



FARM CREDIT

2018 ANNUAL  
REPORT

**ARBORONE, ACA**  
***2018 ANNUAL REPORT***

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**Management**

Kathy S. Heustess .....	President and Chief Executive Officer
Tammy G. Smith.....	Chief Financial Officer and Treasurer
Richard O. Pitts .....	Chief Operating Officer
Sarah H. Jackson.....	Chief Human Resources Officer and Corporate Secretary

**Board of Directors**

William DuPree Atkinson.....	Chairman
John Lee Newman. ....	Vice Chairman
Harry B. DuRant .....	Director
John E. Lay.....	Director
J. Whit Player.....	Director
Jimmy Poston.....	Director
James M. Ward .....	Director
Kelly O. Wiseman.....	Director

## *Message from the President*

Dear Stockholder:

Reflecting on 2018 brings mixed emotions. Commodity prices remained low. We do have a new Farm Bill; however, we have not seen the effects of implementation. Immigration reform and tariff wars, as well as many other critical issues, remain unresolved in Congress. Closer to home, we experienced extreme weather events once again. Hurricane Florence took its toll directly impacting some customers, followed by catastrophic flooding of our rivers in eastern SC. Rain inundated our territory late in 2018, causing devastating issues for some who had previously escaped the impacts of the hurricane and flooding. Multiple years of a downturned ag economy coupled with extreme weather events, occurring at harvest, have taken a tremendous toll on many.

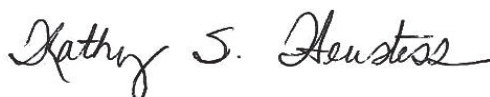
We are thankful to support agriculture and rural communities with reliable, consistent credit and financial services, today and tomorrow. We want to provide support to you. Whether your goals involve running a large row crop or poultry operation, having a couple hundred acres of hunting property or timberland, or simply getting away to that great rural retreat with a few acres and a fish pond, we get it. Not only do we get it, we want to help YOU “get it,” too. Because we are the ag experts, we can do just that. We know the joys and challenges of farming and living in rural areas. We can help you navigate the hurdles – from helping you locate and purchase that perfect piece of property, assisting in developing budgets, cash flows and other financial tools that will benefit your business planning, to designing financing terms that will meet your unique cash flows – we are here to serve your needs.

We are committed to providing you the best customer experience each and every time you connect with us. That’s why in 2018 we surveyed our customers to gauge your level of satisfaction with your entire experience with us, as well as how we can make improvements. Because at the core of our business is customer relationships, we want to continue to give you a reason to choose ArborOne Farm Credit and a reason to recommend us to someone who has a great deal of trust in you – a family member, a good friend or someone who has similar goals or interests!

We want to better communicate with you about the values of being a member of a cooperative. Local ownership and control – specifically, elected member directors – and the benefit of a “patronage refund” are beneficial reasons that come to mind. We want to emphasize the value of patronage with you so that you can have more reasons to love doing business with us! This is a change from prior years when some funds were paid now and some in future years. **In 2018, we will return to you about 25 cents of every dollar of interest you paid – IN CASH!** Ask your relationship manager to show you how your effective interest rate is reduced because of patronage. Then watch your mailbox for the refund check that will come around the end of March. **This check will represent one-fourth of what you paid to us in 2018 returned back to you in cash** – because we are financially stable and we know what struggles ag has encountered in the past several years! These funds will be in your hands so that you can reinvest in your operation, take that long-awaited vacation or help pay a portion of your child’s college tuition – whatever you choose.

In 2019, we will seek ways to continue to align our offerings and services with what is most important to you. We will hold many events with your needs in mind. We will continue to have our customer appreciation events to say we know how important, yet challenging and risky, what you do is and how much we appreciate that you choose to partner with ArborOne Farm Credit. We will host educational opportunities on topics that interest you. We will continue to promote crop insurance as a means to protect your investment. As a leader of this company, it is my responsibility to find ways to leverage what you have told us and to find more customers “just like you”! Even though each customer has different goals that we can help support to reality, in most cases, saying something good about ArborOne to a friend or relative is the best source of marketing that we have. We want to say thank you for what you do to keep your cooperative growing!

All the best in 2019!



Kathy S. Heustess  
President and Chief Executive Officer

March 13, 2019

## *Report of Management*

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of **ArborOne, ACA** (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

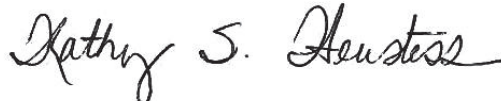
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been audited by independent auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

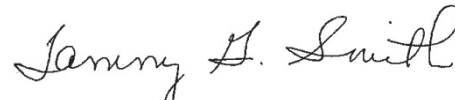
The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2018 Annual Report of **ArborOne, ACA**, that the report has been prepared under the oversight of the audit committee of the 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.



William Dupree Atkinson  
Chairman of the Board



Kathy S. Heustess  
President and Chief Executive Officer



Tammy G. Smith  
Chief Financial Officer and Treasurer

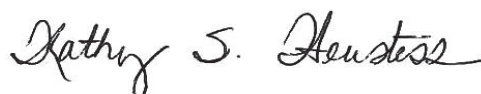
March 13, 2019

## *Report on Internal Control Over Financial Reporting*

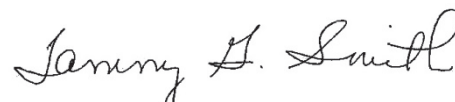
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal 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 effected by its Board of Directors, management and other personnel, to provide 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 and 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 December 31, 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 December 31, 2018, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2018.



Kathy S. Heustess  
President and Chief Executive Officer



Tammy G. Smith  
Chief Financial Officer and Treasurer

March 13, 2019

# Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	December 31,				
	2018	2017	2016	2015	2014
<b>Balance Sheet Data</b>					
Cash	\$ 48	\$ 181	\$ 12	\$ 2	\$ 2
Investments in debt securities	9,268	14,309	18,489	22,171	29,767
Loans	495,168	459,894	447,150	383,427	340,945
Allowance for loan losses	(12,804)	(10,844)	(8,676)	(7,379)	(4,904)
Net loans	482,364	449,050	438,474	376,048	336,041
Equity investments in other Farm Credit institutions	5,945	5,924	5,659	9,316	10,497
Other property owned	822	783	623	1,553	3,807
Other assets	20,516	20,627	20,421	20,080	21,360
Total assets	\$ 518,963	\$ 490,874	\$ 483,678	\$ 429,170	\$ 401,474
Notes payable to AgFirst Farm Credit Bank*	\$ 418,933	\$ 392,398	\$ 386,383	\$ 335,894	\$ 309,286
Accrued interest payable and other liabilities with maturities of less than one year	12,255	11,594	12,777	12,656	13,802
Total liabilities	431,188	403,992	399,160	348,550	323,088
Protected borrower stock	52	53	62	62	78
Capital stock and participation certificates	1,510	1,413	1,351	1,290	1,229
Retained earnings					
Allocated	58,095	57,424	54,690	52,625	51,516
Unallocated	28,044	27,867	28,196	25,945	24,578
Accumulated other comprehensive income	74	125	219	698	985
Total members' equity	87,775	86,882	84,518	80,620	78,386
Total liabilities and members' equity	\$ 518,963	\$ 490,874	\$ 483,678	\$ 429,170	\$ 401,474
<b>Statement of Income Data</b>					
Net interest income	\$ 12,622	\$ 12,192	\$ 11,768	\$ 10,683	\$ 9,959
Provision for loan losses	2,369	2,611	1,711	2,703	347
Noninterest income (expense), net	(1,343)	(1,195)	(1,280)	(380)	452
Net income	\$ 8,910	\$ 8,386	\$ 8,777	\$ 7,600	\$ 10,064
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	1.76%	1.72%	1.92%	1.85%	2.57%
Total members' equity	9.89%	9.60%	10.33%	9.24%	12.71%
Net interest income as a percentage of average earning assets					
Net (chargeoffs) recoveries to average loans	(0.085)%	(0.096)%	(0.099)%	(0.063)%	0.021%
Total members' equity to total assets	16.91%	17.70%	17.47%	18.79%	19.52%
Debt to members' equity (:1)	4.91	4.65	4.72	4.32	4.12
Allowance for loan losses to loans	2.59%	2.36%	1.94%	1.92%	1.44%
Permanent capital ratio	17.48%	18.44%	19.42%	20.83%	21.11%
Total surplus ratio	**	**	19.10%	20.45%	20.71%
Core surplus ratio	**	**	16.46%	19.36%	18.38%
Common equity tier 1 capital ratio	17.26%	18.20%	**	**	**
Tier 1 capital ratio	17.26%	18.20%	**	**	**
Total regulatory capital ratio	18.52%	19.46%	**	**	**
Tier 1 leverage ratio	16.03%	16.58%	**	**	**
Unallocated retained earnings (URE) and URE equivalents leverage ratio					
URE equivalents leverage ratio	8.13%	8.24%	**	**	**
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ 6,167	\$ 2,495	\$ 1,992	\$ 1,636	\$ 2,415
Qualified allocated retained earnings	—	—	332	1,091	—
Nonqualified allocated retained earnings	—	4,845	4,317	2,726	3,634
Nonqualified retained earnings	2,468	977	—	—	2,000

\* General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2019.

\*\* Not applicable due to changes in regulatory capital requirements effective January 1, 2017.

# Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of ArborOne, ACA, (Association) for the year ended December 31, 2018 with comparisons to the years ended December 31, 2017 and December 31, 2016. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements, and other sections in this Annual Report. The accompanying Consolidated Financial Statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of 12 counties located in northeastern South Carolina. Refer to Note 1, *Organization and Operations*, of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be materially affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 2764, or writing Matthew Miller, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.arborone.com](http://www.arborone.com), or by calling 1-800-741-7332, extension 2317, or writing Sarah Jackson, Corporate Secretary, ArborOne, ACA, P.O. Box 3699, Florence, S.C. 29502. The Association prepares an electronic version of the Annual

Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

## FORWARD LOOKING INFORMATION

This annual information statement 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 the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## AGRICULTURAL OUTLOOK

The following United States Department of Agriculture (USDA) analysis provides a general understanding of the U.S. agricultural economic outlook. However, this outlook does not take into account all aspects of the Association's business. References to USDA information in this section refer to the U.S. agricultural market data and are not limited to information/data in the Association's territory.

Production agriculture is a cyclical business that is heavily influenced by commodity prices, weather, tax and trade policies, interest rates and various other factors. From 2010 through 2014,

the U.S. farm sector generally experienced favorable economic conditions driven by high commodity and livestock prices and increasing farmland values. This generally fostered improved financial strength across the farm sector, with farmer working capital peaking in 2012. Working capital is defined as the amount of cash and cash convertible assets minus liabilities due to creditors within 12 months. However, since 2014, the agricultural environment has been more challenging. Currency fluctuations, large inventories and current U.S. trade policies, including the retaliatory action by other countries, have begun to adversely impact demand and prices for agricultural exports, which have reduced net farm income (a broad measure of profits) and eroded farmer working capital. Higher interest rates could exacerbate the reduction in net farm income by increasing interest expense for farmers with floating-rate loans or other liabilities that reprice periodically to current market interest rates. The following table illustrates USDA data on net farm income and farmer working capital:

(dollars in billions)	Year Ended December 31,			
	2018*	2017	2016	2015
Net Farm Income	\$66.295	\$75.381	\$61.542	\$81.053
Farmer Working Capital	\$49.879	\$72.279	\$65.197	\$82.657

\*Forecasted

The substantial risk-bearing capacity, gained prior to 2015, has afforded U.S. crop producers time to transition their operations to the new environment of lower commodity prices, compressed margins and higher interest rates. Optimal input usage, adoption of cost-saving technologies, negotiation of adjustments to various business arrangements, such as rental cost of agriculture real estate, and effective use of hedging and other price risk management strategies are all critical in yielding positive net farm income for producers. Producers who are able to realize cost of production efficiencies and market their farm products effectively are most likely to adapt to the current price environment. However, if these current market conditions persist, farm sector financial strength will continue to weaken, challenging a greater number of producers who may not be able to sufficiently adjust their operations to avoid loan repayment challenges.

The February 2019 USDA forecast estimates 2018 farmers' net cash income, which is a measure of the cash income after payment of business expenses, at \$95.0 billion, down \$9.0 billion from 2017. The forecasted decrease in farmers' net cash income for 2018 is primarily due to an expected increase in cash expenses of \$11.9 billion, led by increases in fuels/oil, interest, feed, and hired labor.

The February 2019 USDA outlook for the farm economy, as a whole, projects 2019 farmers' net cash income to increase to \$97.7 billion, a \$2.7 billion increase from 2018. The forecasted increase in farmers' net cash income for 2019 is primarily due to an expected decrease in cash expenses of \$4.4 billion and increase in cash receipts for crops of \$2.2 billion, partially offset by a decrease in direct government payments of \$2.8 billion.

As estimated by the USDA in November 2018, the System's market share of farm business debt (defined as debt incurred by those involved in on-farm agricultural production) decreased slightly to 40.4 percent at December 31, 2017 (the latest available data), as compared with 40.9 percent at December 31, 2016.

While 2018 net farm income and working capital have declined, a healthy U.S. economy is expected to support domestic demand for most agricultural commodities in the foreseeable future. The primary area of risk will remain the export component of the demand for U.S. agricultural commodities, with a stronger dollar and ongoing uncertainty surrounding the future of U.S. trade policy. Major cash crops in the U.S. are projected to remain at elevated supply levels resulting from a combination of factors, including overall excellent crop conditions, tariffs and strong harvests in recent years. In addition to cash crops, pork and dairy are heavily dependent upon exports and most susceptible to foreign trade-related disruptions. The risk in the export component of the demand for U.S. agricultural commodities has been minimally mitigated by Market Facilitation Program assistance to producers impacted by retaliatory tariffs. Additionally, the revised Dairy Margin Protection Program in the 2018 Farm Bill and the new Dairy Revenue Protection Program will provide some support for dairy farmers. Mid-sized dairies, especially operations that are more highly leveraged or have high relative costs, will continue to face financial challenges at least into mid-2019.

The following table sets forth the commodity prices per bushel for certain crops, by hundredweight for hogs, milk, and beef cattle, and by pound for broilers and turkeys from December 31, 2015 to December 31, 2018:

Commodity	12/31/18	12/31/17	12/31/16	12/31/15
Hogs	\$43.40	\$48.60	\$43.10	\$42.80
Milk	\$16.40	\$17.20	\$18.90	\$17.30
Broilers	\$0.51	\$0.50	\$0.48	\$0.47
Turkeys	\$0.50	\$0.53	\$0.74	\$0.89
Corn	\$3.54	\$3.23	\$3.32	\$3.65
Soybeans	\$8.57	\$9.30	\$9.64	\$8.76
Wheat	\$5.28	\$4.50	\$3.90	\$4.75
Beef Cattle	\$117.00	\$118.00	\$111.00	\$122.00

In a prolonged period of less favorable conditions in agriculture, the Association's financial performance and credit quality measures would likely be negatively impacted. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

## CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies:

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by



management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including: economic and political conditions, loan portfolio composition, credit quality, and prior loan loss experience.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record; the prospects for support from any financially responsible guarantor; and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations, and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations, and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects, and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, other property owned (OPO), pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

## ECONOMIC CONDITIONS

During 2018, general economic conditions in our region were stable to improving when compared to 2017. Agricultural loan demand was stable in 2018 due to continued low commodity prices. Competition for agricultural loans continued strong in 2018 despite the stumbling agriculture economy. Unemployment in all of our 12 counties improved year over year. South Carolina's unemployment rate was improved year over year ending 2018 at 3.3%. The overall U.S. unemployment rate ended the year at 3.9% showing improvement over the previous year's 4.1%. The housing and real estate markets in our region continued to do well again during 2018.

