
AgSouth Farm Credit, ACA

THIRD QUARTER 2018

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CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2018 quarterly report of AgSouth Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Pat Calhoun
Chief Executive Officer



Bo Fennell
Chief Financial Officer



James C. Carter, Jr.
Chairman of the Board

November 8, 2018

Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and affected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

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 Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2018. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of September 30, 2018, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association's management determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2018.



Pat Calhoun

Chief Executive Officer



Bo Fennell
Chief Financial Officer

November 8, 2018

Management's Discussion and Analysis of Financial Condition and Results of Operations

(dollars in thousands)

The following commentary reviews the financial condition and results of operations of AgSouth Farm Credit, ACA (Association) for the period ended September 30, 2018. This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2017 Annual Report of AgSouth Farm Credit, ACA. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

FORWARD LOOKING INFORMATION

This quarterly report contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a wide range of agricultural commodities produced in our region,

including timber, poultry (broilers, turkeys and eggs), sod, nursery and horticulture, cotton, feed grains, soybeans and hay, beef cattle, horses, peanuts, blueberries, fruits, and nuts. Loans to producers of these commodities total \$1,567,118 or 86.87 percent of the Association's portfolio. Farm size varies, and many of the Association's customers have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, reduce to some degree the level of income dependency on any given commodity.

AGRICULTURE OVERVIEW

AgSouth experienced fairly favorable growing conditions during the third quarter of 2018 with a normal Summer weather pattern. Crops across the service area were in generally good condition. September brought Hurricane Florence which veered away from a direct hit to both South Carolina and Georgia with very little impact to the service territory. The National Agricultural Statistics Service (NASS) crop production report for the end of the third quarter 2018 indicates some reduction in yield estimates from previous months.

At the end of the third quarter of 2018, the NASS reported South Carolina soil moisture as being 51 percent adequate and Georgia as being 49 percent adequate.

Corn harvest is complete and the South Carolina state yield forecast is projected to be 121 bushels per acre. Corn for grain production in South Carolina is at 37.5 million bushels, down 15 percent from 2017. Georgia corn production is forecasted with a yield of 170 bushels per acre. Corn for grain production is at 46.8 million bushels, up 8 percent from 2017 in Georgia.

NASS reported the crop condition of peanuts in South Carolina as 70 percent good to excellent, 27 percent fair and 14 percent of the crop harvested to date. For Georgia, 74 percent were rated good to excellent, 19 percent fair and 25 percent of the crop harvested to date. Peanut production in Georgia is expected to be down 17 percent from 2017's record high production at 2.95 billion pounds. In South Carolina, peanut production is expected to be down 37 percent from 2017's record high production at 295 million pounds.

Cotton harvest was reported by NASS to be 10 percent complete at the end of the third quarter, 2018 and rated the condition of the cotton crop to be 58 percent good to excellent with 35 percent fair in South Carolina and about the same in

Georgia at 62 percent rated good to excellent with 29 percent fair. Crop progress shows 6 percent of the cotton harvested to date in Georgia.

The 2018 Soybean harvest is just in the early stages, but NASS is rating the 2018 crop as 41 percent good to excellent with 48 percent fair in South Carolina and 61 percent good to excellent with 29 percent fair in Georgia. Soybean production is expected to be down 23 percent from 2017 at 4.86 million bushels in Georgia and down 19 percent from 2017 at 12 million bushels in South Carolina.

The 2018 blueberry harvest was impacted by a late freeze that impacted yields on certain varieties. Higher prices helped most growers offset lost production; however, there has been some deterioration in the credit quality of the blueberry portfolio with freezes impacting this crop for both 2017 and 2018.

Tobacco production for 2018 is predicted to be down 14 percent and 19 percent, respectively for Georgia and South Carolina from 2017.

Pasture quality for both Georgia and South Carolina decreased during third quarter with the majority of the acreage rated fair to good.

Domestic broiler growers placed 175 million chicks for meat production as of September 29, 2018, which is down 2 percent from the comparable week a year earlier. South Carolina chick placements were 5.1 million, which was up by 15 percent from the same week in 2017. Georgia hatcheries placed 24.8 million chicks, which is down 8 percent from the same week in 2017. Integrators in South Carolina and Georgia are still using intensive biohazard management practices to control any disease issues that may occur in poultry houses. Poultry remains our highest concentration paid from agricultural income.

Timber stumpage markets across the South were interrupted by weather in the third quarter with Tropical Storm Gordon and Hurricane Florence. Florence made landfall in North Carolina on September 14th with heavy rain leading to severe flooding in the coastal areas of North Carolina and northeastern South Carolina. Several lumber mills suspended operations for several days due to flooding. The flooding also limited the supply of logs to the mills and several major highways were blocked. The South Carolina region of AgSouth was spared from any major damage from the wind or flooding from Florence.

Southern pine lumber prices fell in the third quarter of 2018 as did prices for Oriented Strand Board (OSB) and Southern Pine Plywood. As expected, stumpage prices increased across the South due to heavy rains impacting the available supply especially in those areas directly affected by the hurricanes.

Timber stumpage prices across the service territory for AgSouth vary depending on markets and proximity to mills. In summary for the third quarter of 2018, reports are showing

stable to increasing stumpage prices per ton: pine pulpwood (\$8-\$22), pine chip-n-saw (\$14-\$24), pine sawtimber (\$23-\$34), hardwood pulpwood (\$7-\$14) and hardwood sawtimber (\$18-\$50), vary greatly depending on species.

The U.S. 2018 Farm Bill was not passed by the target date of September 30, 2018. The Conference Committee of the U.S. House of Representatives and the U.S. Senate are still in disagreement on major parts of the bill. At this point, it is expected that no action will happen before the national elections in November 2018. An announcement is expected in the coming days from the United States, Mexico and Canada regarding an agreement on a new trade deal to replace the North American Free Trade Agreement (NAFTA). The new trade agreement will be called the United States Mexico Canada Agreement (USMCA). The initial analysis shows increases in available markets for U.S. dairy and U.S. wheat.

United States housing starts were up over 9.2 percent to an annualized rate of 1,282 thousand in August 2018. Year-over-year, housing starts increased 9.4 percent. In the South, total housing starts were up. Single family homebuilding increased 1.9 percent to 876 thousand units in August 2018. Building permits dropped 5.7 percent which represents the lowest rating since May 2017.

The Conference Board Leading Economic Index (LEI) was 111.2 in August 2018, up from 110.7 in July 2018, and 109.8 in June 2018. The strengths among the LEI components supports an outlook of 3.0 percent growth for the remainder of 2018. The Conference Board U.S. Consumer Confidence Index rose from 134.7 in August 2018 to 138.4 in September 2018. The Conference Board stated "After a considerable improvement in August, Consumer Confidence increased further in September and hovers at an 18-year high. The September reading is not far from the all-time high of 144.7 reached in 2000. Consumers' assessment of current conditions remains extremely favorable, bolstered by a strong economy and robust job growth."

Unemployment in South Carolina is at 3.4 percent as of August 2018. This is a drop from 3.8 percent in June 2018 and 3.6 percent in July 2018. The South Carolina unemployment rate peaked in December 2009 at 11.7 percent and is now 8.3 percentage points lower. Unemployment in Georgia, while higher than in South Carolina, has been decreasing all of 2018 from 4.5 percent at the beginning of the year to 3.8 percent at August 2018 month end. The U.S. Unemployment Rate dropped to 3.7 percent in September 2018 after remaining at 3.9 percent for July 2018 and August 2018.

With the strength and growth shown by the U.S. economy, the Federal Reserve raised interest rates (25 basis points) for the third time this year on September 27, 2018.

ASSOCIATION BALANCE SHEET

The gross loan volume of the Association as of September 30, 2018 was \$1,804,024, an increase of \$93,926 or 5.49 percent compared to \$1,710,098 at December 31, 2017. Net loans outstanding at September 30, 2018 were \$1,789,087 as compared to \$1,695,283 at December 31, 2017. Net loans accounted for 95.20 percent of total assets at September 30, 2018, as compared to 94.14 percent of total assets at December 31, 2017.

The increase in gross loan volume during the reporting period is attributed to the funding of operating lines of credit and term loans during the busiest time of the growing season. Advances on most operating lines are now funded and anticipated additional growth by the sales team is being realized. Competition for good quality loans remains strong from some commercial banks, but the Association has remained competitive in a difficult rate environment.

The Association typically structures loans to meet the needs of the borrower. Many term loans are made for ten years or less allowing the borrower to build equity faster and thus reducing the risk in the loan portfolio.

