           | Average      |
|                                      | Balance             | Equivalent    | Yield/       | Balance           | Equivalent    | Yield/       | Balance           | Equivalent    | Yield/       |
|                                      |                     | Interest      | Rate         |                   | Interest      | Rate         |                   | Interest      | Rate         |
| <b>INTEREST EARNING ASSETS:</b>      |                     |               |              |                   |               |              |                   |               |              |
| 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%        |
| <b>Total earning assets</b>          | <b>996,595</b>      | <b>64,173</b> | <b>6.44%</b> | <b>834,334</b>    | <b>56,242</b> | <b>6.74%</b> | <b>729,528</b>    | <b>46,335</b> | <b>6.35%</b> |
| <b>NON EARNING ASSETS:</b>           |                     |               |              |                   |               |              |                   |               |              |
| 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            |               |              |
| <b>Total assets</b>                  | <b>\$ 1,113,102</b> |               |              | <b>\$ 925,631</b> |               |              | <b>\$ 800,174</b> |               |              |
| <b>INTEREST BEARING LIABILITIES:</b> |                     |               |              |                   |               |              |                   |               |              |
|                                      | \$ 114,889          | 813           | 0.71%        | \$ 109,370        | 1,880         | 1.72%        | \$ 105,476        | 1,664         | 1.58%        |

|   |                     |                  |              |                   |                  |              |                   |                  |              |
|---|---------------------|------------------|--------------|-------------------|------------------|--------------|-------------------|------------------|--------------|
| Interest bearing                                  |                     |                  |              |                   |                  |              |                   |                  |              |
| Demand deposits                                   |                     |                  |              |                   |                  |              |                   |                  |              |
| 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%        |
| <b>Total interest bearing liabilities</b>         | <b>867,291</b>      | <b>25,606</b>    | <b>2.95%</b> | <b>716,220</b>    | <b>25,959</b>    | <b>3.62%</b> | <b>618,652</b>    | <b>19,732</b>    | <b>3.19%</b> |
| <b>NONINTEREST BEARING LIABILITIES:</b>           |                     |                  |              |                   |                  |              |                   |                  |              |
| Demand deposits                                   | 95,552              |                  |              | 80,128            |                  |              | 73,650            |                  |              |
| Other   | 6,633               |                  |              | 10,037            |                  |              | 15,908            |                  |              |
| Shareholders' equity                              | 143,626             |                  |              | 119,246           |                  |              | 91,964            |                  |              |
| <b>Total liabilities and equity</b>               | <b>\$ 1,113,102</b> |                  |              | <b>\$ 925,631</b> |                  |              | <b>\$ 800,174</b> |                  |              |
| <b>Net interest income (FTE)</b>                  |                     | <b>\$ 38,567</b> |              |                   | <b>\$ 30,283</b> |              |                   | <b>\$ 26,603</b> |              |
| <b>Net yield on interest earning assets (FTE)</b> |                     |                  | <b>3.87%</b> |                   |                  | <b>3.63%</b> |                   |                  | <b>3.65%</b> |

### Net Interest Income

The Corporation derives the majority of its gross income from interest earned on loans and investments, while its most significant expense is the interest cost incurred for funds used. Net interest income is the amount by which interest income on earning assets exceeds the interest cost of deposits and borrowings. Net interest income is influenced by changes in the balance and mix of assets and liabilities and market interest rates. Management exerts

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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      |                 |                 | 2007 Compared to 2006      |               |                 |
|--|----------------------------|-----------------|-----------------|----------------------------|---------------|-----------------|
|  | Increase (Decrease) Due to |                 |                 | Increase (Decrease) Due to |               |                 |
|  | Volume                     | Rate            | Net             | Volume                     | Rate          | Net             |
| <b>CHANGES IN INTEREST INCOME:</b>         |                            |                 |                 |                            |               |                 |
| 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              |
| <b>Total changes in interest income</b>    | <b>10,443</b>              | <b>(2,512)</b>  | <b>7,931</b>    | <b>7,074</b>               | <b>2,833</b>  | <b>9,907</b>    |
| <b>CHANGES IN INTEREST EXPENSE:</b>        |                            |                 |                 |                            |               |                 |
| 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             |
| <b>Total changes in interest expense</b>   | <b>5,665</b>               | <b>(6,018)</b>  | <b>(353)</b>    | <b>3,569</b>               | <b>2,658</b>  | <b>6,227</b>    |
| <b>Net change in interest margin (FTE)</b> | <b>\$ 4,778</b>            | <b>\$ 3,506</b> | <b>\$ 8,284</b> | <b>\$ 3,505</b>            | <b>\$ 175</b> | <b>\$ 3,680</b> |

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

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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.