For the year ended December 31, 2018, the credit quality of the loan portfolio improved in comparison to the previous year end. For the agricultural sector in 2018, continued high input prices coupled with continued lower commodity prices made profit margins slim for farm producers. The protein sector profit margins were stable during 2018. Industries tied to housing such as forestry, sawmills, sod, and landscape nurseries saw increases in demand and profitability during 2018. Overall, we expect the credit quality of the Association's loan portfolio to remain stable in 2019. Improvements to credit quality will most likely be gradual due to a continued weak agricultural economy, coupled with natural disasters impacting farmers during their fall/winter harvest three out of the last four years (2015, 2016, and 2018).

During 2018, the Association continued to operate under tightened lending practices and policies in order to strengthen its capital and loan portfolio. By taking these actions beginning in 2010 and continuing thereafter, the Association has the tools necessary to weather any difficulties that may come to fruition during 2019. The Association continues efforts to expand services, increase public knowledge of our services, and streamline our current delivery of products to enhance our value to our customer owners.

## 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 through numerous product types.

The gross loan volume of the Association as of December 31, 2018 was \$495,168, an increase of \$35,274 or 7.67 percent as compared to \$459,894 at December 31, 2017, and an increase of \$48,018 or 10.74 percent as compared to \$447,150 at December 31, 2016. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2018 were \$482,364, as compared to \$449,050 at December 31, 2017, and \$438,474 at December 31, 2016. Net loans accounted for 92.95 percent of total assets on December 31, 2018, as compared to 91.48 percent of total assets at December 31, 2017, and 90.65 percent of total assets at December 31, 2016.

The diversification of the Association's loan volume by type for each of the past three years at December 31 is shown in the below table.

Loan Type	December 31,					
	2018		2017		2016	
	<i>(dollars in thousands)</i>					
Real estate mortgage	\$ 243,247	49.13 %	\$ 230,206	50.06 %	\$ 232,251	51.94 %
Production and intermediate term	216,817	43.79	201,131	43.73	185,439	41.47
Loans to cooperatives	3,152	0.64	739	0.16	1,866	0.42
Processing and marketing	16,054	3.24	17,028	3.70	16,385	3.67
Farm-related business	9,399	1.90	4,455	0.97	4,599	1.03
Power & Water/waste disposal	1,757	0.35	1,842	0.40	860	.19
Rural residential real estate	3,818	0.77	3,548	0.77	4,784	1.07
International	856	0.17	856	0.19	856	.19
Lease receivables	68	0.01	89	0.02	110	.02
Total	\$ 495,168	100.00 %	\$ 459,894	100.00 %	\$ 447,150	100.00 %

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified. The following tables reflect the geographic locations served and the commodities financed for both core and participation purchased loans.

The geographic distribution of the loan volume by county for the past three years is as follows:

County	December 31,		
	2018	2017	2016
Clarendon	13.8%	14.0%	14.6%
Horry*	12.7	12.0	11.7
Sumter	8.6	8.5	7.9
Darlington	8.6	8.3	8.7
Florence*	7.3	7.0	6.9
Lee	6.2	7.3	7.1
Williamsburg	5.2	5.1	5.4
Dillon	5.0	5.1	5.1
Marion	3.9	3.0	2.6
Chesterfield	3.6	4.0	4.6
Georgetown	3.2	3.9	3.6
Marlboro	1.1	1.1	1.2
Other**	20.8	20.7	20.6
Total	100.0%	100.0%	100.0%

\*Branch Locations

\*\*The Other category above consists of loans originated and participated outside our territory.

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are field crops, cash grains, poultry, and forestry which constitute 67 percent of the entire portfolio.

Commodity Group	December 31,					
	2018		2017		2016	
	<i>(dollars in thousands)</i>					
Field Crops	\$ 119,624	24%	\$ 105,376	23%	\$ 94,440	21%
Cash Grains	90,196	18	86,156	19	84,856	19
Poultry & Eggs	65,388	13	62,114	13	60,346	13
Forestry & Logging	61,711	12	60,918	13	63,258	14
Miscellaneous	41,246	8	34,891	7	30,628	7
Livestock & Animal Specialties	34,685	7	30,415	6	30,373	7
General Farms	32,613	6	26,833	6	28,193	6
Agricultural Services	16,247	3	14,340	3	15,397	3
Vegetables & Fruits	8,443	2	6,713	1	7,899	1
Horticultural Specialties	7,679	1	7,900	2	7,034	1
Mission Related Investments	6,235	1	6,424	1	6,602	1
Food Preparations	5,287	1	11,299	2	12,775	3
Rural Home Loans	4,518	1	4,885	1	4,126	1
Rural Utilities	742	1	801	1	860	1
Tobacco Stem & Redry	513	1	576	1	217	1
Non-Farm Income	41	1	253	1	146	1
Total	\$ 495,168	100%	\$ 459,894	100%	\$ 447,150	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's largest concentrations based on risk volume are in cash grains, cotton, tobacco, contract poultry and forestry. Although a large percentage of the loan portfolio is concentrated in these industries, many of these operations are diversified within their enterprise and/or with crop production and additional sources of income, including non-farm businesses and salaried income, which reduces overall risk exposure. Demand for protein, prices of commodities, and international trade are some of the factors affecting these industries. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase in net loan volume for the twelve months ended December 31, 2018, was primarily attributed to an increase in originated loan volume within our twelve counties. The general economy continued to do well during 2018. The agricultural economy continued to slump during 2018 due mainly to low commodity prices. Thus, the impact to association volume is expected to remain stable within its twelve counties.

Beginning in 2009 and continuing through 2016, the Association has decreased purchased loan activity year over year. However, during 2017 and 2018, the Association had a slight increase in participation purchased loans resulting from net advances and new loan volume. The Association utilizes purchased loans as a means to spread credit concentration risk and realize non-patronage sourced interest and fee income. The strategy is to purchase accounts with acceptable credit risk to the Association.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. In 2016, given the Association's strong capital position, the Association canceled its participation in the Capitalized Participation Pool (CPP) program with the Bank. As a result, the Association repurchased \$37,552 of participations previously sold to AgFirst. This decision was made effective October 1, 2016.

Loan Participations:	December 31,		
	2018	2017	2016
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 44,671	\$ 43,489	\$ 39,654
Participations Purchased			
– Non-FCS Institutions	–	–	1,831
Participations Sold	(35,051)	(27,285)	(27,389)
Total	\$ 9,620	\$ 16,204	\$ 14,096

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2018.

The Farmer Mac Long Term Stand-By program was established by Congress to provide liquidity to agricultural lenders. At December 31, 2018 and 2017, the Association had no loans in this program; however, at December 31, 2016, the Association had loans amounting to \$63, which were 100 percent guaranteed by Farmer Mac. The Association had other federal guaranteed loans in the amount of \$4,759 at

December 31, 2018, compared to \$4,894 at December 31, 2017, and \$5,019 at December 31, 2016. In addition, the Association had \$78,267 in Farm Services Agency (FSA) guaranteed loans at December 31, 2018, compared to \$76,334 at December 31, 2017, and \$70,661 at December 31, 2016.

### MISSION RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot under the Mission Related Investments umbrella, as described below.

In October 2005, the FCA authorized AgFirst and the associations to make investments in Rural America Bonds under a three-year pilot period, and in October 2008 approved a continuation of the program. Effective December 31, 2014, the FCA concluded each pilot program approved as part of the Investment in Rural America program. Each institution participating in such programs may continue to hold its investment through the maturity dates for the investments, provided the institution continues to meet all approval conditions. Although the pilot programs are concluded, the FCA can consider future requests on a case-by-case basis. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, economic development, infrastructure, or community development and revitalization projects in rural areas. Examples would include investments in: value-added food and fiber processors/marketers, agribusiness, rural commercial enterprises, community services, schools, hospitals, and municipalities. These along with many other activities that sustain or revitalize rural communities and their economics would be a focus. The objective of this program was to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2018, 2017, and 2016, the Association had \$6,235, \$6,425, and \$6,603, respectively, in Rural America Bonds classified as Loans and \$9,268, \$14,309, and \$18,489, respectively, in Rural American Bonds classified as Investments on the Consolidated Balance Sheets.

Refer to Note 4, *Investments*, of the Notes to the Consolidated Financial Statements for additional information regarding the Mission Related Investments.

### INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds.

During 2014, the Association judged that since there had been no significant sales of the available-for-sale securities for an extended period of time that a held-to-maturity classification more closely reflects the way in which it expects to benefit from the cash flows from those assets. As a result, on October 1, 2014, the Association transferred its remaining available-for-sale investments to a held-to-maturity classification.

For a debt security transferred into the held-to-maturity category, the use of fair value may create a premium or discount that, under amortized cost accounting, shall be amortized thereafter as an adjustment of yield. The investments were transferred to held-to-maturity at fair value with unrealized gains and losses recognized in Other Comprehensive Income (OCI). These OCI amounts will be amortized or accreted to interest income ratably over the remaining life of each individual security in accordance with generally accepted accounting principles (GAAP). The amortization of an unrealized holding gain or loss reported in OCI will offset or mitigate the effect on interest income of the amortization of any premium or discount recorded on transfer to held-to-maturity for each security.

During 2018, investment securities decreased by \$5,041. The decrease was mainly due to the payoff of one investment security in the amount of \$4,540, a final settlement payment for the disposition of collateral on a substandard security in the amount of \$96, normal payments in the amount of \$320, and the amortization of the net unrealized gain from the transfer to HTM in the amount of \$91. These decreases were partially offset by the partial accretion to interest income of a fee on one investment security in the amount of \$6.

As of December 31, 2018, the majority of the Association’s held-to-maturity Mission Related Investments are guaranteed; therefore the risk of credit loss to the Association is reduced. However, as of December 31, 2018, one security was rated as other assets especially mentioned (OAEM), which made this security an ineligible investment under FCA regulation. FCA has been notified of this downgrade as required.

No additional credit impairments were taken in 2016, 2017, or 2018 on any ineligible investment. However, a partial accretion to interest income of the credit impairment on the substandard investment security was recognized during 2016 in the amount of \$510. This accretion, along with the substandard security’s final settlement payment for the disposition of collateral in December of 2018, cleared the remaining credit impairment in the amount of \$2,024. No new bonds were added during 2016, 2017, or 2018.

**CREDIT RISK MANAGEMENT**

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history

- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower’s credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower’s ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Long term real estate mortgage loans may be made only in amounts up to 85 percent of the original purchase price or appraised value, the lesser of the two, of the property taken as collateral or up to 97 percent of the purchase price or appraised value, the lesser of the two, if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage as outlined in the previous statement. Evaluations are required for loans with an amortization of 10 years and greater. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions, and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2018	2017	2016
Acceptable & OAEM	95.60%	94.72%	97.64%
Substandard	4.40%	5.28%	2.36%
Doubtful	–%	–%	–%
Total	100.00%	100.00%	100.00%

*Nonperforming Assets*

The Association's loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

High-risk Assets	December 31,		
	2018	2017	2016
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 19,078	\$ 10,627	\$ 10,929
Restructured loans	6,987	8,730	9,432
Accruing loans 90 days past due	—	—	—
Total high-risk loans	26,065	19,357	20,361
Other property owned	822	783	623
Total high-risk assets	\$ 26,887	\$ 20,140	\$ 20,984
<b>Ratios</b>			
Nonaccrual loans to total loans	3.85%	2.31%	2.44%
High-risk assets to total assets	5.18%	4.10%	4.34%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$8,451 or 79.52% in 2018. This increase was mainly due to the transfer of a couple of core loans into nonaccrual status. The increase was partially offset by chargeoffs, normal payments, the transfer of several core loans to other property owned, and the reinstatement of a core loan to accruing status. Of the \$19,078 in nonaccrual volume at December 31, 2018, \$9,368 or 49.10% compared to 28.69% and 36.80% at December 31, 2017 and 2016, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status. Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

*Allowance for Loan Losses*

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for each of the past three years at December 31.

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2018	2017	2016
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 10,844	\$ 8,676	\$ 7,379
Charge-offs:			
Real estate mortgage	(299)	(285)	(300)
Production and intermediate-term	(189)	(386)	(342)
Total charge-offs	(488)	(671)	(642)
Recoveries:			
Real estate mortgage	—	124	70
Production and intermediate-term	79	95	158
Agribusiness	—	9	—
Total recoveries	79	228	228
Net (charge-offs) recoveries	(409)	(443)	(414)
Provision for (reversal of allowance for) loan losses	2,369	2,611	1,711
Balance at end of year	\$ 12,804	\$ 10,844	\$ 8,676
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.085)%	(0.096)%	(0.099)%

The loan charge-offs were primarily associated with one large core loan. The recoveries were mainly attributed to several core loans.

Provision for loan loss was increased due to an increase in specific reserves on two core accounts along with an additional special allowance for significant weather conditions experienced during the harvest of 2018.

The allowance for loan losses by loan type for each of the past three years at December 31 is shown in the below table.

	Year Ended December 31,			
	2018		2017	
	Amount	%	Amount	%
Real estate mortgage	\$ 3,124	24.40%	\$ 2,879	26.55%
Production and intermediate-term	9,177	71.67	7,432	68.54
Agribusiness	463	3.62	377	3.48
Power & Water/waste disposal	12	0.09	14	0.13
Rural residential real estate	19	0.15	22	0.20
International	9	0.07	9	0.08
Lease receivables	—	—	111	1.02
Total	\$ 12,804	100.00%	\$ 10,844	100.00%

	For Year Ended December 31,	
	Amount	%
Real estate mortgage	\$ 1,823	21.01%
Production and intermediate-term	6,410	73.88
Agribusiness	297	3.43
Power & Water/waste disposal	8	0.09
Rural residential real estate	18	0.21
International	7	0.08
Lease receivables	113	1.30
Total	\$ 8,676	100.00%

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31,		
	2018	2017	2016
Total loans	2.59%	2.36%	1.94%
Total high risk loans	49.12%	56.02%	42.61%
Nonaccrual loans	67.11%	102.04%	79.39%

Please refer to Note 3, *Loans and Allowance for Loan Losses*, of the Notes to the Consolidated Financial Statements for further information concerning the allowance for loan losses.

## RESULTS OF OPERATIONS

Net income for the year ended December 31, 2018 totaled \$8,910, an increase of \$524 or 6.25 percent as compared to \$8,386 for the same period of 2017, and an increase of \$133 or 1.52 percent as compared to \$8,777 for the same period of 2016.

### Net Interest Income

Net interest income was \$12,622, \$12,192, and \$11,768 in 2018, 2017, and 2016, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets, and

cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:	Nonaccrual			Total
	Volume*	Rate	Income	
<i>(dollars in thousands)</i>				
<b>12/31/18 - 12/31/17</b>				
Interest income	\$ 930	\$ 1,614	\$ (137)	\$ 2,407
Interest expense	374	1,603	—	1,977
Change in net interest income	\$ 556	\$ 11	\$ (137)	\$ 430
<b>12/31/17 - 12/31/16</b>				
Interest income	\$ 1,644	\$ 329	\$ 31	\$ 2,004
Interest expense	710	870	—	1,580
Change in net interest income	\$ 934	\$ (541)	\$ 31	\$ 424

\* Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

Net interest income increased by \$430 or 3.53 percent in 2018 compared to 2017 and increased by \$854 or 7.26 percent compared to 2016. The key reason for the increase of \$430 was due to an increase in loan volume. Interest expense increased mainly due to an increase in rates.

The Association's net interest income as a percentage of average earning assets was 2.55 percent on December 31, 2018, compared to 2.56 percent on December 31, 2017, and 2.67 percent on December 31, 2016.

### Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2018/ 2017	2017/ 2016
	2018	2017	2016		
<i>(dollars in thousands)</i>					
Loan fees	\$ 914	\$ 858	\$ 1,693	6.53%	(49.32)%
Fees for financially related services	1,178	1,044	979	12.84	6.64
Patronage refund from other Farm Credit Institutions	6,655	6,931	6,792	(3.98)	2.05
Gains (losses) on sales of premises and equipment, net	(1)	4	32	(125.00)	(87.50)
Gains (losses) on other transactions	(10)	(254)	26	96.06	(1,076.92)
Insurance Fund refunds	277	—	—	277.00	—
Other noninterest income	151	1	4	150.00	(75.00)
Total noninterest income	\$ 9,164	\$ 8,584	\$ 9,526	6.76%	(9.89)%

The increase in loan fees of \$56 for the 2018 year resulted mainly from fees for new loan volume, which also increased in 2018. This increase was partially offset by the decrease in Rural America Bond fees, which is attributed to the decrease in bond volume.