At December 31, 2017 the Association held Investments in debt securities totaling \$5,533. These investments are Rural America Bonds made under the authority for Mission Related Investments granted by the Farm Credit Administration (FCA). At September 30, 2018, Investments in debt securities totaled \$5,345, a decrease of \$188 from December 31, 2017. The 3.40 percent decrease is from expected payments made year to date in 2018.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality is at an acceptable level and credit administration remains satisfactory. Nonaccrual loans decreased from \$14,978 at December 31, 2017 to \$11,729 at September 30, 2018. The balance of nonaccrual loans is decreased by liquidations, loans returning to accrual status, or transfer of assets to other property owned offset by transfers to nonaccrual status. Association staff is working diligently to work out all nonaccrual debt situations.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2018 was \$14,937 compared to \$14,815 at December 31, 2017 and was considered by management to be adequate to cover possible losses. The increase in the allowance account is in conjunction with additional loan volume during the third quarter of 2018 and represents similar risk characteristics to the portfolio as a whole. The reserve set aside for unfunded commitments is \$563 which is an increase of \$374 compared to the total at December 31, 2017 of \$189. The reserve for unfunded commitments is included in Other liabilities. The Asset/Liability Committee (ALCO) of the Association, which is comprised of members of senior

management and staff assigned to special assets management, met in September 2018 to review the allowance account. The ALCO determined that the composition between the allowance for loan losses on the outstanding portfolio and the reserve required for unfunded commitments needed to be adjusted and an additional general reserve was required. The ALCO considered the general economic conditions, the potential for deterioration in the existing portfolio, the loan growth in the portfolio, and the amount of outstanding loan commitments in determining the level of allowance.

As of the end of the third quarter of 2018, the Association had originated \$117,817 in loans for the secondary market. Originations for the same period 2017 were \$111,557. The 5.61 percent increase is due to increased volume as the market continues to remain strong for both refinancing and new home purchases despite rising interest rates. As of September 30, 2018 the Association held \$1,413 in qualifying Loans held for sale. At December 31, 2017 loans held for sale totaled \$3,375.

Accrued interest receivable increased \$3,393 or 20.12 percent from \$16,860 to \$20,253. The increase is directly tied to the increase in loans outstanding for the current period compared to December 31, 2017, as well as, the current rising interest rate environment.

Investments in other Farm Credit institutions decreased from \$23,568 at December 31, 2017 to \$23,564 at September 30, 2018. The slight decrease of \$4, or less than one percent, is the result of a slightly lower balance of investment in other Farm Credit institutions related to participations sold on a patronage basis.

Premises and equipment net increased \$1,396 from \$19,724 at December 31, 2017 to \$21,120 at September 30, 2018. The increase of 7.08 percent is the result of the increase associated with the new operations center in Statesboro, GA. The building and grounds around the new operations center were finalized during the second quarter of 2018. The consolidation of all Administrative staff at the Statesboro, GA headquarters is now complete.

Other property owned increased to \$4,103 at September 30, 2018 from \$3,669 at December 31, 2017. The increase of \$434 or 11.83 percent in Other property owned is the result of transfers to Other property owned exceeding sales and write-downs of existing Other property owned during the reporting period. The Association is actively marketing all properties for sale. For details, please visit our website at www.agsouthfc.com and click on *Property For Sale*.

Accounts receivable decreased \$15,523 from \$25,710 at December 31, 2017 to \$10,187 at September 30, 2018. The decrease is the result of the patronage distribution receivable at December 31, 2017 from AgFirst and other Farm Credit institutions, which totaled \$12,124 in regular distribution and \$13,279 in a special distribution. As of September 30, 2018 this line item included only three quarters of accrual of

patronage from AgFirst and other Farm Credit institutions totaling \$9,450.

Other assets were unchanged from \$2,170 at December 31, 2017 to \$2,170 at September 30, 2018. The majority of other assets is made up of prepaid retirement expense which totaled \$1,438 as of September 30, 2018 compared to \$1,375 as of December 31, 2017.

On the liability side of the balance sheet, Notes payable to AgFirst Farm Credit Bank increased from \$1,405,074 at December 31, 2017 to \$1,480,247 at September 30, 2018. The \$75,173 or 5.35 percent increase is tied to the increase in loans outstanding.

Accrued interest payable increased \$432 or 12.36 percent from \$3,495 to \$3,927. The increase is tied to the increase in the notes outstanding balance and an increase in the weighted average interest rate on the notes payable balance outstanding.

Patronage refunds payable decreased \$9,688 from \$9,901 at December 31, 2017 to \$213 at September 30, 2018. The decrease is the result of the cash portion of the 2017 Patronage distribution on the Association's records at December 31, 2017 moving from Patronage refund payable to Other liabilities. This amount totaled \$9,720 at December 31, 2017. At September 30, 2018 no patronage distribution for 2018 has been declared.

Accounts payable decreased \$842 from \$2,310 at December 31, 2017 to \$1,468 at September 30, 2018. The 36.45 percent decrease is due to the payable established to pay the insurance premiums on loans to the Farm Credit System Insurance Corporation (FCSIC). At December 31, 2017 the payable related to the FCSIC totaled \$1,888, and at September 30, 2018 the payable was \$869.

Other liabilities increased \$1,039 from \$14,570 at December 31, 2017 to \$15,609 at September 30, 2018. The 7.13 percent increase is primarily due to expected changes in the pension plan, the accrual for employee incentives, and the controlled disbursement accounts.

Capital stock and participation certificates increased from \$9,097 at December 31, 2017 to \$9,466 at September 30, 2018. The increase of \$369 or 4.06 percent is due to new borrowers purchasing stock during the reporting period in excess of liquidations of stock when loans pay out.

Allocated surplus decreased from \$121,876 at December 31, 2017 to \$102,386 at September 30, 2018. This is a decrease of \$19,490 or 15.99 percent. The reduction is from the decision made by the Board of Directors to revolve the 2012 series of Allocated Surplus in February 2018. This revolvment totaled \$19,426. The checks and notices for this revolvment were generated and mailed in March 2018.

Unallocated surplus increased \$31,522 or 13.42 percent from the December 31, 2017 balance of \$234,892. The balance of \$266,414 at September 30, 2018 includes the retention of a

portion of 2017 fiscal year end earnings and earnings year to date in 2018.

RESULTS OF OPERATIONS

For the three months ended September 30, 2018

Net income for the three months ended September 30, 2018, totaled \$11,385 as compared to \$9,760 for the same period in 2017. This is an increase of \$1,625 or 16.65 percent. The following commentary explains the variance.

At September 30, 2018 interest income increased \$1,909 from \$25,445 at September 30, 2017 to \$27,354. This increase of 7.50 percent is primarily due to the increase in the weighted average loan yield between the two reporting periods. Nonaccrual income, which is included in interest income, was \$169 for the three months ended September 30, 2018, as compared to \$336 for the same period in 2017.

For the three months ended September 30, 2018 interest income on investments totaled \$90 compared to \$94 for the three months ended September 30, 2017. Investment income declined \$4 or 4.26 percent due to the lower outstanding balance of investments between the two reporting periods.

Interest expense for the three months ended September 30, 2018 increased \$1,547 from \$10,326 at September 30, 2017 to \$11,873 at September 30, 2018. The variance is 14.98 percent and is tied to the increase in the direct note balance and the weighted average direct note rate between the two reporting periods.

Net interest income before the provision for loan loss increased \$362 for the three months ended September 30, 2018 as compared to the same period in 2017 due primarily to the increased earnings on a higher balance of average earning assets.

Net interest income after the provision for loan losses increased \$932 during the quarter ending September 30, 2018 compared to September 30, 2017. A net provision for loan losses of \$729 was made in the quarter ending September 30, 2018. The provision entry represents an adjustment between the general provision and the unfunded commitments provision which is booked to Other liabilities.

Noninterest income increased \$782 over the same period last year. The commentary that follows will detail the aggregate difference.

Loan fees increased \$164 or 21.33 percent due to an increase in late fees and SMM origination fees earned during the quarter compared to the same period in 2017. Fees for financially related services increased \$305 from \$184 at September 30, 2017 to \$489 at September 30, 2018. The increase of 165.76 percent is due to an increase in commissions earned on the sale of multi-peril crop insurance and lease commissions during the reporting period.

Patronage refunds from other Farm Credit institutions increased \$303 from \$3,027 at September 30, 2017 to \$3,330 at September 30, 2018. The increase of 10.01 percent is related to an increase in loans sold to AgFirst and other Farm Credit Institutions. See *Note 2* for more information.

Gains on the sale of rural home loans decreased \$52 from \$483 at September 30, 2017 compared to \$431 at September 30, 2018. Even with a slight increase in originations between the two reporting periods, a decrease was realized due to market pressure and increased competition.

Gains on the sale of premises and equipment for the period ending September 30, 2018 totaled \$10 compared to \$33 for the period ending September 30, 2017. For 2018, the gains are primarily tied to sales of excess Association automobiles disposed of during the reporting period. For 2017, the gains are a direct result of the sale of the Spartanburg branch located on Asheville Highway.

