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ArborOne, ACA

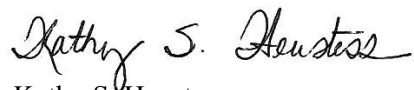
**THIRD QUARTER 2016**

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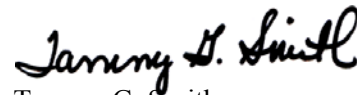
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**CERTIFICATION**

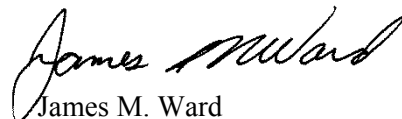
The undersigned certify that we have reviewed the September 30, 2016 quarterly report of **ArborOne, ACA**, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information 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



James M. Ward  
Chairman of the Board

November 8, 2016

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ArborOne, ACA

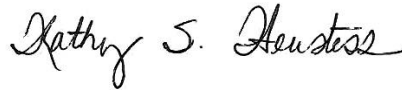
## Report on Internal Control Over Financial Reporting

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 September 30, 2016. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of September 30, 2016, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association's management determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2016.



Kathy S. Heustess  
President and Chief Executive Officer



Tammy G. Smith  
Chief Financial Officer

November 8, 2016

# 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 September 30, 2016. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2015 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, tobacco, forestry, 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-three 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 nineteen percent of the assets carry federal guarantees as a risk management tool.

The gross loan volume of the Association as of September 30, 2016, was \$432,201, an increase of \$48,774 as compared to \$383,427 at December 31, 2015. Net loans outstanding at September 30, 2016, were \$424,245 as compared to \$376,048 at December 31, 2015. The Association had investment securities classified as held-to-maturity in the amount of \$21,959 at September 30, 2016 compared to \$22,171 at December 31, 2015. Net loans and investments accounted for 94.49 percent of total assets at September 30, 2016, as compared to 92.79 percent of total assets at December 31, 2015.

Net loans increased by \$48,197 during the reporting period. This increase was mainly due to an increase in originated loan volume of \$54,632.

The increase in originated loan volume is attributed to seasonal draws and the terming out of operating lines, as well as continued growth, including a couple of large real estate loans.

This increase was partially offset by a decrease in participations purchased loan volume of \$2,369, an increase in participations sold volume of \$5,568, and an increase in allowance for loan loss of \$577. The decrease in participations purchases loan volume is due to several payoffs, which were partially offset by three new participations purchased loans. The increase in participations sold loan volume was the result of several new participated core loans, which was partially offset by the reduction in the Association's sold participations to the Bank through the capitalized participation pools (CPP) program. This decrease in the CPP loan volume was mainly due to loan repayments and refinances in the normal course of business. As of September 30, 2016, the Association had \$37,552 of such participations outstanding, a decrease of \$12,491 when compared to December 31, 2015. The increase in the allowance was due to an increase in originated loan volume and a decline in credit quality during the first nine months of 2016.

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) as a net unrealized gain as discussed in Note 4, *Investments*, of the Association's 2015 Annual Report.

The HTM investment securities decreased by \$212 when compared to December 31, 2015. This decrease was mainly due to normal payments in the amount of \$556 and the amortization of the net unrealized gain from the transfer to HTM in the amount of \$29. These decreases were offset by the partial accretion to interest income of the credit impairment on the substandard investment security in the amount of \$373.

As of September 30, 2016, 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 September 30, 2016, 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, 2015 totaled \$2,534. No additional credit impairments were taken during the first nine months of 2016;

however, a partial accretion to interest income of the credit impairment on the remaining substandard investment security was recognized in the amount of \$373, reducing the total credit impairment to \$2,161 as of September 30, 2016.

Other investments consisted of only a Rural Business Investment Company (RBIC) known as Meritus Ventures, L.P. (Meritus). In 2011, the Association made a final capital call for a total investment of \$250 in Meritus. During 2013, 2014, and 2015, as a result of evaluations on this RBIC, the Association recognized credit impairment losses totaling \$250.

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 \$9,469 at December 31, 2015, to \$11,713 at September 30, 2016. This was mainly due to the transfer of several core agricultural loans to nonaccrual status in the amount of \$4,718. This increase was partially offset by the repayments on the nonaccrual loans in the amount of \$2,046, the transfer of two core agricultural loans from nonaccrual status into accruing status of \$160, charge offs totaling \$201, and the transfer of one core agricultural loan from nonaccrual status to Other Property Owned of \$129.

As of September 30, 2016, the Association has three properties classed as Other Property Owned (OPO) totaling \$1,433, a decrease of \$120 as compared to \$1,553 at December 31, 2015. The decrease was due to the sale of one core account and the final sales on two investment security accounts totaling \$118, writedowns of \$81, as well as the application of cash proceeds from two participation accounts in the amount of \$50. This decrease was offset by the transfer of one core nonaccrual loan to OPO in the amount of \$129. 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 September 30, 2016, was \$7,956, compared to \$7,379 at December 31, 2015. The \$7,956 allowance for loan losses consisted of \$7,280 in general reserves and \$676 in specific reserves for five core agricultural loans and one Rural America Bond. The charge-offs for the nine months ended September 30, 2016 were \$201 mainly on several nonaccrual core agricultural loans. There were recoveries of \$112 for the nine months ended September 30, 2016 attributed to both core agricultural and participation loans. The allowance for loan losses for the period ending September 30, 2016 is considered by management to be adequate to cover any future possible losses.

Extensive flooding and high winds in South Carolina due to a hurricane in early October is not expected to have a material impact on the Association's financial condition or results of operations at this time. The impact is still being assessed; however, crop insurance and guarantees mitigate potential borrower losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2016***

Net income for the three months ended September 30, 2016, totaled \$1,724, a decrease of \$784, as compared to \$2,508 for the same period in 2015. This decrease was mainly due to a decrease in noninterest income of \$714 and an increase in provision of \$242, which were partially offset by an increase in net interest income of \$225.

Interest income on accruing loans increased by \$647 for the three months ended September 30, 2016 compared to \$4,392 for the three months ended September 30, 2015, as a result of an increase in originated loan volume. Nonaccrual interest income remained comparable to the same period in 2015. Interest income on investment securities was \$444 compared to \$474 for the same period in 2015. The decrease in investment interest income is due to the reduction in volume as a result of payments in the normal course of business, which was partially offset by the accretion of a portion of the credit impairment on the substandard security.

Interest expense increased \$392 for the three months ended September 30, 2016, as compared to the comparable period of 2015. The interest expense increase was primarily due to the increase in originated loan volume and was partially offset by the reduction in the HTM investment securities.

The Association recorded a provision for loan losses of \$403 as compared to \$161 for the comparable period of 2015. The increase in provision was due to a 2015 decrease in the general reserve resulting from the payoff on one large participation purchased loan as well as continued loan growth in 2016.

Noninterest income for the three months ended September 30, 2016, totaled \$1,515 as compared to \$2,229 for the same period of 2015, a decrease of \$714. This decrease was mainly due to a decrease in loan fees of \$207 and a decrease in fees for financially related services of \$450. The decrease in loan fees was mainly due to a timing difference of fee income received on an investment security in 2016 when compared to the same period in 2015. The decrease in fees for financially related services of \$450 was due to a timing delay from the insurance agencies.

Noninterest expense for the three months ended September 30, 2016, increased \$57 compared to the same period of 2015.

This increase was mainly due to an increase in insurance funds premiums of \$53 as a result of rate increases and increased loan volume during 2016.

The Association recorded no provision for income taxes for the three months ended September 30, 2016, as compared to a provision of \$4 for the same period in 2015.

#### ***For the nine months ended September 30, 2016***

Net income for the nine months ended September 30, 2016, totaled 5,551, as compared to \$5,439 for the same period in 2015. The increase was mainly due to an increase in net interest income of \$783 and a decrease in the provision of \$387, which was partially offset by a decrease in noninterest income of \$791 and an increase in noninterest expense of \$274.

Interest income on loans increased by \$1,615 primarily due to increased loan volume. Interest income on investment securities increased by \$13 primarily due to the partial accretion to interest income of the credit impairment.

Interest expense increased by \$845 compared to the same period of 2015, primarily due to the increase in loan volume, partially offset by the decrease in the HTM investment securities, and the decrease in association prepayment penalties as a result of paying off the note for the Association's administration building during the first quarter of 2015.

The Association recorded a provision for loan losses of \$666 for the nine months ended September 30, 2016, as compared to a provision for loan losses of \$1,053 for the same period in 2015. The decrease is mainly due to additional charge offs on core loan volume in 2015 and a large increase in general reserves resulting from the increase in volume during the first nine months of 2015. Even though loan volume continued to increase in 2016, the unused reserves from the flood and drought at the end of 2015 were able to offset the additional provisions from loan volume. See the 2015 Annual Report for further information.