The increase in fees for financially related services was \$134, which was primarily a result of additional customers for the 2018 crop year and the purchase of additional endorsements or coverage.

Regarding patronage refunds received from other Farm Credit Institutions, the Association received \$3,197 in a patronage refund and \$3,364 in a special distribution from the Bank for the year ended December 31, 2018, compared to \$3,039 and \$3,785 for 2017, and \$4,194 and \$2,486 for 2016. Of the

patronage refund, patronage paid on the CPP loans was \$1,382 for 2016. In 2016, given the Association's strong capital position, the Association canceled its participation in the CPPs program with the Bank.

Losses on other transactions decreased \$244 for the year ended December 31, 2018. This decrease is mainly the result of a large loss on a patronage receivable that occurred in 2017.

The increase in insurance fund refunds was the result of a one-time insurance refund of \$277 that occurred in 2018.

Other noninterest income increased \$150 for the year ended December 31, 2018. This increase was mainly the result of a final disposition of collateral on a substandard security.

*Noninterest Expense*

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2018/	2017/
	2018	2017	2016	2017	2016
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 7,381	\$ 7,082	\$ 7,311	4.22%	(3.13)%
Occupancy and equipment	537	482	498	11.41	(3.21)
Insurance Fund premiums	314	481	495	(34.72)	(2.83)
(Gains) losses on other property owned, net	(43)	465	232	(109.25)	100.43
Other operating expenses	2,312	1,266	2,255	82.62	(43.86)
Total noninterest expense	\$ 10,501	\$ 9,776	\$ 10,791	7.42%	(9.41)%

Noninterest expense increased \$725 or 7.42 percent for December 31, 2018 as compared to the same period for 2017 and decreased \$290 or 2.69 percent compared to December 31, 2016.

Salaries and employee benefits increased in 2018, when compared with 2017, primarily due to merit increases along with an increase in postretirement benefit costs.

During 2017, the method of recording expenses for the Association's defined benefit pension plan and other postretirement benefit plan was modified. This change resulted in the reduction of Other Assets by \$2,101 and the reduction of Other Liabilities by \$3,078 on the Association's Balance Sheets, and a corresponding reduction of postretirement benefit costs on the Association's Statements of Income of \$977, included in other operating expenses in the table above, during 2017. Refer to Note 9, *Employee Benefit Plans*, of the Notes to the Consolidated Financial Statements, for further information concerning postretirement benefit expenses.

Occupancy and equipment increased 11.41 percent for the twelve months ended December 31, 2018, compared to the same period of 2017. This increase was attributed mainly to furniture and equipment maintenance and repair, cost of space maintenance expenses, and depreciation resulting from the expansion of the administrative office.

Insurance Fund premiums expense decreased 34.72 percent for the twelve months ended December 31, 2018, compared to the same period of 2017. This was primarily due to a decrease in the rates from prior year on accruing volume, which was partially offset by increased loan volume.

The Association had a net gain on other property owned of \$43 for the twelve months ended December 31, 2018. This was mainly due to writedown recoveries on two OPO accounts.

Other operating expenses increased by 82.62 percent for the twelve months ended December 31, 2018. This increase was mainly due to the change in reporting methods of the pension plans, which reduced postretirement benefit costs in the amount of \$977 in 2017.

*Income Taxes*

The Association recorded a provision of \$6 for income taxes for the year ended December 31, 2018, as compared to a provision of \$3 for income taxes for 2017, and a benefit of \$15 for 2016. Refer to Note 2, *Summary of Significant Accounting*

*Policies, Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

*Key Results of Operations Comparisons*

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/18	12/31/17	12/31/16
Return on average assets	1.76%	1.72%	1.92%
Return on average members' equity	9.89%	9.60%	10.33%
Net interest income as a percentage of average earning assets	2.55%	2.56%	2.67%
Net (charge-offs) recoveries to average loans	(0.085)%	(0.096)%	(0.099)%

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goals are to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet these goals, the agricultural economy must improve and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

**LIQUIDITY AND FUNDING SOURCES**

*Liquidity and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA 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, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and liability management. The notes payable are segmented into variable rate and fixed rate components. 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. Association capital levels effectively create a borrowing margin between the amount of loans

outstanding and the amount of notes payable outstanding. This margin is commonly referred to as “Loanable Funds.”

Total notes payable to the Bank at December 31, 2018 was \$418,933, as compared to \$392,398 at December 31, 2017, and \$386,383 at December 31, 2016. The increases of 6.76 percent and 1.56 for December 31, 2017 and 2016, respectively, were mainly attributed to an increase in originated loan volume, which was partially offset by a decrease in investment securities. The average volume of outstanding notes payable to the Bank was \$406,778, \$393,461, and \$365,988 for the years ended December 31, 2018, 2017, and 2016, respectively. Refer to Note 6, *Debt - Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association’s notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses, and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association’s note payable to the Bank. The Association’s participation in the Farmer Mac, investments, and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association. The Association did not have any lines of credit from third party financial institutions as of December 31, 2018.

#### *Funds Management*

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable, and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate, the 30-day London Interbank Offered Rate (LIBOR), or the 90-day LIBOR. Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association’s Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify, and control risk associated with the loan portfolio.

#### *Relationship with the Bank*

The Association’s statutory obligation to borrow only from the Bank is discussed in Note 6, *Debt - Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements in this Annual Report.

The Bank’s ability to access capital of the Association is discussed in Note 4, *Investments – Equity Investments in Other Farm Credit Institutions*, of the Notes to the Consolidated Financial Statements.

The Bank’s role in mitigating the Association’s exposure to interest rate risk is described in the “Liquidity and Funding Sources” section of this Management’s Discussion and Analysis and in Note 6, *Debt - Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements included in this Annual Report.

## CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2018 that would affect minimum stock purchases or would have an effect on the Association’s ability to retire stock and distribute earnings.

Total members’ equity at December 31, 2018 increased 1.03 percent to \$87,775 from the December 31, 2017 total of \$86,882. At December 31, 2017, total members’ equity increased 2.80 percent from the December 31, 2016 total of \$84,518. The increase from prior year was primarily attributed to an increase in retained earnings as well as capital stock and was partially offset by a decrease in accumulated other comprehensive income.

Total capital stock and participation certificates were \$1,562 on December 31, 2018, compared to \$1,466 on December 31, 2017, and \$1,413 on December 31, 2016. The increase from prior year was attributed to a net increase of \$96 in capital stock, participation certificates, and unprotected borrower stock. The increase in capital stock was a result of growth in originated loan volume.

FCA sets minimum regulatory capital requirements for System banks and associations. Effective January 1, 2017, these requirements were modified to make System regulatory requirements more transparent and to ensure that the System’s capital requirements are compatible with the Basel III framework and the standardized approach of federal banking regulatory agencies. New regulations replaced core surplus and total surplus ratios with common equity tier 1 (CET1) capital, tier 1 capital, and total capital risk-based capital ratios. The new regulations also include a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio (PCR) remains in effect.



Risk-adjusted assets have been defined by FCA Regulations as the Balance Sheet assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes which generally have the effect of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Calculation of PCR risk-adjusted assets includes the allowance for loan losses as a deduction from risk-adjusted assets. This differs from the other risk-based capital calculations.

The ratios are calculated using three-month average daily balances, in accordance with FCA regulations, as follows:

- The CET1 capital 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 revolvement, 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 revolvement 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.

For all periods represented, the Association exceeded minimum regulatory standards for all the ratios.

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 December 31,	
				2018	2017
Risk-adjusted ratios:					
CET1 Capital	4.5%	1.25%	5.75%	17.26%	18.20%
Tier 1 Capital	6.0%	1.25%	7.25%	17.26%	18.20%
Total Capital	8.0%	1.25%	9.25%	18.52%	19.46%
Permanent Capital	7.0%	0.0%	7.0%	17.48%	18.44%
Non-risk-adjusted ratios:					
Tier 1 Leverage	4.0%	1.0%	5.0%	16.03%	16.58%
URE and UREE Leverage	1.5%	0.0%	1.5%	8.13%	8.24%

\* 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.

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 regulatory Capital ratios as previously reported:

	Regulatory Minimum	2016	2015	2014	2013	2012
Permanent Capital Ratio	7.00%	19.42%	20.83%	21.11%	20.13%	20.22%
Total Surplus Ratio	7.00%	19.10%	20.45%	20.71%	19.69%	19.80%
Core Surplus Ratio	3.50%	16.46%	19.36%	18.38%	18.99%	17.19%

There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 7, *Members' Equity*, of the Consolidated Financial Statements, for further information concerning capital resources.

**PATRONAGE PROGRAM**

Prior to the beginning of any fiscal year, the Association’s Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association’s Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) non-patronage participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members’ Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$8,635 in 2018, \$8,317 in 2017, and \$6,641 in 2016.

**YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM**

The Association’s mission is to provide financial services to agriculture and the rural community, which includes providing credit to Young\*, Beginning\*\* and Small\*\*\* farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. At quarter end, the Association was meeting all of its YBS goals.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

	As of December 31, 2018	
	Number of Loans	Amount of Loans
Young	378	\$48,488
Beginning	611	84,074
Small	845	92,864

*Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.*

The 2012 USDA Ag census data has been used as a benchmark to measure penetration of the Association’s marketing efforts. Slight differences between the Census and the Association’s YBS information are as follows:

- The Census shows young farmers in a group up to age 34, whereas the Association’s YBS information shows young farmers up to age 35.
- The Census shows years on present farm up to nine years, whereas the Association’s YBS information shows 10 years or less for a beginning farmer.
- The Census data is based on number of farms, whereas the Association’s YBS information is based on number of loans.

The 2012 census data indicated that within the Association’s chartered territory (counties) there were 5,610 reported farmers of which by definition 458 or 8.16 percent were Young, 1,438 or 25.63 percent were Beginning, and 4,977 or 88.72 percent were Small. Comparatively, as of December 31, 2018, the demographics of the Association’s agricultural portfolio (by definition) are as follows: 378 or 12.70 percent were Young, 611 or 20.53 percent were Beginning, and 845 or 28.39 percent were Small.

The Association is committed to the future success of young, beginning, and small farmers.

- \* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- \*\* Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- \*\*\* Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

**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 became effective January 1, 2019.

**Farm Bill**

The Agricultural Improvement Act of 2018 (Farm Bill) was signed into law on December 20, 2018. This new Farm Bill will govern an array of federal farm and food programs, including commodity price support payments, farm credit, conservation programs, research, rural development and foreign and domestic food programs for five years through 2023. The new Farm Bill continues to provide support for crop insurance and commodity support programs, strengthen livestock disaster programs, and provides dairy producers with an updated voluntary margin protection program that will provide additional risk management options to dairy operations.

The Farm Bill also clarifies and updates the Insurance Corporation’s authorities to act as conservator or receiver of a System institution. The Congressional Conference Committee report states that Congress intends “for the authorities of the Corporation to be functionally equivalent to the parallel

authorities of the Federal Deposit Insurance Corporation.” In addition, the Farm Bill provides, among other authorities, the Insurance Corporation with the authority to organize, and the Farm Credit Administration to charter, a System bridge bank, which has all the powers of a System bank with a maximum life span of five years.

Many provisions of the Farm Bill will require the United States Department of Agriculture to develop rules and procedures to fully implement these authorities. The timing for the issuance of those rules is uncertain.

## LIBOR TRANSITION

On July 27, 2017, the United Kingdom Financial Conduct Authority (the Conduct Authority) announced that it will no longer persuade or compel such banks to submit rates for the calculation of the LIBOR rates after 2021. The Conduct Authority regulates the panel banks that submit quotes for the purpose of calculating LIBOR to the Intercontinental Exchange (ICE) Benchmark Administration (the entity that is responsible for calculating LIBOR). Accordingly, it is uncertain whether the ICE Benchmark Administration will continue to quote LIBOR after 2021. Furthermore, in the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee (ARRC) of the Federal Reserve Board and the Federal Reserve Bank of New York. Specifically, the ARRC has proposed the Secured Overnight Financing Rate (SOFR) as the recommended alternative to LIBOR and the Federal Reserve Bank of New York began publishing SOFR in April of 2018. SOFR is based on a broad segment of the overnight Treasury repurchase market and is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

At this time, it is not possible to predict, among other uncertainties, whether (i) LIBOR will be discontinued, (ii) the effect of any changes to the methodology for calculating LIBOR, or (iii) any establishment of alternative reference rates or any other reforms to LIBOR that may be enacted in the United Kingdom, in the United States or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for LIBOR based instruments, including certain of the Systemwide Debt Securities, System borrowings, loans, investments, derivatives, other System assets and liabilities and preferred stock that are indexed to LIBOR. Accordingly, reform of, or the replacement or disappearance of, LIBOR and the proposed regulation of LIBOR and other “benchmarks” may adversely affect the rates of interest the System pays on its Systemwide Debt Securities (including changes to their value and liquidity, return, and usefulness for intended purpose), on other borrowings and preferred stock, as well as the value of and return on loans and investments and the value and effectiveness of derivatives. This could adversely affect the System’s cash flows. Moreover, if LIBOR is replaced, System institutions will need to take steps to restructure their debt and derivatives, which could adversely affect operations.

The System institutions are currently evaluating the potential impact of the eventual replacement of the LIBOR benchmark interest rate, including the possibility of using SOFR as the alternative to LIBOR. While each system institution is required by the regulator to have a transition plan, the transition from LIBOR to SOFR is expected to be complex and to include the development of term and credit adjustments to minimize, to the extent possible, discrepancies between LIBOR and SOFR. Accordingly, the transition may introduce additional basis risk for market participants, including when an alternative index, e.g., SOFR, exists in conjunction with LIBOR. There can be no guarantee that SOFR will become the dominant alternative to U.S. dollar LIBOR or that SOFR will be widely used. In addition, other alternatives may or may not be developed with additional complications.

Changes in LIBOR may result in interest rates and/or payments that are higher or lower than, or that do not otherwise correlate over time with, the interest rates and/or payments that would have been associated with LIBOR-based Systemwide Debt Securities, or loans or investments that are based on LIBOR, which may increase or decrease the payments to be made on such LIBOR-based Systemwide Debt Securities, or loans or investments that are based on LIBOR.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

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
<b>ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</b>	
<ul style="list-style-type: none"> <li>• 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.</li> <li>• Changes the present incurred loss impairment guidance for loans to a CECL model.</li> <li>• 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.</li> <li>• Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets.</li> <li>• Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption.</li> <li>• 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.</li> </ul>	<ul style="list-style-type: none"> <li>• The Association has begun implementation efforts by establishing a cross-discipline governance structure and will implement a third-party model. The Association is currently identifying key interpretive issues and assessing processes against the new guidance to determine what modifications may be required.</li> <li>• 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"> <li>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,</li> <li>2. An allowance will be established for estimated credit losses on any debt securities,</li> <li>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.</li> </ol> </li> <li>• 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.</li> <li>• The Association expects to adopt the guidance in first quarter 2021.</li> </ul>
<b>ASU 2016-02 – Leases (Topic 842)</b>	
<ul style="list-style-type: none"> <li>• 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.</li> <li>• Lessor accounting activities are largely unchanged from existing lease accounting.</li> <li>• The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification.</li> <li>• Also, expands qualitative and quantitative disclosures of leasing arrangements.</li> <li>• 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.</li> <li>• Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted.</li> </ul>	<ul style="list-style-type: none"> <li>• The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees.</li> <li>• The Association completed its evaluation of leasing contracts and activities and developed its methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments. There will not be a material change to the timing of expense recognition.</li> <li>• Given the limited changes to lessor accounting, there were no material changes to recognition or measurement for the Association.</li> <li>• The Association will need to provide additional disclosure information as a result of adopting the Update.</li> <li>• The Association will adopt the guidance in first quarter 2019 using the optional modified retrospective method and practical expedients for transition.</li> <li>• Upon adoption, the Association will record a cumulative-effect adjustment to equity of approximately \$1. In addition, a Right of Use Asset in the amount of \$37 and Lease Liability in the amount of \$36 will be recorded.</li> </ul>

# *Disclosure Required by Farm Credit Administration Regulations*

## Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered, and related Farm Credit organizations are incorporated herein by reference to Note 1, *Organization and Operations*, of the Consolidated Financial Statements included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, borrower patronage or dividends, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, concentrations of assets, and changes in patronage policies or practices, if any, is incorporated in *“Management’s Discussion and Analysis of Financial Condition and Results of Operations”* included in this Annual Report.