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

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

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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.

**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<br>Amount | % of<br>Each<br>Category<br>to<br>Total<br>Loans | Allowance<br>Amount | % of<br>Each<br>Category<br>to<br>Total<br>Loans | Allowance<br>Amount | % of<br>Each<br>Category<br>to<br>Total<br>Loans | Allowance<br>Amount | % of<br>Each<br>Category<br>to<br>Total<br>Loans | Allowance<br>Amount | % of<br>Each<br>Category<br>to<br>Total<br>Loans |
| Commercial and       | \$ 3,632            | 50.7%  | \$ 2,458            | 46.0%  | \$ 2,687            | 43.3%  | \$ 2,771            | 46.9%  | \$ 2,634            | 42.0%  |
| Cultural             | 3,832               | 43.4%  | 1,341               | 48.6%  | 1,367               | 50.9%  | 1,192               | 46.8%  | 1,463               | 50.0%  |
| Real estate mortgage | 1,736               | 4.5%   | 2,195               | 4.8%   | 2,434               | 5.1%   | 2,286               | 5.8%   | 1,606               | 6.0%   |
| Consumer installment | 2,065               | 1.4%   | 703                 | 0.6%   | 594                 | 0.7%   | 184                 | 0.5%   | 304                 | 0.0%   |
| Secured loans        | 717                 | 0.0%   | 604                 | 0.0%   | 523                 | 0.0%   | 466                 | 0.0%   | 437                 | 0.0%   |
| Unallocated          |                     |  |                     |  |                     |  |                     |  |                     |  |
| <b>Total</b>         | <b>\$ 11,982</b>    | <b>100.0%</b>                                    | <b>\$ 7,301</b>     | <b>100.0%</b>                                    | <b>\$ 7,605</b>     | <b>100.0%</b>                                    | <b>\$ 6,899</b>     | <b>100.0%</b>                                    | <b>\$ 6,444</b>     | <b>100.0%</b>                                    |

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.

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

**Nonperforming Assets**

|  | <b>Year Ended December 31,</b> |                 |                 |                 |                 |
|--|--------------------------------|-----------------|-----------------|-----------------|-----------------|
|  | <b>2008</b>                    | <b>2007</b>     | <b>2006</b>     | <b>2005</b>     | <b>2004</b>     |
| 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             |
| <b>Total nonperforming loans</b>                   | <b>16,976</b>                  | <b>6,568</b>    | <b>5,326</b>    | <b>3,158</b>    | <b>3,288</b>    |
| Other real estate owned                            | 2,770                          | 1,376           | 562             | 122             | 40              |
| Repossessed assets                                 | 153                            |                 |                 |                 |                 |
| <b>Total nonperforming assets</b>                  | <b>\$ 19,899</b>               | <b>\$ 7,944</b> | <b>\$ 5,888</b> | <b>\$ 3,280</b> | <b>\$ 3,328</b> |
| <b>Nonperforming loans as a % of total loans</b>   | <b>2.31%</b>                   | <b>1.07%</b>    | <b>0.90%</b>    | <b>0.65%</b>    | <b>0.73%</b>    |
| <b>Nonperforming assets as a % of total assets</b> | <b>1.75%</b>                   | <b>0.83%</b>    | <b>0.65%</b>    | <b>0.44%</b>    | <b>0.49%</b>    |

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 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.