Noninterest income for the nine months ended September 30, 2016, totaled \$4,796 as compared to \$5,587 for the same period of 2015, a decrease of \$791. The decrease is mainly due to a decrease in fees for financially related services of \$468 as a result of a timing delay from the insurance agencies. In addition, there was also a decrease in patronage refunds from other Farm Credit institutions of \$373, which was primarily from the declining CPP loan volume. Declining CPP loan volume reduces noninterest income; however, it increases the interest income on originated loan volume.

Noninterest expense for the nine months ended September 30, 2016, increased \$274 compared to the same period of 2015. This increase is due to an increase in insurance fund premiums of \$116 resulting from rate increases during 2016 and

increased loan volume; and an increase in losses on other property owned of \$219, which was mainly due to a 2015 charge off recovery in the amount of \$286 on a large core account.

The Association did not record a provision for income taxes for the nine months ended September 30, 2016 as compared to a provision for income taxes of \$7 during the same period in 2015.

#### **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 September 30, 2016, was \$378,999 as compared to \$335,894 at December 31, 2015. The increase during the period is a result of overall increases in loan volume.

#### **CAPITAL RESOURCES**

Total members' equity increased by \$5,602 from \$80,620 at December 31, 2015 to \$86,222 at September 30, 2016, primarily due to an increase in retained earnings.

Total capital stock and participation certificates were \$1,405 on September 30, 2016, compared to \$1,352 on December 31, 2015. This increase is 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 loss of \$219 as of September 30, 2016, as compared to an unrealized loss of \$224 as of December 31, 2015 for FAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." The Association also has an unrealized net gain of \$893 as of September 30, 2016 as compared to an unrealized net gain of \$922 as of December 31, 2015 on the HTM investment securities. The resulting effect was a net loss of \$24 to Accumulated Other Comprehensive Income for the nine months ending September 30, 2016.

FCA regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2016, the Association's total surplus ratio and core surplus ratio were 18.90 percent and 18.28 percent, respectively, and the permanent capital ratio was 19.24 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

### 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 2015 Annual Report to Shareholders for recently issued accounting pronouncements.

### REGULATORY MATTERS

On March 10, 2016, the FCA adopted a final regulation to modify the regulatory capital requirements for System banks and associations. The stated objectives of the rule are as follows:

- To modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- To 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, but also to ensure that the rules recognize the cooperative structure and the organization of the System,
- To make System regulatory capital requirements more transparent, and
- To meet the requirements of section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The final rule will replace existing core surplus and total surplus requirements with Common Equity Tier 1, Tier 1 and Total Capital risk-based capital ratio requirements. The final rule will also replace the existing net collateral ratio with a Tier 1 Leverage ratio and is applicable to all banks and associations. The Permanent Capital Ratio will remain in effect with the final rule. The following sets forth the new regulatory capital ratios:

| Ratio                               | Primary Components of Numerator   | Denominator          | Minimum Requirement | Minimum Requirement with Conservation Buffer |
|-------------------------------------|---|----------------------|---------------------|--|
| Common Equity Tier 1 (CET1) Capital | Unallocated retained earnings/surplus (URE), Common Stock (subject to certain conditions)         | Risk-weighted assets | 4.5%                | 7.0%   |
| Tier 1 Capital                      | CET1 Capital, Non-cumulative perpetual preferred stock  | Risk-weighted assets | 6.0%                | 8.5%   |
| Total Capital                       | Tier 1 Capital, Allowance for Loan Losses, other equity securities not included in Tier 1 Capital | Risk-weighted assets | 8.0%                | 10.5%  |
| Tier 1 Leverage                     | Tier 1 Capital (1.5% must be URE or URE equivalents)  | Total assets         | 4.0%                | 5.0%   |

On July 28, 2016, the FCA published the final regulation in the Federal Register, and the effective date of the new capital requirements will be January 1, 2017, with a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. District institutions are expected to be in compliance with the new requirements at adoption.

On November 30, 2015, the FCA, along with four other federal agencies, published in the Federal Register a final rule to establish capital and margin requirements for covered swap entities as required by the Dodd-Frank Act. See below for further information regarding the Dodd-Frank Act. This rule is not expected to have a material impact for District institutions.

On July 25, 2014, the FCA published a proposed rule in the Federal Register to revise the requirements governing the eligibility of investments for System banks and associations. The public comment period ended on October 23, 2014. The FCA expects to issue a final regulation in 2016. The proposed investment regulations are expected to have a minimal impact

for District institutions. The stated objectives of the proposed rule are as follows:

- To strengthen the safety and soundness of System banks and associations,
- To ensure that System banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption,
- To enhance the ability of the System banks to supply credit to agricultural and aquatic producers,
- To comply with the requirements of section 939A of the Dodd-Frank Act,
- To modernize the investment eligibility criteria for System banks, and
- To revise the investment regulation for System associations to improve their investment management practices so they are more resilient to risk.

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## FINANCIAL REGULATORY REFORM

See discussion of the Dodd-Frank Act in the Financial Regulatory Reform section of the Association's 2015 Annual Report.

**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. 2832, or writing Susanne Caughman, 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>  | September 30,<br>2016<br><i>(unaudited)</i> | December 31,<br>2015<br><i>(audited)</i> |
|--|---|--|
| <b>Assets</b>  |   |  |
| Cash   | \$ 2  | \$ 2                                     |
| Investment securities:   |   |  |
| Held to maturity (fair value of \$24,367 and \$22,466, respectively) | 21,959                                      | 22,171                                   |
| Loans  | 432,201                                     | 383,427                                  |
| Allowance for loan losses  | (7,956)                                     | (7,379)                                  |
| Net loans  | 424,245                                     | 376,048                                  |
| Accrued interest receivable  | 6,686                                       | 5,313                                    |
| Investments in other Farm Credit institutions                        | 8,287                                       | 9,316                                    |
| Premises and equipment, net  | 3,954                                       | 3,972                                    |
| Other property owned   | 1,433                                       | 1,553                                    |
| Accounts receivable  | 3,258                                       | 7,428                                    |
| Other assets   | 2,414                                       | 3,367                                    |
| Total assets   | <b>\$ 472,238</b>                           | <b>\$ 429,170</b>                        |
| <b>Liabilities</b>   |   |  |
| Notes payable to AgFirst Farm Credit Bank                            | \$ 378,999                                  | \$ 335,894                               |
| Accrued interest payable   | 814   | 714                                      |
| Patronage refunds payable  | 712   | 2,345                                    |
| Accounts payable   | 507   | 466                                      |
| Other liabilities  | 4,984                                       | 9,131                                    |
| Total liabilities  | <b>386,016</b>                              | <b>348,550</b>                           |
| Commitments and contingencies (Note 8)                               |   |  |
| <b>Members' Equity</b>   |   |  |
| Protected borrower stock   | 62  | 62                                       |
| Capital stock and participation certificates                         | 1,343                                       | 1,290                                    |
| Retained earnings  |   |  |
| Allocated  | 52,531                                      | 52,625                                   |
| Unallocated  | 31,612                                      | 25,945                                   |
| Accumulated other comprehensive income                               | 674   | 698                                      |
| Total members' equity  | <b>86,222</b>                               | <b>80,620</b>                            |
| Total liabilities and members' equity                                | <b>\$ 472,238</b>                           | <b>\$ 429,170</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<br>ended September 30, |          | For the nine months<br>ended September 30, |           |
|---|---|----------|--|-----------|
|   | 2016  | 2015     | 2016                                       | 2015      |
| <b>Interest Income</b>                                    |   |          |  |           |
| Loans   | \$ 5,048                                    | \$ 4,401 | \$ 14,111                                  | \$ 12,496 |
| Investments   | 444   | 474      | 1,331                                      | 1,318     |
| Total interest income                                     | <b>5,492</b>                                | 4,875    | <b>15,442</b>                              | 13,814    |
| <b>Interest Expense</b>                                   |   |          |  |           |
| Notes payable to AgFirst Farm Credit Bank                 | <b>2,474</b>                                | 2,082    | <b>6,849</b>                               | 6,004     |
| Net interest income                                       | <b>3,018</b>                                | 2,793    | <b>8,593</b>                               | 7,810     |
| Provision for loan losses                                 | <b>403</b>                                  | 161      | <b>666</b>                                 | 1,053     |
| Net interest income after provision for loan losses       | <b>2,615</b>                                | 2,632    | <b>7,927</b>                               | 6,757     |
| <b>Noninterest Income</b>                                 |   |          |  |           |
| Loan fees   | <b>274</b>                                  | 481      | <b>1,333</b>                               | 1,334     |
| Fees for financially related services                     | <b>123</b>                                  | 573      | <b>156</b>                                 | 624       |
| Patronage refunds from other Farm Credit institutions     | <b>1,098</b>                                | 1,152    | <b>3,242</b>                               | 3,615     |
| Gains (losses) on sales of premises and equipment, net    | —   | 47       | <b>32</b>                                  | 61        |
| Gains (losses) on other transactions                      | <b>19</b>                                   | (26)     | <b>30</b>                                  | (13)      |
| Net other-than-temporary impairment losses on investments | —   | —        | —  | (40)      |
| Other noninterest income                                  | <b>1</b>                                    | 2        | <b>3</b>                                   | 6         |
| Total noninterest income                                  | <b>1,515</b>                                | 2,229    | <b>4,796</b>                               | 5,587     |
| <b>Noninterest Expense</b>                                |   |          |  |           |
| Salaries and employee benefits                            | <b>1,583</b>                                | 1,571    | <b>4,760</b>                               | 4,801     |
| Occupancy and equipment                                   | <b>115</b>                                  | 115      | <b>318</b>                                 | 313       |
| Insurance Fund premiums                                   | <b>137</b>                                  | 84       | <b>349</b>                                 | 233       |
| (Gains) losses on other property owned, net               | <b>42</b>                                   | 38       | <b>123</b>                                 | (96)      |
| Other operating expenses                                  | <b>529</b>                                  | 541      | <b>1,622</b>                               | 1,647     |
| Total noninterest expense                                 | <b>2,406</b>                                | 2,349    | <b>7,172</b>                               | 6,898     |
| Income before income taxes                                | <b>1,724</b>                                | 2,512    | <b>5,551</b>                               | 5,446     |
| Provision for income taxes                                | —   | 4        | —  | 7         |
| Net income  | <b>\$ 1,724</b>                             | \$ 2,508 | <b>\$ 5,551</b>                            | \$ 5,439  |

