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ArborOne, ACA

**SECOND QUARTER 2018**

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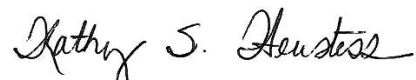
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**CERTIFICATION**

The undersigned certify that we have reviewed the June 30, 2018 quarterly 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.

  
Kathy S. Heustess  
President and Chief Executive Officer

  
Tammy G. Smith  
Chief Financial Officer and Treasurer

  
William Dupree Atkinson  
Chairman of the Board

August 8, 2018

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## ArborOne, ACA

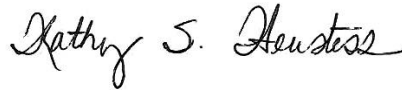
# Report on Internal Control Over Financial Reporting

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. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

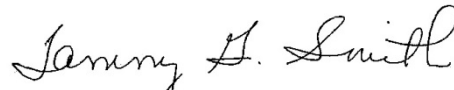
Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

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

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



Kathy S. Heustess  
President and Chief Executive Officer



Tammy G. Smith  
Chief Financial Officer and Treasurer

August 8, 2018

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

*(dollars in thousands)*

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

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including cash grains, cotton, forestry, tobacco, poultry, and farm services. Farm size varies and many of the borrowers in the region have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, somewhat impact the level of dependency on a given commodity. Approximately twenty-two percent of the portfolio has significant outside income to diversify dependence on agriculture, consisting of lifestyle loans and loans to less than full-time farmers with retirement income, salaried income and non-agricultural business income. Further, approximately sixteen percent of the assets carry federal guarantees as a risk management tool.

The gross loan volume of the Association as of June 30, 2018, was \$493,028, an increase of \$33,134 as compared to \$459,894 at December 31, 2017. Net loans outstanding at June 30, 2018, were \$481,497 as compared to \$449,050 at December 31, 2017. The Association had investment securities classified as held-to-maturity in the amount of \$14,170. Net loans and investments accounted for 95.73 percent of total assets at June 30, 2018, as compared to 94.39 percent of total assets at December 31, 2017.

Net loans increased by \$32,447 during the reporting period. This increase was mainly due to an increase in originated loan volume of \$34,491. This increase was partially offset by a decrease in participations purchased loan volume of \$1,558, an increase in participations sold loan volume of \$9,763, and an increase in allowance for loan losses of \$687.

The increase in originated volume was attributed to new loan volume and seasonal draws on existing operating lines of credit. The Association had \$91,194 in available commitments, an increase of \$904 when compared to \$90,290 at December 31, 2017.

The decrease in participations purchased loan volume of \$1,558 resulted mainly from the payoff of a large purchased loan. The increase in participations sold loan volume was due to additional funding on a large sold core agricultural loan. The increase in allowance for loan losses was primarily due to the increase in loan volume as well as additional specific reserves on a few core agricultural loans, which had declining credit quality and were moved to nonaccrual.

Investment securities held-to-maturity (HTM) consist of mission related investments (Rural America Bonds). The investments were transferred in 2014 to HTM from available-for-sale (AFS) 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 the transfer to held-to-maturity for each security.

The HTM investment securities decreased by \$139 when compared to December 31, 2017. This decrease was mainly due to normal payments in the amount of \$130, the amortization of the net unrealized loss from the transfer to HTM in the amount of \$12, and the realized amortization of a fee in the amount of \$3.

As of June 30, 2018, the majority of the Association's HTM Rural America Bonds were guaranteed; therefore the risk of credit loss to the Association was reduced. However, as of June 30, 2018, one security was rated as substandard and one security was rated as other assets especially mentioned (OAEM), which made these securities ineligible investments under Farm Credit Administration (FCA) regulation. FCA has been notified of these downgrades as required. Unrealized credit impairments on the HTM investment portfolio as of December 31, 2017 totaled \$2,024. No additional credit impairments were taken during the first six months of 2018.

There is an inherent risk in the extension of any type of credit. However, portfolio credit quality continues to be maintained at

an acceptable level, and credit administration remains satisfactory. Nonaccrual loans increased from \$10,627 at December 31, 2017, to \$20,684 at June 30, 2018. The increase in nonaccrual loan volume was mainly due to the decline in credit quality on two large core accounts as a result of lower commodity prices coupled with the adverse weather conditions from the fall of 2015 and 2016.

As of June 30, 2018, the Association has three properties classed as Other Property Owned (OPO) totaling \$708, a decrease of \$75 as compared to \$783 at December 31, 2017. The decrease was due to write-downs and sales. Association staff is working diligently to market the OPO properties.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on credit quality, credit history, current conditions, and expected future conditions.

The allowance for loan losses at June 30, 2018, was \$11,531, compared to \$10,844 at December 31, 2017. The \$11,531 allowance for loan losses consisted of \$8,422 in general reserves and \$3,109 in specific reserves for several core agricultural loans and a Rural America Bond. The charge-offs for the six months ended June 30, 2018 were \$32 on a nonaccrual core agricultural loan. There were recoveries of \$66 for the six months ended June 30, 2018 attributed primarily to several core agricultural loans. The allowance for loan losses for the period ending June 30, 2018 was considered by management to be adequate to cover any future possible losses.