**Table of Contents****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       |  |
|---|-----------------|-----------------|------------------------|---------------|-----------------|---------------|--------------|--|
|   | 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%         |  |
| <b>Total service charges and fees</b>                             | <b>6,370</b>    | <b>5,894</b>    | <b>476</b>             | <b>8.1%</b>   | <b>5,490</b>    | <b>404</b>    | <b>7.4%</b>  |  |
| 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%        |  |
| 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   | 225             | 584             | (359)                  | -61.5%        | 507             | 77            | 15.2%        |  |
| <b>Total other</b>  | <b>704</b>      | <b>1,207</b>    | <b>(503)</b>           | <b>-41.7%</b> | <b>1,012</b>    | <b>195</b>    | <b>19.3%</b> |  |
| <b>Total noninterest income</b>                                   | <b>\$ 7,802</b> | <b>\$ 9,962</b> | <b>\$ (2,160)</b>      | <b>-21.7%</b> | <b>\$ 9,098</b> | <b>\$ 864</b> | <b>9.5%</b>  |  |

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

|   | Year Ended December 31 |                 |                   |               |                 |               |              |  |
|---|------------------------|-----------------|-------------------|---------------|-----------------|---------------|--------------|--|
|   | 2008                   | 2007            | Change            |               | 2006            | Change        |              |  |
|   |                        |                 | \$                | %             |                 | \$            | %            |  |
| 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%         |  |
| <b>Total service charges and fees</b>                             | <b>5,957</b>           | <b>5,894</b>    | <b>63</b>         | <b>1.1%</b>   | <b>5,490</b>    | <b>404</b>    | <b>7.4%</b>  |  |
| 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%        |  |
| <b>Total other</b>  | <b>646</b>             | <b>1,207</b>    | <b>(561)</b>      | <b>-46.5%</b> | <b>1,012</b>    | <b>195</b>    | <b>19.3%</b> |  |
| <b>Total noninterest income</b>                                   | <b>\$ 7,280</b>        | <b>\$ 9,962</b> | <b>\$ (2,682)</b> | <b>-26.9%</b> | <b>\$ 9,098</b> | <b>\$ 864</b> | <b>9.5%</b>  |  |

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

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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).

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.

**Table of Contents****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       |  |
|--------------------------------------|---------------|---------------|------------------------|--------------|---------------|--------------|--------------|--|
|                                      | 2008          | 2007          | \$                     | %            | 2006          | \$           | %            |  |
| <b>Compensation</b>                  |               |               |                        |              |               |              |              |  |
| 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%         |  |
| <b>Total compensation</b>            | <b>16,992</b> | <b>15,618</b> | <b>1,374</b>           | <b>8.8%</b>  | <b>13,869</b> | <b>1,749</b> | <b>12.6%</b> |  |
| <b>Occupancy</b>                     |               |               |                        |              |               |              |              |  |
| 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%       |  |
| <b>Total occupancy</b>               | <b>2,035</b>  | <b>1,766</b>  | <b>269</b>             | <b>15.2%</b> | <b>1,730</b>  | <b>36</b>    | <b>2.1%</b>  |  |
| <b>Furniture and equipment</b>       |               |               |                        |              |               |              |              |  |
| 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%        |  |
| <b>Total furniture and equipment</b> | <b>3,849</b>  | <b>3,297</b>  | <b>552</b>             | <b>16.7%</b> | <b>2,868</b>  | <b>429</b>   | <b>15.0%</b> |  |
| <b>Other</b>                         |               |               |                        |              |               |              |              |  |
| 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%        |  |
| Amortization of deposit premium      | 415           | 278           | 137                    | 49.3%        | 160           | 118          | 73.8%        |  |
| Foreclosed assets                    | 419           | 157           | 262                    | 166.9%       | 41            | 116          | N/M          |  |

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|                                   |                  |                  |                 |              |                  |                 |              |
|-----------------------------------|------------------|------------------|-----------------|--------------|------------------|-----------------|--------------|
| 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%        |
| <b>Total other</b>                | <b>7,828</b>     | <b>6,548</b>     | <b>1,280</b>    | <b>19.5%</b> | <b>6,006</b>     | <b>542</b>      | <b>9.0%</b>  |
| <b>Total noninterest expenses</b> | <b>\$ 30,704</b> | <b>\$ 27,229</b> | <b>\$ 3,475</b> | <b>12.8%</b> | <b>\$ 24,473</b> | <b>\$ 2,756</b> | <b>11.3%</b> |