*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<br>ended September 30, |          | For the nine months<br>ended September 30, |          |
|--|---|----------|--|----------|
|  | 2016  | 2015     | 2016                                       | 2015     |
| Net income                                   | \$ 1,724                                    | \$ 2,508 | \$ 5,551                                   | \$ 5,439 |
| <b>Other comprehensive income net of tax</b> |   |          |  |          |
| Unrealized gains (losses) on investments:    |   |          |  |          |
| Other-than-temporarily impaired              | 2   | 2        | 5  | 5        |
| Not other-than-temporarily impaired          | (12)  | (280)    | (34)                                       | (313)    |
| Employee benefit plans adjustments           | 2   | 2        | 5  | 6        |
| Other comprehensive income (Note 5)          | (8)   | (276)    | (24)                                       | (302)    |
| Comprehensive income                         | \$ 1,716                                    | \$ 2,232 | \$ 5,527                                   | \$ 5,137 |

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

ArborOne, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

| <i>(dollars in thousands)</i>   | Protected<br>Borrower<br>Stock | Capital<br>Stock and<br>Participation<br>Certificates | Retained Earnings |                  | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Members'<br>Equity |
|---|--------------------------------|---|-------------------|------------------|---|-----------------------------|
|   |                                |   | Allocated         | Unallocated      |   |                             |
| Balance at December 31, 2014  | \$ 78                          | \$ 1,229  | \$ 51,516         | \$ 24,578        | \$ 985  | \$ 78,386                   |
| Comprehensive income (loss)   |                                |   |                   | 5,439            | (302)   | 5,137                       |
| Protected borrower stock issued/(retired), net                            | (14)                           |   |                   |                  |   | (14)                        |
| Capital stock/participation<br>certificates issued/(retired), net         |                                | 50  |                   |                  |   | 50                          |
| Patronage distribution adjustment   |                                |   | 1,144             | (780)            |   | 364                         |
| <b>Balance at September 30, 2015</b>                                      | <b>\$ 64</b>                   | <b>\$ 1,279</b>                                       | <b>\$ 52,660</b>  | <b>\$ 29,237</b> | <b>\$ 683</b>                                   | <b>\$ 83,923</b>            |
| Balance at December 31, 2015  | \$ 62                          | \$ 1,290  | \$ 52,625         | \$ 25,945        | \$ 698  | \$ 80,620                   |
| <b>Comprehensive income (loss)</b>  |                                |   |                   | <b>5,551</b>     | <b>(24)</b>                                     | <b>5,527</b>                |
| <b>Capital stock/participation<br/>certificates issued/(retired), net</b> |                                | <b>53</b>   |                   |                  |   | <b>53</b>                   |
| <b>Retained earnings retired</b>  |                                |   | <b>(12)</b>       |                  |   | <b>(12)</b>                 |
| <b>Patronage distribution adjustment</b>                                  |                                |   | <b>(82)</b>       | <b>116</b>       |   | <b>34</b>                   |
| <b>Balance at September 30, 2016</b>                                      | <b>\$ 62</b>                   | <b>\$ 1,343</b>                                       | <b>\$ 52,531</b>  | <b>\$ 31,612</b> | <b>\$ 674</b>                                   | <b>\$ 86,222</b>            |

*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, 2015, are contained in the 2015 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 Annual Report:

- In August, 2016, the FASB issued ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). Stakeholders had indicated there was diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The Update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments are to be applied using a retrospective transition method to each period presented.
- In June, 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The Update improves 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. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant

estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The Update will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. 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. For all other organizations, the ASU will take effect for fiscal years beginning after December 15, 2020, and for interim periods within fiscal years beginning after December 15, 2021. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

- In May, 2016, the FASB issued ASU 2016-12 Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The guidance addresses certain issues identified by the Transition Resource Group (TRG) in the guidance on assessing collectibility, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09).
- In April, 2016, the FASB issued ASU 2016-10 Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. The Update clarifies the following two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09).
- In March, 2016, the FASB issued ASU 2016-08 Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). The amendments clarify the implementation guidance on principal versus agent considerations. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09).
- In March, 2016, the FASB issued ASU 2016-07 Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method

of Accounting. To simplify the accounting for equity method investments, the amendments in the Update eliminate the requirement that an entity retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership or degree of influence. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Earlier application is permitted. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method.

#### ***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:

- 2016-02 Leases (Topic 842): In February, 2016, the FASB issued an update that requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- 2016-01 Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities: In January, 2016, the FASB issued an update that is intended to improve the recognition and measurement of financial instruments. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- 2015-14 Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date: In August, 2015, the FASB issued an update that defers by one year the effective date of ASU 2014-09, Revenue from Contracts with Customers. The new ASU reflects decisions reached by the FASB at its meeting on July 9, 2015. 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:

- 2015-07 Fair Value Measurement (Topic 820): Disclosure for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) – The amendment was adopted prospectively. There were no changes to the Association’s statements of financial condition or results of operations as a result of this guidance. See Note 6, *Fair Value Measurement*, for the disclosures required by this guidance.
- 2015-01 Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items – The amendment was adopted retrospectively. There were no changes to the Association’s statements of financial condition or results of operations as a result of this guidance.
- 2014-15 Income Statement – Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern: This amendment is effective for the annual reporting period ended

December 31, 2016 and interim and annual periods thereafter. It may require additional disclosures but will not have a material impact on the Association’s financial condition or results of operations.

## Note 2 — Loans and Allowance for Loan Losses

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

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

A summary of loans outstanding at period end follows:

|                                  | September 30, 2016 | December 31, 2015 |
|----------------------------------|--------------------|-------------------|
| Real estate mortgage             | \$ 206,958         | \$ 187,971        |
| Production and intermediate-term | 191,174            | 162,608           |
| Loans to cooperatives            | 2,469              | 436               |
| Processing and marketing         | 18,423             | 21,591            |
| Farm-related business            | 5,543              | 3,929             |
| Energy and water/waste disposal  | 2,333              | 2,391             |
| Rural residential real estate    | 4,330              | 4,371             |
| International                    | 856                | –                 |
| Lease receivables                | 115                | 130               |
| Total Loans                      | <u>\$ 432,201</u>  | <u>\$ 383,427</u> |

