ISABELLA BANK Corp
Form 10-Q
August 07, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2018
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number: 0-18415

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

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

(989) 772-9471
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ý Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ý Yes ¨ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨		Accelerated filer	ý
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
¨ Yes ý No

The number of common shares outstanding of the registrant’s Common Stock (no par value) was 7,845,606 as of August 1, 2018.

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Forward Looking Statements

This report contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended and Rule 3b-6 promulgated thereunder. We intend such forward looking statements to be covered by the safe harbor provisions for forward looking statements contained in the Private Securities Litigation Reform Act of 1995, and are included in this statement for purposes of these safe harbor provisions. Forward looking statements, which are based on certain assumptions and describe future plans, strategies and expectations, are generally identifiable by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project,” or similar expressions. Our ability to predict resu or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects include, but are not limited to, changes in: interest rates, general economic conditions, federal or state tax laws, monetary and fiscal policy, the quality or composition of the loan or investment portfolios, demand for loan products, fluctuation in the value of collateral securing our loan portfolio, deposit flows, competition, cyber-security risk, demand for financial services in our market area, and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward looking statements and undue reliance should not be placed on such statements. Further information concerning our business, including additional factors that could materially affect our financial results, is included in our filings with the SEC.

Glossary of Acronyms and Abbreviations

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

AFS: Available-for-sale
ALLL: Allowance for loan and lease losses
AOCI: Accumulated other comprehensive income
ASC: FASB Accounting Standards Codification
ASU: FASB Accounting Standards Update
ATM: Automated Teller Machine
BHC Act: Bank Holding Company Act of 1956
CECL: Current Expected Credit Losses
CFPB: Consumer Financial Protection Bureau
CIK: Central Index Key
CRA: Community Reinvestment Act
DIF: Deposit Insurance Fund
DIFS: Department of Insurance and Financial Services
Directors Plan: Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors
Dividend Reinvestment Plan: Isabella Bank Corporation Stockholder Dividend Reinvestment Plan and Employee Stock Purchase Plan
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
ESOP: Employee Stock Ownership Plan
Exchange Act: Securities Exchange Act of 1934
FASB: Financial Accounting Standards Board
FDI Act: Federal Deposit Insurance Act
GAAP: U.S. generally accepted accounting principles
GLB Act: Gramm-Leach-Bliley Act of 1999
IFRS: International Financial Reporting Standards
IRR: Interest rate risk
ISDA: International Swaps and Derivatives Association
JOBS Act: Jumpstart our Business Startups Act
LIBOR: London Interbank Offered Rate
N/A: Not applicable
N/M: Not meaningful
NASDAQ: NASDAQ Stock Market Index
NASDAQ Banks: NASDAQ Bank Stock Index
NAV: Net asset value
NOW: Negotiable order of withdrawal
NSF: Non-sufficient funds
OCI: Other comprehensive income (loss)
OMSR: Originated mortgage servicing rights
OREO: Other real estate owned
OTTI: Other-than-temporary impairment
PBO: Projected benefit obligation

FDIC: Federal Deposit Insurance Corporation

FFIEC: Federal Financial Institutions Examinations Council

FRB: Federal Reserve Bank

FHLB: Federal Home Loan Bank

Freddie Mac: Federal Home Loan Mortgage Corporation

FTE: Fully taxable equivalent

PCAOB: Public Company Accounting Oversight Board

Rabbi Trust: A trust established to fund the Directors Plan

SEC: U.S. Securities and Exchange Commission

SOX: Sarbanes-Oxley Act of 2002

Tax Act: Tax Cuts and Jobs Act, enacted December 22, 2017

TDR: Troubled debt restructuring

XBRL: eXtensible Business Reporting Language

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements.
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(Dollars in thousands)

	June 30 2018	December 31 2017
ASSETS		
Cash and cash equivalents		
Cash and demand deposits due from banks	$22,055	$25,267
Interest bearing balances due from banks	158	5,581
Total cash and cash equivalents	22,213	30,848
AFS securities, at fair value	524,108	548,730
Equity securities, at fair value	—	3,577
Mortgage loans AFS	1,420	1,560
Loans		
Commercial	691,623	634,759
Agricultural	125,249	128,269
Residential real estate	273,607	272,368
Consumer	61,277	56,123
Gross loans	1,151,756	1,091,519
Less allowance for loan and lease losses	8,200	7,700
Net loans	1,143,556	1,083,819
Premises and equipment	28,267	28,450
Corporate owned life insurance policies	27,377	27,026
Accrued interest receivable	5,684	7,063
Equity securities without readily determinable fair values	23,743	23,454
Goodwill and other intangible assets	48,497	48,547
Other assets	12,090	10,056
TOTAL ASSETS	$1,836,955	$1,813,130
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$234,377	$237,511
NOW accounts	222,678	231,666
Certificates of deposit under $250 and other savings	745,065	728,090
Certificates of deposit over $250	72,642	67,991
Total deposits	1,274,762	1,265,258
Borrowed funds	362,496	344,878
Accrued interest payable and other liabilities	7,748	8,089
Total liabilities	1,645,006	1,618,225
Shareholders' equity		
Common stock — no par value 15,000,000 shares authorized; issued and outstanding 7,933,250 shares (including 21,652 shares held in the Rabbi Trust) in 2018 and 7,857,293 shares (including 31,769 shares held in the Rabbi Trust) in 2017	142,489	140,277
Shares to be issued for deferred compensation obligations	5,423	5,502
Retained earnings	54,204	51,728
Accumulated other comprehensive income (loss)	(10,167)	(2,602)
Total shareholders' equity	191,949	194,905
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,836,955	$1,813,130

See notes to interim condensed consolidated financial statements (unaudited).