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

|                                      | Year Ended December 31 |               |             |              |               |              |              |  |
|--------------------------------------|------------------------|---------------|-------------|--------------|---------------|--------------|--------------|--|
|                                      | 2008                   | 2007          | Change      |              | 2006          | Change       |              |  |
|                                      |                        |               | \$          | %            |               | \$           | %            |  |
| 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%         |  |
| <b>Total compensation</b>            | <b>15,537</b>          | <b>15,618</b> | <b>(81)</b> | <b>-0.5%</b> | <b>13,869</b> | <b>1,749</b> | <b>12.6%</b> |  |
| 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%       |  |
| <b>Total occupancy</b>               | <b>1,814</b>           | <b>1,766</b>  | <b>48</b>   | <b>2.7%</b>  | <b>1,730</b>  | <b>36</b>    | <b>2.1%</b>  |  |
| 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%        |  |
| <b>Total furniture and equipment</b> | <b>3,512</b>           | <b>3,297</b>  | <b>215</b>  | <b>6.5%</b>  | <b>2,868</b>  | <b>429</b>   | <b>15.0%</b> |  |
| 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%       |  |

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|                                   |                  |                  |               |             |                  |                 |              |
|-----------------------------------|------------------|------------------|---------------|-------------|------------------|-----------------|--------------|
| 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%        |
| <b>Total other</b>                | <b>6,993</b>     | <b>6,548</b>     | <b>445</b>    | <b>6.8%</b> | <b>6,006</b>     | <b>542</b>      | <b>9.0%</b>  |
| <b>Total noninterest expenses</b> | <b>\$ 27,856</b> | <b>\$ 27,229</b> | <b>\$ 627</b> | <b>2.3%</b> | <b>\$ 24,473</b> | <b>\$ 2,756</b> | <b>11.3%</b> |

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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.

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

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reconciliation 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.

**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.

|  | <b>December 31</b>  |                   | <b>\$ Change</b>  | <b>% Change</b> |
|--|---------------------|-------------------|-------------------|-----------------|
|  | <b>2008</b>         | <b>2007</b>       |                   |                 |
| <b>ASSETS</b>  |                     |                   |                   |                 |
| 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%          |
| <b>Total assets</b>  | <b>\$ 1,139,263</b> | <b>\$ 957,282</b> | <b>\$ 181,981</b> | <b>19.01%</b>   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                |                     |                   |                   |                 |
| <b>Liabilities</b>   |                     |                   |                   |                 |
| 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%          |
| <b>Total liabilities</b>                                   | <b>1,004,787</b>    | <b>834,202</b>    | <b>170,585</b>    | <b>20.45%</b>   |
| <b>Shareholders' equity</b>                                | <b>134,476</b>      | <b>123,080</b>    | <b>11,396</b>     | <b>9.26%</b>    |
| <b>Total liabilities and shareholders' equity</b>          | <b>\$ 1,139,263</b> | <b>\$ 957,282</b> | <b>\$ 181,981</b> | <b>19.01%</b>   |

**Table of Contents****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      |
| <b>ASSETS</b>  |                     |                   |                  |               |
| 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%        |
| <b>Total assets</b>  | <b>\$ 1,031,276</b> | <b>\$ 957,282</b> | <b>\$ 73,994</b> | <b>7.73%</b>  |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                 |                     |                   |                  |               |
| <b>Liabilities</b>   |                     |                   |                  |               |
| 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%        |
| <b>Total liabilities</b>                                   | <b>908,865</b>      | <b>834,202</b>    | <b>74,663</b>    | <b>8.95%</b>  |
| <b>Shareholders equity</b>                                 | <b>122,411</b>      | <b>123,080</b>    | <b>(669)</b>     | <b>-0.54%</b> |
| <b>Total liabilities and shareholders equity</b>           | <b>\$ 1,031,276</b> | <b>\$ 957,282</b> | <b>\$ 73,994</b> | <b>7.73%</b>  |

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).

**Table of Contents****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:

|                                      | 2008              | December 31<br>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            |
| <b>Total</b>                         | <b>\$ 246,455</b> | <b>\$ 213,127</b>   | <b>\$ 213,450</b> |

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

|                                      | December 31<br>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            |
| <b>Total</b>                         | <b>\$ 21,775</b>    | <b>\$ 25,064</b> |

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).