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

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

|                                  | September 30, 2016          |                        |                             |                        |                             |                        |                             |                        |
|----------------------------------|-----------------------------|------------------------|-----------------------------|------------------------|-----------------------------|------------------------|-----------------------------|------------------------|
|                                  | Within AgFirst District     |                        | Within Farm Credit System   |                        | Outside Farm Credit System  |                        | Total                       |                        |
|                                  | Participations<br>Purchased | Participations<br>Sold | Participations<br>Purchased | Participations<br>Sold | Participations<br>Purchased | Participations<br>Sold | Participations<br>Purchased | Participations<br>Sold |
| Real estate mortgage             | \$ 5,620                    | \$ 44,667              | \$ –                        | \$ –                   | \$ –                        | \$ –                   | \$ 5,620                    | \$ 44,667              |
| Production and intermediate-term | 19,863                      | 11,873                 | –                           | –                      | –                           | –                      | 19,863                      | 11,873                 |
| Loans to cooperatives            | 2,050                       | –                      | –                           | –                      | –                           | –                      | 2,050                       | –                      |
| Processing and marketing         | 10,215                      | 10,814                 | –                           | –                      | –                           | –                      | 10,215                      | 10,814                 |
| Farm-related business            | 3,028                       | 76                     | –                           | –                      | –                           | –                      | 3,028                       | 76                     |
| Energy and water/waste disposal  | 1,588                       | –                      | –                           | –                      | –                           | –                      | 1,588                       | –                      |
| Rural residential real estate    | –                           | –                      | –                           | –                      | 1,831                       | –                      | 1,831                       | –                      |
| International                    | 857                         | –                      | –                           | –                      | –                           | –                      | 857                         | –                      |
| Total                            | <u>\$ 43,221</u>            | <u>\$ 67,430</u>       | <u>\$ –</u>                 | <u>\$ –</u>            | <u>\$ 1,831</u>             | <u>\$ –</u>            | <u>\$ 45,052</u>            | <u>\$ 67,430</u>       |

December 31, 2015

|                                  | 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             | \$ 5,805                 | \$ 44,839           | \$ -                      | \$ -                | \$ -                       | \$ -                | \$ 5,805                 | \$ 44,839           |
| Production and intermediate-term | 21,613                   | 15,357              | -                         | -                   | -                          | -                   | 21,613                   | 15,357              |
| Processing and marketing         | 14,836                   | 1,529               | -                         | -                   | -                          | -                   | 14,836                   | 1,529               |
| Farm-related business            | 2,689                    | 83                  | -                         | -                   | -                          | -                   | 2,689                    | 83                  |
| Energy and water/waste disposal  | 1,647                    | -                   | -                         | -                   | -                          | -                   | 1,647                    | -                   |
| Rural residential real estate    | -                        | -                   | -                         | -                   | 2,102                      | -                   | 2,102                    | -                   |
| Total                            | \$ 46,590                | \$ 61,808           | \$ -                      | \$ -                | \$ 2,102                   | \$ -                | \$ 48,692                | \$ 61,808           |

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

|                                  | September 30, 2016   |                       |                   |            |
|----------------------------------|----------------------|-----------------------|-------------------|------------|
|                                  | Due less than 1 year | Due 1 Through 5 years | Due after 5 years | Total      |
| Real estate mortgage             | \$ 9,250             | \$ 28,493             | \$ 169,215        | \$ 206,958 |
| Production and intermediate-term | 83,918               | 68,042                | 39,214            | 191,174    |
| Loans to cooperatives            | -                    | 177                   | 2,292             | 2,469      |
| Processing and marketing         | -                    | 10,637                | 7,786             | 18,423     |
| Farm-related business            | 3,278                | 598                   | 1,667             | 5,543      |
| Energy and water/waste disposal  | 753                  | 1,580                 | -                 | 2,333      |
| Rural residential real estate    | 15                   | 151                   | 4,164             | 4,330      |
| International                    | -                    | -                     | 856               | 856        |
| Lease receivables                | -                    | 115                   | -                 | 115        |
| Total Loans                      | \$ 97,214            | \$ 109,793            | \$ 225,194        | \$ 432,201 |
| Percentage                       | 22.49%               | 25.40%                | 52.11%            | 100.00%    |

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

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

|  | September 30, 2016 | December 31, 2015 |   | September 30, 2016 | December 31, 2015 |
|--|--------------------|-------------------|---|--------------------|-------------------|
| <b>Real estate mortgage:</b>             |                    |                   | <b>Energy and water/waste disposal:</b> |                    |                   |
| Acceptable                               | 91.17%             | 92.65%            | Acceptable                              | 67.55%             | 68.49%            |
| OAEM                                     | 4.18               | 2.70              | OAEM                                    | -                  | -                 |
| Substandard/doubtful/loss                | 4.65               | 4.65              | Substandard/doubtful/loss               | 32.45              | 31.51             |
|  | 100.00%            | 100.00%           |   | 100.00%            | 100.00%           |
| <b>Production and intermediate-term:</b> |                    |                   | <b>Rural residential real estate:</b>   |                    |                   |
| Acceptable                               | 88.44%             | 93.09%            | Acceptable                              | 99.16%             | 98.07%            |
| OAEM                                     | 9.60               | 4.91              | OAEM                                    | -                  | -                 |
| Substandard/doubtful/loss                | 1.96               | 2.00              | Substandard/doubtful/loss               | 0.84               | 1.93              |
|  | 100.00%            | 100.00%           |   | 100.00%            | 100.00%           |
| <b>Loans to cooperatives:</b>            |                    |                   | <b>International:</b>                   |                    |                   |
| Acceptable                               | 100.00%            | 100.00%           | Acceptable                              | 100.00%            | -%                |
| OAEM                                     | -                  | -                 | OAEM                                    | -                  | -                 |
| Substandard/doubtful/loss                | -                  | -                 | Substandard/doubtful/loss               | -                  | -                 |
|  | 100.00%            | 100.00%           |   | 100.00%            | -%                |
| <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               | -                  | -                 |
|  | 100.00%            | 100.00%           |   | 100.00%            | 100.00%           |
| <b>Farm-related business:</b>            |                    |                   | <b>Total Loans:</b>                     |                    |                   |
| Acceptable                               | 97.22%             | 100.00%           | Acceptable                              | 90.44%             | 93.24%            |
| OAEM                                     | 2.78               | -                 | OAEM                                    | 6.29               | 3.41              |
| Substandard/doubtful/loss                | -                  | -                 | Substandard/doubtful/loss               | 3.27               | 3.35              |
|  | 100.00%            | 100.00%           |   | 100.00%            | 100.00%           |

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

| September 30, 2016               |                                   |                             |                   |  |             |  |
|----------------------------------|-----------------------------------|-----------------------------|-------------------|--|-------------|--|
|                                  | 30 Through<br>89 Days Past<br>Due | 90 Days or More<br>Past Due | Total Past<br>Due | Not Past Due or<br>Less Than 30<br>Days Past Due | Total Loans | Recorded<br>Investment 90 Days<br>or More Past Due<br>and Accruing<br>Interest |
| Real estate mortgage             | \$ 476                            | \$ 3,969                    | \$ 4,445          | \$ 205,295                                       | \$ 209,740  | \$ -   |
| Production and intermediate-term | 81                                | 3,633                       | 3,714             | 190,611  | 194,325     | -  |
| Loans to cooperatives            | -                                 | -                           | -                 | 2,492  | 2,492       | -  |
| Processing and marketing         | -                                 | -                           | -                 | 18,633   | 18,633      | -  |
| Farm-related business            | -                                 | -                           | -                 | 5,588  | 5,588       | -  |
| Energy and water/waste disposal  | -                                 | -                           | -                 | 2,340  | 2,340       | -  |
| Rural residential real estate    | -                                 | -                           | -                 | 4,366  | 4,366       | -  |
| International                    | -                                 | -                           | -                 | 857  | 857         | -  |
| Lease receivables                | -                                 | -                           | -                 | 116  | 116         | -  |
| Total                            | \$ 557                            | \$ 7,602                    | \$ 8,159          | \$ 430,298                                       | \$ 438,457  | \$ -   |

| December 31, 2015                |                                   |                             |                   |  |             |  |
|----------------------------------|-----------------------------------|-----------------------------|-------------------|--|-------------|--|
|                                  | 30 Through<br>89 Days Past<br>Due | 90 Days or More<br>Past Due | Total Past<br>Due | Not Past Due or<br>Less Than 30<br>Days Past Due | Total Loans | Recorded<br>Investment 90 Days<br>or More Past Due<br>and Accruing<br>Interest |
| Real estate mortgage             | \$ 2,013                          | \$ 3,187                    | \$ 5,200          | \$ 185,223                                       | \$ 190,423  | \$ -   |
| Production and intermediate-term | 132                               | 2,103                       | 2,235             | 162,866  | 165,101     | -  |
| Loans to cooperatives            | -                                 | -                           | -                 | 436  | 436         | -  |
| Processing and marketing         | -                                 | -                           | -                 | 21,701   | 21,701      | -  |
| Farm-related business            | -                                 | -                           | -                 | 3,953  | 3,953       | -  |
| Energy and water/waste disposal  | -                                 | -                           | -                 | 2,390  | 2,390       | -  |
| Rural residential real estate    | -                                 | -                           | -                 | 4,405  | 4,405       | -  |
| Lease receivables                | -                                 | -                           | -                 | 131  | 131         | -  |
| Total                            | \$ 2,145                          | \$ 5,290                    | \$ 7,435          | \$ 381,105                                       | \$ 388,540  | \$ -   |