Gains on other transactions totaled \$207 at September 30, 2018. For the same period in 2017, Gains on other transactions totaled \$131. The difference of \$76 is directly related to the increase in allowance for unfunded commitments of \$156.

Other noninterest income was \$37 during the three months ended September 30, 2018, compared to \$28 for the three months ending September 30, 2017. This line item captures the volume premium paid by AgFirst for secondary market loans sold to AgFirst.

Noninterest expense for the three months ended September 30, 2018 totaled \$8,804 and increased \$92 or 1.06 percent when compared to \$8,712 for the same period of 2017. Salaries and employee benefits expense are the largest portion of noninterest expense and totaled \$6,324 for the three months ended September 30, 2018. Salaries and employee benefits increased \$238 between the two reporting periods. The majority of the 3.91 percent increase is tied to an increase in expense related to the pension plan and incentive between the reporting periods.

Occupancy and equipment expense at September 30, 2018 was \$530 compared to \$486 for the same period in 2017. This is an increase of \$44 or 9.05 percent. The increase is tied to the new operations center in Statesboro, GA, which is now complete.

The Insurance Fund premiums at September 30, 2017 was \$488 and at September 30, 2018 it was \$300. The \$188 or 38.52 percent decrease is due to the lower premium on accruing loans offset by the increase in average loan volume.

In the three months ending September 30, 2018 the Association experienced losses on the sale of Other property owned in the amount of \$15. During the same period of 2017, the Association booked losses on the sale of Other property owned of \$13. The losses and expenses incurred in 2017 included write-downs on some of the properties at sale or when a new appraisal was received justifying the write-down.

Other operating expenses decreased \$4 from \$1,639 at September 30, 2017 compared to \$1,635 at September 30, 2018. The decrease of less than one percent is primarily attributed to a decrease in purchased services, advertising, and phone service expenses between the reporting periods. Other operating expenses also include communications, printing and office supplies and all other expenses necessary to run the business.

For the nine months ended September 30, 2018

Net income for the nine months ended September 30, 2018, totaled \$31,502 as compared to \$25,990 for the same period in 2017. This is an increase of \$5,512 or 21.21 percent. The following narrative will explain the variance.

At September 30, 2018 Total interest income increased \$5,109 compared to the same period in 2017. The increase was due to the amount of interest income earned on loans. Interest income on loans increased \$5,123. The increase is tied to the increase in accruing loan volume between the reporting periods and an increase in the overall weighted average interest rate earned. Nonaccrual income, which is included in interest income, was \$670 for the nine months ended September 30, 2018 as compared to \$751 for the same period in 2017. The decrease of \$81 is the result of a decrease in the recognition of interest income when nonaccrual loans pay off or pay down.

For the nine months ending September 30, 2017 interest income on investments totaled \$284 compared to \$270 for the same period ended September 30, 2018. Investment income declined \$14 or 4.93 percent due to the lower outstanding balance of investments between the two reporting periods.

Interest expense increased \$3,948 or 13.63 percent from \$28,967 at September 30, 2017 to \$32,915 as for the nine months ended September 30, 2018. The increase is attributable to the higher direct note balance between the reporting periods and a higher weighted average direct note rate.

Net interest income before the provision for loan loss increased \$1,161 or 2.64 percent for the nine months ended September 30, 2018 as compared to the same period in 2017 primarily due to the increase in loan volume. Net interest income after the provision for loan losses increased \$2,948 for the period ending September 30, 2018 primarily due to the decrease in the provision.

The Provision for loan losses amount in the 2017 reporting period totaled \$1,954 and there were provision entries totaling \$167 in the 2018 reporting period. In September, 2018 the Association's ALCO made the decision that the allowance account required an increase to the general reserve, a decrease to the specific reserve and a decrease to the allowance for unfunded commitments which resides within Other liabilities. The net effect on the total allowance for loan losses was an increase of \$518 or 3.46 percent. These decisions were made after analyzing the risk in the current portfolio. The ALCO

analysis included reviewing historical trends, loan size, loan performance and credit quality reports.

Noninterest income for the nine months ended September 30, 2018 increased \$3,224 compared to the same period in 2017. Loan fees increased \$97 or 3.83 percent. In the first nine months of 2018, late fees on loans decreased \$66 to \$133 compared to \$199 for 2017. Fees earned on loans sold in the secondary market for the first nine months of 2018 were \$122 or 7.35 percent higher than the same period in 2017. The volume of loans sold increased as well. Loan fees on portfolio activity increased slightly between the two reporting periods.

Fees for financially related services increased \$449 from \$561 at September 30, 2017 compared to \$1,010 at September 30, 2018. The 80.04 percent increase in Fees for financially related services is the result of an increase in fee income earned on the sale of multi-peril crop insurance.

The Patronage refunds from other Farm Credit institutions increased \$635 from \$9,193 at September 30, 2017 to \$9,828 at September 30, 2018. The increase is due to an increase in the balance of loans sold to AgFirst and other Farm Credit institutions which resulted in a higher patronage refund amount accrued.

Gains on the sale of rural home loans decreased \$138 from \$1,485 at September 30, 2017 to \$1,347 at September 30, 2018. Gains decreased slightly due to the reduced yield premium earned on each origination.

Gains on the sale of premises and equipment decreased \$79 from \$218 for the period ending September 30, 2017 to \$139 at September 30, 2018. The gains were recorded when Association automobiles were replaced and from the sale of the Spartanburg, South Carolina branch in the 2017 reporting period and relocated that office to 101 North Town Drive in Spartanburg. The gain on the sale of the Spartanburg branch building in 2017 was \$162.

Losses on other transactions totaled \$309 for the nine months ended September 30, 2018 compared to a loss of \$1,540 for the same period in 2017. The loss recorded in the 2018 reporting period is related to the allowance entry for unfunded commitments. The loss in the 2017 reporting period is related to the payment for disputed claims that were litigated.

The Insurance Fund refund increased from \$0 as of September 30, 2017 to \$989 as of September 30, 2018. This line item includes a nonrecurring refund from the Farm Credit System Insurance Corporation of \$989 that occurred in the first quarter of 2018.

Other noninterest income increased \$40 from \$104 at September 30, 2017 compared to \$144 at September 30, 2018. The variance of 38.46 percent is due to volume premiums paid by AgFirst for secondary market activity. In 2017, the Association earned \$77 in volume premiums and for the period

ending September 30, 2018 the Association has earned \$102 in volume premiums.

Noninterest expense for the nine months ended September 30, 2018, increased \$665 compared to the same period of 2017 from \$28,542 to \$29,207. Salaries and employee benefit expense increased \$876 between the two reporting periods. The 4.34 percent increase in salaries and employee benefits is tied to the increase in the expense for pension funding and a higher accrual for incentive compensation. The Association booked an accrual for the 2018 incentive payment based upon plan results which is included in salary and benefit expense. The Association evaluated 2018 performance measures for incentive purposes and determined that some employees could earn incentive in 2018. Based upon this information, the Association accrued for incentive in June 2018 and the accrual balance as of that date was \$1,485. Association results will be re-evaluated prior to the end of the fourth quarter 2018 to determine if an additional accrual is warranted.

Occupancy and equipment expense at September 30, 2018 was \$1,868 compared to \$1,676 for the same period in 2017. The increase is from the normal cost of operations and some timing differences of expenses. The Association has completed construction on an operations center in Statesboro to consolidate all accounting and human resource staff to that location. Some expenses to date are included in Occupancy and equipment expense related to the completion of that project.

The Insurance Fund premium decreased from \$1,399 at September 30, 2017 to \$869 at September 30, 2018. The decrease of \$530 or 37.88 percent is tied to the decrease in the premium on loans in accrual status offset by the increase in loan volume.

Losses on the sale or write-down of Other property owned totaled \$20 for the nine months ending September 30, 2018. When compared to the same period in 2017, losses on Other property owned totaled \$14. The losses or write-downs were required after new contracts, sale closings, and/or new appraisals were obtained and the book value needed to more accurately reflect the current market value. No significant write-downs or sales have occurred year to date September 2018.

Other operating expenses increased \$121 from \$5,281 at September 30, 2017 compared to \$5,402 at September 30, 2018. The increase is primarily due to an increase in purchased services. The increase was offset by a decrease in public and member relations expenses.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit

and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2018 was \$1,480,247 as compared to \$1,405,074 at December 31, 2017. The \$75,173 increase, or 5.35 percent, is directly tied to an increase in loan volume.