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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.

|                                      | <b>Maturing</b>        |                  |                          |                  |                         |                  |                        |                        |
|--------------------------------------|------------------------|------------------|--------------------------|------------------|-------------------------|------------------|------------------------|------------------------|
|                                      | <b>After One Year</b>  |                  | <b>After Five Years</b>  |                  | <b>After Five Years</b> |                  | <b>After Ten Years</b> |                        |
|                                      | <b>Within One Year</b> | <b>But</b>       | <b>Within Five Years</b> | <b>But</b>       | <b>Within Ten Years</b> | <b>But</b>       | <b>After Ten Years</b> | <b>After Ten Years</b> |
|                                      | <b>Amount</b>          | <b>Yield (%)</b> | <b>Amount</b>            | <b>Yield (%)</b> | <b>Amount</b>           | <b>Yield (%)</b> | <b>Amount</b>          | <b>Yield (%)</b>       |
| 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             |                          |                  |                         |                  |                        |                        |
| <b>Total</b>                         | <b>\$ 27,188</b>       | <b>4.76</b>      | <b>\$ 75,249</b>         | <b>5.00</b>      | <b>\$ 82,617</b>        | <b>5.41</b>      | <b>\$ 61,401</b>       | <b>4.90</b>            |

**Loans**

The largest component of earning assets is loans. The proper management of credit and market risk inherent in the loan portfolio is critical to the financial well-being of the Corporation. To control these risks, the Corporation has adopted strict underwriting standards. 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:

|                                  | <b>2008</b>       | <b>2007</b>       | <b>2006</b>       | <b>2005</b>       | <b>2004</b>       |
|----------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| 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            |
|                                  | <b>\$ 735,385</b> | <b>\$ 612,687</b> | <b>\$ 591,042</b> | <b>\$ 483,242</b> | <b>\$ 452,895</b> |

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:

|                                     | <b>Consolidated</b> | <b>Less<br/>loans<br/>Acquired<br/>from<br/>GCFC</b> | <b>Adjusted<br/>Consolidated</b> |                   | <b>Consolidated</b> |                 |
|-------------------------------------|---------------------|--|----------------------------------|-------------------|---------------------|-----------------|
|                                     | <b>12/31/08</b>     |  | <b>12/31/08</b>                  | <b>12/31/07</b>   | <b>\$ Change</b>    | <b>% Change</b> |
| 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<br>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%           |
|                                     | <b>\$ 735,385</b>   | <b>\$ 88,613</b>                                     | <b>\$ 646,772</b>                | <b>\$ 612,687</b> | <b>\$ 34,085</b>    | <b>5.6%</b>     |

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).

**Table of Contents****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             |                   |
| <b>Total</b>                        | <b>\$ 775,630</b> | <b>\$ 733,473</b> | <b>\$ 725,840</b> | <b>\$ 592,478</b> | <b>\$ 563,876</b> |

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%       |
| <b>Total</b>                        | <b>\$ 42,157</b> | <b>5.7%</b> | <b>\$ 7,633</b> | <b>1.1%</b> | <b>\$ 133,362</b> | <b>22.5%</b> |

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

| Consolidated | Less Deposits Acquired from GCFC | Adjusted Consolidated | Consolidated | Consolidated | % Change |
|--------------|----------------------------------|-----------------------|--------------|--------------|----------|
| 12/31/08     |                                  | 12/31/08              | 12/31/07     | \$ 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%       |
| <b>Total</b>                        | <b>\$ 775,630</b> | <b>\$ 90,151</b> | <b>\$ 685,479</b> | <b>\$ 733,473</b> | <b>\$ (47,994)</b> | <b>-6.5%</b> |

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. The

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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% |
| <b>Total</b>                        | <b>\$ 817,041</b> |       | <b>\$ 727,762</b> |       | <b>\$ 639,046</b> |       |

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            |
| <b>Total</b>          | <b>\$ 141,422</b> |

**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

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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:

|                      | <b>Isabella Bank<br/>Corporation<br/>December 31, 2008</b> |               |
|----------------------|--|---------------|
|                      | <b>Required</b>  | <b>Actual</b> |
| Equity Capital       | 4.00%  | 12.27%        |
| Secondary Capital    | 4.00%  | 1.25%         |
| <b>Total Capital</b> | <b>8.00%</b>   | <b>13.52%</b> |

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

The Federal Reserve 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.

**Table of Contents*****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.

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***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

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\$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.