Nonperforming assets (including the recorded investment for loans) and related credit quality statistics at period end were as follows:

|   | September 30, 2016 | December 31, 2015 |
|---|--------------------|-------------------|
| <b>Nonaccrual loans:</b>  |                    |                   |
| Real estate mortgage  | \$ 6,794           | \$ 6,003          |
| Production and intermediate-term  | 4,919              | 3,420             |
| Rural residential real estate   | -                  | 46                |
| Total   | \$ 11,713          | \$ 9,469          |
| <b>Accruing restructured loans:</b>   |                    |                   |
| Real estate mortgage  | \$ 7,472           | \$ 6,612          |
| Production and intermediate-term  | 635                | 634               |
| Lease receivables   | 116                | 131               |
| Total   | \$ 8,223           | \$ 7,377          |
| <b>Accruing loans 90 days or more past due:</b>                                 |                    |                   |
| Total   | \$ -               | \$ -              |
| Total nonperforming loans   | \$ 19,936          | \$ 16,846         |
| Other property owned  | 1,433              | 1,553             |
| Total nonperforming assets  | \$ 21,369          | \$ 18,399         |
| Nonaccrual loans as a percentage of total loans                                 | 2.71%              | 2.47%             |
| Nonperforming assets as a percentage of total loans<br>and other property owned | 4.93%              | 4.78%             |
| Nonperforming assets as a percentage of capital                                 | 24.78%             | 22.82%            |



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

|                                      | September 30, 2016 | December 31, 2015 |
|--------------------------------------|--------------------|-------------------|
| <b>Impaired nonaccrual loans:</b>    |                    |                   |
| Current as to principal and interest | \$ 3,762           | \$ 3,206          |
| Past due                             | 7,951              | 6,263             |
| Total                                | <u>11,713</u>      | <u>9,469</u>      |
| <b>Impaired accrual loans:</b>       |                    |                   |
| Restructured                         | 8,223              | 7,377             |
| 90 days or more past due             | -                  | -                 |
| Total                                | <u>8,223</u>       | <u>7,377</u>      |
| Total impaired loans                 | <u>\$ 19,936</u>   | <u>\$ 16,846</u>  |
| Additional commitments to lend       | <u>\$ -</u>        | <u>\$ 7</u>       |

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

|   | September 30, 2016     |                                |                      | Quarter Ended<br>September 30, 2016 |  | Nine Months Ended<br>September 30, 2016 |  |
|---|------------------------|--------------------------------|----------------------|-------------------------------------|--|---|--|
|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Impaired<br>Loans        | Interest Income<br>Recognized on<br>Impaired Loans | Average<br>Impaired<br>Loans            | Interest Income<br>Recognized on<br>Impaired Loans |
| <b>Impaired loans:</b>                              |                        |                                |                      |                                     |  |   |  |
| <b>With a related allowance for credit losses:</b>  |                        |                                |                      |                                     |  |   |  |
| Real estate mortgage                                | \$ 3,906               | \$ 3,860                       | \$ 417               | \$ 4,019                            | \$ 26  | \$ 3,673                                | \$ 95  |
| Production and intermediate-term                    | 2,981                  | 2,987                          | 146                  | 3,067                               | 20   | 2,802                                   | 72   |
| Lease receivables                                   | 116                    | 116                            | 113                  | 119                                 | 1  | 109                                     | 3  |
| Total   | <u>\$ 7,003</u>        | <u>\$ 6,963</u>                | <u>\$ 676</u>        | <u>\$ 7,205</u>                     | <u>\$ 47</u>                                       | <u>\$ 6,584</u>                         | <u>\$ 170</u>                                      |
| <b>With no related allowance for credit losses:</b> |                        |                                |                      |                                     |  |   |  |
| Real estate mortgage                                | \$ 10,360              | \$ 10,775                      | \$ -                 | \$ 10,660                           | \$ 69  | \$ 9,740                                | \$ 250   |
| Production and intermediate-term                    | 2,573                  | 3,816                          | -                    | 2,648                               | 17   | 2,420                                   | 63   |
| Rural residential real estate                       | -                      | 31                             | -                    | -                                   | -  | -                                       | -  |
| Total   | <u>\$ 12,933</u>       | <u>\$ 14,622</u>               | <u>\$ -</u>          | <u>\$ 13,308</u>                    | <u>\$ 86</u>                                       | <u>\$ 12,160</u>                        | <u>\$ 313</u>                                      |
| <b>Total:</b>                                       |                        |                                |                      |                                     |  |   |  |
| Real estate mortgage                                | \$ 14,266              | \$ 14,635                      | \$ 417               | \$ 14,679                           | \$ 95  | \$ 13,413                               | \$ 345   |
| Production and intermediate-term                    | 5,554                  | 6,803                          | 146                  | 5,715                               | 37   | 5,222                                   | 135  |
| Rural residential real estate                       | -                      | 31                             | -                    | -                                   | -  | -                                       | -  |
| Lease receivables                                   | 116                    | 116                            | 113                  | 119                                 | 1  | 109                                     | 3  |
| Total   | <u>\$ 19,936</u>       | <u>\$ 21,585</u>               | <u>\$ 676</u>        | <u>\$ 20,513</u>                    | <u>\$ 133</u>                                      | <u>\$ 18,744</u>                        | <u>\$ 483</u>                                      |

|   | December 31, 2015      |                                |                      | Year Ended<br>December 31, 2015 |  |
|---|------------------------|--------------------------------|----------------------|---------------------------------|--|
|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Impaired<br>Loans    | Interest Income<br>Recognized on<br>Impaired Loans |
| <b>Impaired loans:</b>                              |                        |                                |                      |                                 |  |
| <b>With a related allowance for credit losses:</b>  |                        |                                |                      |                                 |  |
| Real estate mortgage                                | \$ 4,240               | \$ 4,213                       | \$ 435               | \$ 3,719                        | \$ 138   |
| Production and intermediate-term                    | 1,707                  | 1,692                          | 143                  | 1,496                           | 56   |
| Lease receivables                                   | 131                    | 131                            | 117                  | 115                             | 4  |
| Total   | <u>\$ 6,078</u>        | <u>\$ 6,036</u>                | <u>\$ 695</u>        | <u>5,330</u>                    | <u>\$ 198</u>                                      |
| <b>With no related allowance for credit losses:</b> |                        |                                |                      |                                 |  |
| Real estate mortgage                                | \$ 8,375               | \$ 8,738                       | \$ -                 | \$ 7,342                        | \$ 273   |
| Production and intermediate-term                    | 2,347                  | 3,441                          | -                    | 2,059                           | 76   |
| Rural residential real estate                       | 46                     | 107                            | -                    | 40                              | 2  |
| Total   | <u>\$ 10,768</u>       | <u>\$ 12,286</u>               | <u>\$ -</u>          | <u>\$ 9,441</u>                 | <u>\$ 351</u>                                      |
| <b>Total:</b>                                       |                        |                                |                      |                                 |  |
| Real estate mortgage                                | \$ 12,615              | \$ 12,951                      | \$ 435               | \$ 11,061                       | \$ 411   |
| Production and intermediate-term                    | 4,054                  | 5,133                          | 143                  | 3,555                           | 132  |
| Rural residential real estate                       | 46                     | 107                            | -                    | 40                              | 2  |
| Lease receivables                                   | 131                    | 131                            | 117                  | 115                             | 4  |
| Total   | <u>\$ 16,846</u>       | <u>\$ 18,322</u>               | <u>\$ 695</u>        | <u>\$ 14,771</u>                | <u>\$ 549</u>                                      |

A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows. Prior to issuance of the Association's 2015 Annual Report, management identified errors in classification of the loan portfolio among the various FCA loan type categories that are used to report disaggregated loan information in footnote disclosures. As discussed in Note 3, *Loans and Allowance for Loan Losses*, of the Association's 2015 Annual Report, FCA loan type classifications prior to December 31, 2015 have been revised as necessary to reflect these loan type classifications, as adjusted. In the table below, activity for the quarter and nine months ended September 30, 2015 is presented as revised.