CAPITAL RESOURCES

Total members' equity at December 31, 2017 totaled \$365,491. At September 30, 2018 total members' equity had increased by \$12,406 to \$377,897. The increase in total members' equity is due to the increase in Unallocated retained earnings offset by a decrease in Allocated retained earnings between the two reporting periods. At December 31, 2017 Allocated retained earnings totaled \$121,876 compared to \$102,386 at September 30, 2018. The decrease is due to the revolvment of the 2012 series of allocated surplus in the first quarter of 2018. At December 31, 2017 Unallocated retained earnings totaled \$234,892. At September 30, 2018 the Unallocated retained earnings had increased to \$266,414. The increase in Unallocated retained earnings is due to the decision to retain a portion of the 2017 earnings for capital purposes and year to date 2018 earnings.

Total Capital stock and participation certificates were \$9,466 on September 30, 2018 compared to \$9,097 on December 31, 2017. The increase is attributed to the purchase of new stock and participation certificates for new borrowing entities offset by the retirement of stock and participation certificates on loans liquidated in the normal course of business.

The Association's capital ratios are calculated in accordance with FCA regulations, as follows:

- The CET1 ratio is the sum of statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvment, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of investments in other System institutions, divided by average risk-adjusted assets.
- The tier 1 capital ratio is CET1 capital plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- The total capital ratio is tier 1 capital plus other required borrower stock held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance for loan losses and reserve for unfunded commitments under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- The permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain investments in other System institutions, divided by PCR risk-adjusted assets.
- The tier 1 leverage ratio is tier 1 capital, divided by average assets less regulatory deductions to tier 1 capital.
- The UREE leverage ratio is unallocated retained earnings, paid-in capital, and allocated surplus not subject to revolvment less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions to tier 1 capital.

If the capital ratios fall below the minimum regulatory requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

The following sets forth the regulatory capital ratios, which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of September 30, 2018
Risk-adjusted ratios:				
CET1 Capital	4.5%	0.625%	5.125%	13.95%
Tier 1 Capital	6.0%	0.625%	6.625%	13.95%
Total Capital	8.0%	0.625%	8.625%	20.71%
Permanent Capital Ratio	7.0%	0.0%	7.0%	20.01%
Non-risk-adjusted:				
Tier 1 Leverage Ratio	4.0%	1.0%	5.0%	13.24%
UREE Leverage Ratio	1.5%	0.0%	1.5%	13.08%

**The capital conservation buffers have a 3 year phase-in period and will become fully effective January 1, 2020. Risk-adjusted ratio minimums will increase 0.625% each year until fully phased in. There is no phase-in period for the tier 1 leverage ratio.*

REGULATORY MATTERS

On May 10, 2018, the Farm Credit Administration adopted a final rule that amends the regulations governing investments of System banks and associations. The final rule strengthens eligibility criteria for the investments the banks may purchase and hold. It also implements Section 939A of the Dodd-Frank Act by removing references to and requirements for credit ratings and substitutes the eligibility requirement with other appropriate standards of credit worthiness. In addition, it grants associations greater flexibility regarding the risk management purposes for investments and limits the type and amount of investments that an association may hold. Only securities that are issued by, or are unconditionally guaranteed or insured as to the timely payment of principal and interest by, the U.S. government or its agencies are eligible for association

risk management purposes. An association may purchase and hold investments not to exceed 10 percent of its 90-day average daily balance of outstanding loans on the last business day of the quarter. The final rule will become effective January 1, 2019.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 1, *Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*, in the Notes to the Financial Statements, and the 2017 Annual Report to Shareholders for recently issued accounting pronouncements. Additional information is provided in the following table.

The following Accounting Standards Updates (ASUs) were issued by the Financial Accounting Standards Board (FASB) but have not yet been adopted:

Summary of Guidance	Adoption and Potential Financial Statement Impact
<i>ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</i>	
<ul style="list-style-type: none"> • Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management’s estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets. • Changes the present incurred loss impairment guidance for loans to a CECL model. • The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit. • Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets. • Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. • Effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. 	<ul style="list-style-type: none"> • The Association has begun implementation efforts by establishing a cross-discipline governance structure. The Association is currently identifying key interpretive issues, and assessing existing credit loss forecasting models and processes against the new guidance to determine what modifications may be required. • The Association expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including: <ol style="list-style-type: none"> 1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions, 2. An allowance will be established for estimated credit losses on any debt securities, 3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans. • The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Association’s portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date. • The Association expects to adopt the guidance in first quarter 2021.

ASU 2016-02 – Leases (Topic 842)

<ul style="list-style-type: none">• Requires lessees to recognize leases on the balance sheet with lease liabilities and corresponding right-of-use assets based on the present value of lease payments.• Lessor accounting activities are largely unchanged from existing lease accounting.• The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification.• Also, expands qualitative and quantitative disclosures of leasing arrangements.• Requires adoption using a modified cumulative effect approach wherein the guidance is applied to all periods presented. A recent amendment provides an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.• Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted.	<ul style="list-style-type: none">• The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees.• The Association has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities.• As a lessee the Association is developing its methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments but does not expect a material change to the timing of expense recognition.• Given the limited changes to lessor accounting, the Association does not expect material changes to recognition or measurement, but the implementation process and the impact will continue to be evaluated.• The Association is evaluating existing disclosures and may need to provide additional information as a result of adopting the Update.• The Association expects to adopt the guidance in first quarter 2019 using the optional modified retrospective method and practical expedients for transition.
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NOTE: Shareholder investment in the Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst’s annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2764, or writing Matthew Miller, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, www.agfirst.com. Copies of the Association’s annual and quarterly reports are also available upon request free of charge by calling 1-800-633-9091, ext. 2674, writing Bo Fennell, CFO, AgSouth Farm Credit, ACA, P.O. Box 718, Statesboro, GA 30459, or accessing the Association’s website www.agsouthfc.com. The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual report to Shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Reports of suspected or actual wrongdoings involving the Association, its employees and/or Directors, can be made anonymously and confidentially through the Association’s Whistleblower Hotline (Speak Up) at 1-844-850-6496 or speakupAgSouthFC.ethix360.com.

AgSouth Farm Credit, ACA

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30, 2018 <i>(unaudited)</i>	December 31, 2017 <i>(audited)</i>
Assets		
Cash	\$ 2,119	\$ 4,949
Investments in debt securities:		
Held to maturity (fair value of \$5,288 and \$5,456, respectively)	5,345	5,533
Loans	1,804,024	1,710,098
Allowance for loan losses	(14,937)	(14,815)
Net loans	1,789,087	1,695,283
Loans held for sale	1,413	3,375
Accrued interest receivable	20,253	16,860
Equity investments in other Farm Credit institutions	23,564	23,568
Premises and equipment, net	21,120	19,724
Other property owned	4,103	3,669
Accounts receivable	10,187	25,710
Other assets	2,170	2,170
Total assets	\$ 1,879,361	\$ 1,800,841
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 1,480,247	\$ 1,405,074
Accrued interest payable	3,927	3,495
Patronage refunds payable	213	9,901
Accounts payable	1,468	2,310
Other liabilities	15,609	14,570
Total liabilities	1,501,464	1,435,350
Commitments and contingencies (Note 8)		
Members' Equity		
Capital stock and participation certificates	9,466	9,097
Retained earnings		
Allocated	102,386	121,876
Unallocated	266,414	234,892
Accumulated other comprehensive income (loss)	(369)	(374)
Total members' equity	377,897	365,491
Total liabilities and members' equity	\$ 1,879,361	\$ 1,800,841

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

AgSouth Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Interest Income				
Loans	\$ 27,264	\$ 25,351	\$ 77,743	\$ 72,620
Investments	90	94	270	284
Total interest income	27,354	25,445	78,013	72,904
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	11,788	10,224	32,706	28,766
Other	85	102	209	201
Total interest expense	11,873	10,326	32,915	28,967
Net interest income	15,481	15,119	45,098	43,937
Provision for loan losses	729	1,299	167	1,954
Net interest income after provision for loan losses	14,752	13,820	44,931	41,983
Noninterest Income				
Loan fees	933	769	2,630	2,533
Fees for financially related services	489	184	1,010	561
Patronage refunds from other Farm Credit institutions	3,330	3,027	9,828	9,193
Gains (losses) on sales of rural home loans, net	431	483	1,347	1,485
Gains (losses) on sales of premises and equipment, net	10	33	139	218
Gains (losses) on other transactions	207	131	(309)	(1,540)
Insurance Fund refund	—	—	989	—
Other noninterest income	37	28	144	104
Total noninterest income	5,437	4,655	15,778	12,554
Noninterest Expense				
Salaries and employee benefits	6,324	6,086	21,048	20,172
Occupancy and equipment	530	486	1,868	1,676
Insurance Fund premiums	300	488	869	1,399
(Gains) losses on other property owned, net	15	13	20	14
Other operating expenses	1,635	1,639	5,402	5,281
Total noninterest expense	8,804	8,712	29,207	28,542
Income before income taxes	11,385	9,763	31,502	25,995
Provision for income taxes	—	3	—	5
Net income	\$ 11,385	\$ 9,760	\$ 31,502	\$ 25,990