The Association holds an equity investment in the following Unincorporated Business Entities (UBEs) as an equity interest holder of the limited liability company (LLC). The LLCs were organized for the stated purpose of holding and managing unusual or complex collateral associated with former loans, until such time as the assets may be sold or otherwise disposed of pursuant to the terms of Operating Agreements of the respective LLCs.

Each LLC held by the Association as of December 31, 2018, along with the entity type, the state in which it was established, and the ownership percentage is listed below.

Name	Entity Type	State	Entity Purpose	Ownership
A1 Ledges Wilder, LLC	LLC	South Carolina	Manage Acquired Property	27.28%
A1 Sequatchie Point, LLC	LLC	South Carolina	Manage Acquired Property	27.28%
Pickens County Properties, LLC	LLC	South Carolina	Manage Acquired Property	27.25%

## Description of Property

The following table sets forth certain information regarding the principal office properties of the reporting entity, all of which are located in South Carolina:

Location	Description	Form of Ownership
800 Woody Jones Boulevard Florence	Administrative/ Branch	Owned
1720 Mill Pond Road Conway	Branch	Owned

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 11, *Commitments and Contingencies*, of the Consolidated Financial Statements included in this Annual Report.

## Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7, *Members’ Equity*, of the Consolidated Financial Statements included in this Annual Report.

## Description of Liabilities

The description of liabilities, contingent liabilities, and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 9, and 11 of the Consolidated Financial Statements included in this Annual Report.

## Management’s Discussion and Analysis of Financial Condition and Results of Operations

*“Management’s Discussion and Analysis of Financial Condition and Results of Operations,”* which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

**Senior Officers**

The following represents certain information regarding the senior officers of the Association and their business experience for the past five years:

Name and Title	Term of Office	Term of Office
Kathy S. Heustess, <i>President and Chief Executive Officer</i>	11/3/2011 – present	Started career with ArborOne in 1989 as Controller. Served as Chief Financial Officer and assumed the role of Chief Operating Officer in 2008. In 2011, assumed the role of President. As of January 2012, assumed the role of Chief Executive Officer. Additionally, serves on a local university foundation board, the Palmetto Agribusiness Council board, and on the Farm Credit Council Services board, compensation committee (chair).
Tammy G. Smith, <i>Chief Financial Officer and Treasurer</i>	1/1/2009 – present	Started career with ArborOne in 1991 as an accountant. Served as Controller and assumed the role of Chief Financial Officer in 2009 and Treasurer in 2010.
Richard O. Pitts*, <i>Chief Lending Officer</i>	11/1/2008 – present	Started career with ArborOne in 2002 as a credit analyst. Served as Credit Manager and assumed the role of Chief Lending Officer in 2008.
Sarah H. Jackson, <i>Chief Human Resources Officer and Corporate Secretary</i>	1/1/2018 – present	Started career with ArborOne in 2006 as a financial analyst. Also, served as a Senior Credit Analyst and Senior Human Resources Administrator / Corporate Secretary and Director of Human Resources. As of January 2018, assumed the role of Chief Human Resources Officer.

*\*Effective March 7, 2019, Richard O. Pitts, currently Chief Lending Officer, will become Chief Operating Officer.*

The total amount of compensation (in whole dollars) earned by the CEO and senior officers (excluding the CEO) as a group during the years ended December 31, 2018, 2017, and 2016, is presented in the following tables. The first table presented illustrates actual compensation received in cash in the form of salary and incentives.

Name of Individual or Number in Group	Year	Received Compensation			Total Received Compensation (a)
		Salary	Incentives	Compensation (a)	
Kathy S. Heustess	2018	\$ 330,013	\$ 192,000	\$ 522,013	
Kathy S. Heustess	2017	\$ 315,212	\$ 145,401	\$ 460,613	
Kathy S. Heustess	2016	\$ 300,011	\$ 143,800	\$ 443,811	
6 Officers	2018	\$ 836,750	\$ 378,930	\$ 1,215,680	
6 Officers	2017	\$ 797,186	\$ 295,508	\$ 1,092,694	
6 Officers	2016	\$ 750,471	\$ 281,868	\$ 1,032,339	

The table below discloses forms of perquisites and other noncash compensation and these items are described in detail in the subsequent paragraphs, which do not reflect actual cash compensation received by the CEO or officers presented. The total of all cash (a) and noncash (b) compensation for the CEO and officers is also presented here.

Name of Individual or Number in Group	Year	Perquisites and Noncash Compensation				Total Received and Noncash Compensation (a+b)
		Change in Pension*	Deferred / Perq. **	Total Perquisites and Noncash (b)	Total Received and Noncash Compensation (a+b)	
Kathy S. Heustess	2018	\$ 62,574	\$ 55,237	\$ 117,811	\$ 639,824	
Kathy S. Heustess	2017	\$ 50,889	\$ 255,824	\$ 306,713	\$ 767,326	
Kathy S. Heustess	2016	\$ 404,344	\$ 43,834	\$ 448,178	\$ 891,989	
6 Officers	2018	\$ (32,039)	\$ 80,040	\$ 48,001	\$ 1,263,681	
6 Officers	2017	\$ 478,364	\$ 73,196	\$ 551,560	\$ 1,644,255	
6 Officers	2016	\$ 409,211	\$ 68,133	\$ 477,344	\$ 1,509,683	

*\* This figure is a third party actuarial determination of the change in the present value of the estimated pension cash flows for employees as of December 31, 2018. This does not represent any actual cash compensation provided to any employee but is simply a change in the calculation that is affected by a number of assumptions and inputs.*

*\*\*The Deferred/Perquisites amount disclosed in the above chart includes automobile allowance, deferred compensation, life insurance, and spousal travel.*

The Association participates in District and multi-District sponsored benefit plans. Change in pension value is considered a part of compensation. The table below illustrates the present value of pension benefits for the CEO and other officers presented. This value represents the third party actuarial determination of the present value of the estimated pension cash flows for employees as of December 31, 2018. This does not represent any actual cash compensation provided to any employee but is simply a calculation that is affected by a number of assumptions and inputs. Actual funds received can differ based on how actual events compare to assumptions used in the calculation.

**Pension Benefits Table  
As of December 31, 2018**

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits	Payments During 2018
<b>CEO:</b>					
Kathy S. Heustess	2018	AgFirst Retirement Plan	30.83	\$ 2,686,646	\$ -
			Total	\$ 2,686,646	\$ -
<b>Senior Officers</b>					
** 3 Officers, excluding the CEO	2018	AgFirst Retirement Plan	21.64*	\$ 2,505,800	\$ -
			Total	\$ 2,505,800	\$ -

\* Represents the average years of credited service for the group  
 \*\* Three of the six senior officers are not part of the AgFirst Retirement Plan as they were employed after December 31, 2002.

In addition to a base salary, all employees are eligible for additional compensation utilizing incentive plans. Specified employees are eligible for individual incentive plans. The executive management is eligible for a long-term incentive plan.

The incentive plans are designed to maximize financial performance while improving the Association’s financial position and shareholder wealth providing employees with a competitive total compensation package. The plans’ criteria include a balance of credit and financial results. The board of directors reviews and approves all the plans and authorizes all incentive payouts. At the discretion of the board of directors, an incentive was paid to all eligible staff based on financial results in 2018.

Pro-rata participation is granted to persons who terminate due to death or become disabled during the Plan Year. Employees who are in good standing and provide adequate notice and a mutually agreed upon retirement date may be granted pro-rata participation. No participation in any plan is allowed for persons involuntarily or voluntarily terminating employment prior to the fiscal year end or persons having unsatisfactory performance evaluations or on probation without prior approval from the CEO. New employees receive a pro rata share. The plans are paid based on percentage of salary, and will be paid from the Association’s earnings. Bonuses are shown on the financial statements as an expense in the year earned, which may be different than the year of payment.

The 2018 Association plan for all employees included four tiers based on job functionality and four percentage levels of payout based upon incremental income, with increments of one million dollars per level, in excess of budget which results in a cap on incentive paid as a percentage of salary. The 2018 plan has “on/off” switches on payout to include Credit Quality, Return on Assets, and Total Capital ratio requirements to align the plan with the Association’s business plan objectives and focus.

The individual incentive plans are specifically for relationship managers, financial related services (FRS) managers, and credit analysts to reward based on level of accomplishments and provide variable pay to maintain competitive compensation practices in the financial services industry. The Relationship Managers Plan includes criteria for average daily balance of loan volume outstanding, spreads, fee income, gains/ (losses) on loans and other property owned, and delinquency rate. The FRS Managers Plan includes criteria for commissions collected and any loss/recovery on claims. The Credit Analyst Plan includes criteria for average daily balance of loan volume outstanding, spreads, fee income, gains/ (losses) on loans and other property owned, and credit administration of B’s and C’s by volume.

The long-term plan is based on long-range financial results achieved over a three-year period. The objective of the plan is to reward and retain key decision makers as well as establish long-range goals to protect the Association’s viability. Long-term incentive awards are earned over a three year performance period. The 2018 plan is subject to forfeiture based upon the Association’s performance during the two-year performance period immediately following the plan year. Specifically, the long-term award will be reduced by an amount equal to one-half of the original award for each subsequent year during the two-year performance period in which any one of the performance thresholds are not achieved.

Disclosure of information on the total compensation paid during 2018 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

**Directors**

The following chart details the year the director began serving on the board, the current term of expiration, and total cash compensation paid for 2018:

<b>DIRECTOR</b>	<b>ORIGINAL YEAR OF ELECTION OR APPOINTMENT</b>	<b>CURRENT TERM EXPIRATION</b>	<b>TOTAL COMPENSATION PAID DURING 2018</b>
William DuPree Atkinson, <i>Chairman</i>	1999	2019	\$40,350
John Lee Newman, <i>Vice-Chairman</i>	2008	2020	34,300
Harry B. Durant	1997	2022	32,100
John E. Lay	2017	2023	35,600
J. Whit Player	2011	2023	35,400
Jimmy Poston	1994	2021	33,350
James M. Ward	1998	2024	34,500
Kelly O. Wiseman	2007	2019	44,100
			<b>\$289,700</b>

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years. Committee assignments can change during the year; therefore, service rendered may not cover the full 12 months of 2018.

**William DuPree Atkinson**, Chairman of the Board, is a self-employed farmer and owner of Atkinson Farms, LLC. He served on the board of Pee Dee Peanut, LLC (peanut purchasing) in which he is an officer and has part ownership interest. He also served on the State Peanut Board (peanuts), the State Tobacco Board (tobacco), and Marion County Farm Bureau (insurance). He served on the audit and compensation committees during 2018.

**John Lee Newman**, Vice Chairman of the Board, is a self-employed farmer and owner of Lee Newman Farms, JLN Services, LLC (planting services), and A & L Farms (poultry). He served on the board of Sumter County Farm Bureau (insurance) and the Sumter County Soil and Water Board (agriculture). He served as Chairman of the Compensation Committee and was on the credit committee during 2018.

**Harry B. DuRant**, is a self-employed farmer and part owner of Double D Farms and Alcolu Peanut, LLC (peanut purchasing). He served as an alternate to the AgFirst Farm Credit Bank District Advisory Committee (agriculture). He served on the credit and governance committees during 2018.

**John E. Lay**, Chairman of the Credit Committee, retired from AgFirst Farm Credit Bank in February 2016 as Vice President and Treasurer after approximately 34 years of service. He also served on the governance committee during 2018.

**J. Whit Player**, is a self-employed farmer and owner of J. Whit Player Farm and Player’s Stoney Run Farm. He is also a forestry technician with SC Forestry Commission. He served on the board of St. Charles Gin Co. (cotton ginning) in which he is an officer and has part ownership interest. He served on the board of the South Carolina Boll Weevil Eradication Program (agriculture), Pork Chop Welsh Scholarship Board (education), the Carolina Cotton Growers Board (agriculture), and the AgFirst Farm Credit Bank District Advisory Committee (agriculture). He also served on the audit committee and as Chairman of the Governance Committee during 2018.

**Jimmy Poston**, is a self-employed farmer and part owner of Triple P Farms. He served on the board of Florence County Soil and Water Conservation District (agriculture), and the South Carolina Tobacco Grower Association (agriculture). He also served on the compensation, credit, and governance committees during 2018.

**James M. Ward**, is a self-employed farmer and partner of Mickey Ward Farms. He served on the audit and compensation committees during 2018.

**Kelly O. Wiseman**, Chairman of the Audit Committee, is a certified public accountant with approximately 15 years experience with a major accounting firm.

Subject to approval by the Board, the Association may allow directors honoraria of \$1,200 for attendance at meetings or special assignments, except for the Chairman of the Board who receives \$1,450. Directors are paid honoraria \$500 for committee meetings and \$600 if chairman of the committee. Outside directors are paid a \$750 quarterly retainer. The directors are paid honoraria on a quarterly basis and includes a payment for each month within the quarter that does not have a scheduled board or special meeting as well. Total compensation paid to directors as a group was \$289,700 for 2018. No director received more than \$5,000 in non-cash compensation during the year.



The following chart details the number of meetings, other activities, and additional compensation paid for other activities (if applicable) for each director:

Name of Director	Days Served		Committee Assignments**	Comp. Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
William Dupree Atkinson, <i>Chairman</i>	5	25	Audit Committee and Compensation Committee	\$ 22,950
John Lee Newman, <i>Vice-Chairman and Chairman of Compensation Committee</i>	5	21	Credit Committee and Chairman of the Compensation Committee	19,900
Harry B. Durant	5	20	Credit Committee, Governance Committee, and as Alternate to the AgFirst Farm Credit Bank District Advisory Committee.	17,700
John E. Lay, <i>Chairman of Credit Committee</i>	5	20	Governance Committee and Chairman of the Credit Committee	21,200
J. Whit Player, <i>Chairman of Governance Committee</i>	5	23	Audit Committee, AgFirst Farm Credit Bank District Advisory Committee, and Chairman of the Governance Committee	21,000
Jimmy Poston,	5	22	Compensation Committee, Governance Committee, and Credit Committee	18,950
James M. Ward	5	22	Audit Committee and Compensation Committee	20,100
Kelly O. Wiseman, <i>Chairman of Audit Committee</i>	5	28	Compensation Committee and Chairman of the Audit Committee	29,700
				\$ 171,500

\* Includes board committee meetings and other board activities other than regular board meetings.  
 \*\* Assignments are for the full 12 months of 2018 unless otherwise noted.

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$76,497 for 2018, \$73,592 for 2017, and \$82,477 for 2016.

**Transactions with Senior Officers and Directors**

The reporting entity’s policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 10, *Related Party Transactions*, of the Consolidated Financial Statements included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

**Transactions Other Than Loans**

There have been no transactions that occurred at any time during the year ended December 31, 2018, between the Association and senior officers or directors, their immediate family members or any organizations with which they are affiliated, which require reporting per FCA regulations. Some directors have transacted business with borrowers of the Association. These transactions were performed at market prices, at an arm’s length, and in the normal course of business. There were no transactions with any senior officer or director related to the purchase or retirement of preferred stock of the Association for the year ended December 31, 2018.

**Involvement in Certain Legal Proceedings**

There were no matters which came to the attention of management or the Board of Directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

**Relationship with Independent Auditors**

There were no changes in or material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

Aggregate fees paid by the Association for services rendered by its independent auditors for the year ended December 31, 2018 were as follows:

	<u>2018</u>
<i>Independent Auditors</i>	
PricewaterhouseCoopers LLP	
Audit services	\$ 51,781
Total	\$ 51,781

Audit service fees were for the annual audit of the consolidated financial statements.