|   | Real Estate<br>Mortgage | Production and<br>Intermediate-<br>term | Agribusiness* | Energy and<br>Water/Waste<br>Disposal | Rural<br>Residential<br>Real Estate | International | Lease<br>Receivables | Total      |
|---|-------------------------|---|---------------|---------------------------------------|-------------------------------------|---------------|----------------------|------------|
| <b>Activity related to the allowance for credit losses:</b>   |                         |   |               |                                       |                                     |               |                      |            |
| Balance at June 30, 2016                                      | \$ 1,794                | \$ 5,070                                | \$ 334        | \$ 276                                | \$ 12                               | \$ 7          | \$ 114               | \$ 7,607   |
| Charge-offs   | –                       | (136)                                   | –             | –                                     | –                                   | –             | –                    | (136)      |
| Recoveries  | –                       | 82                                      | –             | –                                     | –                                   | –             | –                    | 82         |
| Provision for loan losses                                     | (136)                   | 566                                     | (24)          | (3)                                   | –                                   | 1             | (1)                  | 403        |
| Balance at September 30, 2016                                 | \$ 1,658                | \$ 5,582                                | \$ 310        | \$ 273                                | \$ 12                               | \$ 8          | \$ 113               | \$ 7,956   |
| Balance at December 31, 2015                                  | \$ 1,811                | \$ 4,872                                | \$ 293        | \$ 277                                | \$ 9                                | \$ –          | \$ 117               | \$ 7,379   |
| Charge-offs   | –                       | (201)                                   | –             | –                                     | –                                   | –             | –                    | (201)      |
| Recoveries  | 4                       | 108                                     | –             | –                                     | –                                   | –             | –                    | 112        |
| Provision for loan losses                                     | (157)                   | 803                                     | 17            | (4)                                   | 3                                   | 8             | (4)                  | 666        |
| Balance at September 30, 2016                                 | \$ 1,658                | \$ 5,582                                | \$ 310        | \$ 273                                | \$ 12                               | \$ 8          | \$ 113               | \$ 7,956   |
| Balance at June 30, 2015                                      | \$ 1,671                | \$ 2,650                                | \$ 673        | \$ 260                                | \$ 9                                | \$ –          | \$ 114               | \$ 5,377   |
| Charge-offs   | –                       | (7)                                     | –             | –                                     | –                                   | –             | –                    | (7)        |
| Recoveries  | 2                       | 14                                      | –             | –                                     | –                                   | –             | –                    | 16         |
| Provision for loan losses                                     | 94                      | 537                                     | (470)         | (1)                                   | 1                                   | –             | –                    | 161        |
| Balance at September 30, 2015                                 | \$ 1,767                | \$ 3,194                                | \$ 203        | \$ 259                                | \$ 10                               | \$ –          | \$ 114               | \$ 5,547   |
| Balance at December 31, 2014                                  | \$ 1,360                | \$ 2,314                                | \$ 809        | \$ 301                                | \$ 7                                | \$ –          | \$ 113               | \$ 4,904   |
| Charge-offs   | (269)                   | (187)                                   | –             | –                                     | –                                   | –             | –                    | (456)      |
| Recoveries  | 20                      | 26                                      | –             | –                                     | –                                   | –             | –                    | 46         |
| Provision for loan losses                                     | 656                     | 1,041                                   | (606)         | (42)                                  | 3                                   | –             | 1                    | 1,053      |
| Balance at September 30, 2015                                 | \$ 1,767                | \$ 3,194                                | \$ 203        | \$ 259                                | \$ 10                               | \$ –          | \$ 114               | \$ 5,547   |
| <b>Allowance on loans evaluated for impairment:</b>           |                         |   |               |                                       |                                     |               |                      |            |
| Individually  | \$ 417                  | \$ 146                                  | \$ –          | \$ –                                  | \$ –                                | \$ –          | \$ 113               | \$ 676     |
| Collectively  | 1,241                   | 5,436                                   | 310           | 273                                   | 12                                  | 8             | –                    | 7,280      |
| Balance at September 30, 2016                                 | \$ 1,658                | \$ 5,582                                | \$ 310        | \$ 273                                | \$ 12                               | \$ 8          | \$ 113               | \$ 7,956   |
| Individually  | \$ 435                  | \$ 143                                  | \$ –          | \$ –                                  | \$ –                                | \$ –          | \$ 117               | \$ 695     |
| Collectively  | 1,376                   | 4,729                                   | 293           | 277                                   | 9                                   | –             | –                    | 6,684      |
| Balance at December 31, 2015                                  | \$ 1,811                | \$ 4,872                                | \$ 293        | \$ 277                                | \$ 9                                | \$ –          | \$ 117               | \$ 7,379   |
| <b>Recorded investment in loans evaluated for impairment:</b> |                         |   |               |                                       |                                     |               |                      |            |
| Individually  | \$ 14,266               | \$ 5,554                                | \$ –          | \$ –                                  | \$ –                                | \$ –          | \$ 116               | \$ 19,936  |
| Collectively  | 195,474                 | 188,771                                 | 26,713        | 2,340                                 | 4,366                               | 857           | –                    | 418,521    |
| Balance at September 30, 2016                                 | \$ 209,740              | \$ 194,325                              | \$ 26,713     | \$ 2,340                              | \$ 4,366                            | \$ 857        | \$ 116               | \$ 438,457 |
| Individually  | \$ 12,615               | \$ 4,348                                | \$ –          | \$ –                                  | \$ 46                               | \$ –          | \$ 131               | \$ 17,140  |
| Collectively  | 177,808                 | 160,753                                 | 26,090        | 2,390                                 | 4,359                               | –             | –                    | 371,400    |
| Balance at December 31, 2015                                  | \$ 190,423              | \$ 165,101                              | \$ 26,090     | \$ 2,390                              | \$ 4,405                            | \$ –          | \$ 131               | \$ 388,540 |

\*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. In the tables below, activity for the quarter and nine months ended September 30, 2015 is presented as revised for FCA loan type reclassifications discussed above.

| Outstanding Recorded Investment | Three Months Ended September 30, 2016 |                          |                      |        | Charge-offs |
|---------------------------------|---------------------------------------|--------------------------|----------------------|--------|-------------|
|                                 | Interest<br>Concessions               | Principal<br>Concessions | Other<br>Concessions | Total  |             |
| <b>Pre-modification:</b>        |                                       |                          |                      |        |             |
| Real estate mortgage            | \$ –                                  | \$ –                     | \$ 252               | \$ 252 |             |
| Total                           | \$ –                                  | \$ –                     | \$ 252               | \$ 252 |             |
| <b>Post-modification:</b>       |                                       |                          |                      |        |             |
| Real estate mortgage            | \$ –                                  | \$ –                     | \$ 253               | \$ 253 | \$ –        |
| Total                           | \$ –                                  | \$ –                     | \$ 253               | \$ 253 | \$ –        |

| Nine Months Ended September 30, 2016 |                      |                       |                   |          |             |
|--------------------------------------|----------------------|-----------------------|-------------------|----------|-------------|
| Outstanding Recorded Investment      | Interest Concessions | Principal Concessions | Other Concessions | Total    | Charge-offs |
| <b>Pre-modification:</b>             |                      |                       |                   |          |             |
| Real estate mortgage                 | \$ -                 | \$ 697                | \$ 252            | \$ 949   |             |
| Production and intermediate-term     | -                    | 506                   | -                 | 506      |             |
| Total                                | \$ -                 | \$ 1,203              | \$ 252            | \$ 1,455 |             |
| <b>Post-modification:</b>            |                      |                       |                   |          |             |
| Real estate mortgage                 | \$ -                 | \$ 697                | \$ 253            | \$ 950   | \$ -        |
| Production and intermediate-term     | -                    | 520                   | -                 | 520      | -           |
| Total                                | \$ -                 | \$ 1,217              | \$ 253            | \$ 1,470 | \$ -        |

| Three Months Ended September 30, 2015 (as revised) |                      |                       |                   |        |             |
|--|----------------------|-----------------------|-------------------|--------|-------------|
| Outstanding Recorded Investment                    | Interest Concessions | Principal Concessions | Other Concessions | Total  | Charge-offs |
| <b>Pre-modification:</b>                           |                      |                       |                   |        |             |
| Production and intermediate-term                   | \$ -                 | \$ 105                | \$ -              | \$ 105 |             |
| Total  | \$ -                 | \$ 105                | \$ -              | \$ 105 |             |
| <b>Post-modification:</b>                          |                      |                       |                   |        |             |
| Production and intermediate-term                   | \$ -                 | \$ 105                | \$ -              | \$ 105 | \$ -        |
| Total  | \$ -                 | \$ 105                | \$ -              | \$ 105 | \$ -        |

| Nine Months Ended September 30, 2015 (as revised) |                      |                       |                   |          |             |
|---|----------------------|-----------------------|-------------------|----------|-------------|
| Outstanding Recorded Investment                   | Interest Concessions | Principal Concessions | Other Concessions | Total    | Charge-offs |
| <b>Pre-modification:</b>                          |                      |                       |                   |          |             |
| Real estate mortgage                              | \$ -                 | \$ 843                | \$ -              | \$ 843   |             |
| Production and intermediate-term                  | -                    | 947                   | -                 | 947      |             |
| Total   | \$ -                 | \$ 1,790              | \$ -              | \$ 1,790 |             |
| <b>Post-modification:</b>                         |                      |                       |                   |          |             |
| Real estate mortgage                              | \$ -                 | \$ 1,392              | \$ -              | \$ 1,392 | \$ -        |
| Production and intermediate-term                  | -                    | 961                   | -                 | 961      | (52)        |
| Total   | \$ -                 | \$ 2,353              | \$ -              | \$ 2,353 | \$ (52)     |

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.