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

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
Interest income				
Loans, including fees	$12,076	$10,685	$23,372	$20,805
AFS securities				
Taxable	2,110	2,188	4,232	4,301
Nontaxable	1,331	1,413	2,713	2,828
Federal funds sold and other	196	212	517	425
Total interest income	15,713	14,498	30,834	28,359
Interest expense				
Deposits	2,230	1,615	4,276	3,155
Borrowings	1,511	1,413	2,866	2,704
Total interest expense	3,741	3,028	7,142	5,859
Net interest income	11,972	11,470	23,692	22,500
Provision for loan losses	328	9	712	36
Net interest income after provision for loan losses	11,644	11,461	22,980	22,464
Noninterest income				
Service charges and fees	1,488	1,405	2,976	2,935
Net gain on sale of mortgage loans	87	199	168	354
Earnings on corporate owned life insurance policies	181	183	351	363
Net gains on sale of AFS securities	—	142	—	142
Other	980	859	1,728	1,610
Total noninterest income	2,736	2,788	5,223	5,404
Noninterest expenses				
Compensation and benefits	5,679	4,817	11,173	10,374
Furniture and equipment	1,571	1,352	3,050	2,696
Occupancy	807	815	1,631	1,652
Other	2,727	2,523	5,026	4,736
Total noninterest expenses	10,784	9,507	20,880	19,458
Income before federal income tax expense	3,596	4,742	7,323	8,410
Federal income tax expense	263	898	528	1,430
NET INCOME	$3,333	$3,844	$6,795	$6,980
Earnings per common share				
Basic	$0.42	$0.49	$0.86	$0.89
Diluted	$0.41	$0.48	$0.84	$0.87
Cash dividends per common share	$0.26	$0.25	$0.52	$0.50

See notes to interim condensed consolidated financial statements (unaudited).

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(Dollars in thousands)

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
Net income	$3,333	$3,844	$6,795	$6,980
Unrealized gains (losses) on AFS securities				
Unrealized gains (losses) on AFS securities arising during the period	(1,978)	2,570	(10,035)	4,247
Reclassification adjustment for net (gains) losses included in net income	—	(142)	—	(142)
Tax effect (1)	442	(762)	2,126	(1,212)
Unrealized gains (losses) on AFS securities, net of tax	(1,536)	1,666	(7,909)	2,893
Unrealized gains (losses) on derivative instruments arising during the period	31	(61)	153	(44)
Tax effect (1)	(6)	21	(32)	15
Unrealized gains (losses) on derivative instruments, net of tax	25	(40)	121	(29)
Other comprehensive income (loss), net of tax	(1,511)	1,626	(7,788)	2,864
Comprehensive income	$1,822	$5,470	$(993)	$9,844

(1) See “Note 11 – Accumulated Other Comprehensive Income” for tax effect reconciliation.

See notes to interim condensed consolidated financial statements (unaudited).

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(Dollars in thousands except per share amounts)

	Common Stock					
	Common Shares Outstanding	Amount	Common Shares to be Issued for Deferred Compensation Obligations	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Totals
Balance, January 1, 2017	7,821,069	$139,525	$ 5,038	$46,114	$ (2,778)	$187,899
Comprehensive income (loss)	—	—	—	6,980	2,864	9,844
Issuance of common stock	135,516	3,764	—	—	—	3,764
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	176	(176)	—	—	—
Share-based payment awards under equity compensation plan	—	—	302	—	—	302
Common stock purchased for deferred compensation obligations	—	(197)	—	—	—	(197)
Common stock repurchased pursuant to publicly announced repurchase plan	(94,032)	(2,622)	—	—	—	(2,622)
Cash dividends paid ($0.50 per common share)	—	—	—	(3,920)	—	(3,920)
Balance, June 30, 2017	7,862,553	$140,646	$ 5,164	$49,174	$ 86	$195,070
Balance, January 1, 2018	7,857,293	$140,277	$ 5,502	$51,728	$ (2,602)	$194,905
Comprehensive income (loss)	—	—	—	6,795	(7,788)	(993)
Adoption of ASU 2016-01	—	—	—	(223)	223	—
Issuance of common stock	121,437	3,272	—	—	—	3,272
Common stock transferred from the Rabbi Trust to satisfy deferred compensation obligations	—	383	(383)	—	—	—
Share-based payment awards under equity compensation plan	—	—	304	—	—	304
Common stock purchased for deferred compensation obligations	—	(205)	—	—	—	(205)
Common stock repurchased pursuant to publicly announced repurchase plan	(45,480)	(1,238)	—	—	—	(1,238)
Cash dividends paid ($0.52 per common share)	—	—	—	(4,096)	—	(4,096)
Balance, June 30, 2018	7,933,250	$142,489	$ 5,423	$54,204	$ (10,167)	$191,949

See notes to interim condensed consolidated financial statements (unaudited).

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

	Six Months Ended June 30	
	2018	2017
OPERATING ACTIVITIES		
Net income	$6,795	$6,980
Reconciliation of net income to net cash provided by operating activities:		
Provision for loan losses	712	36
Impairment of foreclosed assets	—	28
Depreciation	1,448	1,440
Amortization of OMSR	153	170
Amortization of acquisition intangibles	50	62
Net amortization of AFS securities	969	1,062
Net unrealized (gains) losses on equity securities, at fair value	41	—
Net (gains) losses on sale of AFS securities	—	(142)
Net (gains) losses on sale of equity securities, at fair value	(1)	—
Net gain on sale of mortgage loans	(168)	(354)
Increase in cash value of corporate owned life insurance policies	(351)	(363)
Share-based payment awards under equity compensation plan	304	302
Origination of loans held-for-sale	(10,178)	(19,081)
Proceeds from loan sales	10,486	19,769
Net changes in operating assets and liabilities which provided (used) cash:		
Accrued interest receivable	1,379	894
Other assets	(353)	(1,734)
Accrued interest payable and other liabilities	(341)	(382)
Net cash provided by (used in) operating activities	10,945	8,687
INVESTING ACTIVITIES		
Activity in AFS securities		
Sales	—	12,827
Maturities, calls, and principal payments	39,609	45,021
Purchases	(25,991)	(64,429)
Sale of equity securities, at fair value	3,537	—
Net loan principal (originations) collections	(60,517)	(37,842)
Proceeds from sales of foreclosed assets	192	98
Purchases of premises and equipment	(1,265)	(805)
Net cash provided by (used in) investing activities	(44,435)	(45,130)