## RESULTS OF OPERATIONS

### *For the three months ended June 30, 2018*

Net income for the three months ended June 30, 2018, totaled \$1,746, an increase of \$412, as compared to \$1,334 for the same period in 2017. This increase was mainly due an increase in net interest income of \$132, a decrease in provision of \$121, and a decrease in noninterest expense of \$134.

Interest income on accruing loans increased by \$543 for the three months ended June 30, 2018 compared to \$5,391 for the three months ended June 30, 2017, as a result of an increase in originated loan volume. Nonaccrual interest income decreased by \$16 as compared to the same period in 2017, which was mainly due to the reinstatement of a nonaccrual core agricultural loan that occurred in 2017. Interest income on investment securities was \$202 compared to \$215 for the same period in 2017. The decrease in investment interest income was due to the reduction in volume as a result of payoffs and repayments in the normal course of business.

Interest expense increased \$382 for the three months ended June 30, 2018, as compared to the comparable period of 2017.

The interest expense increase was primarily due to the increase in originated loan volume as well as an increase in rates, which was partially offset by the reduction in the HTM investment securities.

The Association recorded a provision for loan losses of \$146 as compared to \$267 for the comparable period of 2017. The decrease in provision was mainly due to a decrease in charge-offs and an increase in recoveries on nonaccrual core agricultural loans during 2018.

Noninterest income for the three months ended June 30, 2018, totaled \$1,019 as compared to \$994 for the same period of 2017, an increase of \$25. This increase was mainly due to an increase in loan fees of \$22, an increase in patronage refunds from other Farm Credit institutions of \$24, and was partially offset by a decrease in gains on other transactions of \$16.

Noninterest expense for the three months ended June 30, 2018, decreased \$134 compared to the same period of 2017. This reduction was mainly a result from a decrease in salaries and employee benefits of \$98, a decrease in insurance fund premiums of \$43, and a decrease in losses on other property owned of \$53, which was partially offset by an increase in other operating expenses of \$45.

The Association recorded no provision or benefit for income taxes for the three months ended June 30, 2018, and for the same period in 2017.

### *For the six months ended June 30, 2018*

Net income for the six months ended June 30, 2018, totaled \$3,354, as compared to \$2,607 for the same period in 2017. The increase was mainly due to an increase in noninterest income of \$409, an increase in net interest income of \$198, and a decrease in noninterest expense of \$182.

Interest income on accruing loans increased by \$923, which was primarily due to increased loan volume. Nonaccrual interest income decreased by \$21 as compared to the same period in 2017. This decrease was mainly due to a few reinstatements on nonaccrual core agricultural loans that occurred in 2017. Interest income on investment securities decreased by \$46 primarily due to the reduction in volume as a result of payoffs and repayments in the normal course of business.

Interest expense increased by \$658 compared to the same period of 2017. This increase was primarily a result of increased loan volume as well as an increase in rates, which was partially offset by the decrease in the HTM investment securities.

The Association recorded a provision for loan losses of \$653 for the six months ended June 30, 2018, as compared to a provision for loan losses of \$611 for the same period in 2017.

This increase was mainly due to the increase in nonaccruals along with credit quality changes.

Noninterest income for the six months ended June 30, 2018, totaled \$2,574 as compared to \$2,165 for the same period of 2017, an increase of \$409. The increase was mainly due to an increase in fees for financially related services of \$103 and a one-time insurance fund refund of \$277 from the 2017 year that was received in 2018.

Noninterest expense for the six months ended June 30, 2018, decreased \$182 compared to the same period of 2017. This decrease was mainly due to the decrease in salaries and employee benefits of \$162, a decrease in insurance fund premiums of \$85, and a decrease in losses on other property owned of \$78. These decreases were partially offset by an increase in other operating expenses of \$125.

The Association recorded no provision or benefit for income taxes for the six months ended June 30, 2018, and for the same period in 2017.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2018, was \$417,504 as compared to \$392,398 at December 31, 2017. The increase during the period was a result of an increase in originated loan volume.

## CAPITAL RESOURCES

Total members' equity increased by \$3,378 from \$86,882 at December 31, 2017 to \$90,260 at June 30, 2018, primarily due to an increase in retained earnings.

Total capital stock and participation certificates were \$1,527 on June 30, 2018, compared to \$1,466 on December 31, 2017. This increase was attributed to the purchases of capital stock and participation certificates on loans in the normal course of business.

The Association reports other comprehensive income (loss) (OCI) in its Consolidated Statements of Changes in Members' Equity. The Association has an unrealized gain of \$5 as of June 30, 2018, as compared to an unrealized loss of \$33 as of December 31, 2017 for FAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." The Association also has an unrealized net loss of \$13 as of June 30, 2018 as compared to an unrealized net loss of \$61 as of December 31, 2017 on the HTM investment securities. The resulting effect was a net loss of \$8 to Accumulated Other Comprehensive Income for the six months ending June 30, 2018.