**Consolidated Financial Statements**

The Consolidated Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 13, 2019 and the report of management, which appear in this Annual Report, are incorporated herein by reference.

Copies of the Association's Annual and unaudited Quarterly reports are available upon request free of charge by calling 1-800-741-7332, or writing Sarah Jackson, Corporate Secretary, ArborOne, ACA, P.O. Box 3699, Florence, SC 29502, or accessing the website, [www.arborone.com](http://www.arborone.com). The Association prepares an electronic version of the Annual Report which is available on the Association's website within 75 days after the end of the fiscal year and distributes the Annual Reports 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.

#### **Borrower Information Regulations**

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers, and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

#### **Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products**

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* section included in this Annual Report to the shareholders.

#### **Shareholder Investment**

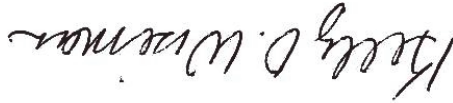
Shareholder investment in the Association could be materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2764, 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 by going to AgFirst's website at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report, which is available on the Bank's website, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

March 13, 2019

William Dupree Atkinson  
 J. Whit Player  
 James M. Ward

### Members of Audit Committee

Kelly O. Wiseman  
 Chairman of the Audit Committee



The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of **ArborOne, ACA** (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditors for 2018, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). The Committee discussed with PwC its independence from ArborOne, ACA. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2018. The foregoing report is provided by the following independent directors, who constitute the Committee:

## Report of the Audit Committee



## Report of Independent Auditors

To the Board of Directors and Management of  
ArborOne, ACA

We have audited the accompanying consolidated financial statements of ArborOne, ACA and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2018, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in members' equity and cash flows for the years then ended.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ArborOne, ACA and its subsidiaries as of December 31, 2018, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

Miami, Florida

March 13, 2019

# Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31,		
	2018	2017	2016
<b>Assets</b>			
Cash	\$ 48	\$ 181	\$ 12
Investments in debt securities:			
Held to maturity (fair value of \$9,612, \$14,905, and \$18,449, respectively)	9,268	14,309	18,489
Loans	495,168	459,894	447,150
Allowance for loan losses	(12,804)	(10,844)	(8,676)
Net loans	482,364	449,050	438,474
Accrued interest receivable	8,962	7,165	6,692
Equity investments in other Farm Credit institutions	5,945	5,924	5,659
Premises and equipment, net	3,972	3,800	3,940
Other property owned	822	783	623
Accounts receivable	6,697	8,739	7,040
Other assets	885	923	2,749
Total assets	<b>\$ 518,963</b>	<b>\$ 490,874</b>	<b>\$ 483,678</b>
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 418,933	\$ 392,398	\$ 386,383
Accrued interest payable	1,215	982	868
Patronage refunds payable	7,238	3,653	2,896
Accounts payable	322	562	602
Other liabilities	3,480	6,397	8,411
Total liabilities	<b>431,188</b>	<b>403,992</b>	<b>399,160</b>
Commitments and contingencies (Note 11)			
<b>Members' Equity</b>			
Protected borrower stock	52	53	62
Capital stock and participation certificates	1,510	1,413	1,351
Retained earnings			
Allocated	58,095	57,424	54,690
Unallocated	28,044	27,867	28,196
Accumulated other comprehensive income	74	125	219
Total members' equity	<b>87,775</b>	<b>86,882</b>	<b>84,518</b>
Total liabilities and members' equity	<b>\$ 518,963</b>	<b>\$ 490,874</b>	<b>\$ 483,678</b>

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

# Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2018	2017	2016
<b>Interest Income</b>			
Loans	\$ 24,861	\$ 22,370	\$ 19,454
Investments	782	867	1,779
Total interest income	<b>25,643</b>	23,237	21,233
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	<b>13,021</b>	11,045	9,465
Net interest income	<b>12,622</b>	12,192	11,768
Provision for loan losses	<b>2,369</b>	2,611	1,711
Net interest income after provision for loan losses	<b>10,253</b>	9,581	10,057
<b>Noninterest Income</b>			
Loan fees	914	858	1,693
Fees for financially related services	1,178	1,044	979
Patronage refunds from other Farm Credit institutions	6,655	6,931	6,792
Gains (losses) on sales of premises and equipment, net	(1)	4	32
Gains (losses) on other transactions	(10)	(254)	26
Insurance Fund refunds	277	—	—
Other noninterest income	151	1	4
Total noninterest income	<b>9,164</b>	8,584	9,526
<b>Noninterest Expense</b>			
Salaries and employee benefits	7,381	7,082	7,311
Occupancy and equipment	537	482	498
Insurance Fund premiums	314	481	495
(Gains) losses on other property owned, net	(43)	465	232
Other operating expenses	2,312	1,266	2,255
Total noninterest expense	<b>10,501</b>	9,776	10,791
Income before income taxes	<b>8,916</b>	8,389	8,792
Provision for income taxes	6	3	15
Net income	<b>\$ 8,910</b>	\$ 8,386	\$ 8,777

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

# Consolidated Statements of Comprehensive Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2018	2017	2016
Net income	\$ 8,910	\$ 8,386	\$ 8,777
<b>Other comprehensive income net of tax</b>			
Unrealized gains (losses) on investments:			
Other-than-temporarily impaired	95	—	6
Not other-than-temporarily impaired	(187)	(61)	(475)
Employee benefit plans adjustments	41	(33)	(10)
Other comprehensive income (Note 7)	(51)	(94)	(479)
Comprehensive income	\$ 8,859	\$ 8,292	\$ 8,298

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

# Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2015	\$ 62	\$ 1,290	\$ 52,625	\$ 25,945	\$ 698	\$ 80,620
Comprehensive income				8,777	(479)	8,298
Capital stock/participation certificates issued/(retired), net		61				61
Patronage distribution						
Cash				(1,992)		(1,992)
Qualified allocated retained earnings			332	(332)		—
Nonqualified allocated retained earnings			4,317	(4,317)		—
Retained earnings retired			(2,502)			(2,502)
Patronage distribution adjustment			(82)	115		33
<b>Balance at December 31, 2016</b>	<b>\$ 62</b>	<b>\$ 1,351</b>	<b>\$ 54,690</b>	<b>\$ 28,196</b>	<b>\$ 219</b>	<b>\$ 84,518</b>
Comprehensive income				8,386	(94)	8,292
Protected borrower stock issued/(retired), net	(9)					(9)
Capital stock/participation certificates issued/(retired), net		62				62
Patronage distribution						
Cash				(2,495)		(2,495)
Nonqualified allocated retained earnings			4,845	(4,845)		—
Nonqualified retained earnings			977	(977)		—
Retained earnings retired			(3,365)			(3,365)
Patronage distribution adjustment			277	(398)		(121)
<b>Balance at December 31, 2017</b>	<b>\$ 53</b>	<b>\$ 1,413</b>	<b>\$ 57,424</b>	<b>\$ 27,867</b>	<b>\$ 125</b>	<b>\$ 86,882</b>
<b>Comprehensive income</b>				<b>8,910</b>	<b>(51)</b>	<b>8,859</b>
<b>Protected borrower stock issued/(retired), net</b>	<b>(1)</b>					<b>(1)</b>
<b>Capital stock/participation certificates issued/(retired), net</b>		<b>97</b>				<b>97</b>
<b>Patronage distribution</b>						
<b>Cash</b>				<b>(6,167)</b>		<b>(6,167)</b>
<b>Nonqualified retained earnings</b>			<b>2,468</b>	<b>(2,468)</b>		<b>—</b>
<b>Retained earnings retired</b>			<b>(1,865)</b>			<b>(1,865)</b>
<b>Patronage distribution adjustment</b>			<b>68</b>	<b>(98)</b>		<b>(30)</b>
<b>Balance at December 31, 2018</b>	<b>\$ 52</b>	<b>\$ 1,510</b>	<b>\$ 58,095</b>	<b>\$ 28,044</b>	<b>\$ 74</b>	<b>\$ 87,775</b>

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



# Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2018	2017	2016
<b>Cash flows from operating activities:</b>			
Net income	\$ 8,910	\$ 8,386	\$ 8,777
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	393	412	383
Amortization (accretion) of net deferred loan costs (fees)	(60)	(46)	(43)
Premium amortization (discount accretion) on investments in debt securities	(6)	(1)	(510)
Provision for loan losses	2,369	2,611	1,711
(Gains) losses on other property owned	(125)	370	145
(Gains) losses on sales of premises and equipment, net	1	(4)	(32)
(Gains) losses on other transactions	10	254	(26)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(1,797)	(473)	(1,379)
(Increase) decrease in accounts receivable	2,042	(1,699)	388
(Increase) decrease in other assets	38	1,826	618
Increase (decrease) in accrued interest payable	233	114	154
Increase (decrease) in accounts payable	(240)	(40)	136
Increase (decrease) in other liabilities	(2,886)	(2,301)	(704)
Total adjustments	(28)	1,023	841
Net cash provided by (used in) operating activities	8,882	9,409	9,618
<b>Cash flows from investing activities:</b>			
Proceeds from maturities of or principal payments received on investments in debt securities, held to maturity	4,955	4,120	3,723
Net (increase) decrease in loans	(35,760)	(13,868)	(64,223)
(Increase) decrease in equity investments in other Farm Credit institutions	(21)	(265)	3,657
Purchases of premises and equipment	(566)	(272)	(355)
Proceeds from sales of premises and equipment	—	4	36
Proceeds from sales of other property owned	223	197	914
Net cash provided by (used in) investing activities	(31,169)	(10,084)	(56,248)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	26,535	6,015	50,489
Protected borrower stock retired	(1)	(9)	—
Capital stock and participation certificates issued/(retired), net	97	62	61
Patronage refunds and dividends paid	(2,612)	(1,859)	(1,408)
Retained earnings retired	(1,865)	(3,365)	(2,502)
Net cash provided by (used in) financing activities	22,154	844	46,640
Net increase (decrease) in cash	(133)	169	10
Cash, beginning of period	181	12	2
Cash, end of period	\$ 48	\$ 181	\$ 12
<b>Supplemental schedule of non-cash activities:</b>			
Financed sales of other property owned	\$ —	\$ —	\$ 6
Receipt of property in settlement of loans	137	727	135
Estimated cash dividends or patronage distributions declared or payable	6,167	2,495	1,992
Change in unrealized gains (losses) on investments	(92)	(61)	(469)
Employee benefit plans adjustments (Note 9)	(41)	33	10
<b>Supplemental information:</b>			
Interest paid	12,788	10,931	9,311

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

# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

A. **Organization:** ArborOne, ACA (Association) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers. The territory of the Association extends across a diverse agricultural region of the following 12 counties in northeastern South Carolina: *Chesterfield, Clarendon, Darlington, Dillon, Florence, Georgetown, Horry, Lee, Marion, Marlboro, Sumter, and Williamsburg.*

The Association is a lending institution in the Farm Credit System (System), a nationwide network of cooperatively owned banks and associations. It was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

The nation is served by three Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), (collectively, the System Banks) each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities.

Each System Bank serves one or more Agricultural Credit Associations (ACAs) that originate long-term, short-term and intermediate-term loans, Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, and/or Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans. These associations borrow a majority of the funds for their lending activities from their related bank. System Banks are also responsible for supervising the activities of associations within their districts. AgFirst (Bank) and its related associations (Associations or District Associations) are collectively referred to as the AgFirst District. The District Associations jointly own substantially all of AgFirst's voting stock. As of year end, the District consisted of the Bank and nineteen District Associations. All nineteen were structured as ACA holding companies, with PCA and FLCA subsidiaries. FLCAs are tax-exempt while ACAs and PCAs are taxable.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure

the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation at its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure base amount to System institutions. However, it must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity and financial services that can be offered by the Association, and the persons eligible to borrow.

The Associations borrow from the Bank and in turn may originate and service short- and intermediate-term loans to their members, as well as long-term real estate mortgage loans.

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' earning assets. These lines of credit (or Direct Notes) are collateralized by a pledge of substantially all of each Association's assets. The terms of the Direct Notes are governed by a General Financing Agreement (GFA) between the Bank and Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized.

In addition to providing funding for earning assets, the Bank provides District Associations with banking and support services such as accounting, human resources, information systems, and marketing. The costs of these support services are included in the cost of the Direct Note, or in some cases billed directly to certain Associations that use a specific service.

The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or

harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

## Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

The accompanying consolidated financial statements include the accounts of the ACA, PCA and FLCA.

Certain amounts in the prior year financial statements have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or total members' equity of prior years.

- A. **Cash:** Cash represents cash on hand and on deposit at banks.
- B. **Loans and Allowance for Loan Losses:** The Association is authorized to make long-term real estate loans with maturities of 5 to 40 years and certain short- and intermediate-term loans for agricultural production or operating purposes with maturities of not more than 10 years.

Loans are carried at their principal amount outstanding adjusted for charge-offs, premiums, discounts, deferred loan fees or costs, and derivative instruments and hedging valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the total investment in a loan and its principal amount may be deferred as part of the carrying amount of the loan and the net difference amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

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 and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan

remains contractually past due until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full. A formal restructuring may also cure a past due status.

Loans are generally classified as nonaccrual when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, payments are applied against the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments received in cash may be recognized as interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified "doubtful" or "loss." Loans are charged off at the time they are determined to be uncollectible.

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is maintained 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. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The Association considers the following factors, among others, when determining the allowance for loan losses:

- Changes in credit risk classifications
- Changes in collateral values
- Changes in risk concentrations
- Changes in weather-related conditions
- Changes in economic conditions

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The Association uses a two-dimensional loan rating model based on internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the 14 categories carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

- C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.
- D. **Other Property Owned (OPO):** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of

the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) from Other Property Owned, Net in the Consolidated Statements of Income.

- E. **Premises and Equipment:** Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or circumstances indicate that the carrying value of the asset may not be recoverable.

From time to time, assets classified as premises and equipment are transferred to held for sale for various reasons. These assets are carried in Other Assets at the lower of the recorded investment in the asset or fair value less estimated cost to sell based upon the property's appraised value at the date of transfer. Any write-down of property held for sale is recorded as a loss in the period identified.

- F. **Investments:** The Association may hold investments as described below.

#### *Equity Investments in Other Farm Credit System Institutions*

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.

#### *Investments in Debt Securities*

The Association holds certain investment securities, as permitted under the FCA regulations. These investments are classified based on management's intention on the date of purchase and are generally recorded in the Consolidated Balance Sheets as securities on the trade date.

Securities for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity (HTM) and carried at amortized cost. Investment securities classified as available-for-sale (AFS) are carried at fair value with net unrealized gains and losses included as a component of Other Comprehensive Income (OCI). Purchase premiums and discounts are amortized or accreted ratably over the term of the respective security using the interest method. The amortization of premiums on certain purchased callable debt securities that have explicit, noncontingent call features and that are callable at fixed prices on preset dates are amortized to the earliest call date.

For any debt security transferred into the HTM category, the use of fair value may create a premium or discount that, under amortized cost accounting, shall be amortized or accreted thereafter as an adjustment of yield. OCI amounts resulting from the transfer are also amortized or accreted to

interest income ratably over the remaining life of each individual security as an adjustment of yield.

#### **Impairment**

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. As mentioned above, changes in the fair value of AFS investments are reflected in OCI, unless the investment is deemed to be other-than-temporarily impaired (OTTI). Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a “credit loss”). If the Association intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but the Association does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and is separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is charged to current earnings, with the remainder of the loss amount recognized in OCI.

In subsequent periods, if the present value of cash flows expected to be collected is less than the amortized cost basis, the Association will record additional OTTI and adjust the yield of the security prospectively. The amount of total OTTI for an AFS security that previously was impaired is determined as the difference between its carrying amount prior to the determination of OTTI and its fair value.