There were no TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the periods presented. Payment default is defined as a payment that was thirty days or more past due.

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    |                   |
|----------------------------------|--------------------|-------------------|--------------------|-------------------|
|                                  | September 30, 2016 | December 31, 2015 | September 30, 2016 | December 31, 2015 |
| Real estate mortgage             | \$ 7,472           | \$ 6,612          | \$ -               | \$ -              |
| Production and intermediate-term | 1,649              | 2,249             | 1,014              | 1,615             |
| Lease receivables                | 116                | 131               | -                  | -                 |
| Total Loans                      | \$ 9,237           | \$ 8,992          | \$ 1,014           | \$ 1,615          |
| Additional commitments to lend   | \$ -               | \$ -              |                    |                   |

The following table presents information as of period end:

|   | September 30, 2016 | December 31, 2015 |
|---|--------------------|-------------------|
| 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

#### Investment 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 September 30, 2016, the Association held two ineligible RABs whose credit quality had deteriorated beyond the program limits. A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

| September 30, 2016 |                |                        |                         |            |       |
|--------------------|----------------|------------------------|-------------------------|------------|-------|
|                    | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| RABs (a)           | \$ 21,959      | \$ 2,479               | \$ (71)                 | \$ 24,367  | 6.10% |

| December 31, 2015 |                |                        |                         |            |       |
|-------------------|----------------|------------------------|-------------------------|------------|-------|
|                   | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| RABs (b)          | \$ 22,171      | \$ 569                 | \$ (274)                | \$ 22,466  | 6.09% |

- (a) Gross unrealized losses included non-credit related other-than-temporary impairment recognized in AOCI of \$96.  
 (b) Gross unrealized losses included non-credit related other-than-temporary impairment recognized in AOCI of \$101.

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

| September 30, 2016                 |                |            |                        |
|------------------------------------|----------------|------------|------------------------|
|                                    | Amortized Cost | Fair Value | Weighted Average Yield |
| In one year or less                | \$ —           | \$ —       | —%                     |
| After one year through five years  | 892            | 895        | 5.00                   |
| After five years through ten years | —              | —          | —                      |
| After ten years                    | 21,067         | 23,472     | 6.14                   |
| Total                              | \$ 21,959      | \$ 24,367  | 6.10%                  |

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

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

| September 30, 2016  |                   |                      |                   |
|---------------------|-------------------|----------------------|-------------------|
| Less than 12 Months |                   | 12 Months or Greater |                   |
| Fair Value          | Unrealized Losses | Fair Value           | Unrealized Losses |
| \$ —                | \$ —              | \$ 3,417             | \$ (71)           |

| December 31, 2015   |                   |                      |                   |
|---------------------|-------------------|----------------------|-------------------|
| Less than 12 Months |                   | 12 Months or Greater |                   |
| Fair Value          | Unrealized Losses | Fair Value           | Unrealized Losses |
| \$ 10,831           | \$ (237)          | \$ 348               | \$ (37)           |

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 nine months ended September 30, 2016 or 2015. Accretion to interest income of previously recognized credit impairment of \$373 was recognized for the nine months ended September 30, 2016 compared to \$102 for the nine months ended September 30, 2015. Since the Association does not intend to sell this other-than-temporarily impaired debt security 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.

|  | Three Months Ended September 30, |                 | Nine Months Ended September 30, |                 |
|--|----------------------------------|-----------------|---------------------------------|-----------------|
|  | 2016                             | 2015            | 2016                            | 2015            |
| <b>Amount related to credit loss-beginning balance</b> | \$ 2,286                         | \$ 2,757        | \$ 2,534                        | \$ 2,757        |
| Additions for initial credit impairments               | —                                | —               | —                               | —               |
| Additions for subsequent credit impairments            | —                                | —               | —                               | —               |
| Reductions for increases in expected cash flows        | (125)                            | (102)           | (373)                           | (102)           |
| Reductions for securities sold, settled, or matured    | —                                | —               | —                               | —               |
| <b>Amount related to credit loss-ending balance</b>    | <b>2,161</b>                     | <b>2,655</b>    | <b>2,161</b>                    | <b>2,655</b>    |
| Life to date incurred credit losses                    | —                                | —               | —                               | —               |
| <b>Remaining unrealized credit losses</b>              | <b>\$ 2,161</b>                  | <b>\$ 2,655</b> | <b>\$ 2,161</b>                 | <b>\$ 2,655</b> |

#### ***Investments in other Farm Credit Institutions***

The Association is required to maintain ownership in AgFirst Farm Credit Bank (AgFirst or the Bank) of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association owned 2.90 percent of the issued stock of the Bank as of September 30, 2016 net of any reciprocal investment. As of that date, the Bank's assets totaled \$32.7 billion and shareholders' equity totaled \$2.5 billion. The Bank's earnings were \$241 million for the first nine months of 2016. In addition, the Association held investments of \$834 related to other Farm Credit institutions.

#### ***Other Investments***

In 2006, the Association agreed to become one of several investors in a USDA approved Rural Business Investment Company (RBIC). This investment was made under the USDA's Rural Business Investment Program, which is authorized by the Farm Security and Rural Investment Act (FSRIA). It permits USDA to license RBICs and provide guarantees and grants to promote rural economic development and job opportunities and meet equity capital investment needs of small rural enterprises. FSRIA authorizes FCS institutions to establish and invest in RBICs, provided that such investments are not greater than 5 percent of the capital and surplus of the FCS institution.

Over the years, the Association purchased total equity investments in the RBIC of \$250. There are no outstanding commitments to make additional equity purchases beyond this amount. Beginning in 2013, analyses indicated that decreases in value of the investment had occurred that were other than temporary, due to a series of losses and other factors. As a result, the Association recognized other-than-temporary impairment of \$0 and \$40 for the nine months ended September 30, 2016 and 2015, respectively, which is included in Impairment Losses on Investments in the Statements of Income. As of both September 30, 2016 and December 31, 2015, RBIC investments had been written down to \$0.

#### **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 <sup>(a)</sup> |          |                                 |          |
|---|---|----------|---------------------------------|----------|
|   | Three Months Ended September 30,  |          | Nine Months Ended September 30, |          |
|   | 2016  | 2015     | 2016                            | 2015     |
| <b>Unrealized Gains (Losses) on Investments</b>     |   |          |                                 |          |
| Balance at beginning of period                      | \$ 903  | \$ 1,210 | \$ 922                          | \$ 1,240 |
| Other comprehensive income before reclassifications | —   | —        | —                               | —        |
| Amounts reclassified from AOCI                      | (10)  | (278)    | (29)                            | (308)    |
| Net current period other comprehensive income       | (10)  | (278)    | (29)                            | (308)    |
| Balance at end of period                            | \$ 893  | \$ 932   | \$ 893                          | \$ 932   |
| <b>Employee Benefit Plans:</b>                      |   |          |                                 |          |
| Balance at beginning of period                      | \$ (221)  | \$ (251) | \$ (224)                        | \$ (255) |
| Other comprehensive income before reclassifications | —   | —        | —                               | —        |
| Amounts reclassified from AOCI                      | 2   | 2        | 5                               | 6        |
| Net current period other comprehensive income       | 2   | 2        | 5                               | 6        |
| Balance at end of period                            | \$ (219)  | \$ (249) | \$ (219)                        | \$ (249) |
| <b>Accumulated Other Comprehensive Income</b>       |   |          |                                 |          |
| Balance at beginning of period                      | \$ 682  | \$ 959   | \$ 698                          | \$ 985   |
| Other comprehensive income before reclassifications | —   | —        | —                               | —        |
| Amounts reclassified from AOCI                      | (8)   | (276)    | (24)                            | (302)    |
| Net current period other comprehensive income       | (8)   | (276)    | (24)                            | (302)    |
| Balance at end of period                            | \$ 674  | \$ 683   | \$ 674                          | \$ 683   |

|                                       | Reclassifications Out of Accumulated Other Comprehensive Income <sup>(b)</sup> |        |                                 |        |                                     |
|---------------------------------------|--|--------|---------------------------------|--------|-------------------------------------|
|                                       | Three Months Ended September 30,   |        | Nine Months Ended September 30, |        | Income Statement Line Item          |
|                                       | 2016   | 2015   | 2016                            | 2015   |                                     |
| <b>Investment Securities:</b>         |  |        |                                 |        |                                     |
| Sales gains & losses                  | \$ —   | \$ —   | \$ —                            | \$ —   | Gains (losses) on investments, net  |
| Holding gains & losses                | —  | —      | —                               | —      | Net other-than-temporary impairment |
| Amortization                          | 10   | 278    | 29                              | 308    | Interest income on investments      |
| Net amounts reclassified              | 10   | 278    | 29                              | 308    |                                     |
| <b>Defined Benefit Pension Plans:</b> |  |        |                                 |        |                                     |
| Periodic pension costs                | (2)  | (2)    | (5)                             | (6)    | See Note 7.                         |
| Net amounts reclassified              | (2)  | (2)    | (5)                             | (6)    |                                     |
| Total reclassifications for period    | \$ 8   | \$ 276 | \$ 24                           | \$ 302 |                                     |

<sup>(a)</sup> Amounts in parentheses indicate debits to AOCI.