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. Refer to Note 7, *Members' Equity*, of the Association's 2017 Annual Report for additional information.

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

<b>Ratio</b>	<b>Minimum Requirement</b>	<b>Capital Conservation Buffer*</b>	<b>Minimum Requirement with Capital Conservation Buffer</b>	<b>Capital Ratios as of June 30, 2018</b>
Risk-adjusted ratios:				
CET1 Capital	5.125%	0.625%	5.75%	18.23%
Tier 1 Capital	6.625%	0.625%	7.25%	18.23%
Total Capital	8.625%	0.625%	9.25%	19.49%
Permanent Capital Ratio	7.0%	0.0%	7.0%	18.46%
Non-risk-adjusted:				
Tier 1 Leverage Ratio	4.0%	1.0%	5.0%	17.08%
UREE Leverage Ratio	1.5%	0.0%	1.5%	8.30%

\* - 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.

For the period presented, the Association exceeded minimum regulatory standards for all the ratios.

#### **REGULATORY MATTERS**

On May 10, 2018, the Farm Credit Administration adopted a final rule that primarily implements the requirements of Section 939A of the Dodd-Frank Act and grants associations greater flexibility regarding the risk management purposes for investments. The regulation also sets forth the types of eligible investments and establishes a portfolio limit on the amount of investments they 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 risk management purposes. An association may purchase and hold investments not to exceed 10 percent of its 90-day average daily balance of outstanding loans on the last business day of the quarter. The final rule will become effective January 1, 2019.

#### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

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

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

Summary of Guidance	Adoption and Potential Financial Statement Impact
<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. The Association is currently identifying key interpretive issues, and assessing existing credit loss forecasting models and processes against the new guidance to determine what modifications may be required.</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 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.</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 has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities.</li> <li>• As a lessee the Association is developing its methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments but does not expect a material change to the timing of expense recognition.</li> <li>• Given the limited changes to lessor accounting, the Association does not expect material changes to recognition or measurement, but it is early in the implementation process and the impact will continue to be evaluated.</li> <li>• The Association is evaluating existing disclosures and may need to provide additional information as a result of adopting the Update.</li> <li>• The Association expects to adopt the guidance in first quarter 2019 using the modified retrospective method and practical expedients for transition.</li> </ul>

**NOTE:** Shareholder investment in the Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2764, or writing Matthew Miller, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association’s Annual and Quarterly reports are also available upon request free of charge by calling 1-800-741-7332, 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 a 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.

**ArborOne, ACA**  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>June 30, 2018</b> <i>(unaudited)</i>	<b>December 31, 2017</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 2	\$ 181
Investments in debt securities: Held to maturity (fair value of \$14,249 and \$14,905, respectively)	14,170	14,309
Loans	493,028	459,894
Allowance for loan losses	(11,531)	(10,844)
Net loans	481,497	449,050
Accrued interest receivable	6,877	7,165
Equity investments in other Farm Credit institutions	5,883	5,924
Premises and equipment, net	4,070	3,800
Other property owned	708	783
Accounts receivable	3,711	8,739
Other assets	832	923
Total assets	<b>\$ 517,750</b>	<b>\$ 490,874</b>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 417,504	\$ 392,398
Accrued interest payable	1,069	982
Patronage refunds payable	1,112	3,653
Accounts payable	168	562
Other liabilities	7,637	6,397
Total liabilities	<b>427,490</b>	<b>403,992</b>
Commitments and contingencies (Note 8)		
<b>Members' Equity</b>		
Protected borrower stock	52	53
Capital stock and participation certificates	1,475	1,413
Retained earnings		
Allocated	57,493	57,424
Unallocated	31,123	27,867
Accumulated other comprehensive income	117	125
Total members' equity	<b>90,260</b>	<b>86,882</b>
Total liabilities and members' equity	<b>\$ 517,750</b>	<b>\$ 490,874</b>

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



**ArborOne, ACA**  
**Consolidated Statements of Income**

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended June 30,		For the six months ended June 30,	
	2018	2017	2018	2017
<b>Interest Income</b>				
Loans	\$ 5,936	\$ 5,409	\$ 11,445	\$ 10,543
Investments	202	215	408	454
Total interest income	<b>6,138</b>	5,624	<b>11,853</b>	10,997
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	<b>3,076</b>	2,694	<b>5,850</b>	5,192
Net interest income	<b>3,062</b>	2,930	<b>6,003</b>	5,805
Provision for loan losses	<b>146</b>	267	<b>653</b>	611
Net interest income after provision for loan losses	<b>2,916</b>	2,663	<b>5,350</b>	5,194
<b>Noninterest Income</b>				
Loan fees	<b>216</b>	194	<b>618</b>	580
Fees for financially related services	<b>4</b>	15	<b>119</b>	16
Patronage refunds from other Farm Credit institutions	<b>791</b>	767	<b>1,547</b>	1,528
Gains (losses) on sales of premises and equipment, net	—	2	—	2
Gains (losses) on other transactions	—	16	<b>5</b>	39
Insurance Fund refund	—	—	<b>277</b>	—
Other noninterest income	<b>8</b>	—	<b>8</b>	—
Total noninterest income	<b>1,019</b>	994	<b>2,574</b>	2,165
<b>Noninterest Expense</b>				
Salaries and employee benefits	<b>1,530</b>	1,628	<b>3,078</b>	3,240
Occupancy and equipment	<b>119</b>	104	<b>229</b>	211
Insurance Fund premiums	<b>76</b>	119	<b>146</b>	231
(Gains) losses on other property owned, net	<b>(30)</b>	23	<b>(39)</b>	39
Other operating expenses	<b>494</b>	449	<b>1,156</b>	1,031
Total noninterest expense	<b>2,189</b>	2,323	<b>4,570</b>	4,752
Income before income taxes	<b>1,746</b>	1,334	<b>3,354</b>	2,607
Provision for income taxes	—	—	—	—
Net income	<b>\$ 1,746</b>	\$ 1,334	<b>\$ 3,354</b>	\$ 2,607