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

	Six Months Ended June 30	
	2018	2017
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	$9,504	$15,112
Net increase (decrease) in borrowed funds	17,618	23,246
Cash dividends paid on common stock	(4,096)	(3,920)
Proceeds from issuance of common stock	3,272	3,764
Common stock repurchased	(1,238)	(2,622)
Common stock purchased for deferred compensation obligations	(205)	(197)
Net cash provided by (used in) financing activities	24,855	35,383
Increase (decrease) in cash and cash equivalents	(8,635)	(1,060)
Cash and cash equivalents at beginning of period	30,848	22,894
Cash and cash equivalents at end of period	$22,213	$21,834
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	$7,120	$5,872
Income taxes paid	$—	$1,630
SUPPLEMENTAL NONCASH INFORMATION:		
Transfers of loans to foreclosed assets	$68	$124

See notes to interim condensed consolidated financial statements (unaudited).

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(Dollars in thousands except per share amounts)

Note 1 – Basis of Presentation

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

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2017.

Our accounting policies are materially the same as those discussed in Note 1 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017.

Reclassifications: Certain amounts reported in the interim 2017 consolidated financial statements have been reclassified to conform with the 2018 presentation.

Note 2 – Accounting Standards Updates

Recently Adopted Accounting Standards Updates

ASU No. 2014-09: “Revenue from Contracts with Customers”

In May 2014, ASU No. 2014-09 was issued and created new Topic 606 to provide a common revenue standard to achieve consistency and clarification to the revenue recognition principles. The guidance outlines steps to achieve the core principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. These steps consist of: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

The new authoritative guidance, as amended, was effective on January 1, 2018. We reviewed our contracts related to trust and investment services and those related to other noninterest income to determine if changes in income recognition were required as a result of this guidance. Implementation of this guidance did not have a significant impact on our operating results for the three and six month periods ended June 30, 2018.

ASU No. 2016-01: “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities” and ASU No. 2018-03: “Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10: Recognition and Measurement of Financial Assets and Financial Liabilities”

In January 2016, ASU No. 2016-01 was issued and set forth the following: 1) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment and requiring measurement of the investment at fair value when an impairment exists; 3) for public entities, eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; 4) for public entities, requires the use of exit price notion when measuring the fair value of financial instruments for disclosure purposes; 5) requires an entity to present separately in other comprehensive income, the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; 6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and 7) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

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The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017. As a result of this guidance, the change in the fair value of equity investments has been recorded in net income beginning on January 1, 2018. Equity securities are now recorded separately from AFS securities and are recorded at a fair value which approximates an exit price notion. Adoption of this guidance had an insignificant impact on our operations and its future impact will depend on the fair value of these investments at the future measurement dates. The disclosures related to equity investment securities reflect a fully retrospective presentation for comparative purposes.

For discussion of the fair value measurement of financial instruments, refer to “Note 12 – Fair Value”.

In February 2018, ASU No. 2018-03 was issued and sets forth correction or improvement amendments for specific issues that may arise within the scope of ASU 2016-01. These amendments have been adopted and did not have a significant impact on our operating results or financial statement disclosures.

ASU No. 2017-09: “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting”

In May 2017, ASU No. 2017-09 was issued and provided guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting under Topic 718. The current disclosure requirements in Topic 718 apply regardless of whether an entity is required to apply modification accounting under the amendments in this update. An entity should account for the effects of a modification unless all of the following are met:

1. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.
2. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
3. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017 and did not have a significant impact on our operating results or financial statement disclosures.

Pending Accounting Standards Updates

ASU No. 2016-02: “Leases (Topic 842)”

In February 2016, ASU No. 2016-02 was issued to create Topic 842 - Leases which will require recognition of lease assets and lease liabilities on the balance sheet for leases previously classified as operating leases. Accounting guidance is set forth for both lessee and lessor accounting. Under lessee accounting, a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term.

For finance leases, a lessee is required to do the following: 1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position; 2) recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income; and 3) classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, a lessee is required to do the following: 1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position; 2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and 3) classify all cash payments within operating activities in the statement of cash flows.

The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2018. We have and will continue to review our lease agreements to determine the appropriate treatment under this guidance. We do not expect these changes to have a significant impact on our operating results or financial statement disclosures.

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ASU No. 2016-13: “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”

In June 2016, ASU No. 2016-13 was issued and updated the measurement for credit losses for AFS debt securities and assets measured at amortized cost which include loans, trade receivables, and any other financial assets with the contractual right to receive cash. Current GAAP requires an “incurred loss” methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. Under the incurred loss approach, entities are limited to a probable initial recognition threshold when credit losses are measured under GAAP; an entity generally only considers past events and current conditions in measuring the incurred loss.

Under the new guidance, the incurred loss impairment methodology in current GAAP is replaced with a methodology that reflects current expected credit losses (CECL). This methodology requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances which applies to assets measured either collectively or individually.

The update allows an entity to revert to historical loss information that is reflective of the contractual term (considering the effect of prepayments) for periods that are beyond the time frame for which the entity is able to develop reasonable and supportable forecasts. In addition, the disclosures of credit quality indicators in relation to the amortized cost of financing receivables, a current disclosure requirement, are further disaggregated by year of origination (or vintage). The vintage information will be useful for financial statement users to better assess changes in underwriting standards and credit quality trends in asset portfolios over time and the effect of those changes on credit losses.