<sup>(b)</sup> 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.

Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

There were no Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. Fair values are estimated at least annually, or when information suggests a significant change in value, for assets measured at fair value on a nonrecurring 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.

| At or For the Nine Months Ended September 30, 2016 |            |         |         |                  |                                |          |
|--|------------|---------|---------|------------------|--------------------------------|----------|
| Total Carrying Amount                              | Level 1    | Level 2 | Level 3 | Total Fair Value | Fair Value Effects On Earnings |          |
| <b>Recurring Measurements</b>                      |            |         |         |                  |                                |          |
| <b>Assets:</b>                                     |            |         |         |                  |                                |          |
| Assets held in Trust funds                         | \$ 515     | \$ 515  | \$ –    | \$ –             | \$ 515                         |          |
| Recurring Assets                                   | \$ 515     | \$ 515  | \$ –    | \$ –             | \$ 515                         |          |
| <b>Liabilities:</b>                                |            |         |         |                  |                                |          |
| Recurring Liabilities                              | \$ –       | \$ –    | \$ –    | \$ –             | \$ –                           |          |
| <b>Nonrecurring Measurements</b>                   |            |         |         |                  |                                |          |
| <b>Assets:</b>                                     |            |         |         |                  |                                |          |
| Impaired loans                                     | \$ 19,260  | \$ –    | \$ –    | \$ 19,260        | \$ 19,260                      | \$ (72)  |
| Other property owned                               | 1,433      | –       | –       | 1,568            | 1,568                          | (81)     |
| Nonrecurring Assets                                | \$ 20,693  | \$ –    | \$ –    | \$ 20,828        | \$ 20,828                      | \$ (153) |
| <b>Other Financial Instruments</b>                 |            |         |         |                  |                                |          |
| <b>Assets:</b>                                     |            |         |         |                  |                                |          |
| Cash   | \$ 2       | \$ 2    | \$ –    | \$ –             | \$ 2                           |          |
| Investment securities, held-to-maturity            | 21,959     | –       | –       | 24,367           | 24,367                         |          |
| Loans  | 404,985    | –       | –       | 405,554          | 405,554                        |          |
| Other Financial Assets                             | \$ 426,946 | \$ 2    | \$ –    | \$ 429,921       | \$ 429,923                     |          |
| <b>Liabilities:</b>                                |            |         |         |                  |                                |          |
| Notes payable to AgFirst Farm Credit Bank          | \$ 378,999 | \$ –    | \$ –    | \$ 383,920       | \$ 383,920                     |          |
| Other Financial Liabilities                        | \$ 378,999 | \$ –    | \$ –    | \$ 383,920       | \$ 383,920                     |          |

| At or For the Year Ended December 31, 2015 |            |         |         |                  |                                |          |
|--|------------|---------|---------|------------------|--------------------------------|----------|
| Total Carrying Amount                      | Level 1    | Level 2 | Level 3 | Total Fair Value | Fair Value Effects On Earnings |          |
| <b>Recurring Measurements</b>              |            |         |         |                  |                                |          |
| <b>Assets:</b>                             |            |         |         |                  |                                |          |
| Assets held in Trust funds                 | \$ 506     | \$ 506  | \$ –    | \$ –             | \$ 506                         |          |
| Recurring Assets                           | \$ 506     | \$ 506  | \$ –    | \$ –             | \$ 506                         |          |
| <b>Liabilities:</b>                        |            |         |         |                  |                                |          |
| Recurring Liabilities                      | \$ –       | \$ –    | \$ –    | \$ –             | \$ –                           |          |
| <b>Nonrecurring Measurements</b>           |            |         |         |                  |                                |          |
| <b>Assets:</b>                             |            |         |         |                  |                                |          |
| Impaired loans                             | \$ 16,151  | \$ –    | \$ –    | \$ 16,151        | \$ 16,151                      | \$ (184) |
| Other property owned                       | 1,553      | –       | –       | 1,700            | 1,700                          | (77)     |
| Other investments                          | –          | –       | –       | –                | –                              | (40)     |
| Nonrecurring Assets                        | \$ 17,704  | \$ –    | \$ –    | \$ 17,851        | \$ 17,851                      | \$ (301) |
| <b>Other Financial Instruments</b>         |            |         |         |                  |                                |          |
| <b>Assets:</b>                             |            |         |         |                  |                                |          |
| Cash                                       | \$ 2       | \$ 2    | \$ –    | \$ –             | \$ 2                           |          |
| Investment securities, held-to-maturity    | 22,171     | –       | –       | 22,466           | 22,466                         |          |
| Loans                                      | 359,897    | –       | –       | 360,853          | 360,853                        |          |
| Other investments                          | –          | –       | –       | –                | –                              |          |
| Other Financial Assets                     | \$ 382,070 | \$ 2    | \$ –    | \$ 383,319       | \$ 383,321                     |          |
| <b>Liabilities:</b>                        |            |         |         |                  |                                |          |
| Notes payable to AgFirst Farm Credit Bank  | \$ 335,894 | \$ –    | \$ –    | \$ 336,063       | \$ 336,063                     |          |
| Other Financial Liabilities                | \$ 335,894 | \$ –    | \$ –    | \$ 336,063       | \$ 336,063                     |          |

## SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

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

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

## INVESTMENT SECURITIES

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

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

Generally, a change in the assumption used for defaults is accompanied by a directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite change in the assumption used for prepayments. Unobservable inputs for loss severities do not normally increase or decrease based on movements in the other significant unobservable inputs for these Level 3 assets.

### *Inputs to Valuation Techniques*

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

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

### Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

|   | Fair Value | Valuation Technique(s) | Unobservable Input        | Range          |
|---|------------|------------------------|---------------------------|----------------|
| Impaired loans and other property owned | \$ 20,828  | Appraisal              | Income and expense        | *              |
|   |            |                        | Comparable sales          | *              |
|   |            |                        | Replacement cost          | *              |
|   |            |                        | Comparability adjustments | *              |
| Other Investments-RBIC                  | \$ –       | Third party evaluation | Income, expense, capital  | Not applicable |

\* 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                                |
| Investment 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<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|-------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                               | 2016                                | 2015   | 2016                               | 2015     |
| Pension                       | \$ 350                              | \$ 344 | \$ 1,051                           | \$ 1,031 |
| 401(k)                        | 58                                  | 57     | 183                                | 171      |
| Other postretirement benefits | 62                                  | 79     | 185                                | 238      |
| Total                         | \$ 470                              | \$ 480 | \$ 1,419                           | \$ 1,440 |

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

|                               | Actual<br>YTD<br>Through<br>9/30/16 | Projected<br>Contributions<br>For Remainder<br>of 2016 | Projected<br>Total<br>Contributions<br>2016 |
|-------------------------------|-------------------------------------|--|---|
|                               | Pension                             | \$ 38  | \$ 751                                      |
| Other postretirement benefits | 141                                 | 49   | 190   |
| Total                         | \$ 179                              | \$ 800   | \$ 979                                      |

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, 2016.

Further details regarding employee benefit plans are contained in the 2015 Annual Report to Shareholders, including a discussion of benefit plan changes related to the termination of the AgFirst Farm Credit Cash Balance Retirement Plan.

## 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 — Subsequent Events

The Association evaluated subsequent events and determined that, except as described below, there were none requiring disclosure through November 8, 2016, which was the date the financial statements were issued.

Extensive flooding and high winds in South Carolina due to a hurricane in early October is not expected to have a material impact on the Association's financial condition or results of operations at this time. The impact is still being assessed; however, crop insurance and guarantees mitigate potential borrower losses.

On October 17, 2016, AgFirst's Board of Directors declared a special patronage distribution to be paid on January 1, 2017. The Association will receive approximately \$2,501 which will be recorded in October 2016 as patronage refunds from other Farm Credit institutions.