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

AgSouth Farm Credit, ACA
Consolidated Statements of
Comprehensive Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Net income	\$ 11,385	\$ 9,760	\$ 31,502	\$ 25,990
Other comprehensive income net of tax				
Employee benefit plans adjustments	2	40	5	119
Comprehensive income	\$ 11,387	\$ 9,800	\$ 31,507	\$ 26,109

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

AgSouth Farm Credit, ACA
Consolidated Statements of Changes in
Members' Equity

(unaudited)

(dollars in thousands)

	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2016	\$ 2	\$ 8,493	\$ 118,570	\$ 212,028	\$ (393)	\$ 338,700
Comprehensive income				25,990	119	26,109
Protected borrower stock issued/(retired), net	(2)					(2)
Capital stock/participation certificates issued/(retired), net		487				487
Retained earnings retired			(19,372)			(19,372)
Patronage distribution adjustment			(1)	2		1
Balance at September 30, 2017	\$ —	\$ 8,980	\$ 99,197	\$ 238,020	\$ (274)	\$ 345,923
Balance at December 31, 2017	\$ —	\$ 9,097	\$ 121,876	\$ 234,892	\$ (374)	\$ 365,491
Comprehensive income				31,502	5	31,507
Capital stock/participation certificates issued/(retired), net		369				369
Retained earnings retired			(19,476)			(19,476)
Patronage distribution adjustment			(14)	20		6
Balance at September 30, 2018	\$ —	\$ 9,466	\$ 102,386	\$ 266,414	\$ (369)	\$ 377,897

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

AgSouth Farm Credit, ACA

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)
(unaudited)

Note 1 — Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements

Organization

The accompanying financial statements include the accounts of AgSouth Farm Credit, ACA and its Production Credit Association (PCA) and Federal Land Credit Association (FLCA) subsidiaries (collectively, the Association). A description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations for the Association as of and for the year ended December 31, 2017 are contained in the 2017 Annual Report to Shareholders. These unaudited interim consolidated financial statements should be read in conjunction with the latest Annual Report to Shareholders.

Basis of Presentation

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair statement of results for the periods presented. These adjustments are of a normal recurring nature, unless otherwise disclosed.

Certain amounts in the prior period's consolidated financial statements have been reclassified to conform to the current period presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The results of any interim period are not necessarily indicative of those to be expected for a full year.

Significant Accounting Policies

The Association's accounting and reporting policies conform with U.S. generally accepted accounting principles (GAAP) and practices in the financial services industry. To prepare the financial statements in conformity with GAAP, management must make estimates based on assumptions about future economic and market conditions (for example, unemployment, market liquidity, real estate prices, etc.) that affect the reported amounts of assets and liabilities at the date of the financial statements, income and expenses during the reporting period, and the related disclosures. Although these estimates contemplate current conditions and expectations of change in the future, it is reasonably possible that actual conditions may be different than anticipated, which could materially affect results of operations and financial condition.

Management has made significant estimates in several areas, including loans and allowance for loan losses (Note 2, *Loans and Allowance for Loan Losses*), investment securities and

other-than-temporary impairment (Note 3, *Investments*), and financial instruments (Note 6, *Fair Value Measurement*). Actual results could differ from those estimates.

For further details of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, from the latest Annual Report.

Accounting Standards Updates (ASUs) Issued During the Period

The following ASUs were issued by the Financial Accounting Standards Board (FASB) since the most recent year end:

- In August 2018, the FASB issued ASU 2018-15 Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption.
- In August 2018, the FASB issued ASU 2018-13 Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. The amendments are part of the FASB's disclosure framework project. The project's objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity's financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of

entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Entities may early adopt the provisions in whole upon issuance or may early adopt any removed or modified disclosures upon issuance and delay adoption of the additional disclosures until their effective date.

- In July 2018, the FASB issued ASU 2018-11 Leases (Topic 842): Targeted Improvements. The amendments are intended to reduce costs and ease implementation of the leases standard for financial statement preparers. It addresses certain areas identified as possible sources of unnecessary cost or complexity in the standard. Specifically, the amendments provide an option to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements and a practical expedient that permits lessors to not separate nonlease components from the associated lease component if certain conditions are met. For entities that have not adopted Topic 842 before the issuance of this Update, the effective date and transition requirements for the amendments related to separating components of a contract are the same as the effective date and transition requirements in ASU 2016-02.
- In July 2018, the FASB issued ASU 2018-10 Codification Improvements to Topic 842, Leases. The amendments affect narrow aspects of the guidance issued in ASU 2016-02. Specifically, the Update corrects, clarifies or changes inconsistent language to improve application of the guidance in ASU 2016-02. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in ASU 2016-02.
- In July 2018, the FASB issued ASU 2018-09 Codification Improvements. The amendments affect a wide variety of Topics in the Codification. They apply to all reporting entities within the scope of the affected accounting guidance. The Board has an ongoing project on its agenda about improvements to clarify the Codification or to correct unintended application of guidance. Those items generally are not expected to have a significant effect on current accounting practice. The transition and effective date guidance is based on the facts and circumstances of each amendment.
- In February 2018, the FASB issued ASU 2018-03 Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this Update include items brought to

the Board's attention by stakeholders. The amendments clarify certain aspects of the guidance issued in Update 2016-01. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted Update 2016-01.

- In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted.

ASUs Pending Effective Date

For a detailed description of the ASUs below, see the latest Annual Report.

Potential effects of ASUs issued in previous periods:

- In March 2017, the FASB issued ASU 2017-08 Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update will be effective for interim and annual periods beginning after December 15, 2018 for public business entities. Early adoption is permitted. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use

forward-looking information to better estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

- In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This Update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Early adoption is permitted. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

Accounting Standards Effective During the Period

There were no changes in the accounting principles applied from the latest Annual Report, other than any discussed below.

No recently adopted accounting guidance issued by the FASB had a significant effect on the current period reporting. See the most recent Annual Report for a detailed description of each of the standards below:

- In March 2017, the FASB issued ASU 2017-07 Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost related to the income statement presentation of the components of net periodic benefit cost for an entity’s sponsored defined benefit pension and other postretirement plans. The amendments were effective January 1, 2018 for the Association. Adoption in 2018 did not have a material effect on the Association’s financial statements, but did require reclassification of service costs to Other Operating Expenses.
- In February 2017, the FASB issued ASU 2017-05 Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The Update clarifies whether certain transactions are within the scope of the guidance on derecognition and the accounting for

partial sales of nonfinancial assets, and defines the term in substance nonfinancial asset. The amendments conform the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. The amendments were effective January 1, 2018 for the Association. Adoption in 2018 had no impact on the statements of financial condition and results of operations of the Association.

- In January 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also support more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The ASU was effective January 1, 2018 for the Association. The amendments were applied prospectively. Adoption of the guidance in 2018 had no impact on the statements of financial condition and results of operations.
- In January 2016, the FASB issued ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The Update was intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP.

Transition Information

- The Association identified investment securities affected by this Update and adopted the guidance on January 1, 2018.
- The amendments related to equity securities without readily determinable fair values were applied prospectively to equity investments that existed as of the date of adoption.
- Application of the amendments did not require a cumulative effect adjustment.
- Adoption did not have an impact on the Association's financial condition or results of operations.
- The new standard did result in changes to certain disclosures.
- In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance changed the recognition of revenue from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance also included expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity’s contracts with customers. Based on input received from stakeholders, the

FASB issued several additional Updates that generally provided clarifying guidance where there was the potential for diversity in practice, or address the cost and complexity of applying Topic 606.

Transition Information

- The Association identified ancillary revenues affected by this Update and adopted the guidance on January 1, 2018.
- The amendments were applied using the modified retrospective approach.
- The Association elected to only apply the guidance to contracts that were not completed at the date of initial application.
- Subtopics 610-20 on gains and losses from the derecognition of nonfinancial assets, and 340-40 on other assets and deferred costs-contracts with customers were adopted using the same transition options.
- Adoption did not have an impact on the Association's financial condition or results of operations.
- The new standard did result in enhanced disclosures about revenue (see Note 9, *Revenue from Contracts with Customers*).