**Table of Contents****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.

|  | <b>0 to 3<br/>Months</b> | <b>4 to 12<br/>Months</b> | <b>1 to 5<br/>Years</b> | <b>Over 5<br/>Years</b> |
|--|--------------------------|---------------------------|-------------------------|-------------------------|
| <b>Interest Sensitive Assets</b>             |                          |                           |                         |                         |
| Trading securities                           | \$ 21,775                | \$                        | \$                      | \$                      |
| Investment securities                        | 32,312                   | 50,540                    | 57,075                  | 106,528                 |
| Loans  | 187,926                  | 94,142                    | 384,450                 | 57,692                  |
| <b>Total</b>                                 | <b>\$ 242,013</b>        | <b>\$ 144,682</b>         | <b>\$ 441,525</b>       | <b>\$ 164,220</b>       |
| <b>Interest Sensitive Liabilities</b>        |                          |                           |                         |                         |
| 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                  |                         |
| <b>Total</b>                                 | <b>\$ 199,931</b>        | <b>\$ 255,994</b>         | <b>\$ 412,920</b>       | <b>\$ 31,589</b>        |
| 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.

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

**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.

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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.

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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.

|                                      | 2009                   | 2010       | December 31, 2008 |           |           |            | Thereafter | Total      | Fair Value 12/31/08 |
|--------------------------------------|------------------------|------------|-------------------|-----------|-----------|------------|------------|------------|---------------------|
|                                      | (Dollars in thousands) |            |                   |           |           |            |            |            |                     |
| 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%      |            |                     |

Average interest  
rates

|   | 2008       | 2009      | December 31, 2007 |           |           |            | Total      | Fair<br>Value<br>12/31/07 |
|---|------------|-----------|-------------------|-----------|-----------|------------|------------|---------------------------|
|   |            |           | 2010              | 2011      | 2012      | Thereafter |            |                           |
| Rate sensitive<br>assets                |            |           |                   |           |           |            |            |                           |
| Other interest<br>bearing assets        | \$ 1,457   | \$        | \$                | \$        | \$        | \$         | \$ 1,457   | \$ 1,457                  |
| Average interest<br>rates               | 3.21%      |           |                   |           |           |            | 3.21%      |                           |
| Trading securities                      | \$ 9,342   | \$ 2,213  | \$ 3,269          | \$ 2,750  | \$ 2,820  | \$ 4,670   | \$ 25,064  | \$ 25,064                 |
| Average interest<br>rates               | 4.86%      | 4.86%     | 4.20%             | 4.34%     | 3.50%     | 6.98%      | 4.96%      |                           |
| Fixed interest rate<br>securities       | \$ 74,950  | \$ 24,122 | \$ 8,450          | \$ 8,082  | \$ 2,826  | \$ 94,697  | \$ 213,127 | \$ 213,127                |
| Average interest<br>rates               | 5.54%      | 4.98%     | 4.57%             | 3.99%     | 4.13%     | 3.94%      | 4.65%      |                           |
| Fixed interest rate<br>loans            | \$ 124,447 | \$ 99,132 | \$ 98,275         | \$ 78,152 | \$ 63,957 | \$ 58,037  | \$ 522,000 | \$ 523,454                |
| Average interest<br>rates               | 6.72%      | 6.65%     | 6.87%             | 7.25%     | 7.28%     | 6.50%      | 6.86%      |                           |
| Variable interest<br>rate loans         | \$ 41,596  | \$ 14,613 | \$ 18,792         | \$ 4,796  | \$ 6,435  | \$ 4,455   | \$ 90,687  | \$ 90,687                 |
| Average interest<br>rates               | 7.94%      | 7.67%     | 7.66%             | 7.52%     | 7.31%     | 7.56%      | 7.75%      |                           |
| Rate sensitive<br>liabilities           |            |           |                   |           |           |            |            |                           |
| Borrowed funds                          | \$ 30,387  | \$ 6,500  | \$ 24,000         | \$        | \$ 17,000 | \$ 15,000  | \$ 92,887  | \$ 91,897                 |
| Average interest<br>rates               | 4.77%      | 4.34%     | 4.69%             |           | 4.19%     | 4.73%      | 4.61%      |                           |
| Savings and NOW<br>accounts             | \$ 132,008 | \$ 71,320 | \$ 69,183         | \$ 23,972 | \$ 5,725  | \$         | \$ 302,208 | \$ 302,208                |
| Average interest<br>rates               | 2.61%      | 1.15%     | 0.62%             | 0.59%     | 0.86%     |            | 1.62%      |                           |
| Fixed interest rate<br>time deposits    | \$ 226,090 | \$ 33,477 | \$ 42,835         | \$ 23,067 | \$ 18,853 | \$ 137     | \$ 344,459 | \$ 346,528                |
| Average interest<br>rates               | 4.61%      | 4.42%     | 4.53%             | 4.81%     | 4.63%     | 4.40%      | 4.60%      |                           |
| Variable interest<br>rate time deposits | \$ 1,375   | \$ 585    | \$                | \$        | \$        | \$         | \$ 1,960   | \$ 1,960                  |
| Average interest<br>rates               | 4.09%      | 4.10%     |                   |           |           |            | 4.09%      |                           |