At acquisition, and at each reporting date thereafter, the appropriateness of the classification of the Association’s investment securities is reassessed. If an entity does not have the intent and ability to hold securities to maturity, their classification as HTM would not be appropriate. Likewise, if securities are reclassified from AFS in one period, judgment is required in determining when circumstances have changed such that management can assert with a greater degree of credibility that it now has the intent and ability to hold securities to maturity. These determinations are made by management on a case by case basis. The transfer of a security between categories of investments is accounted for at fair value.

#### **Investment Income**

Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities are recognized in current earnings using the specific identification method.

Dividends from Investments in Other Farm Credit Institutions are generally recorded as patronage income and included in Noninterest Income.

#### **Other Investments**

As discussed in Note 8, certain investments, consisting primarily of mutual funds, are held in trust and investment accounts and are reported at fair value. Holding period gains and losses are included within Noninterest Income on the Consolidated Statements of Income and the balance of these investments, totaling \$704, is included in Other Assets on the accompanying Consolidated Balance Sheets as of December 31, 2018.

The Association holds minority equity interests in a Rural Business Investment Company (RBIC). This investment is carried at cost less any impairment, plus or minus adjustments resulting from any observable price changes.

- G. Voluntary Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower’s access to such advance payments is restricted, the advanced conditional payments are netted against the borrower’s related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as other liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.
- H. Employee Benefit Plans:** The Association participates in District and multi-District sponsored benefit plans. These plans may include defined benefit final average pay retirement, defined benefit cash balance retirement, defined benefit other postretirement benefits, and defined contribution plans.

#### **Defined Contribution Plans**

Substantially all employees are eligible to participate in the defined contribution Farm Credit Benefit Alliance (FCBA) 401(k) Plan, subsequently referred to as the 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Company contributions to the 401(k) Plan are expensed as funded.

Additional information may be found in Note 9.

#### **Multi-Employer Defined Benefit Plans**

Substantially all employees hired before January 1, 2003 may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and considered multi-employer under FASB accounting guidance. The Plan is noncontributory and includes eligible Association and District employees. The “Projected Unit Credit” actuarial method is used for financial reporting purposes.

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-District sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents

during the years the employee renders service necessary to become eligible for benefits.

Since the foregoing plans are multiemployer, the Association does not apply the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Annual Information Statement of the Farm Credit System.

Additional information may be found in Note 9 and in the Notes to the Annual Information Statement of the Farm Credit System.

#### **Single Employer Defined Benefit Plans**

The Association also sponsors a single employer defined benefit supplemental retirement plan and offers a FCBA supplemental 401(k) plan for certain key employees. These plans are nonqualified; therefore, the associated liabilities are included in the Association's Consolidated Balance Sheets in Other Liabilities.

The foregoing defined benefit plan is considered single employer, therefore the Association applies the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. See Note 9 for additional information.

- I. **Income Taxes:** The Association evaluates tax positions taken in previous and current years according to FASB guidance. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to, an entity's status, including its status as a pass-through entity or tax-exempt entity.

The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to

apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the expected patronage program, which reduces taxable earnings.

- J. **Due from AgFirst Farm Credit Bank:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

- K. **Valuation Methodologies:** FASB guidance defines fair value 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. This guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It prescribes three levels of inputs that may be used to measure fair value.

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

Level 2 inputs to the valuation methodology 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 to the valuation methodology 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 a third-party valuation or internal model pricing.

The Association may use the Bank, internal resources or third parties to obtain fair value prices. Quoted market prices are generally used when estimating fair values of any assets or liabilities for which observable, active markets exist.

A number of methodologies may be employed to value items for which an observable active market does not exist. Examples of these items include: impaired loans, other property owned, and certain derivatives, investment securities and other financial instruments. Inputs to these valuations can involve estimates and assumptions that require a substantial degree of judgment. Some of the assumptions used include, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on results of operations.

Additional information may be found in Note 8.

- L. **Off-Balance-Sheet Credit Exposures:** The credit risk associated with commitments to extend credit and letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party.

- M. **Revenue Recognition:** The Association generates income from multiple sources.

#### **Financial Instruments**

The largest source of revenue for the Association is Interest Income. Interest income is recognized on an accrual basis driven by nondiscretionary formulas based on written contracts, such as loan agreements or securities contracts. Credit-related fees, including letter of credit fees, finance charges and other fees are recognized in Noninterest Income when earned. Other types of noninterest revenues, such as service charges, professional services and broker fees, are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

#### **Contracts with Customers**

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance, which became effective January 1, 2018, 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.

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.

#### 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.

#### **Gains and Losses from Nonfinancial Assets**

Any gains or losses on sales of Premises and Equipment and OPO are included as part of Noninterest Income. These gains and losses are recognized, and the nonfinancial asset is derecognized, when the Association has entered into a valid contract with a noncustomer and transferred control of the asset. If the criteria to meet the definition of a contract have not been met, the Association does not derecognize the nonfinancial asset and any consideration received is recognized as a liability. If the criteria for a contract are subsequently met, or if the consideration received is or becomes nonrefundable, a gain or loss may be recognized at that time.

- N. **Accounting Standards Updates (ASUs):** 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. Adoption of the guidance will have no impact on the statements of financial condition and results of operations.

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. The Association has adopted the removed disclosures effective with the 2018 Annual Report.

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 2018-02 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. 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 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. 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 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 certain periodic pension costs to Other Operating Expenses.

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 of the Association.

In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update, and subsequent clarifying guidance issued, 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. The Association will implement the guidance in first quarter 2019 using the practical expedients and does not expect a material impact to the financial statements.

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, and subsequent clarifying guidance issued, 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.

### Note 3 — Loans and Allowance for Loan Losses

For a description of the Association's accounting for loans, including impaired loans, and the allowance for loan losses, see Note 2 subsection B above.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation which exists in outstanding loans. 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.

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate collateral. As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional structure, incorporating a 14-point probability of default scale (see further discussion in Note 2 subsection B above) and a separate scale addressing estimated percentage loss in the event of default. The loan rating structure incorporates borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, and collateral).

The Association's loan portfolio, which includes purchased interests in loans, has been segmented by the following loan types as defined by the FCA:

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised

value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.

- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.
- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.
- Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.
- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.
- Communication loans — loans primarily to finance rural communication providers.
- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.
- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.
- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.
- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans follows:

	December 31,		
	2018	2017	2016
Real estate mortgage	\$ 243,247	\$ 230,206	\$ 232,251
Production and intermediate-term	216,817	201,131	185,439
Loans to cooperatives	3,152	739	1,866
Processing and marketing	16,054	17,028	16,385
Farm-related business	9,399	4,455	4,599
Power and water/waste disposal	1,757	1,842	860
Rural residential real estate	3,818	3,548	4,784
International	856	856	856
Lease receivables	68	89	110
Total loans	\$ 495,168	\$ 459,894	\$ 447,150

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

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in loan to value ratios in excess of the regulatory maximum.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. During 2016, the Association canceled its participation in the Capitalized Participation Pool program with the Bank. As a result, the Association repurchased \$37,552 of participations previously sold to AgFirst. The following tables present the principal balance of participation loans at periods ended:

	December 31, 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	\$ 10,447	\$ 11,094	\$ -	\$ -	\$ -	\$ -	\$ 10,447	\$ 11,094
Production and intermediate-term	20,342	2,782	-	-	-	-	20,342	2,782
Loans to cooperatives	2,496	-	-	-	-	-	2,496	-
Processing and marketing	7,422	21,175	-	-	-	-	7,422	21,175
Farm-related business	1,342	-	-	-	-	-	1,342	-
Power and water/waste disposal	1,765	-	-	-	-	-	1,765	-
International	857	-	-	-	-	-	857	-
Total	\$ 44,671	\$ 35,051	\$ -	\$ -	\$ -	\$ -	\$ 44,671	\$ 35,051

	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	\$ 5,627	\$ 13,855	\$ -	\$ -	\$ -	\$ -	\$ 5,627	\$ 13,855
Production and intermediate-term	23,642	2,737	-	-	-	-	23,642	2,737
Loans to cooperatives	153	-	-	-	-	-	153	-
Processing and marketing	9,588	10,693	-	-	-	-	9,588	10,693
Farm-related business	1,770	-	-	-	-	-	1,770	-
Power and water/waste disposal	1,852	-	-	-	-	-	1,852	-
International	857	-	-	-	-	-	857	-
Total	\$ 43,489	\$ 27,285	\$ -	\$ -	\$ -	\$ -	\$ 43,489	\$ 27,285

	December 31, 2016							
	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	\$ 5,638	\$ 15,270	\$ -	\$ -	\$ -	\$ -	\$ 5,638	\$ 15,270
Production and intermediate-term	19,784	4,244	-	-	-	-	19,784	4,244
Loans to cooperatives	1,453	-	-	-	-	-	1,453	-
Processing and marketing	8,626	7,875	-	-	-	-	8,626	7,875
Farm-related business	2,429	-	-	-	-	-	2,429	-
Power and water/waste disposal	867	-	-	-	-	-	867	-
Rural residential real estate	-	-	-	-	1,831	-	1,831	-
International	857	-	-	-	-	-	857	-
Total	\$ 39,654	\$ 27,389	\$ -	\$ -	\$ 1,831	\$ -	\$ 41,485	\$ 27,389

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:

	December 31, 2018			
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 4,145	\$ 26,542	\$ 212,560	\$ 243,247
Production and intermediate-term	102,586	75,118	39,113	216,817
Loans to cooperatives	300	417	2,435	3,152
Processing and marketing	36	9,213	6,805	16,054
Farm-related business	5,338	3,784	277	9,399
Power and water/waste disposal	—	—	1,757	1,757
Rural residential real estate	1	206	3,611	3,818
International	—	686	170	856
Lease receivables	—	68	—	68
Total loans	\$ 112,406	\$ 116,034	\$ 266,728	\$ 495,168
Percentages	22.70%	23.43%	53.87%	100.00%

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

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

	December 31,				December 31,		
	2018	2017	2016		2018	2017	2016
<b>Real estate mortgage:</b>				<b>Power and water/waste disposal:</b>			
Acceptable	91.39%	91.17%	92.45%	Acceptable	100.00%	100.00%	100.00%
OAEM	5.59	5.26	4.26	OAEM	—	—	—
Substandard/doubtful/loss	3.02	3.57	3.29	Substandard/doubtful/loss	—	—	—
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Production and intermediate-term:</b>				<b>Rural residential real estate:</b>			
Acceptable	86.44%	81.71%	87.68%	Acceptable	92.18%	95.98%	99.26%
OAEM	6.93	10.32	10.78	OAEM	7.82	4.02	—
Substandard/doubtful/loss	6.63	7.97	1.54	Substandard/doubtful/loss	—	—	0.74
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Loans to cooperatives:</b>				<b>International:</b>			
Acceptable	100.00%	100.00%	100.00%	Acceptable	100.00%	100.00%	100.00%
OAEM	—	—	—	OAEM	—	—	—
Substandard/doubtful/loss	—	—	—	Substandard/doubtful/loss	—	—	—
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Processing and marketing:</b>				<b>Lease receivables:</b>			
Acceptable	100.00%	100.00%	100.00%	Acceptable	100.00%	100.00%	100.00%
OAEM	—	—	—	OAEM	—	—	—
Substandard/doubtful/loss	—	—	—	Substandard/doubtful/loss	—	—	—
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Farm-related business:</b>				<b>Total loans:</b>			
Acceptable	96.67%	100.00%	96.99%	Acceptable	89.70%	87.54%	90.92%
OAEM	3.33	—	3.01	OAEM	5.91	7.18	6.72
Substandard/doubtful/loss	—	—	—	Substandard/doubtful/loss	4.39	5.28	2.36
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%

The following tables provide an aging analysis of past due loans and related accrued interest as of:

	December 31, 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	\$ 1,219	\$ 2,640	\$ 3,859	\$ 243,164	\$ 247,023
Production and intermediate-term	1,893	4,655	6,548	214,996	221,544
Loans to cooperatives	—	—	—	3,155	3,155
Processing and marketing	—	—	—	16,280	16,280
Farm-related business	—	—	—	9,512	9,512
Power and water/waste disposal	—	—	—	1,758	1,758
Rural residential real estate	151	—	151	3,681	3,832
International	—	—	—	858	858
Lease receivables	—	—	—	68	68
Total	\$ 3,263	\$ 7,295	\$ 10,558	\$ 493,472	\$ 504,030

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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	\$ 1,801	\$ 1,744	\$ 3,545	\$ 230,111	\$	233,656
Production and intermediate-term	545	4,812	5,357	199,115		204,472
Loans to cooperatives	—	—	—	743		743
Processing and marketing	—	—	—	17,178		17,178
Farm-related business	—	—	—	4,531		4,531
Power and water/waste disposal	—	—	—	1,843		1,843
Rural residential real estate	—	—	—	3,562		3,562
International	—	—	—	857		857
Lease receivables	—	—	—	90		90
Total	\$ 2,346	\$ 6,556	\$ 8,902	\$ 458,030	\$	466,932

December 31, 2016						
	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	\$ 223	\$ 3,604	\$ 3,827	\$ 231,682	\$	235,509
Production and intermediate-term	1,665	2,256	3,921	184,590		188,511
Loans to cooperatives	—	—	—	1,872		1,872
Processing and marketing	—	—	—	16,543		16,543
Farm-related business	—	—	—	4,617		4,617
Power and water/waste disposal	—	—	—	862		862
Rural residential real estate	—	—	—	4,817		4,817
International	—	—	—	857		857
Lease receivables	—	—	—	111		111
Total	\$ 1,888	\$ 5,860	\$ 7,748	\$ 445,951	\$	453,699

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

	December 31,		
	2018	2017	2016
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 5,266	\$ 3,564	\$ 5,915
Production and intermediate-term	13,812	7,063	5,014
Total	\$ 19,078	\$ 10,627	\$ 10,929
<b>Accruing restructured loans:</b>			
Real estate mortgage	\$ 6,655	\$ 7,092	\$ 7,346
Production and intermediate-term	264	1,548	1,975
Lease receivables	68	90	111
Total	\$ 6,987	\$ 8,730	\$ 9,432
<b>Accruing loans 90 days or more past due:</b>			
Total	\$ —	\$ —	\$ —
Total nonperforming loans	\$ 26,065	\$ 19,357	\$ 20,361
Other property owned	822	783	623
Total nonperforming assets	\$ 26,887	\$ 20,140	\$ 20,984
Nonaccrual loans as a percentage of total loans	3.85%	2.31%	2.44%
Nonperforming assets as a percentage of total loans and other property owned	5.42%	4.37%	4.69%
Nonperforming assets as a percentage of capital	30.63%	23.18%	24.83%

The following table presents information relating to impaired loans (including accrued interest) as defined in Note 2:

	December 31,		
	2018	2017	2016
<b>Impaired nonaccrual loans:</b>			
Current as to principal and interest	\$ 9,368	\$ 3,049	\$ 4,022
Past due	9,710	7,578	6,907
Total	\$ 19,078	\$ 10,627	\$ 10,929
<b>Impaired accrual loans:</b>			
Restructured	\$ 6,987	\$ 8,730	\$ 9,432
90 days or more past due	—	—	—
Total	\$ 6,987	\$ 8,730	\$ 9,432
Total impaired loans	\$ 26,065	\$ 19,357	\$ 20,361
Additional commitments to lend	\$ 298	\$ 8	\$ 10

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

Impaired Loans	December 31, 2018			Year Ended December 31, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>With a related allowance for credit losses:</b>					
Real estate mortgage	\$ 4,399	\$ 4,468	\$ 415	\$ 4,286	\$ 93
Production and intermediate-term	8,605	8,669	2,650	8,385	182
Total	\$ 13,004	\$ 13,137	\$ 3,065	\$ 12,671	\$ 275
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 7,522	\$ 9,362	\$ —	\$ 7,331	\$ 159
Production and intermediate-term	5,471	6,228	—	5,331	116
Rural residential real estate	—	14	—	—	—
Lease receivables	68	68	—	66	1
Total	\$ 13,061	\$ 15,672	\$ —	\$ 12,728	\$ 276
<b>Total:</b>					
Real estate mortgage	\$ 11,921	\$ 13,830	\$ 415	\$ 11,617	\$ 252
Production and intermediate-term	14,076	14,897	2,650	13,716	298
Rural residential real estate	—	14	—	—	—
Lease receivables	68	68	—	66	1
Total	\$ 26,065	\$ 28,809	\$ 3,065	\$ 25,399	\$ 551