Note 2 — Loans and Allowance for Loan Losses

The Association maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. See Note 3, *Loans and Allowance for Loan Losses*, from the latest Annual Report for further discussion.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

A summary of loans outstanding at period end follows:

	September 30, 2018	December 31, 2017
Real estate mortgage	\$ 1,342,828	\$ 1,308,602
Production and intermediate-term	355,258	307,691
Processing and marketing	20,159	15,763
Farm-related business	24,536	16,477
Rural residential real estate	60,798	61,100
Other (including Mission Related)	445	465
Total loans	<u>\$ 1,804,024</u>	<u>\$ 1,710,098</u>

A substantial portion of the Association's lending activities is collateralized, and exposure to credit loss associated with lending activities is reduced accordingly.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration (FCA) regulations. The following tables present the principal balance of participation loans at periods ended:

	September 30, 2018							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 3,268	\$ 163,538	\$ —	\$ 9,551	\$ —	\$ —	\$ 3,268	\$ 173,089
Production and intermediate-term	—	57,618	645	—	3,090	—	3,735	57,618
Processing and marketing	—	15,562	145	9,467	—	—	145	25,029
Farm-related business	4,027	12,500	—	—	—	—	4,027	12,500
Total	<u>\$ 7,295</u>	<u>\$ 249,218</u>	<u>\$ 790</u>	<u>\$ 19,018</u>	<u>\$ 3,090</u>	<u>\$ —</u>	<u>\$ 11,175</u>	<u>\$ 268,236</u>

	December 31, 2017							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ —	\$ 175,459	\$ —	\$ 17,819	\$ —	\$ —	\$ —	\$ 193,278
Production and intermediate-term	—	49,732	636	—	3,504	—	4,140	49,732
Processing and marketing	—	14,029	—	1,833	—	—	—	15,862
Farm-related business	—	9,167	—	—	—	—	—	9,167
Total	<u>\$ —</u>	<u>\$ 248,387</u>	<u>\$ 636</u>	<u>\$ 19,652</u>	<u>\$ 3,504</u>	<u>\$ —</u>	<u>\$ 4,140</u>	<u>\$ 268,039</u>

A significant source of liquidity for the Association is the repayments of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

September 30, 2018				
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 30,191	\$ 247,792	\$ 1,064,845	\$ 1,342,828
Production and intermediate-term	186,413	128,082	40,763	355,258
Processing and marketing	4,768	4,150	11,241	20,159
Farm-related business	3,457	11,944	9,135	24,536
Rural residential real estate	4,113	2,073	54,612	60,798
Other (including Mission Related)	—	—	445	445
Total loans	\$ 228,942	\$ 394,041	\$ 1,181,041	\$ 1,804,024
Percentage	12.69%	21.84%	65.47%	100.00%

The recorded investment in a receivable is the face amount increased or decreased by applicable accrued interest, unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

The following table shows the recorded investment of loans, classified under the FCA Uniform Loan Classification System, as a percentage of the recorded investment of total loans by loan type as of:

	September 30, 2018	December 31, 2017		September 30, 2018	December 31, 2017
Real estate mortgage:			Rural residential real estate:		
Acceptable	97.75%	97.12%	Acceptable	98.22%	98.03%
OAEM	1.53	1.71	OAEM	1.01	0.86
Substandard/doubtful/loss	0.72	1.17	Substandard/doubtful/loss	0.77	1.11
	100.00%	100.00%		100.00%	100.00%
Production and intermediate-term:			Other (including Mission Related):		
Acceptable	96.95%	95.42%	Acceptable	100.00%	100.00%
OAEM	2.39	3.74	OAEM	—	—
Substandard/doubtful/loss	0.66	0.84	Substandard/doubtful/loss	—	—
	100.00%	100.00%		100.00%	100.00%
Processing and marketing:			Total loans:		
Acceptable	93.72%	91.83%	Acceptable	97.54%	96.80%
OAEM	—	8.17	OAEM	1.69	2.11
Substandard/doubtful/loss	6.28	—	Substandard/doubtful/loss	0.77	1.09
	100.00%	100.00%		100.00%	100.00%
Farm-related business:					
Acceptable	96.10%	97.60%			
OAEM	3.72	2.38			
Substandard/doubtful/loss	0.18	0.02			
	100.00%	100.00%			

The following tables provide an aging analysis of the recorded investment of past due loans as of:

September 30, 2018					
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 6,347	\$ 2,985	\$ 9,332	\$ 1,346,280	\$ 1,355,612
Production and intermediate-term	1,307	2,585	3,892	358,128	362,020
Processing and marketing	988	—	988	19,456	20,444
Farm-related business	844	2	846	23,810	24,656
Rural residential real estate	623	168	791	60,278	61,069
Other (including Mission Related)	—	—	—	447	447
Total	\$ 10,109	\$ 5,740	\$ 15,849	\$ 1,808,399	\$ 1,824,248

December 31, 2017					
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 6,402	\$ 3,894	\$ 10,296	\$ 1,309,635	\$ 1,319,931
Production and intermediate-term	2,287	1,521	3,808	308,801	312,609
Processing and marketing	340	—	340	15,711	16,051
Farm-related business	165	3	168	16,393	16,561
Rural residential real estate	697	340	1,037	60,272	61,309
Other (including Mission Related)	—	—	—	466	466
Total	\$ 9,891	\$ 5,758	\$ 15,649	\$ 1,711,278	\$ 1,726,927

Nonperforming assets (including related accrued interest as applicable) and related credit quality statistics at period end were as follows:

	September 30, 2018	December 31, 2017
Nonaccrual loans:		
Real estate mortgage	\$ 7,042	\$ 10,751
Production and intermediate-term	4,293	3,671
Farm-related business	45	3
Rural residential real estate	349	553
Total	<u>\$ 11,729</u>	<u>\$ 14,978</u>
Accruing restructured loans:		
Real estate mortgage	\$ 6,460	\$ 5,946
Production and intermediate-term	221	757
Rural residential real estate	158	160
Total	<u>\$ 6,839</u>	<u>\$ 6,863</u>
Accruing loans 90 days or more past due:		
Total	<u>\$ -</u>	<u>\$ -</u>
Total nonperforming loans	\$ 18,568	\$ 21,841
Other property owned	4,103	3,669
Total nonperforming assets	<u>\$ 22,671</u>	<u>\$ 25,510</u>
Nonaccrual loans as a percentage of total loans	0.65%	0.88%
Nonperforming assets as a percentage of total loans and other property owned	1.25%	1.49%
Nonperforming assets as a percentage of capital	<u>6.00%</u>	<u>6.98%</u>

The following table presents information related to the recorded investment of impaired loans at period end. Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan.

	September 30, 2018	December 31, 2017
Impaired nonaccrual loans:		
Current as to principal and interest	\$ 4,862	\$ 6,634
Past due	6,867	8,344
Total	<u>\$ 11,729</u>	<u>\$ 14,978</u>
Impaired accrual loans:		
Restructured	\$ 6,839	\$ 6,863
90 days or more past due	-	-
Total	<u>\$ 6,839</u>	<u>\$ 6,863</u>
Total impaired loans	<u>\$ 18,568</u>	<u>\$ 21,841</u>
Additional commitments to lend	<u>\$ -</u>	<u>\$ -</u>

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

	September 30, 2018			Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
Impaired loans:							
With a related allowance for credit losses:							
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Production and intermediate-term	355	480	29	366	5	382	18
Farm-related business	-	-	-	-	-	-	-
Rural residential real estate	-	-	-	-	-	-	-
Total	<u>\$ 355</u>	<u>\$ 480</u>	<u>\$ 29</u>	<u>\$ 366</u>	<u>\$ 5</u>	<u>\$ 382</u>	<u>\$ 18</u>
With no related allowance for credit losses:							
Real estate mortgage	\$ 13,502	\$ 15,641	\$ -	\$ 13,933	\$ 187	\$ 14,554	\$ 696
Production and intermediate-term	4,159	5,475	-	4,292	58	4,484	215
Farm-related business	45	132	-	47	1	49	2
Rural residential real estate	507	696	-	523	7	547	26
Total	<u>\$ 18,213</u>	<u>\$ 21,944</u>	<u>\$ -</u>	<u>\$ 18,795</u>	<u>\$ 253</u>	<u>\$ 19,634</u>	<u>\$ 939</u>
Total:							
Real estate mortgage	\$ 13,502	\$ 15,641	\$ -	\$ 13,933	\$ 187	\$ 14,554	\$ 696
Production and intermediate-term	4,514	5,955	29	4,658	63	4,866	233
Farm-related business	45	132	-	47	1	49	2
Rural residential real estate	507	696	-	523	7	547	26
Total	<u>\$ 18,568</u>	<u>\$ 22,424</u>	<u>\$ 29</u>	<u>\$ 19,161</u>	<u>\$ 258</u>	<u>\$ 20,016</u>	<u>\$ 957</u>