Overall, the update will allow entities the ability to measure expected credit losses without the restriction of incurred or probable losses that exist under current GAAP. For users of the financial statements, the update provides decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2019 and may have a significant impact on our operations and financial statement disclosures as well as that of the banking industry as a whole.

We have invested a considerable amount of effort toward this guidance and will continue to invest considerable effort until its effective date. A committee was formed and has developed a road map to implementation. This committee will monitor progress to ensure timely and accurate adoption of the guidance. We have identified and collected required borrower and loan level data, as we recognize that quality data is key to properly identify loan segments and then apply the most appropriate methodology to each segment. We’ve identified a software solution that will support us in estimating the ALLL under CECL guidance and are currently in contract negotiations with the vendor that will enable us to run parallel models during 2019. This will allow us to solidify our methodology for implementation in 2020.

Note 3 – AFS Securities

The amortized cost and fair value of AFS securities, with gross unrealized gains and losses, are as follows at:

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$194	$ —	$ 4	$190
States and political subdivisions	200,976	1,857	560	202,273
Auction rate money market preferred	3,200	—	65	3,135
Mortgage-backed securities	204,411	41	6,815	197,637
Collateralized mortgage obligations	124,544	50	3,721	120,873
Total	$533,325	$ 1,948	$ 11,165	$524,108

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	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Government sponsored enterprises	$217	$ —	$ 1	$216
States and political subdivisions	204,131	4,486	143	208,474
Auction rate money market preferred	3,200	—	151	3,049
Mortgage-backed securities	210,757	390	2,350	208,797
Collateralized mortgage obligations	129,607	160	1,573	128,194
Total	$547,912	$ 5,036	$ 4,218	$548,730

The amortized cost and fair value of AFS securities by contractual maturity at June 30, 2018 are as follows:

	Maturing					
	Due in One Year or Less	After One Year But Within Five Years	After Five Years But Within Ten Years	After Ten Years	Securities with Variable Monthly Payments or Noncontractual Maturities	Total
Government sponsored enterprises	$—	$ 194	$—	$ —	$ —	$194
States and political subdivisions	27,593	81,665	62,446	29,272	—	200,976
Auction rate money market preferred	—	—	—	—	3,200	3,200
Mortgage-backed securities	—	—	—	—	204,411	204,411
Collateralized mortgage obligations	—	—	—	—	124,544	124,544
Total amortized cost	$27,593	$ 81,859	$62,446	$ 29,272	$ 332,155	$533,325
Fair value	$27,640	$ 82,336	$63,199	$ 29,288	$ 321,645	$524,108

Expected maturities for government sponsored enterprises and states and political subdivisions may differ from contractual maturities because issuers may have the right to call or prepay obligations.

As the auction rate money market preferred stocks have continual call dates, they are not reported by a specific maturity group. Because of their variable monthly payments, mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group.

A summary of the sales activity of AFS securities was as follows for the:

	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
Proceeds from sales of AFS securities	$—	$12,827	$—	$12,827
Gross realized gains (losses)	$—	$142	$—	$142
Applicable income tax expense (benefit)	$—	$48	$—	$48

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The following information pertains to AFS securities with gross unrealized losses at June 30, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position.

	June 30, 2018				
	Less Than Twelve Months		Twelve Months or More		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Government sponsored enterprises	$4	$190	$ —	$ —	$ 4
States and political subdivisions	378	32,949	182	9,012	560
Auction rate money market preferred	—	—	65	3,135	65
Mortgage-backed securities	3,265	125,130	3,550	69,214	6,815
Collateralized mortgage obligations	2,490	94,355	1,231	22,523	3,721
Total	$6,137	$252,624	$ 5,028	$ 103,884	$ 11,165
Number of securities in an unrealized loss position:		159		91	250

	December 31, 2017				
	Less Than Twelve Months		Twelve Months or More		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Government sponsored enterprises	$1	$216	$ —	$ —	$ 1
States and political subdivisions	142	16,139	1	188	143
Auction rate money market preferred	—	—	151	3,049	151
Mortgage-backed securities	454	72,007	1,896	76,065	2,350
Collateralized mortgage obligations	701	76,435	872	25,308	1,573
Total	$1,298	$164,797	$ 2,920	$ 104,610	$ 4,218
Number of securities in an unrealized loss position:		81		24	105

Unrealized losses on our AFS securities portfolio are the result of recent increases in intermediate-term and long-term benchmark interest rates and not credit issues.

As of June 30, 2018 and December 31, 2017, we conducted an analysis to determine whether any AFS securities currently in an unrealized loss position should be other-than-temporarily impaired. Such analyses considered, among other factors, the following criteria:

- Has the value of the investment declined more than what is deemed to be reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable the issuer will be unable to pay the amount when due?
- Is it more likely than not that we will have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended?

During the fourth quarter of 2016, we identified one municipal bond as other-than-temporarily impaired. While management estimated the OTTI to be realized, we also engaged the services of an independent investment valuation firm to estimate the amount of impairment as of December 31, 2016. The valuation calculated the estimated market value utilizing two different approaches:

1) Market - Appraisal and Comparable Investments
2) Income - Discounted Cash Flow Method

The two methods were then weighted, with a higher weighting applied to the Market approach, to determine the estimated impairment. As a result of this analysis, we reduced the carrying value to $230 which required us to recognized an OTTI of $770 in earnings for the year ended December 31, 2016. Based on internal analysis of this bond as of June 30, 2018, there was no additional OTTI recognized as of June 30, 2018 and the carrying value of this bond remained at $230.

Based on our analysis which included the criteria outlined above, the fact that we have asserted that we do not have the intent to sell AFS securities in an unrealized loss position, and considering it is unlikely that we will have to sell any AFS securities in

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an unrealized loss position before recovery of their cost basis, we do not believe that the values of any other AFS securities are other-than-temporarily impaired as of June 30, 2018 or December 31, 2017, with the exception of the one municipal bond discussed above.