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
<b>With a related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,343	\$ 3,326	\$ 354	\$ 3,733	\$ 128
Production and intermediate-term	1,629	1,712	94	1,820	63
Lease receivables	90	89	111	100	3
Total	\$ 5,062	\$ 5,127	\$ 559	\$ 5,653	\$ 194
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 7,313	\$ 8,759	\$ —	\$ 8,167	\$ 281
Production and intermediate-term	6,982	7,737	—	7,797	268
Rural residential real estate	—	23	—	—	—
Total	\$ 14,295	\$ 16,519	\$ —	\$ 15,964	\$ 549
<b>Total:</b>					
Real estate mortgage	\$ 10,656	\$ 12,085	\$ 354	\$ 11,900	\$ 409
Production and intermediate-term	8,611	9,449	94	9,617	331
Rural residential real estate	—	23	—	—	—
Lease receivables	90	89	111	100	3
Total	\$ 19,357	\$ 21,646	\$ 559	\$ 21,617	\$ 743

Impaired Loans	December 31, 2016			Year Ended December 31, 2016	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>With a related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,506	\$ 3,488	\$ 335	\$ 3,311	\$ 119
Production and intermediate-term	1,428	1,474	138	1,349	48
Lease receivables	111	111	113	105	4
Total	\$ 5,045	\$ 5,073	\$ 586	\$ 4,765	\$ 171
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 9,755	\$ 10,603	\$ —	\$ 9,214	\$ 330
Production and intermediate-term	5,561	6,348	—	5,251	189
Rural residential real estate	—	29	—	—	—
Total	\$ 15,316	\$ 16,980	\$ —	\$ 14,465	\$ 519
<b>Total:</b>					
Real estate mortgage	\$ 13,261	\$ 14,091	\$ 335	\$ 12,525	\$ 449
Production and intermediate-term	6,989	7,822	138	6,600	237
Rural residential real estate	—	29	—	—	—
Lease receivables	111	111	113	105	4
Total	\$ 20,361	\$ 22,053	\$ 586	\$ 19,230	\$ 690

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate- term	Agribusiness*	Power and Water/Waste Disposal	Rural Residential Real Estate	International	Lease Receivables	Total
<b>Activity related to the allowance for credit losses:</b>								
Balance at December 31, 2017	\$ 2,879	\$ 7,432	\$ 377	\$ 14	\$ 22	\$ 9	\$ 111	\$ 10,844
Charge-offs	(299)	(189)	–	–	–	–	–	(488)
Recoveries	–	79	–	–	–	–	–	79
Provision for loan losses	544	1,855	86	(2)	(3)	–	(111)	2,369
Balance at December 31, 2018	\$ 3,124	\$ 9,177	\$ 463	\$ 12	\$ 19	\$ 9	\$ –	\$ 12,804
Balance at December 31, 2016	\$ 1,823	\$ 6,410	\$ 297	\$ 8	\$ 18	\$ 7	\$ 113	\$ 8,676
Charge-offs	(285)	(386)	–	–	–	–	–	(671)
Recoveries	124	95	9	–	–	–	–	228
Provision for loan losses	1,217	1,313	71	6	4	2	(2)	2,611
Balance at December 31, 2017	\$ 2,879	\$ 7,432	\$ 377	\$ 14	\$ 22	\$ 9	\$ 111	\$ 10,844
Balance at December 31, 2015	\$ 1,811	\$ 4,872	\$ 293	\$ 277	\$ 9	\$ –	\$ 117	\$ 7,379
Charge-offs	(300)	(342)	–	–	–	–	–	(642)
Recoveries	70	158	–	–	–	–	–	228
Provision for loan losses	242	1,722	4	(269)	9	7	(4)	1,711
Balance at December 31, 2016	\$ 1,823	\$ 6,410	\$ 297	\$ 8	\$ 18	\$ 7	\$ 113	\$ 8,676
<b>Allowance on loans evaluated for impairment:</b>								
Individually	\$ 415	\$ 2,650	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 3,065
Collectively	2,709	6,527	463	12	19	9	–	9,739
Balance at December 31, 2018	\$ 3,124	\$ 9,177	\$ 463	\$ 12	\$ 19	\$ 9	\$ –	\$ 12,804
Individually	\$ 354	\$ 94	\$ –	\$ –	\$ –	\$ –	\$ 111	\$ 559
Collectively	2,525	7,338	377	14	22	9	–	10,285
Balance at December 31, 2017	\$ 2,879	\$ 7,432	\$ 377	\$ 14	\$ 22	\$ 9	\$ 111	\$ 10,844
Individually	\$ 335	\$ 138	\$ –	\$ –	\$ –	\$ –	\$ 113	\$ 586
Collectively	1,488	6,272	297	8	18	7	–	8,090
Balance at December 31, 2016	\$ 1,823	\$ 6,410	\$ 297	\$ 8	\$ 18	\$ 7	\$ 113	\$ 8,676
<b>Recorded investment in loans evaluated for impairment:</b>								
Individually	\$ 11,921	\$ 14,076	\$ –	\$ –	\$ –	\$ –	\$ 68	\$ 26,065
Collectively	235,102	207,468	28,947	1,758	3,832	858	–	477,965
Balance at December 31, 2018	\$ 247,023	\$ 221,544	\$ 28,947	\$ 1,758	\$ 3,832	\$ 858	\$ 68	\$ 504,030
Individually	\$ 10,656	\$ 8,611	\$ –	\$ –	\$ –	\$ –	\$ 90	\$ 19,357
Collectively	223,000	195,861	22,452	1,843	3,562	857	–	447,575
Balance at December 31, 2017	\$ 233,656	\$ 204,472	\$ 22,452	\$ 1,843	\$ 3,562	\$ 857	\$ 90	\$ 466,932
Individually	\$ 13,261	\$ 6,989	\$ –	\$ –	\$ –	\$ –	\$ 111	\$ 20,361
Collectively	222,248	181,522	23,032	862	4,817	857	–	433,338
Balance at December 31, 2016	\$ 235,509	\$ 188,511	\$ 23,032	\$ 862	\$ 4,817	\$ 857	\$ 111	\$ 453,699

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

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. The guaranteed balance of designated loans under these agreements was \$83,026, \$81,228, and \$75,743 at December 31, 2018, 2017, and 2016, respectively. Fees paid for such guarantee commitments totaled \$0, \$0, and \$1 for 2018, 2017, and 2016, respectively. These amounts are classified as noninterest expense.

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.

Outstanding Recorded Investment	Year Ended December 31, 2018				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification:</b>					
Production and intermediate-term	\$ –	\$ 2,412	\$ –	\$ 2,412	
Total	\$ –	\$ 2,412	\$ –	\$ 2,412	
<b>Post-modification:</b>					
Production and intermediate-term	\$ –	\$ 2,415	\$ –	\$ 2,415	\$ –
Total	\$ –	\$ 2,415	\$ –	\$ 2,415	\$ –

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Outstanding Recorded Investment	Year Ended December 31, 2017					Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total		
<b>Pre-modification:</b>						
Production and intermediate-term	\$ –	\$ 1,275	\$ –	\$ 1,275		
Total	\$ –	\$ 1,275	\$ –	\$ 1,275		
<b>Post-modification:</b>						
Production and intermediate-term	\$ –	\$ 1,363	\$ –	\$ 1,363	\$ –	
Total	\$ –	\$ 1,363	\$ –	\$ 1,363	\$ –	

Outstanding Recorded Investment	Year Ended December 31, 2016					Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total		
<b>Pre-modification:</b>						
Real estate mortgage	\$ –	\$ 1,480	\$ 252	\$ 1,732		
Production and intermediate-term	–	1,846	–	1,846		
Total	\$ –	\$ 3,326	\$ 252	\$ 3,578		
<b>Post-modification:</b>						
Real estate mortgage	\$ –	\$ 1,553	\$ 253	\$ 1,806	\$ –	
Production and intermediate-term	–	1,860	–	1,860	–	
Total	\$ –	\$ 3,413	\$ 253	\$ 3,666	\$ –	

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.

Defaulted troubled debt restructurings	Year Ended December 31,		
	2018	2017	2016
Production and intermediate-term	\$ 96	\$ 67	\$ –
Total	\$ 96	\$ 67	\$ –

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

	Total TDRs			Nonaccrual TDRs		
	December 31,			December 31,		
	2018	2017	2016	2018	2017	2016
Real estate mortgage	\$ 6,655	\$ 7,092	\$ 8,162	\$ –	\$ –	\$ 816
Production and intermediate-term	3,663	3,345	2,811	3,399	1,797	836
Lease receivables	68	90	111	–	–	–
Total loans	\$ 10,386	\$ 10,527	\$ 11,084	\$ 3,399	\$ 1,797	\$ 1,652
Additional commitments to lend	\$ –	\$ –	\$ –			

The following table presents information as of period end:

	December 31, 2018
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	\$ –
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	\$ –

**Note 4 — 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 December 31, 2018, the Association held one RAB totaling \$172 whose credit quality has deteriorated beyond the program limits.

A summary of the amortized cost and fair value of HTM investment securities follows:

December 31, 2018					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs	\$ 9,268	\$ 350	\$ (6)	\$ 9,612	5.90%

December 31, 2017					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs (a)	\$ 14,309	\$ 612	\$ (16)	\$ 14,905	5.88%

December 31, 2016					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs (a)	\$ 18,489	\$ 434	\$ (474)	\$ 18,449	5.87%

(a) Gross unrealized losses include non-credit related other-than-temporary impairment recognized in AOCI of \$95.

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

December 31, 2018				
	Amortized Cost	Fair Value	Weighted Average Yield	
In one year or less	\$ -	\$ -	-%	
After one year through five years	853	879	7.15	
After five years through ten years	-	-	-	
After ten years	8,415	8,733	5.78	
Total	\$ 9,268	\$ 9,612	5.90%	

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 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.

December 31, 2018					
	Less than 12 Months		12 Months or Greater		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
RABs	\$ -	\$ -	\$ 460	\$ (6)	

December 31, 2017					
	Less than 12 Months		12 Months or Greater		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
RABs	\$ -	\$ -	\$ 458	\$ (16)	

December 31, 2016					
	Less than 12 Months		12 Months or Greater		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
RABs	\$ 941	\$ (30)	\$ 3,027	\$ (444)	

The recording of an impairment loss 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.



Based on the results of all analyses, the Association has recognized no credit-related other-than-temporary impairment for 2018, 2017, and 2016. During 2018, 2017 and 2016, accretion to interest income of previously recognized credit impairment of \$0, \$0, and \$510, respectively, was recorded. This accretion, along with the substandard security's final settlement payment for the disposition of collateral in December of 2018, cleared the remaining credit impairment in the amount of \$2,024.

Since the Association does not intend to sell these other-than-temporarily impaired debt securities and is not more likely than not to be required to sell before recovery, the total other-than-temporary impairment is reflected in the Statements of Income

with: (1) a net other-than-temporary impairment amount related to estimated credit loss, and (2) an amount relating to all other factors, recognized as a reclassification to or from Other Comprehensive Income.

For all other impaired investments, the Association has not recognized any credit losses as the 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.

The following schedule details the activity related to cumulative credit losses on investments recognized in earnings:

	For the Year Ended December 31,		
	2018	2017	2016
<b>Amount related to credit loss-beginning balance</b>	\$ 2,024	\$ 2,024	\$ 2,534
Additions for initial credit impairments	—	—	—
Additions for subsequent credit impairments	—	—	—
Reductions for increases in expected cash flows	—	—	(510)
Reductions for securities sold, settled, or matured	(2,024)	—	—
<b>Amount related to credit loss-ending balance</b>	—	2,024	2,024
Life to date incurred credit losses	—	—	—
<b>Remaining unrealized credit losses</b>	\$ —	\$ 2,024	\$ 2,024

**Equity Investments in Other Farm Credit 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.

The Association is required to maintain ownership in 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's investment in the Bank totaled \$5,568 for 2018, \$5,473 for 2017 and \$4,844 for 2016. The Association owns 2.04 percent of the issued stock of the Bank as of December 31, 2018 net of any reciprocal investment. As of that date, the Bank's assets totaled \$33.1 billion and shareholders' equity totaled \$2.2 billion. The Bank's earnings were \$306 million for 2018. In addition, the Association had an investment of \$377 related to other Farm Credit institutions at December 31, 2018.

**Note 5 — Real Estate and Other Property**

**Premises and Equipment**

Premises and equipment consists of the following:

	December 31,		
	2018	2017	2016
Land	\$ 1,212	\$ 1,212	\$ 1,189
Buildings and improvements	3,398	3,006	2,828
Furniture and equipment	1,837	1,815	1,895
	6,447	6,033	5,912
Less: accumulated depreciation	2,475	2,233	1,972
<b>Total</b>	<b>\$ 3,972</b>	<b>\$ 3,800</b>	<b>\$ 3,940</b>

**Other Property Owned**

Net (gains) losses on other property owned consist of the following:

	December 31,		
	2018	2017	2016
(Gains) losses on sale, net	\$ (1)	\$ —	\$ (1)
Carrying value unrealized (gains) losses	(124)	370	146
Operating (income) expense, net	82	95	87
<b>(Gains) losses on other property owned, net</b>	<b>\$ (43)</b>	<b>\$ 465</b>	<b>\$ 232</b>

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2018, 2017, and 2016.

**Note 6 — Debt**

**Notes Payable to AgFirst Farm Credit Bank**

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2018, the Association's notes payable were within the specified limitations.

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 and the terms of the revolving lines of credit are governed by the GFA. Interest rates on both variable and fixed rate advances are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA and which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and the Association.

The weighted average interest rates on the variable rate advances were 3.43 percent for LIBOR-based loans and 3.53 percent for Prime-based loans, and the weighted average remaining maturities were 3.7 years and 1.1 years, respectively, at December 31, 2018. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 3.40 percent, and the weighted average remaining maturity was 9.9 years at December 31, 2018. The weighted-average interest rate on all interest-bearing notes payable was 3.43 percent and the weighted-average remaining maturity was 7.5 years at December 31, 2018. Variable rate and fixed rate notes payable represent approximately 15.78 percent and 84.22 percent, respectively, of total notes payable at December 31, 2018. The weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

#### Note 7 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below:

- A. **Protected Borrower Equity:** Protection of certain borrower equity is provided under the Farm Credit Act which requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.
- B. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm-related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lesser of \$1 thousand or 2 percent of the amount of the loan. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans

designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

#### C. Regulatory Capitalization Requirements and

**Restrictions:** An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

There are currently no prohibitions in place that would prevent the Association from retiring stock, distributing earnings, or paying dividends per the statutory and regulatory restrictions, and the Association has no reason to believe any such restrictions may apply in the future.

Effective January 1, 2017, the regulatory capital requirements for System Banks and associations were modified. The new regulations ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted. New regulations replaced core surplus and total surplus ratios with common equity tier 1 (CET1) capital, tier 1 capital, and total capital risk-based ratios. The new regulations also include a tier 1 leverage ratio and an unallocated retained earnings (URE) and URE equivalents (UREE) leverage ratio. The permanent capital ratio (PCR) remains in effect.

The ratios are calculated using three-month average daily balances, in accordance with FCA regulations, as follows:

- The CET1 capital 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 revolvement, 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 URE and 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.

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 December 31,	
				2018	2017
Risk-adjusted ratios:					
CET1 Capital	4.5%	1.25%	5.75%	17.26%	18.20%
Tier 1 Capital	6.0%	1.25%	7.25%	17.26%	18.20%
Total Capital	8.0%	1.25%	9.25%	18.52%	19.46%
Permanent Capital	7.0%	0.0%	7.0%	17.48%	18.44%
Non-risk-adjusted ratios:					
Tier 1 Leverage	4.0%	1.0%	5.0%	16.03%	16.58%
URE and UREE Leverage	1.5%	0.0%	1.5%	8.13%	8.24%

\* 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.