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

ArborOne, ACA

# Consolidated Statements of Comprehensive Income

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended June 30,		For the six months ended June 30,	
	2018	2017	2018	2017
Net income	\$ 1,746	\$ 1,334	\$ 3,354	\$ 2,607
<b>Other comprehensive income net of tax</b>				
Unrealized gains (losses) on investments	(7)	(74)	(13)	(47)
Employee benefit plans adjustments	3	2	5	4
Other comprehensive income (Note 5)	(4)	(72)	(8)	(43)
Comprehensive income	\$ 1,742	\$ 1,262	\$ 3,346	\$ 2,564

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

ArborOne, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2016	\$ 62	\$ 1,351	\$ 54,690	\$ 28,196	\$ 219	\$ 84,518
Comprehensive income				2,607	(43)	2,564
Capital stock/participation certificates issued/(retired), net		18				18
Patronage distribution adjustment			278	(398)		(120)
Balance at June 30, 2017	\$ 62	\$ 1,369	\$ 54,968	\$ 30,405	\$ 176	\$ 86,980
<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>3,354</b>	<b>(8)</b>	<b>3,346</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>62</b>				<b>62</b>
<b>Patronage distribution adjustment</b>			<b>69</b>	<b>(98)</b>		<b>(29)</b>
Balance at June 30, 2018	\$ 52	\$ 1,475	\$ 57,493	\$ 31,123	\$ 117	\$ 90,260

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

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## ArborOne, ACA

# Notes to the Consolidated Financial Statements

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

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

#### Organization

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

#### Basis of Presentation

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

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

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

#### Significant Accounting Policies

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

Management has made significant estimates in several areas, including loans and allowance for loan losses (Note 2, *Loans and Allowance for Loan Losses*), investment securities and other-than-temporary impairment (Note 3, *Investments*), and

financial instruments (Note 6, *Fair Value Measurement*). Actual results could differ from those estimates.

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

#### Accounting Standards Updates (ASUs) Issued During the Period

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

- In February 2018, the FASB issued ASU 2018-03 Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this Update include items brought to the Board's attention by stakeholders. The amendments clarify certain aspects of the guidance issued in Update 2016-01 as described below. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted Update 2016-01.
- In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted.

### *ASUs Pending Effective Date*

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

Potential effects of ASUs issued in previous periods:

- In March 2017, the FASB issued ASU 2017-08 Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update will be effective for interim and annual periods beginning after December 15, 2018 for public business entities. Early adoption is permitted. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This Update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Early adoption is permitted. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

### *Accounting Standards Effective During the Period*

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

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

- In March 2017, the FASB issued ASU 2017-07 Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost related to the income statement presentation of the components of net periodic benefit cost for an entity's sponsored defined benefit pension and other postretirement plans. The amendments were effective January 1, 2018 for the Association. Adoption in 2018 did not have a material effect on the Association's financial statements, but did require reclassification of service costs to Other Operating Expenses.
- In February 2017, the FASB issued ASU 2017-05 Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The Update clarifies whether certain transactions are within the scope of the guidance on derecognition and the accounting for partial sales of nonfinancial assets, and defines the term in substance nonfinancial asset. The amendments conform the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. The amendments were effective January 1, 2018 for the Association. Adoption in 2018 had no impact on the statements of financial condition and results of operations of the Association.
- In January 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also support more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The ASU was effective January 1, 2018 for the Association. The amendments were applied prospectively. Adoption of the guidance in 2018 had no impact on the statements of financial condition and results of operations.
- In January 2016, the FASB issued ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The Update was intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP.

### Transition Information

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

### Transition Information

- The Association identified ancillary revenues affected by this Update and adopted the guidance on January 1, 2018.