Note 4 – Loans and ALLL

We grant commercial, agricultural, residential real estate, and consumer loans to customers situated primarily in Clare, Gratiot, Isabella, Mecosta, Midland, Montcalm, and Saginaw counties in Michigan. The ability of the borrowers to honor their repayment obligations is often dependent upon the real estate, agricultural, manufacturing, retail, gaming, tourism, higher education, and general economic conditions of this region. Substantially all of our consumer and residential real estate loans are secured by various items of property, while commercial loans are secured primarily by real estate, business assets, and personal guarantees. Some loans are unsecured.

Loans that we have the intent and ability to hold in our portfolio are reported at their outstanding principal balance adjusted for any charge-offs, the ALLL, and any deferred fees or costs. Interest income 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 level yield method.

The accrual of interest on commercial, agricultural, and residential real estate 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. Upon transferring the loans to nonaccrual status, we perform an evaluation to determine the net realizable value of the underlying collateral. This evaluation is used to help determine if any charge-offs are necessary. Consumer 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 status or charged-off at an earlier date if collection of principal or interest is considered doubtful.

For loans that are placed on nonaccrual 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 ALLL. Loans may be returned to accrual status after six months of continuous performance and achievement of current payment status.

Commercial and agricultural loans include loans for commercial real estate, commercial operating loans, advances to mortgage brokers, farmland and agricultural production, and loans to states and political subdivisions. Repayment of these loans is dependent upon the successful operation and management of a business. We minimize our risk by limiting the amount of direct credit exposure to any one borrower to $15,000. Borrowers with direct credit needs of more than $15,000 are serviced through the use of loan participations with other commercial banks. Commercial and agricultural real estate loans commonly require loan-to-value limits of 80% or less. Depending upon the type of loan, past credit history, and current operating results, we may require the borrower to pledge accounts receivable, inventory, and property and equipment. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and sole proprietorships. In addition, we require annual financial statements, prepare cash flow analyses, and review credit reports.

We entered into a mortgage purchase program in 2016 with a financial institution where we participate in advances to mortgage brokers ("advances"). The mortgage brokers originate residential mortgage loans with the intent to sell them on the secondary market. We participate in the advance to the mortgage broker, which is secured by the underlying mortgage loan, until it is ultimately sold on the secondary market. As such, the average life of each participated advance is approximately 20-30 days. Funds from the sale of the loan are used to pay off our participation in the advance to the mortgage broker. We classify these advances as commercial loans and include the outstanding balance in commercial loans on our consolidated balance sheet. Under the participation agreement, we committed to a maximum outstanding aggregate amount of $30,000. The difference between our outstanding balances and the maximum outstanding aggregate amount is classified as "Unfunded commitments under lines of credit" in the "Contractual Obligations and Loan Commitments" section of the Management's Discussion and Analysis of Financial Condition and Results of Operations of this report.

We offer adjustable rate mortgages, construction loans, and fixed rate residential real estate loans which have amortization periods up to a maximum of 30 years. We consider the anticipated direction of interest rates, balance sheet duration, the sensitivity of our balance sheet to changes in interest rates, our liquidity needs, and overall loan demand to determine whether or not to sell fixed rate loans to Freddie Mac.

Our lending policies generally limit the maximum loan-to-value ratio on residential real estate loans to 100% of the lower of the appraised value of the property or the purchase price. Private mortgage insurance is typically required on loans with loan-to-value ratios in excess of 80% unless the loan qualifies for government guarantees.

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Underwriting criteria for originated residential real estate loans generally include:

- Evaluation of the borrower's ability to make monthly payments.
- Evaluation of the value of the property securing the loan.
- Ensuring the payment of principal, interest, taxes, and hazard insurance does not exceed 28% of a borrower's gross income.
- Ensuring all debt servicing does not exceed 40% of income.
- Verification of acceptable credit reports.
- Verification of employment, income, and financial information.

Appraisals are performed by independent appraisers and reviewed for appropriateness. All mortgage loan requests are reviewed by our mortgage loan committee or through a secondary market underwriting system; loans in excess of $500 require the approval of our Internal Loan Committee, the Executive Loan Committee, the Board of Directors' Loan Committee, or the Board of Directors.

Consumer loans include secured and unsecured personal loans. Loans are amortized for a period of up to 15 years based on the age and value of the underlying collateral. The underwriting emphasis is on a borrower's perceived intent and ability to pay rather than collateral value. No consumer loans are sold to the secondary market.

The ALLL is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the ALLL when we believe the uncollectability of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALLL.

The appropriateness of the ALLL is evaluated on a quarterly basis and is based upon a periodic review of the collectability 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 primary factors behind the determination of the level of the ALLL are specific allocations for impaired loans, historical loss percentages, as well as unallocated components. Specific allocations for impaired loans are primarily determined based on the difference between the loan's outstanding balance and the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio, with the exception of advances to mortgage brokers, over the preceding five years. With no historical losses on advances to mortgage brokers, there is no allocation in the commercial segment displayed in the following tables based on historical loss 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 summary of changes in the ALLL and the recorded investment in loans by segments follows:

	Allowance for Loan Losses Three Months Ended June 30, 2018					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
April 1, 2018	$1,840	$ 1,224	$ 2,482	$ 795	$ 1,859	$8,200
Charge-offs	(489)	—	(29)	(48)	—	(566)
Recoveries	101	—	69	68	—	238
Provision for loan losses	745	(242)	(355)	67	113	328
June 30, 2018	$2,197	$ 982	$ 2,167	$ 882	$ 1,972	$8,200

	Allowance for Loan Losses Six Months Ended June 30, 2018					
	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2018	$1,706	$ 611	$ 2,563	$ 900	$ 1,920	$7,700
Charge-offs	(494)	—	(39)	(136)	—	(669)