Impaired loans:	December 31, 2017			Year Ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	\$ 1,109	\$ 1,180	\$ 31	\$ 1,281	\$ 74
Production and intermediate-term	608	695	148	702	40
Farm-related business	—	—	—	—	—
Rural residential real estate	—	—	—	—	—
Total	\$ 1,717	\$ 1,875	\$ 179	\$ 1,983	\$ 114
With no related allowance for credit losses:					
Real estate mortgage	\$ 15,588	\$ 19,436	\$ —	\$ 18,009	\$ 1,037
Production and intermediate-term	3,820	5,121	—	4,413	254
Farm-related business	3	90	—	3	—
Rural residential real estate	713	849	—	824	48
Total	\$ 20,124	\$ 25,496	\$ —	\$ 23,249	\$ 1,339
Total:					
Real estate mortgage	\$ 16,697	\$ 20,616	\$ 31	\$ 19,290	\$ 1,111
Production and intermediate-term	4,428	5,816	148	5,115	294
Farm-related business	3	90	—	3	—
Rural residential real estate	713	849	—	824	48
Total	\$ 21,841	\$ 27,371	\$ 179	\$ 25,232	\$ 1,453

A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows:

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Rural Residential Real Estate	Other (including Mission Related)	Total
Activity related to the allowance for credit losses:						
Balance at June 30, 2018	\$ 10,655	\$ 2,867	\$ 276	\$ 479	\$ 4	\$ 14,281
Charge-offs	(43)	(121)	—	(1)	—	(165)
Recoveries	29	37	1	25	—	92
Provision for loan losses	440	197	95	(3)	—	729
Balance at September 30,	\$ 11,081	\$ 2,980	\$ 372	\$ 500	\$ 4	\$ 14,937
Balance at December 31,	\$ 11,214	\$ 2,797	\$ 280	\$ 520	\$ 4	\$ 14,815
Charge-offs	(112)	(296)	—	(90)	—	(498)
Recoveries	246	169	3	35	—	453
Provision for loan losses	(267)	310	89	35	—	167
Balance at September 30,	\$ 11,081	\$ 2,980	\$ 372	\$ 500	\$ 4	\$ 14,937
Balance at June 30, 2017	\$ 10,006	\$ 2,499	\$ 213	\$ 431	\$ 4	\$ 13,153
Charge-offs	(101)	(150)	—	(14)	—	(265)
Recoveries	22	123	1	—	3	149
Provision for loan losses	831	365	47	59	(3)	1,299
Balance at September 30,	\$ 10,758	\$ 2,837	\$ 261	\$ 476	\$ 4	\$ 14,336
Balance at December 31,	\$ 11,297	\$ 2,271	\$ 178	\$ 426	\$ 11	\$ 14,183
Charge-offs	(1,826)	(209)	—	(67)	—	(2,102)
Recoveries	152	133	3	—	13	301
Provision for loan losses	1,135	642	80	117	(20)	1,954
Balance at September 30,	\$ 10,758	\$ 2,837	\$ 261	\$ 476	\$ 4	\$ 14,336
Allowance on loans evaluated for impairment:						
Individually	\$ —	\$ 29	\$ —	\$ —	\$ —	\$ 29
Collectively	11,081	2,951	372	500	4	14,908
Balance at September 30,	\$ 11,081	\$ 2,980	\$ 372	\$ 500	\$ 4	\$ 14,937
Individually	\$ 31	\$ 148	\$ —	\$ —	\$ —	\$ 179
Collectively	11,183	2,649	280	520	4	14,636
Balance at December 31,	\$ 11,214	\$ 2,797	\$ 280	\$ 520	\$ 4	\$ 14,815
Recorded investment in loans evaluated for impairment:						
Individually	\$ 13,114	\$ 4,515	\$ 45	\$ 508	\$ —	\$ 18,182
Collectively	1,342,498	357,505	45,055	60,561	447	1,806,066
Balance at September 30,	\$ 1,355,612	\$ 362,020	\$ 45,100	\$ 61,069	\$ 447	\$ 1,824,248
Individually	\$ 18,411	\$ 4,438	\$ 3	\$ 715	\$ —	\$ 23,567
Collectively	1,301,520	308,171	32,609	60,594	466	1,703,360
Balance at December 31,	\$ 1,319,931	\$ 312,609	\$ 32,612	\$ 61,309	\$ 466	\$ 1,726,927

*Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented.

Three Months Ended September 30, 2018					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ –	\$ 456	\$ –	\$ 456	
Total	\$ –	\$ 456	\$ –	\$ 456	
Post-modification:					
Real estate mortgage	\$ –	\$ 416	\$ –	\$ 416	\$ –
Total	\$ –	\$ 416	\$ –	\$ 416	\$ –

Nine months Ended September 30, 2018					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ 203	\$ 490	\$ –	\$ 693	
Production and intermediate-term	275	22	–	297	
Total	\$ 478	\$ 512	\$ –	\$ 990	
Post-modification:					
Real estate mortgage	\$ 208	\$ 449	\$ –	\$ 657	\$ –
Production and intermediate-term	287	28	–	315	–
Total	\$ 495	\$ 477	\$ –	\$ 972	\$ –

Three months ended September 30, 2017					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ 509	\$ 1,032	\$ –	\$ 1,541	
Production and intermediate-term	–	160	–	160	
Total	\$ 509	\$ 1,192	\$ –	\$ 1,701	
Post-modification:					
Real estate mortgage	\$ 522	\$ 1,049	\$ –	\$ 1,571	\$ –
Production and intermediate-term	–	162	–	162	–
Total	\$ 522	\$ 1,211	\$ –	\$ 1,733	\$ –

Nine months ended September 30, 2017					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ 509	\$ 2,050	\$ –	\$ 2,559	
Production and intermediate-term	–	846	–	846	
Rural residential real estate	37	–	–	37	
Total	\$ 546	\$ 2,896	\$ –	\$ 3,442	
Post-modification:					
Real estate mortgage	\$ 522	\$ 2,064	\$ –	\$ 2,586	\$ –
Production and intermediate-term	–	858	–	858	–
Rural residential real estate	37	–	–	37	–
Total	\$ 559	\$ 2,922	\$ –	\$ 3,481	\$ –

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

The following table presents outstanding recorded investment for TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the period. Payment default is defined as a payment that was thirty days or more past due.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Real estate mortgage	\$ 114	\$ 1	\$ 229	\$ 36
Production and intermediate-term	185	—	740	628
Rural residential real estate	—	7	—	24
Total	\$ 299	\$ 8	\$ 969	\$ 688

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table:

	Total TDRs		Nonaccrual TDRs	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Real estate mortgage	\$ 10,515	\$ 10,666	\$ 4,055	\$ 4,720
Production and intermediate-term	1,514	1,999	1,293	1,242
Farm-related business	3	3	3	3
Rural residential real estate	198	302	40	142
Total loans	\$ 12,230	\$ 12,970	\$ 5,391	\$ 6,107
Additional commitments to lend	\$ —	\$ —		

The following table presents information as of period end:

	September 30, 2018
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	\$ 115
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	\$ 133

Note 3 — Investments

Investments in Debt Securities

The Association's investments consist primarily of Rural America Bonds (RABs), which are private placement securities purchased under the Mission Related Investment (MRI) program approved by the FCA. In its Conditions of Approval for the program, the FCA generally considers a RAB ineligible if its investment rating, based on the internal 14-point risk rating scale used to also grade loans, falls below 9 and requires System institutions to provide notification to FCA when a security becomes ineligible. Any other bonds purchased under the MRI program, approved on a case-by-case basis by FCA, may have different eligibility requirements. At September 30, 2018, the Association held no RABs whose credit quality had deteriorated beyond the program limits.

A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

	September 30, 2018				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs	\$ 5,345	\$ 12	\$ (69)	\$ 5,288	6.44%

	December 31, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs	\$ 5,533	\$ 91	\$ (168)	\$ 5,456	6.41%

A summary of the contractual maturity, amortized cost and estimated fair value of investment securities held-to-maturity follows:

	September 30, 2018		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ —	\$ —	—%
After one year through five years	—	—	—%
After five years through ten years	1,005	1,017	5.25%
After ten years	4,340	4,271	6.72%
Total	\$ 5,345	\$ 5,288	6.44%

A portion of these investments has contractual maturities in excess of ten years. However, expected maturities for these types of securities can differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

An investment is considered impaired if its fair value is less than its cost. The following tables show the fair value and gross unrealized losses for investments that were in a continuous unrealized loss position aggregated by investment category at each reporting period. A continuous unrealized loss position for an investment is measured from the date the impairment was first identified.

		September 30, 2018			
		Less than 12 Months		12 Months or Greater	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
RABs		\$ 4,340	\$ (69)	\$ -	\$ -

		December 31, 2017			
		Less than 12 Months		12 Months or Greater	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
RABs		\$ -	\$ -	\$ 1,076	\$ (168)

The recording of an impairment is predicated on: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, and (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the Association intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the full difference between amortized cost and fair value of the security. When the Association does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment loss is separated into credit loss and non-credit loss. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the credit worthiness of bond insurers, and (7) volatility of the fair value changes.