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

### **Note 2 — Loans and Allowance for Loan Losses**

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

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

A summary of loans outstanding at period end follows:

	<b>June 30, 2018</b>	<b>December 31, 2017</b>
Real estate mortgage	\$ 236,375	\$ 230,206
Production and intermediate-term	221,225	201,131
Loans to cooperatives	726	739
Processing and marketing	19,679	17,028
Farm-related business	8,632	4,455
Power and water/waste disposal	1,788	1,842
Rural residential real estate	3,669	3,548
International	856	856
Lease receivables	78	89
Total loans	<u>\$ 493,028</u>	<u>\$ 459,894</u>

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

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

June 30, 2018									
Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total			
Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 8,415	\$ 10,699	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,415	\$ 10,699
Production and intermediate-term	18,038	5,184	-	-	-	-	-	18,038	5,184
Loans to cooperatives	153	-	-	-	-	-	-	153	-
Processing and marketing	10,090	21,196	-	-	-	-	-	10,090	21,196
Farm-related business	2,340	-	-	-	-	-	-	2,340	-
Power and water/waste disposal	1,797	-	-	-	-	-	-	1,797	-
International	857	-	-	-	-	-	-	857	-
Total	\$ 41,690	\$ 37,079	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 41,690	\$ 37,079

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	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

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:

June 30, 2018				
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 3,728	\$ 29,673	\$ 202,974	\$ 236,375
Production and intermediate-term	107,019	78,555	35,651	221,225
Loans to cooperatives	200	152	374	726
Processing and marketing	1,069	14,592	4,018	19,679
Farm-related business	5,115	3,224	293	8,632
Power and water/waste disposal	-	-	1,788	1,788
Rural residential real estate	17	261	3,391	3,669
International	-	686	170	856
Lease receivables	78	-	-	78
Total loans	\$ 117,226	\$ 127,143	\$ 248,659	\$ 493,028
Percentage	23.78%	25.79%	50.43%	100.00%

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

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

	June 30, 2018	December 31, 2017		June 30, 2018	December 31, 2017
<b>Real estate mortgage:</b>			<b>Power and water/waste disposal:</b>		
Acceptable	91.97%	91.17%	Acceptable	100.00%	100.00%
OAEM	4.87	5.26	OAEM	—	—
Substandard/doubtful/loss	3.16	3.57	Substandard/doubtful/loss	—	—
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>			<b>Rural residential real estate:</b>		
Acceptable	87.60%	81.71%	Acceptable	96.20%	95.98%
OAEM	5.60	10.32	OAEM	3.80	4.02
Substandard/doubtful/loss	6.80	7.97	Substandard/doubtful/loss	—	—
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Loans to cooperatives:</b>			<b>International:</b>		
Acceptable	100.00%	100.00%	Acceptable	100.00%	100.00%
OAEM	—	—	OAEM	—	—
Substandard/doubtful/loss	—	—	Substandard/doubtful/loss	—	—
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Processing and marketing:</b>			<b>Lease receivables:</b>		
Acceptable	100.00%	100.00%	Acceptable	100.00%	100.00%
OAEM	—	—	OAEM	—	—
Substandard/doubtful/loss	—	—	Substandard/doubtful/loss	—	—
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Farm-related business:</b>			<b>Total loans:</b>		
Acceptable	100.00%	100.00%	Acceptable	90.55%	87.54%
OAEM	—	—	OAEM	4.88	7.18
Substandard/doubtful/loss	—	—	Substandard/doubtful/loss	4.57	5.28
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>

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

	June 30, 2018						Recorded Investment 90 Days or More Past Due and Accruing Interest
	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	\$ 547	\$ 2,548	\$ 3,095	\$ 236,499	\$ 239,594	\$ —	—
Production and intermediate-term	864	4,800	5,664	218,831	224,495	—	—
Loans to cooperatives	—	—	—	728	728	—	—
Processing and marketing	—	—	—	19,875	19,875	—	—
Farm-related business	—	—	—	8,678	8,678	—	—
Power and water/waste disposal	—	—	—	1,789	1,789	—	—
Rural residential real estate	109	—	109	3,576	3,685	—	—
International	—	—	—	858	858	—	—
Lease receivables	—	—	—	79	79	—	—
Total	\$ 1,520	\$ 7,348	\$ 8,868	\$ 490,913	\$ 499,781	\$ —	—

	December 31, 2017						Recorded Investment 90 Days or More Past Due and Accruing Interest
	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	\$ —	—



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

	June 30, 2018	December 31, 2017
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 5,427	\$ 3,564
Production and intermediate-term	15,257	7,063
Total	<u>\$ 20,684</u>	<u>\$ 10,627</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	\$ 6,993	\$ 7,092
Production and intermediate-term	211	1,548
Lease receivables	79	90
Total	<u>\$ 7,283</u>	<u>\$ 8,730</u>
<b>Accruing loans 90 days or more past due:</b>		
Total	<u>\$ —</u>	<u>\$ —</u>
Total nonperforming loans	\$ 27,967	\$ 19,357
Other property owned	708	783
Total nonperforming assets	<u>\$ 28,675</u>	<u>\$ 20,140</u>
Nonaccrual loans as a percentage of total loans	4.20%	2.31%
Nonperforming assets as a percentage of total loans and other property owned	5.81%	4.37%
Nonperforming assets as a percentage of capital	<u>31.77%</u>	<u>23.18%</u>