Recoveries	204	—	125	128	—	457
Provision for loan losses	781	371	(482)	(10)	52	712
June 30, 2018	$2,197	$ 982	$ 2,167	$ 882	$ 1,972	$8,200

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Allowance for Loan Losses and Recorded Investment in Loans
June 30, 2018

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	$506	$ 102	$ 1,451	$ —	$ —	$2,059
Collectively evaluated for impairment	1,691	880	716	882	1,972	6,141
Total	$2,197	$ 982	$ 2,167	$ 882	$ 1,972	$8,200
Loans						
Individually evaluated for impairment	$10,030	$ 12,894	$ 7,748	$ 11		$30,683
Collectively evaluated for impairment	681,593	112,355	265,859	61,266		1,121,073
Total	$691,623	$ 125,249	$ 273,607	$ 61,277		$1,151,756

Allowance for Loan Losses
Three Months Ended June 30, 2017

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
April 1, 2017	$1,771	$ 527	$ 3,098	$ 671	$ 1,433	$7,500
Charge-offs	(25)	—	—	(44)	—	(69)
Recoveries	55	—	63	42	—	160
Provision for loan losses	177	(52)	(563)	(86)	533	9
June 30, 2017	$1,978	$ 475	$ 2,598	$ 583	$ 1,966	$7,600

Allowance for Loan Losses
Six Months Ended June 30, 2017

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
January 1, 2017	$1,814	$ 884	$ 2,664	$ 624	$ 1,414	$7,400
Charge-offs	(52)	—	(43)	(118)	—	(213)
Recoveries	188	—	99	90	—	377
Provision for loan losses	28	(409)	(122)	(13)	552	36
June 30, 2017	$1,978	$ 475	$ 2,598	$ 583	$ 1,966	$7,600

Allowance for Loan Losses and Recorded Investment in Loans
December 31, 2017

	Commercial	Agricultural	Residential Real Estate	Consumer	Unallocated	Total
ALLL						
Individually evaluated for impairment	$650	$ —	$ 1,480	$ —	$ —	$2,130
Collectively evaluated for impairment	1,056	611	1,083	900	1,920	5,570
Total	$1,706	$ 611	$ 2,563	$ 900	$ 1,920	$7,700
Loans						
Individually evaluated for impairment	$8,099	$ 10,598	$ 7,939	$ 17		$26,653
Collectively evaluated for impairment	626,660	117,671	264,429	56,106		1,064,866
Total	$634,759	$ 128,269	$ 272,368	$ 56,123		$1,091,519

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The following table displays the credit quality indicators for commercial and agricultural credit exposures based on internally assigned credit risk ratings as of:

	June 30, 2018							
	Commercial				Agricultural			
	Real Estate	Other	Advances to Mortgage Brokers	Total	Real Estate	Other	Total	Total
Rating								
1 - Excellent	$23	$30	$—	$53	$—	$34	$34	$87
2 - High quality	6,144	19,832	—	25,976	3,026	521	3,547	29,523
3 - High satisfactory	117,355	55,626	23,864	196,845	19,751	7,037	26,788	223,633
4 - Low satisfactory	353,308	91,678	—	444,986	45,287	17,964	63,251	508,237
5 - Special mention	12,205	2,171	—	14,376	9,970	5,245	15,215	29,591
6 - Substandard	5,368	2,073	—	7,441	6,623	6,034	12,657	20,098
7 - Vulnerable	1,646	300	—	1,946	2,152	1,605	3,757	5,703
8 - Doubtful	—	—	—	—	—	—	—	—
Total	$496,049	$171,710	$23,864	$691,623	$86,809	$38,440	$125,249	$816,872

	December 31, 2017							
	Commercial				Agricultural			
	Real Estate	Other	Advances to Mortgage Brokers	Total	Real Estate	Other	Total	Total
Rating								
1 - Excellent	$24	$316	$—	$340	$—	$34	$34	$374
2 - High quality	8,402	12,262	—	20,664	2,909	1,024	3,933	24,597
3 - High satisfactory	131,826	46,668	12,081	190,575	21,072	8,867	29,939	220,514
4 - Low satisfactory	326,166	75,591	—	401,757	47,835	18,467	66,302	468,059
5 - Special mention	8,986	3,889	—	12,875	10,493	8,546	19,039	31,914
6 - Substandard	5,521	2,298	—	7,819	4,325	2,747	7,072	14,891
7 - Vulnerable	729	—	—	729	1,531	419	1,950	2,679
8 - Doubtful	—	—	—	—	—	—	—	—
Total	$481,654	$141,024	$12,081	$634,759	$88,165	$40,104	$128,269	$763,028

Internally assigned credit risk ratings are reviewed, at a minimum, when loans are renewed or when management has knowledge of improvements or deterioration of the credit quality of individual credits. Descriptions of the internally assigned credit risk ratings for commercial and agricultural loans are as follows:

1. EXCELLENT – Substantially Risk Free

Credit has strong financial condition and solid earnings history, characterized by:

- High liquidity, strong cash flow, low leverage.
- Unquestioned ability to meet all obligations when due.
- Experienced management, with management succession in place.
- Secured by cash.

2. HIGH QUALITY – Limited Risk

Credit with sound financial condition and a positive trend in earnings supplemented by:

- Favorable liquidity and leverage ratios.
- Ability to meet all obligations when due.

- Management with successful track record.
- Steady and satisfactory earnings history.
- If loan is secured, collateral is of high quality and readily marketable.

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- Access to alternative financing.
- Well defined primary and secondary source of repayment.
- If supported by guaranty, the financial strength and liquidity of the guarantor(s) are clearly evident.

3. HIGH SATISFACTORY – Reasonable Risk
Credit with satisfactory financial condition and further characterized by:
- Working capital adequate to support operations.
- Cash flow sufficient to pay debts as scheduled.
- Management experience and depth appear favorable.
- Loan performing according to terms.
- If loan is secured, collateral is acceptable and loan is fully protected.