The Association uses the present value of cash flows expected to be collected from each debt security to determine the amount of credit loss. This technique requires assumptions related to the underlying collateral, including default rates, amount and timing of prepayments, and loss severity. Assumptions can vary widely from security to security and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics, and collateral type.

Significant inputs used to estimate the amount of credit loss include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan-to-collateral value ratios, third-party guarantees, current

levels of subordination, vintage, geographic concentration, and credit ratings. The Association may obtain assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party, or generate the assumptions internally.

The Association has not recognized any credit losses as any impairments were deemed temporary and resulted from non-credit related factors. The Association has the ability and intent to hold these temporarily impaired investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements.

Equity Investments in Other Farm Credit System Institutions

Equity investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

Associations are required to maintain ownership in AgFirst (AgFirst or the Bank) in the form of Class B or Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association owned 7.18 percent of the issued stock of the Bank as of September 30, 2018 net of any reciprocal investment. As of that date, the Bank's assets totaled \$32.7 billion and shareholders' equity totaled \$2.4 billion. The Bank's earnings were \$227 million for the first nine months of 2018. In addition, the Association held investments of \$4,603 related to other Farm Credit institutions.

Note 4 — Debt

Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its earning assets. This indebtedness is collateralized by a pledge of substantially all of the Association's assets. The contractual terms of the revolving line of credit are contained in the General Financing Agreement (GFA). The GFA also defines Association performance criteria for borrowing from the Bank, which includes borrowing base margin, earnings and capital covenants, among others.

Note 5 — Members' Equity

Accumulated Other Comprehensive Income (AOCI)

	Changes in Accumulated Other Comprehensive Income by Component (a)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Employee Benefit Plans:				
Balance at beginning of period	\$ (371)	\$ (314)	\$ (374)	\$ (393)
Other comprehensive income before reclassifications	—	—	—	—
Amounts reclassified from AOCI	2	40	5	119
Net current period other comprehensive income	2	40	5	119
Balance at end of period	\$ (369)	\$ (274)	\$ (369)	\$ (274)

	Reclassifications Out of Accumulated Other Comprehensive Income (b)				
	Three Months Ended September 30,		Nine Months Ended September 30,		Income Statement Line Item
	2018	2017	2018	2017	
Defined Benefit Pension Plans:					
Periodic pension costs	\$ (2)	\$ (40)	\$ (5)	\$ (119)	See Note 7.
Net amounts reclassified	\$ (2)	\$ (40)	\$ (5)	\$ (119)	

(a) Amounts in parentheses indicate debits to AOCI.

(b) Amounts in parentheses indicate debits to profit/loss.

Note 6 — Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

The classifications within the fair value hierarchy are as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

Level 3 inputs are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing

that is different than the third-party valuation or internal model pricing.

For a complete discussion of the inputs and other assumptions considered in assigning various assets and liabilities to the fair value hierarchy levels, see the latest Annual Report to Shareholders.

There were no Level 3 assets or liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. Other Financial Instruments are not measured at fair value in the statement of financial position, but their fair values are estimated as of each period end date. The following tables summarize the carrying amounts of these assets and liabilities at period end, and their related fair values.

September 30, 2018					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Assets held in trust funds	\$ 2,132	\$ 2,132	\$ –	\$ –	\$ 2,132
Recurring Assets	\$ 2,132	\$ 2,132	\$ –	\$ –	\$ 2,132
Liabilities:					
Recurring Liabilities	\$ –	\$ –	\$ –	\$ –	\$ –
Nonrecurring Measurements					
Assets:					
Impaired loans	\$ 326	\$ –	\$ –	\$ 326	\$ 326
Other property owned	4,103	–	–	4,443	4,443
Nonrecurring Assets	\$ 4,429	\$ –	\$ –	\$ 4,769	\$ 4,769
Other Financial Instruments					
Assets:					
Cash	\$ 2,119	\$ 2,119	\$ –	\$ –	\$ 2,119
Investment securities, held-to-maturity	5,345	–	–	5,288	5,288
Loans	1,790,174	–	–	1,769,194	1,769,194
Other Financial Assets	\$ 1,797,638	\$ 2,119	\$ –	\$ 1,774,482	\$ 1,776,601
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	\$ 1,480,247	\$ –	\$ –	\$ 1,443,425	\$ 1,443,425
Other Financial Liabilities	\$ 1,480,247	\$ –	\$ –	\$ 1,443,425	\$ 1,443,425
December 31, 2017					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Assets held in trust funds	\$ 1,979	\$ 1,979	\$ –	\$ –	\$ 1,979
Recurring Assets	\$ 1,979	\$ 1,979	\$ –	\$ –	\$ 1,979
Liabilities:					
Recurring Liabilities	\$ –	\$ –	\$ –	\$ –	\$ –
Nonrecurring Measurements					
Assets:					
Impaired loans	\$ 1,538	\$ –	\$ –	\$ 1,538	\$ 1,538
Other property owned	3,669	–	–	3,931	3,931
Nonrecurring Assets	\$ 5,207	\$ –	\$ –	\$ 5,469	\$ 5,469
Other Financial Instruments					
Assets:					
Cash	\$ 4,949	\$ 4,949	\$ –	\$ –	\$ 4,949
Investment securities, held-to-maturity	5,533	–	–	5,456	5,456
Loans	1,697,120	–	–	1,695,034	1,695,034
Other Financial Assets	\$ 1,707,602	\$ 4,949	\$ –	\$ 1,700,490	\$ 1,705,439
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	\$ 1,405,074	\$ –	\$ –	\$ 1,386,868	\$ 1,386,868
Other Financial Liabilities	\$ 1,405,074	\$ –	\$ –	\$ 1,386,868	\$ 1,386,868

SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in

certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

Investment Securities

The fair values of predominantly all Level 3 investment securities have consistent inputs, valuation techniques and correlation to changes in underlying inputs. The models used to determine fair value for these instruments use certain significant unobservable inputs within a discounted cash flow or market comparable pricing valuation technique. Such inputs generally include discount rate components including risk premiums, prepayment estimates, default estimates and loss severities.

These Level 3 assets would decrease (increase) in value based upon an increase (decrease) in discount rates, defaults, or loss severities. Conversely, the fair value of these assets would generally increase (decrease) in value if the prepayment input were to increase (decrease).

Generally, a change in the assumption used for defaults is accompanied by a directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite

change in the assumption used for prepayments. Unobservable inputs for loss severities do not normally increase or decrease based on movements in the other significant unobservable inputs for these Level 3 assets.

Inputs to Valuation Techniques

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

Quoted market prices are generally not available for the instruments presented below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	\$ 4,769	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement cost	*
			Comparability adjustments	*

* Ranges for this type of input are not useful because each collateral property is unique.

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying Value	Par/Principal and appropriate interest yield
Investment securities, held-to-maturity	Discounted cash flow	Prepayment rates
		Risk adjusted discount rate
Loans	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity

Note 7 — Employee Benefit Plans

The following is a table of retirement and other postretirement benefit expenses for the Association:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Pension	\$ 1,313	\$ 1,139	\$ 3,939	\$ 3,416
401(k)	238	221	755	738
Other postretirement benefits	186	175	652	602
Total	\$ 1,737	\$ 1,535	\$ 5,346	\$ 4,756

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 9/30/18	Projected Contributions For Remainder of 2018	Projected Total Contributions 2018
Pension	\$ 121	\$ 5,198	\$ 5,319
Other postretirement benefits	652	254	906
Total	\$ 773	\$ 5,452	\$ 6,225

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's

Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2018.

Further details regarding employee benefit plans are contained in the 2017 Annual Report to Shareholders.

Note 8 — Commitments and Contingent Liabilities

From time to time, legal actions are pending against the Association in which claims for monetary damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association.

Note 9 — Revenue from Contracts with Customers

On January 1, 2018, Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606) became effective. The core principle of the new standard is that companies 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.

The Association maintains contracts with customers to provide support services in various areas such as accounting, lending transactions, consulting, insurance, and information technology. The Association does not generally incur costs to obtain contracts. As most of the contracts are to provide access to expertise or system capacity that the Association maintains, there are no material incremental costs to fulfill these contracts that should be capitalized. Total revenue recognized from contracts with customers was as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
Revenue recognized from contracts with customers:				
At a point in time	\$	652	\$	1,781
Over time		526		1,152
Total	\$	1,178	\$	2,933

Note 10 — Subsequent Events

The Association evaluated subsequent events and determined that, except as described below, there were none requiring disclosure through November 8, 2018, which was the date the financial statements were issued.

As a matter of information, the Association was very fortunate that Hurricane Michael did not have a material impact to our service area with regards to our customers or offices.

On October 15, 2018, AgFirst's Board of Directors indicated an intention to declare, in December 2018, a special patronage distribution. The Association will receive between approximately \$9,125 and \$10,784 which will be recorded as patronage refunds from other Farm Credit institutions.