**Table of Contents****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.

**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.

| Period         | Number<br>of<br>Sales | Number of<br>Shares | Sale Price |          |
|----------------|-----------------------|---------------------|------------|----------|
|                |                       |                     | Low        | 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    |
|                | <b>328</b>            | <b>259,678</b>      |            |          |

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|                |            |                |       |       |
|----------------|------------|----------------|-------|-------|
| 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 |
|                | <b>270</b> | <b>192,082</b> |       |       |

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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           | 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           |
| <b>Total</b>   | <b>\$ 0.65</b> | <b>\$ 0.62</b> |

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<br>Average<br>Price<br>Per Share | Total Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced Plan<br>or Program | Maximum Number of<br>Shares That May Yet<br>Be<br>Purchased Under the<br>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  |
| <b>Balance, December 31, 2008</b> | <b>\$</b>   |  | <b>1,044</b>   |

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

**Table of Contents****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.

**Stock Performance  
Five-Year Total Return**

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

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

| <b>Year</b> | <b>Isabella<br/>Bank<br/>Corporation</b> | <b>NASDAQ</b> | <b>NASDAQ<br/>Banks</b> |
|-------------|--|---------------|-------------------------|
| 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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**SHAREHOLDERS INFORMATION**

**Annual Meeting**

The Annual Meeting of Shareholders will be held at 5:00 p.m., Tuesday, May 5, 2009, Comfort Inn, 2424 S. Mission Street, Mt. Pleasant, Michigan.

**Financial Information and Form 10-K**

Copies of the 2008 Annual Report, Isabella Bank Corporation Form 10-K, and other financial information not contained herein may be obtained, without charge, by writing to:

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

**Mission Statement**

The mission of Isabella Bank Corporation shall be:

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

**Equal Employment Opportunity**

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

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**ISABELLA BANK CORPORATION PROXY**

**401 North Main Street  
Mt. Pleasant, MI 48858**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

The undersigned hereby appoints Sandra L. Caul, Theodore W. Kortes, and Dale D. Weburg as proxies, each with the power to appoint his/her substitute, and hereby authorizes them to represent and to vote as designated below, all the shares of Common Stock of Isabella Bank Corporation held of record by the undersigned on April 1, 2009 at the annual meeting of shareholders to be held on May 5, 2009 or any adjournments thereof.

**1) ELECTION OF DIRECTORS:**

**FOR ALL NOMINEES LISTED  
BELOW q  
EXCEPT AS MARKED TO THE  
CONTRARY BELOW**

**WITHHOLD AUTHORITY TO VOTE q  
FOR ALL NOMINEES LISTED**

**(INSTRUCTION: To withhold authority to vote for any individual nominee, circle the nominee's name in the list below.)**

**Dennis P. Angner      David J. Maness      W. Joseph Manifold      William J. Strickler**

**(continued and to be signed on other side)**

This proxy, when properly executed, will be voted in the manner directed herein by the undersigned shareholder. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED TO ELECT ALL NOMINEES. The shares represented by this proxy will be voted in the discretion of the proxies on any other matters which may come before the meeting.

Please sign below as your name appears on the label. When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign full corporate name by the President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

Dated:

\_\_\_\_\_,  
2009

Please mark, sign, date and return  
Proxy card promptly using the  
enclosed envelope.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature (if held jointly)