4. LOW SATISFACTORY – Acceptable Risk
Credit with bankable risks, although some signs of weaknesses are shown:
- Would include most start-up businesses.
- Occasional instances of trade slowness or repayment delinquency – may have been 10-30 days slow within the past year.
- Management's abilities are apparent, yet unproven.
- Weakness in primary source of repayment with adequate secondary source of repayment.
- Loan structure generally in accordance with policy.
- If secured, loan collateral coverage is marginal.
- Adequate cash flow to service debt, but coverage is low.

To be classified as less than satisfactory, only one of the following criteria must be met.
5. SPECIAL MENTION – Criticized
Credit constitutes an undue and unwarranted credit risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances surrounding a specific loan:
- Downward trend in sales, profit levels, and margins.
- Impaired working capital position.
- Cash flow is strained in order to meet debt repayment.
- Loan delinquency (30-60 days) and overdrafts may occur.
- Shrinking equity cushion.
- Diminishing primary source of repayment and questionable secondary source.
- Management abilities are questionable.
- Weak industry conditions.
- Litigation pending against the borrower.
- Collateral or guaranty offers limited protection.
- Negative debt service coverage, however the credit is well collateralized and payments are current.

6. SUBSTANDARD – Classified
Credit where the borrower's current net worth, paying capacity, and value of the collateral pledged is inadequate. There is a distinct possibility that we will implement collection procedures if the loan deficiencies are not corrected. In addition, the following characteristics may apply:
- Sustained losses have severely eroded the equity and cash flow.
- Deteriorating liquidity.
- Serious management problems or internal fraud.
- Original repayment terms liberalized.
- Likelihood of bankruptcy.
- Inability to access other funding sources.
- Reliance on secondary source of repayment.

- Litigation filed against borrower.
- Collateral provides little or no value.
- Requires excessive attention of the loan officer.
- Borrower is uncooperative with loan officer.

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7. VULNERABLE – Classified
Credit is considered "Substandard" and warrants placing on nonaccrual status. Risk of loss is being evaluated and exit strategy options are under review. Other characteristics that may apply:
- Insufficient cash flow to service debt.
- Minimal or no payments being received.
- Limited options available to avoid the collection process.
- Transition status, expect action will take place to collect loan without immediate progress being made.

8. DOUBTFUL – Workout
Credit has all the weaknesses inherent in a "Substandard" loan with the added characteristic that collection and/or liquidation is pending. The possibility of a loss is extremely high, but its classification as a loss is deferred until liquidation procedures are completed, or reasonably estimable. Other characteristics that may apply:
- Normal operations are severely diminished or have ceased.
- Seriously impaired cash flow.
- Original repayment terms materially altered.
- Secondary source of repayment is inadequate.
- Survivability as a "going concern" is impossible.
- Collection process has begun.
- Bankruptcy petition has been filed.
- Judgments have been filed.
- Portion of the loan balance has been charged-off.

Our primary credit quality indicator for residential real estate and consumer loans is the individual loan's past due aging. The following tables summarize the past due and current loans as of:

	June 30, 2018						
	Accruing Interest and Past Due:				Total Past Due		
	30-59 Days	60-89 Days	90 Days or More	Nonaccrual	and Nonaccrual	Current	Total
Commercial							
Commercial real estate	$1,531	$60	$ —	$ 1,646	$ 3,237	$492,812	$496,049
Commercial other	565	827	—	300	1,692	170,018	171,710
Advances to mortgage brokers	—	—	—	—	—	23,864	23,864
Total commercial	2,096	887	—	1,946	4,929	686,694	691,623
Agricultural							
Agricultural real estate	576	149	125	2,152	3,002	83,807	86,809
Agricultural other	34	410	—	1,605	2,049	36,391	38,440
Total agricultural	610	559	125	3,757	5,051	120,198	125,249
Residential real estate							
Senior liens	1,028	350	29	779	2,186	230,258	232,444
Junior liens	33	—		10	43	6,261	6,304
Home equity lines of credit	38	185	—	—	223	34,636	34,859
Total residential real estate	1,099	535	29	789	2,452	271,155	273,607
Consumer							
Secured	18	8	—	—	26	57,393	57,419
Unsecured	17	—	—	—	17	3,841	3,858
Total consumer	35	8	—	—	43	61,234	61,277
Total	$3,840	$1,989	$ 154	$ 6,492	$ 12,475	$1,139,281	$1,151,756

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	December 31, 2017						
	Accruing Interest and Past Due:				Total Past Due and Nonaccrual		
	30-59 Days	60-89 Days	90 Days or More	Nonaccrual		Current	Total
Commercial							
Commercial real estate	$295	$325	$ 54	$ 729	$ 1,403	$480,251	$481,654
Commercial other	1,069	28	18	—	1,115	139,909	141,024
Advances to mortgage brokers	—	—	—	—	—	12,081	12,081
Total commercial	1,364	353	72	729	2,518	632,241	634,759
Agricultural							
Agricultural real estate	84	190	—	1,531	1,805	86,360	88,165
Agricultural other	39	—	104	419	562	39,542	40,104
Total agricultural	123	190	104	1,950	2,367	125,902	128,269
Residential real estate							
Senior liens	3,718	234	132	325	4,409	225,007	229,416
Junior liens	69	10	—	23	102	6,812	6,914
Home equity lines of credit	293	—	77	—	370	35,668	36,038
Total residential real estate	4,080	244	209	348	4,881	267,487	272,368
Consumer							
Secured	37	10	10	—	57	52,005	52,062
Unsecured	13	—	—	—	13	4,048	4,061
Total consumer	50	10	10	—	70	56,053	56,123
Total	$5,617	$797	$ 395	$ 3,027	$ 9,836	$1,081,683	$1,091,519

Impaired Loans

Loans may be classified as impaired if they meet one or more of the following criteria:

1. There has been a charge-off of its principal balance (in whole or in part);
2. The loan has been classified as a TDR; or
3. The loan is in nonaccrual status.