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.

- D. **Description of Equities:** The Association is authorized to issue or have outstanding Classes A and D Preferred Stock; Classes A, B and C Common Stock; Classes B and C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2018:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	Yes	9,997	\$ 50
B Common/Nonvoting	Yes	501	2
C Common/Voting	No	287,150	1,436
C Participation Certificates/Nonvoting	No	14,765	74
Total Capital Stock and Participation Certificates		312,413	\$ 1,562

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

#### Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board provided that minimum capital standards established by the FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2018, allocated members' equity consisted of \$5,396 of qualified surplus, \$37,154 of nonqualified allocated surplus, and \$15,545 of nonqualified retained surplus.

#### *Dividends*

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A or D Preferred Stock or on all classes of stock and participation certificates.

The rate of dividends paid on Class A Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B and C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B and C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these Consolidated Financial Statements.

#### *Patronage Distributions*

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

#### *Transfer*

Classes A and D Preferred, Classes A, B and C Common Stocks, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

#### *Impairment*

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members'

equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Class C Common Stock and Class C Participation Certificates
2. Classes A and B Common Stock and Class B Participation Certificates
3. Classes A and D Preferred Stock

#### *Liquidation*

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Holders of Classes A and D Preferred Stock
2. Holders of Classes A and B Common Stock and Class B Participation Certificates
3. Holders of Class C Common Stock and Class C Participation Certificates
4. Holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed
5. Holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed
6. Any remaining assets of the Association after such distributions shall be distributed to past and present patrons on a patronage basis, to the extent practicable.

E. Accumulated Other Comprehensive Income (AOCI):

Changes in Accumulated Other Comprehensive income by Component (a)					
For the Years Ended December 31,					
	2018		2017		2016
<b>Unrealized Gains (Losses) on Investments:</b>					
Balance at beginning of period	\$	392	\$	453	\$ 922
Other comprehensive income before reclassifications		-		-	-
Amounts reclassified from AOCI		(92)		(61)	(469)
Net current period OCI		(92)		(61)	(469)
Balance at end of period		300		392	453
<b>Employee Benefit Plans:</b>					
Balance at beginning of period		(267)		(234)	(224)
Other comprehensive income before reclassifications		31		(41)	(17)
Amounts reclassified from AOCI		10		8	7
Net current period OCI		41		(33)	(10)
Balance at end of period		(226)		(267)	(234)
<b>Accumulated Other Comprehensive Income:</b>					
Balance at beginning of period		125		219	698
Other comprehensive income before reclassifications		31		(41)	(17)
Amounts reclassified from AOCI		(82)		(53)	(462)
Net current period OCI		(51)		(94)	(479)
	\$	74	\$	125	\$ 219

Reclassifications Out of Accumulated Other Comprehensive Income (b)						
	2018		2017		2016	Income Statement Line Item
<b>Investment Securities:</b>						
Amortization	\$	92	\$	61	\$ 469	Interest income on investments
Amounts reclassified		92		61	469	
<b>Defined Benefit Pension Plans:</b>						
Periodic pension costs		(10)		(8)	(7)	See Note 9.
Amounts reclassified		(10)		(8)	(7)	
Total reclassifications for the period	\$	82	\$	53	\$ 462	

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

**Note 8 — 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.

Estimating the fair value of the Association's equity investments in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities.

The classifications within the fair value hierarchy (See Note 2) are as follows:

**Level 1**

Assets held in trust funds, related to deferred compensation plans, and assets held in mutual funds, related to the Association's Corporate Giving Fund, are classified as Level 1.

The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

**Level 2**

The Association had no Level 2 assets and liabilities measured at fair value on a recurring basis.

**Level 3**

Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. Certain loans evaluated for impairment under FASB guidance have fair values based upon the underlying collateral, as the loans were collateral-dependent. Specific reserves were established for these loans when the value of the collateral, less estimated cost to sell, was less than the principal balance of the loan. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also

requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters.

Notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired

through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

The fair value of investments in debt securities is estimated by discounting expected future cash flows using prevailing rates for similar instruments at the measurement date.

There were no Level 3 assets and 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.

		December 31, 2018				
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in trust funds	\$	704	\$ 704	\$ -	\$ -	\$ 704
Recurring Assets	\$	704	\$ 704	\$ -	\$ -	\$ 704
<b>Liabilities:</b>						
Recurring Liabilities	\$	-	\$ -	\$ -	\$ -	\$ -
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$	9,939	\$ -	\$ -	\$ 9,939	\$ 9,939
Other property owned		822	-	-	887	887
Nonrecurring Assets	\$	10,761	\$ -	\$ -	\$ 10,826	\$ 10,826
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$	48	\$ 48	\$ -	\$ -	\$ 48
Investments in debt securities, held-to-maturity		9,268	-	-	9,612	9,612
Loans		472,425	-	-	464,880	464,880
Other Financial Assets	\$	481,741	\$ 48	\$ -	\$ 474,492	\$ 474,540
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$	418,933	\$ -	\$ -	\$ 415,125	\$ 415,125
Other Financial Liabilities	\$	418,933	\$ -	\$ -	\$ 415,125	\$ 415,125

		December 31, 2017				
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in trust funds	\$	745	\$ 745	\$ –	\$ –	\$ 745
Recurring Assets	\$	745	\$ 745	\$ –	\$ –	\$ 745
<b>Liabilities:</b>						
Recurring Liabilities	\$	–	\$ –	\$ –	\$ –	\$ –
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$	4,503	\$ –	\$ –	\$ 4,503	\$ 4,503
Other property owned		783	–	–	853	853
Nonrecurring Assets	\$	5,286	\$ –	\$ –	\$ 5,356	\$ 5,356
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$	181	\$ 181	\$ –	\$ –	\$ 181
Investments in debt securities, held-to-maturity		14,309	–	–	14,905	14,905
Loans		444,547	–	–	439,480	439,480
Other Financial Assets	\$	459,037	\$ 181	\$ –	\$ 454,385	\$ 454,566
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$	392,398	\$ –	\$ –	\$ 390,610	\$ 390,610
Other Financial Liabilities	\$	392,398	\$ –	\$ –	\$ 390,610	\$ 390,610
		December 31, 2016				
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in trust funds	\$	499	\$ 499	\$ –	\$ –	\$ 499
Recurring Assets	\$	499	\$ 499	\$ –	\$ –	\$ 499
<b>Liabilities:</b>						
Recurring Liabilities	\$	–	\$ –	\$ –	\$ –	\$ –
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$	4,459	\$ –	\$ –	\$ 4,459	\$ 4,459
Other property owned		623	–	–	718	718
Nonrecurring Assets	\$	5,082	\$ –	\$ –	\$ 5,177	\$ 5,177
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$	12	\$ 12	\$ –	\$ –	\$ 12
Investments in debt securities, held-to-maturity		18,489	–	–	18,449	18,449
Loans		434,015	–	–	428,181	428,181
Other Financial Assets	\$	452,516	\$ 12	\$ –	\$ 446,630	\$ 446,642
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$	386,383	\$ –	\$ –	\$ 383,443	\$ 383,443
Other Financial Liabilities	\$	386,383	\$ –	\$ –	\$ 383,443	\$ 383,443

**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.

**INVESTMENTS IN DEBT SECURITIES**

The fair values of predominantly all Level 3 investments in debt 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	\$ 10.826	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement costs	*
			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
Loans	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity
Investments in debt securities, held-to-maturity	Discounted cash flow	Prepayment rates
		Risk adjusted discount rate
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity

**Note 9 — Employee Benefit Plans**

The Association participates in three District sponsored benefit plans. These plans include a multi-employer defined benefit pension plan, the AgFirst Farm Credit Retirement Plan, which is a final average pay plan (FAP Plan). In addition, the Association participates in a multi-employer defined benefit other postretirement benefits plan (OPEB Plan), the Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plan, and a defined contribution 401(k) plan. The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

1. Assets contributed to multi-employer plans by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If the Association chooses to stop participating in some of its multi-employer plans, the Association may be required to contribute to eliminate the underfunded status of the plan.

The District’s multiemployer plans are not subject to ERISA and no Form 5500 is required. As such, the following information is neither available for nor applicable to the plans:

1. The Employee Identification Number (EIN) and three-digit Pension Plan Number.
2. The most recent Pension Protection Act (PPA) zone status. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.
3. The "FIP/RP Status" indicating whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.
4. The expiration date(s) of collective-bargaining agreement(s).

The FAP Plan covers employees hired prior to January 1, 2003 and includes other District employees that are not employees of the Association. It is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association’s Balance Sheets but are included in the Combined Balance Sheets for the AgFirst District. FAP Plan expenses included in employee benefit costs on the Association’s Statements of Income were \$1,046 for 2018, \$909 for 2017, and \$1,364 for 2016. At December 31, 2018, 2017, and 2016, the total liability balance for the FAP Plan presented in the District



Combined Balance Sheets is \$94,491, \$139,104, and \$119,000, respectively. The FAP Plan is 89.56 percent, 86.41 percent, 86.96 percent funded to the projected benefit obligation as of December 31, 2018, 2017, and 2016, respectively.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. The OPEB Plan includes other Farm Credit System employees that are not employees of the Association or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Statement of Condition for the Farm Credit System. The OPEB Plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs on the Association's Statements of Income were \$189 for 2018, \$174 for 2017, and \$247 for 2016. At December 31, 2018, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition is \$181,820.

During 2017, the method of recording expenses at participating District entities for the FAP and OPEB Plans was modified. Prior to 2017, expense was recorded based on allocations of actuarially-determined costs and any differences between recorded expense and actual contributions were recorded in Other Assets or Other Liabilities on the Consolidated Balance Sheets. For 2017 and future years, participating entities will record employee benefit costs based on the actual contributions to the Plans. This change caused the Association to modify its accounting estimates recorded in Other Assets and Other Liabilities since the assets and liabilities do not impact future contributions to the Plans. The change in estimate resulted in the reduction of Other Assets by \$2,101 and the reduction of Other Liabilities by \$3,078 on the Association's Balance Sheets, and a total reduction of noninterest expenses on the Association's Statements of Income of \$977 during 2017.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes \$0.50 for each \$1.00 of the employee's first 6.00 percent of contribution (based on total compensation) up to the maximum employer contribution of 3.00 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes \$1.00 for each \$1.00 of the employee's first 6.00 percent of contribution up to the maximum employer contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were \$324, \$298, and \$282 for the years ended December 31, 2018, 2017, and 2016, respectively. Beginning in 2015, contributions include an additional 3.00

percent of eligible compensation for employees hired after December 31, 2002.

FASB guidance further requires the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of AOCI. Under the guidance, these amounts are subsequently recognized as components of net periodic benefit costs over time. For 2018, 2017, and 2016, \$41, \$(33) and \$(10) has been recognized as a net credit and net debits to AOCI to reflect these elements.

In addition to the multi-employer plans described above, the Association sponsors nonqualified supplemental retirement and 401(k) plans. The supplemental retirement plan is unfunded and had a projected benefit obligation of \$623 and a net under-funded status of \$623 at December 31, 2018. Assumptions used to determine the projected benefit obligation as of December 31, 2018 included a discount rate of 4.40 percent. The expenses of these nonqualified plans included in noninterest expenses were \$37, \$38, and \$37 for 2018, 2017, and 2016, respectively.

Additional information for the above may be found in the Notes to the Annual Information Statement of the Farm Credit System.

#### **Note 10 — Related Party Transactions**

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates, amortization schedule, and collateral, as those prevailing at the time for comparable transactions with unaffiliated borrowers.

Total loans to such persons at December 31, 2018 amounted to \$9,215. During 2018, \$4,289 of new loans and advances were made and repayments totaled \$4,772. In the opinion of management, none of these loans outstanding at December 31, 2018 involved more than a normal risk of collectibility.

#### **Note 11 — Commitments and Contingencies**

From time to time, legal actions are pending against the Association in which claims for money 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. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

In the normal course of business, the Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers. These financial instruments may include commitments to extend credit or letters of credit.

The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2018, \$88,089 of commitments to extend credit and no commercial letters of credit were outstanding. There was no reserve for unfunded commitments included in Other Liabilities on the Consolidated Balance Sheets at December 31, 2018.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2018, standby letters of credit outstanding totaled \$435 with expiration dates ranging from January 1, 2019 to May 1, 2022. The maximum potential amount of future payments that may be required under these guarantees was \$435.

**Note 12 — Income Taxes**

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2018	2017	2016
Current:			
Federal	\$ 6	\$ 2	\$ 15
State	—	1	—
	<u>6</u>	<u>3</u>	<u>15</u>
Deferred:			
Federal	—	—	—
State	—	—	—
	<u>—</u>	<u>—</u>	<u>—</u>
Total provision (benefit) for income taxes	<u>\$ 6</u>	<u>\$ 3</u>	<u>\$ 15</u>

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31,		
	2018	2017	2016
Federal tax at statutory rate	\$ 1,872	\$ 2,936	\$ 3,077
State tax, net	—	—	(2)
Patronage distributions	(1,295)	(2,037)	(814)
Tax-exempt FLCA earnings	(1,121)	(1,367)	(2,604)
Change in valuation allowance	662	(683)	352
Change due to graduated rate on nonpat income	—	—	10
Deferred tax rate change	—	1,198	—
NOL Carryforward	(13)	—	—
Other	(99)	(44)	(4)
Provision (benefit) for income taxes	<u>\$ 6</u>	<u>\$ 3</u>	<u>\$ 15</u>

In late December 2017, federal tax legislation was enacted which, among other things, lowered the federal corporate tax rate from 35% to 21% beginning on January 1, 2018. The change to the lower corporate tax rate led to an insignificant remeasurement of the deferred tax liabilities and deferred tax assets in 2018, the period of enactment. Deferred tax assets and liabilities are comprised of the following at:

	December 31,		
	2018	2017	2016
Deferred income tax assets:			
Allowance for loan losses	\$ 2,380	\$ 1,939	\$ 2,520
Nonaccrual loan interest	493	293	406
Other property owned writedown	25	13	—
Loan origination fees	11	1	3
Gross deferred tax assets	<u>2,909</u>	<u>2,246</u>	<u>2,929</u>
Less: valuation allowance	<u>(2,909)</u>	<u>(2,246)</u>	<u>(2,929)</u>
Gross deferred tax assets, net of valuation allowance	—	—	—
Deferred income tax liabilities:	—	—	—
Net deferred tax asset (liability)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

At December 31, 2018, deferred income taxes have not been provided by the Association on approximately \$50 of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$2,909, \$2,246 and \$2,929 as of December 31, 2018, 2017 and 2016, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2018 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2015 and forward.

**Note 13 — Additional Financial Information**

***Quarterly Financial Information (Unaudited)***

	<b>2018</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
Net interest income	\$ 2,941	\$ 3,062	\$ 3,368	\$ 3,251	\$ 12,622
Provision for (reversal of allowance for) loan losses	507	146	1,099	617	2,369
Noninterest income (expense), net	(826)	(1,170)	(789)	1,442	(1,343)
Net income	\$ 1,608	\$ 1,746	\$ 1,480	\$ 4,076	\$ 8,910

	<b>2017</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
Net interest income	\$ 2,875	\$ 2,930	\$ 3,110	\$ 3,277	\$ 12,192
Provision for (reversal of allowance for) loan losses	344	267	687	1,313	2,611
Noninterest income (expense), net	(1,258)	(1,329)	(956)	2,348	(1,195)
Net income	\$ 1,273	\$ 1,334	\$ 1,467	\$ 4,312	\$ 8,386

	<b>2016</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
Net interest income	\$ 2,712	\$ 2,863	\$ 3,018	\$ 3,175	\$ 11,768
Provision for (reversal of allowance for) loan losses	57	206	403	1,045	1,711
Noninterest income (expense), net	(938)	(547)	(891)	1,096	(1,280)
Net income	\$ 1,717	\$ 2,110	\$ 1,724	\$ 3,226	\$ 8,777

**Note 14 — Subsequent Events**

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 13, 2019, which was the date the financial statements were issued.