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

	June 30, 2018	December 31, 2017
<b>Impaired nonaccrual loans:</b>		
Current as to principal and interest	\$ 12,658	\$ 3,049
Past due	8,026	7,578
Total	<u>\$ 20,684</u>	<u>\$ 10,627</u>
<b>Impaired accrual loans:</b>		
Restructured	\$ 7,283	\$ 8,730
90 days or more past due	—	—
Total	<u>\$ 7,283</u>	<u>\$ 8,730</u>
Total impaired loans	<u>\$ 27,967</u>	<u>\$ 19,357</u>
Additional commitments to lend	<u>\$ 528</u>	<u>\$ 8</u>

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

Impaired loans:	June 30, 2018			Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>With a related allowance for credit losses:</b>							
Real estate mortgage	\$ 4,088	\$ 4,150	\$ 309	\$ 4,008	\$ 17	\$ 3,426	\$ 36
Production and intermediate-term	8,764	8,682	2,753	8,594	38	7,347	77
Lease receivables	79	78	47	77	—	66	1
Total	<u>\$ 12,931</u>	<u>\$ 12,910</u>	<u>\$ 3,109</u>	<u>\$ 12,679</u>	<u>\$ 55</u>	<u>\$ 10,839</u>	<u>\$ 114</u>
<b>With no related allowance for credit losses:</b>							
Real estate mortgage	\$ 8,332	\$ 9,814	\$ —	\$ 8,170	\$ 36	\$ 6,984	\$ 73
Production and intermediate-term	6,704	7,499	—	6,574	29	5,620	59
Rural residential real estate	—	21	—	—	—	—	—
Total	<u>\$ 15,036</u>	<u>\$ 17,334</u>	<u>\$ —</u>	<u>\$ 14,744</u>	<u>\$ 65</u>	<u>\$ 12,604</u>	<u>\$ 132</u>
<b>Total:</b>							
Real estate mortgage	\$ 12,420	\$ 13,964	\$ 309	\$ 12,178	\$ 53	\$ 10,410	\$ 109
Production and intermediate-term	15,468	16,181	2,753	15,168	67	12,967	136
Rural residential real estate	—	21	—	—	—	—	—
Lease receivables	79	78	47	77	—	66	1
Total	<u>\$ 27,967</u>	<u>\$ 30,244</u>	<u>\$ 3,109</u>	<u>\$ 27,423</u>	<u>\$ 120</u>	<u>\$ 23,443</u>	<u>\$ 246</u>

Impaired loans:	December 31, 2017			Year Ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<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

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

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	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 March 31, 2018	\$ 2,991	\$ 7,875	\$ 380	\$ 14	\$ 21	\$ 9	\$ 82	\$ 11,372
Charge-offs	–	–	–	–	–	–	–	–
Recoveries	–	13	–	–	–	–	–	13
Provision for loan losses	(265)	353	92	(1)	2	–	(35)	146
Balance at June 30, 2018	\$ 2,726	\$ 8,241	\$ 472	\$ 13	\$ 23	\$ 9	\$ 47	\$ 11,531
Balance at December 31, 2017	\$ 2,879	\$ 7,432	\$ 377	\$ 14	\$ 22	\$ 9	\$ 111	\$ 10,844
Charge-offs	–	(32)	–	–	–	–	–	(32)
Recoveries	–	66	–	–	–	–	–	66
Provision for loan losses	(153)	775	95	(1)	1	–	(64)	653
Balance at June 30, 2018	\$ 2,726	\$ 8,241	\$ 472	\$ 13	\$ 23	\$ 9	\$ 47	\$ 11,531
Balance at March 31, 2017	\$ 1,772	\$ 6,852	\$ 273	\$ 8	\$ 18	\$ 7	\$ 112	\$ 9,042
Charge-offs	–	(162)	–	–	–	–	–	(162)
Recoveries	–	5	1	–	–	–	–	6
Provision for loan losses	138	99	29	–	1	–	–	267
Balance at June 30, 2017	\$ 1,910	\$ 6,794	\$ 303	\$ 8	\$ 19	\$ 7	\$ 112	\$ 9,153
Balance at December 31, 2016	\$ 1,823	\$ 6,410	\$ 297	\$ 8	\$ 18	\$ 7	\$ 113	\$ 8,676
Charge-offs	–	(176)	–	–	–	–	–	(176)
Recoveries	33	8	1	–	–	–	–	42
Provision for loan losses	54	552	5	–	1	–	(1)	611
Balance at June 30, 2017	\$ 1,910	\$ 6,794	\$ 303	\$ 8	\$ 19	\$ 7	\$ 112	\$ 9,153
<b>Allowance on loans evaluated for impairment:</b>								
Individually	\$ 309	\$ 2,753	\$ –	\$ –	\$ –	\$ –	\$ 47	\$ 3,109
Collectively	2,417	5,488	472	13	23	9	–	8,422
Balance at June 30, 2018	\$ 2,726	\$ 8,241	\$ 472	\$ 13	\$ 23	\$ 9	\$ 47	\$ 11,531
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
<b>Recorded investment in loans evaluated for impairment:</b>								
Individually	\$ 12,420	\$ 15,468	\$ –	\$ –	\$ –	\$ –	\$ 79	\$ 27,967
Collectively	227,174	209,027	29,281	1,789	3,685	858	–	471,814
Balance at June 30, 2018	\$ 239,594	\$ 224,495	\$ 29,281	\$ 1,789	\$ 3,685	\$ 858	\$ 79	\$ 499,781
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

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

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented. There were no new TDRs that occurred during the three months ended June 30, 2017.

Outstanding Recorded Investment	Three Months Ended June 30, 2018				Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total	
<b>Pre-modification:</b>					
Production and intermediate-term	\$ —	\$ 2,196	\$ —	\$ 2,196	
Total	\$ —	\$ 2,196	\$ —	\$ 2,196	
<b>Post-modification:</b>					
Production and intermediate-term	\$ —	\$ 2,198	\$ —	\$ 2,198	\$ —
Total	\$ —	\$ 2,198	\$ —	\$ 2,198	\$ —

Outstanding Recorded Investment	Six Months Ended June 30, 2018				Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total	
<b>Pre-modification:</b>					
Production and intermediate-term	\$ —	\$ 2,288	\$ —	\$ 2,288	
Total	\$ —	\$ 2,288	\$ —	\$ 2,288	
<b>Post-modification:</b>					
Production and intermediate-term	\$ —	\$ 2,290	\$ —	\$ 2,290	\$ —
Total	\$ —	\$ 2,290	\$ —	\$ 2,290	\$ —

Outstanding Recorded Investment	Six Months Ended June 30, 2017				Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total	
<b>Pre-modification:</b>					
Production and intermediate-term	\$ —	\$ 168	\$ —	\$ 168	
Total	\$ —	\$ 168	\$ —	\$ 168	
<b>Post-modification:</b>					
Production and intermediate-term	\$ —	\$ 168	\$ —	\$ 168	\$ —
Total	\$ —	\$ 168	\$ —	\$ 168	\$ —

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>Defaulted troubled debt restructurings:</b>				
Production and intermediate-term	\$ 597	\$ —	\$ 655	\$ —
Total	\$ 597	\$ —	\$ 655	\$ —

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	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Real estate mortgage	\$ 6,993	\$ 7,092	\$ —	\$ —
Production and intermediate-term	4,148	3,345	3,937	1,797
Lease receivables	79	90	—	—
Total loans	\$ 11,220	\$ 10,527	\$ 3,937	\$ 1,797
Additional commitments to lend	\$ —	\$ —		

The following table presents information as of period end:

	June 30, 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 3 — Investments

#### Investments in Debt Securities

The Association's investments consist primarily of Rural America Bonds (RABs), which are private placement securities purchased under the Mission Related Investment program approved by the FCA. In its Conditions of Approval for the program, the FCA 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. As of June 30, 2018, the Association held two RABs whose credit quality had deteriorated beyond the program limits. A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

	June 30, 2018				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
RABs (a)	\$ 14,170	\$ 187	\$ (108)	\$ 14,249	5.93%

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

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

	June 30, 2018		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 865	\$ 866	5.75%
After one year through five years	—	—	—
After five years through ten years	—	—	—
After ten years	13,305	13,383	5.94
Total	\$ 14,170	\$ 14,249	5.93%

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

An investment is considered impaired if its fair value is less than its cost. The following tables show the fair value and gross unrealized losses for investments that were in a continuous

unrealized loss position aggregated by investment category at each reporting period. A continuous unrealized loss position for an investment is measured from the date the impairment was first identified.

	June 30, 2018			
	Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
RABs	\$ 11,532	\$ (81)	\$ 441	\$ (27)

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

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

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

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

Significant inputs used to estimate the amount of credit loss include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan-to-collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings. The Association may obtain assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party, or generate the assumptions internally.

Based on the results of all analyses, the Association has recognized no credit-related other-than-temporary impairment

related to investment securities in the Statements of Income for the six months ended June 30, 2018 or 2017 and there was no accretion to interest income of previously recognized credit impairment for the six months ended June 30, 2018 or 2017. 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, any 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>Amount related to credit loss-beginning balance</b>	\$ 2,024	\$ 2,024	\$ 2,024	\$ 2,024
Additions for initial credit impairments	—	—	—	—
Additions for subsequent credit impairments	—	—	—	—
Reductions for increases in expected cash flows	—	—	—	—
Reductions for securities sold, settled, or matured	—	—	—	—
<b>Amount related to credit loss-ending balance</b>	\$ 2,024	\$ 2,024	\$ 2,024	\$ 2,024
Life to date incurred credit losses	—	—	—	—
<b>Remaining unrealized credit losses</b>	\$ 2,024	\$ 2,024	\$ 2,024	\$ 2,024

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

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

Associations are required to maintain ownership in AgFirst (AgFirst or the Bank) in the form of Class B or Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association owned 2.07 percent of the issued stock of the Bank as of June 30, 2018 net of any reciprocal investment. As of that date, the Bank's assets totaled \$32.0 billion and shareholders' equity totaled \$2.3 billion. The Bank's earnings were \$152 million for the first six months of 2018. In addition, the Association held investments of \$410 related to other Farm Credit institutions.

#### **Note 4 — Debt**

##### **Notes Payable to AgFirst Farm Credit Bank**

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

## Note 5 — Members' Equity

### Accumulated Other Comprehensive Income (AOCI)

	Changes in Accumulated Other Comprehensive Income by Component (a)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>Unrealized gains (losses) on Investments</b>				
Balance at beginning of period	\$ 386	\$ 480	\$ 392	\$ 453
Other comprehensive income before reclassifications	—	—	—	—
Amounts reclassified from AOCI	(7)	(74)	(13)	(47)
Net current period other comprehensive income	(7)	(74)	(13)	(47)
Balance at end of period	\$ 379	\$ 406	\$ 379	\$ 406
<b>Employee Benefit Plans:</b>				
Balance at beginning of period	\$ (265)	\$ (232)	\$ (267)	\$ (234)
Other comprehensive income before reclassifications	—	—	—	—
Amounts reclassified from AOCI	3	2	5	4
Net current period other comprehensive income	3	2	5	4
Balance at end of period	\$ (262)	\$ (230)	\$ (262)	\$ (230)
<b>Accumulated Other Comprehensive Income</b>				
Balance at beginning of period	\$ 121	\$ 248	\$ 125	\$ 219
Other comprehensive income before reclassifications	—	—	—	—
Amounts reclassified from AOCI	(4)	(72)	(8)	(43)
Net current period other comprehensive income	(4)	(72)	(8)	(43)
Balance at end of period	\$ 117	\$ 176	\$ 117	\$ 176

	Reclassifications Out of Accumulated Other Comprehensive Income (b)				Income Statement Line Item
	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	2017	2018	2017	
<b>Investment Securities:</b>					
Sales gains & losses	\$ —	\$ —	\$ —	\$ —	Gains (losses) on investments, net
Holding gains & losses	—	—	—	—	Net other-than-temporary impairment
Amortization	7	74	13	47	Interest income on investments
Net amounts reclassified	7	74	13	47	
<b>Defined Benefit Pension Plans:</b>					
Periodic pension costs	(3)	(2)	(5)	(4)	See Note 7.
Net amounts reclassified	(3)	(2)	(5)	(4)	
Total reclassifications for period	\$ 4	\$ 72	\$ 8	\$ 43	

(a) Amounts in parentheses indicate debits to AOCI.

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

## Note 6 — Fair Value Measurement

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

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

The classifications within the fair value hierarchy are as follows:

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

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

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

For a complete discussion of the inputs and other assumptions considered in assigning various assets and liabilities to the fair

value hierarchy levels, see the latest Annual Report to Shareholders.

There were no Level 3 assets 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.

		June 30, 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	\$	745	\$ 745	\$ –	\$ –	\$ 745
Recurring Assets	\$	745	\$ 745	\$ –	\$ –	\$ 745
<b>Liabilities:</b>						
Recurring Liabilities	\$	–	\$ –	\$ –	\$ –	\$ –
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$	9,822	\$ –	\$ –	\$ 9,822	\$ 9,822
Other property owned		708	–	–	756	756
Nonrecurring Assets	\$	10,530	\$ –	\$ –	\$ 10,578	\$ 10,578
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$	2	\$ 2	\$ –	\$ –	\$ 2
Investments in debt securities, held-to-maturity		14,170	–	–	14,249	14,249
Loans		471,675	–	–	461,823	461,823
Other Financial Assets	\$	485,847	\$ 2	\$ –	\$ 476,072	\$ 476,074
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$	417,504	\$ –	\$ –	\$ 397,181	\$ 397,181
Other Financial Liabilities	\$	417,504	\$ –	\$ –	\$ 397,181	\$ 397,181
		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

## 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	\$ 10,578	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement cost	*
			Comparability adjustments	*

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

#### Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying Value	Par/Principal and appropriate interest yield
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 7 — Employee Benefit Plans

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Pension	\$ 272	\$ 345	\$ 540	\$ 690
401(k)	65	61	142	133
Other postretirement benefits	50	65	98	131
Total	\$ 387	\$ 471	\$ 780	\$ 954

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

	Actual YTD Through 6/30/18	Projected Contributions For Remainder of 2018	Projected Total Contributions 2018
	Pension	\$ 26	\$ 1,071
Other postretirement benefits	98	87	185
Total	\$ 124	\$ 1,158	\$ 1,282

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

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

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

## Note 8 — Commitments and Contingent Liabilities

From time to time, legal actions are pending against the Association in which claims for 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.

## Note 9 — Revenue from Contracts with Customers

On January 1, 2018, Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606) became effective. The core principle of the new standard is that companies should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

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

<i>(dollars in thousands)</i>	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Revenue recognized from contracts with customers:		
At a point in time	\$ 4	\$ 119
Over time	—	—
Total	\$ 4	\$ 119

## Note 10 — Subsequent Events

The Association evaluated subsequent events and determined there were none requiring disclosure through August 8, 2018, which was the date the financial statements were issued.