Impairment is measured on a loan-by-loan basis for commercial and agricultural loans by comparing the loan's outstanding balance to the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell, if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Impairment is measured on a loan-by-loan basis for residential real estate and consumer loans by comparing the loan's unpaid principal balance to the present value of expected future cash flows discounted at the loan's effective interest rate.

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We do not recognize interest income on impaired loans in nonaccrual status. For impaired loans not classified as nonaccrual, interest income is recognized daily, as earned, according to the terms of the loan agreement and the principal amount outstanding. The following is a summary of information pertaining to impaired loans as of:

	June 30, 2018			December 31, 2017		
	Recorded Balance	Unpaid Principal Balance	Valuation Allowance	Recorded Balance	Unpaid Principal Balance	Valuation Allowance
Impaired loans with a valuation allowance						
Commercial real estate	$4,065	$4,354	$ 492	$4,089	$4,378	$ 626
Commercial other	827	827	14	995	995	24
Agricultural real estate	396	396	102	—	—	—
Residential real estate senior liens	7,662	8,232	1,447	7,816	8,459	1,473
Residential real estate junior liens	23	23	4	44	44	7
Total impaired loans with a valuation allowance	12,973	13,832	2,059	12,944	13,876	2,130
Impaired loans without a valuation allowance						
Commercial real estate	3,701	3,816		1,791	1,865	
Commercial other	1,437	1,481		1,224	1,224	
Agricultural real estate	7,137	7,137		7,913	7,913	
Agricultural other	5,361	5,361		2,685	2,685	
Home equity lines of credit	63	363		79	379	
Consumer secured	11	11		17	17	
Total impaired loans without a valuation allowance	17,710	18,169		13,709	14,083	
Impaired loans						
Commercial	10,030	10,478	506	8,099	8,462	650
Agricultural	12,894	12,894	102	10,598	10,598	—
Residential real estate	7,748	8,618	1,451	7,939	8,882	1,480
Consumer	11	11	—	17	17	—
Total impaired loans	$30,683	$32,001	$ 2,059	$26,653	$27,959	$ 2,130

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The following is a summary of information pertaining to impaired loans for the:

	Three Months Ended June 30			
	2018		2017	
	Average Recorded Balance	Interest Income Recognized	Average Recorded Balance	Interest Income Recognized
Impaired loans with a valuation allowance				
Commercial real estate	$5,006	$ 13	$4,641	$ 84
Commercial other	1,463	15	1,146	23
Agricultural real estate	639	2	—	—
Residential real estate senior liens	7,747	16	8,385	83
Residential real estate junior liens	30	—	77	1
Home equity lines of credit	—		35	—
Total impaired loans with a valuation allowance	14,885	46	14,284	191
Impaired loans without a valuation allowance				
Commercial real estate	3,084	12	1,576	19
Commercial other	1,301	2	119	2
Agricultural real estate	7,610	237	5,937	58
Agricultural other	3,933	115	2,401	33
Home equity lines of credit	68	—	126	5
Consumer secured	12	—	22	—
Total impaired loans without a valuation allowance	16,008	366	10,181	117
Impaired loans				
Commercial	10,854	42	7,482	128
Agricultural	12,182	354	8,338	91
Residential real estate	7,845	16	8,623	89
Consumer	12	—	22	—
Total impaired loans	$30,893	$ 412	$24,465	$ 308

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	Six Months Ended June 30			
	2018		2017	
	Average Recorded Balance	Interest Income Recognized	Average Recorded Balance	Interest Income Recognized
Impaired loans with a valuation allowance				
Commercial real estate	$5,012	$ 104	$4,825	$ 157
Commercial other	1,505	39	1,211	47
Agricultural real estate	540	6	—	—
Agricultural other	—	—	34	—
Residential real estate senior liens	7,785	90	8,403	166
Residential real estate junior liens	35	—	76	1
Home equity lines of credit	—	—	18	—
Total impaired loans with a valuation allowance	14,877	239	14,567	371
Impaired loans without a valuation allowance				
Commercial real estate	2,606	47	1,451	52
Commercial other	1,248	19	117	4
Agricultural real estate	7,804	277	4,990	120
Agricultural other	3,264	151	1,920	46
Home equity lines of credit	72	5	129	10
Consumer secured	13	—	23	—
Total impaired loans without a valuation allowance	15,007	499	8,630	232
Impaired loans				
Commercial	10,371	209	7,604	260
Agricultural	11,608	434	6,944	166
Residential real estate	7,892	95	8,626	177
Consumer	13	—	23	—
Total impaired loans	$29,884	$ 738	$23,197	$ 603

We had committed to advance $105 and $472 in connection with impaired loans, which includes TDRs, as of June 30, 2018 and December 31, 2017, respectively.

Troubled Debt Restructurings

Loan modifications are considered to be TDRs when the modification includes terms outside of normal lending practices to a borrower who is experiencing financial difficulties.

Typical concessions granted include, but are not limited to:

- Agreeing to interest rates below prevailing market rates for debt with similar risk characteristics.
- Extending the amortization period beyond typical lending guidelines for loans with similar risk characteristics.
- Agreeing to an interest only payment structure and delaying principal payments.
- Forgiving principal.
- Forgiving accrued interest.

To determine if a borrower is experiencing financial difficulties, factors we consider include:

- The borrower is currently in default on any of their debt.
- The borrower would likely default on any of their debt if the concession was not granted.
- The borrower’s cash flow was insufficient to service all of their debt if the concession was not granted.
- The borrower has declared, or is in the process of declaring, bankruptcy.
- The borrower is unlikely to continue as a going concern (if the entity is a business).

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The following is a summary of information pertaining to TDRs granted for the:

Three Months Ended June 30			
2018			2017
Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans