# ANNUAL REPORT

Farm Credit
SOUTHWEST GEORGIA

# Southwest Georgia Farm Credit, ACA
# 2017 ANNUAL REPORT

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## Management

Richard S. Monson ..... Chief Executive Officer
Richard H. Horn ..... Chief Credit Officer
Tarrell Bennett ..... Chief Lending Officer
Ryan G. Burtt ..... Chief Financial Officer
Paxton W. Poitevint ..... Chief Operating Officer
Liz Nogowski ..... Marketing and Administrative Officer

## Board of Directors

Kimberly D. Rentz ..... Chairman
James H. Dixon, Jr. ..... Vice Chairman
John M. Bridges, Jr. ..... Director
Jeffrey A. Clark ..... Director
Clifford Dollar, Jr. ..... Director
George T. Harrison, Jr. ..... Director
Robert L. Holden, Sr. ..... Director
Edward D. Milliron ..... Director

# President's Message
# From Richard S. Monson

Innovation is a tricky word. In one sense, it means the ability to think beyond one's own boundaries—to dream about ideas and concepts that far exceed what others have been able to dream about. It's about creativity. In another sense, innovation is purely about delivery. Is anything truly innovative if the idea isn't executed? Would Americans have landed on the moon if we hadn't dreamed…and found a way to get there? It's the *doing* part of achievement.

And that's exactly where we find ourselves today in the financial world—dreaming and daring to be different. When millennials expect service at their fingertips, when technology exists to offer services online that previously required a stack of paperwork, when you can pay your bill at a kiosk, or learn everything you wanted to know about growing blueberries from a blog—well, it's time we start to think like other industries—by that I mean, "think differently."

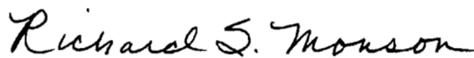
Dr. Albert Szent-Gyorgyi said that "innovation is seeing what everybody has seen and thinking what nobody has thought."

There are some things I see today that haven't changed about Farm Credit or our customers. For the most part, what we offer every day is a very personal experience. We know our customers well and we like to think we understand their needs. And we're pretty good at meeting their expectations.

But it's tomorrow that matters—how we find, acquire, and retain borrowers; how we develop financing programs for their unique circumstances; how we grow our business so as to attract the individual who may not understand that you can live, work, and play in rural America and have abundant opportunity.

The question is not can we achieve it? It's the "it" that matters. It's anticipating needs. It's understanding how a farmer works today, how they manage their time and how their access to financing must be faster, easier and common sense. It's knowing that people who want to own property and maintain a rural lifestyle, also want to get their loan online – in minutes. It's figuring out what we don't know.

This year was a very productive year for your association financially. We continue to maintain a strong competitive presence in the marketplace and our member dividend provides concrete value for our owners. We can never lose sight that value is in the mind of our customer—and our goal is to provide extraordinary value. What will continue to set us apart is how quickly we understand what the future will hold—how big we can dream and how quickly we make those dreams a reality.



Richard S. Monson
President and Chief Executive Officer

March 13 2018

# Report of Management

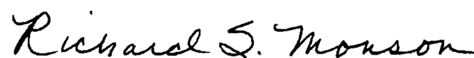
The accompanying Consolidated Financial Statements and related financial information appearing throughout this Annual Report have been prepared by management of Southwest Georgia Farm Credit, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts, which must be based on estimates, represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the Consolidated Financial Statements and financial information contained in this report.

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

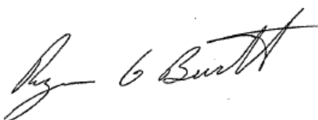
The Consolidated Financial Statements have been audited by Independent Auditors, whose report appears elsewhere in this Annual Report. The Association is also subject to examination by the Farm Credit Administration.

The Consolidated Financial Statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2017 Annual Report of Southwest Georgia Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Kimberly D. Rentz
Chairman of the Board



Richard S. Monson
President and Chief Executive Officer



Ryan G. Burtt
Chief Financial Officer

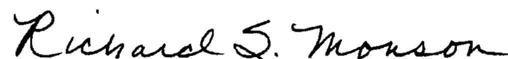
March 13 2018

# *Report on Internal Control Over Financial Reporting*

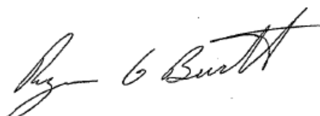
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2017. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of December 31, 2017, the internal control over financial reporting was effectively based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2017.



Richard S. Monson
President and Chief Executive Officer



Ryan Burtt
Chief Financial Officer

March 13 2018

# Consolidated Five - Year Summary of Selected Financial Data

| (dollars in thousands) | 2017 | 2016 | December 31, 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| **Balance Sheet Data** | | | | | |
| Cash | **$ 4,617** | $ 2,041 | $ 3,250 | $ 1,569 | $ 1,810 |
| Investment securities | **6,078** | 6,684 | 14,276 | 14,603 | 7,789 |
| Loans | **414,337** | 377,128 | 399,296 | 385,147 | 394,282 |
| Allowance for loan losses | **(4,057)** | (4,031) | (4,201) | (4,388) | (2,445) |
| Net loans | **410,280** | 373,097 | 395,095 | 380,759 | 391,837 |
| Investments in other Farm Credit institutions | **15,761** | 15,103 | 12,713 | 11,371 | 7,777 |
| Other property owned | **129** | 823 | 1,449 | 2,001 | 2,927 |
| Other assets | **20,696** | 20,005 | 19,414 | 20,170 | 33,701 |
| Total assets | **$ 457,561** | $ 417,753 | $ 446,197 | $ 430,473 | $ 445,841 |
| Notes payable to AgFirst Farm Credit Bank* | **$ 361,645** | $ 327,863 | $ 361,669 | $ 346,949 | $ 366,426 |
| Accrued interest payable and other liabilities with maturities of less than one year | **12,902** | 13,404 | 11,603 | 12,052 | 8,754 |
| Total liabilities | **374,547** | 341,267 | 373,272 | 359,001 | 375,180 |
| Protected borrower stock | **—** | 1 | 7 | 11 | 15 |
| Capital stock and participation certificates | **1,271** | 1,174 | 1,147 | 1,080 | 1,030 |
| Retained earnings | | | | | |
| Allocated | **16,037** | 17,434 | 19,124 | 22,631 | 26,134 |
| Unallocated | **65,706** | 57,877 | 52,647 | 47,750 | 43,482 |
| Total members' equity | **83,014** | 76,486 | 72,925 | 71,472 | 70,661 |
| Total liabilities and members' equity | **$ 457,561** | $ 417,753 | $ 446,197 | $ 430,473 | $ 445,841 |
| **Statement of Income Data** | | | | | |
| Net interest income | **$ 9,774** | $ 9,763 | $ 10,048 | $ 9,855 | $ 10,415 |
| Provision for (reversal of allowance for) loan losses | **14** | (183) | (166) | 1,800 | 767 |
| Noninterest income (expense), net | **3,069** | 27 | (1,366) | 701 | (1,067) |
| Net income | **$ 12,829** | $ 9,973 | $ 8,848 | $ 8,756 | $ 8,581 |
| **Key Financial Ratios** | | | | | |
| Rate of return on average: | | | | | |
| Total assets | **2.90%** | 2.28% | 1.99% | 2.12% | 2.06% |
| Total members' equity | **16.16%** | 13.26% | 12.31% | 12.18% | 12.52% |
| Net interest income as a percentage of average earning assets | **2.34%** | 2.37% | 2.38% | 2.54% | 2.64% |
| Net (chargeoffs) recoveries to average loans | **0.003%** | 0.003% | (0.005)% | 0.038% | (0.345)% |
| Total members' equity to total assets | **18.14%** | 18.31% | 16.34% | 16.60% | 15.85% |
| Debt to members' equity (:1) | **4.51** | 4.46 | 5.12 | 5.02 | 5.31 |
| Allowance for loan losses to loans | **0.98%** | 1.07% | 1.05% | 1.14% | 0.62% |
| Permanent capital ratio | **14.70%** | 16.47% | 15.64% | 17.68% | 17.23% |
| Total surplus ratio | ** | 16.14% | 15.34% | 17.38% | 16.95% |
| Core surplus ratio | ** | 14.75% | 14.22% | 15.52% | 14.57% |
| Common equity tier 1 capital ratio | **13.04%** | ** | ** | ** | ** |
| Tier 1 capital ratio | **13.04%** | ** | ** | ** | ** |
| Total regulatory capital ratio | **15.53%** | ** | ** | ** | ** |
| Tier 1 leverage ratio | **12.26%** | ** | ** | ** | ** |
| Unallocated retained earnings (URE) and URE equivalents leverage ratio | **14.45%** | ** | ** | ** | ** |
| Estimated patronage refunds: | | | | | |
| Cash | **$ 5,000** | $ 4,743 | $ 3,955 | $ 4,500 | $ 2,750 |
| Nonqualified allocated retained earnings | **—** | — | — | — | 2,750 |

** General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2018.*
*** Not applicable due to changes in regulatory capital requirements effective January 1, 2017.*

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

*(dollars in thousands, except as noted)*

**GENERAL OVERVIEW**

The following commentary summarizes the financial condition and results of operations of Southwest Georgia Farm Credit, ACA, (Association) for the year ended December 31, 2017 with comparisons to the years ended December 31, 2016 and December 31, 2015. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

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

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

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, ***www.agfirst.com,*** or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, ***www.swgafarmcredit.com***, or by calling 1-866-304-3276, extension 1150, or writing Belinda Harper, Southwest Georgia Farm Credit, ACA, 305 Colquitt Highway, Bainbridge, Georgia 39817. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly Report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

**FORWARD LOOKING INFORMATION**

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

**AGRICULTURAL OUTLOOK**

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

The February 2018 USDA forecast estimates 2017 farmers' net cash income, which is a measure of the cash income after payment of business expenses, at $96.9 billion, up $2.9 billion from 2016 and down $9.0 billion from its 10-year average of $105.9 billion. The increase in net cash income in 2017 was primarily due to increases in livestock receipts of $12.5 billion and cash farm-related income of $1.8 billion, partially offset by a decrease in crop cash receipts of $4.7 billion and an increase in cash expenses of $5.1 billion.

The February 2018 USDA outlook for the farm economy, as a whole, forecasts 2018 farmers' net cash income to decrease to $91.9 billion, a $5.0 billion decrease from 2017, and $14.0 billion below the 10-year average. The forecasted decrease in farmers' net cash income for 2018 is primarily due to an expected increase in cash expenses of $3.0 billion and decrease in crop and livestock receipts of $2.0 billion.

The following table sets forth the commodity prices per bushel for certain crops, by hundredweight for hogs, milk, and beef cattle, and by pound for broilers and turkeys from December 31, 2014 to December 31, 2017:

| Commodity | 12/31/17 | 12/31/16 | 12/31/15 | 12/31/14 |
|---|---|---|---|---|
| Hogs | $48.60 | $43.10 | $42.80 | $64.30 |
| Milk | $17.20 | $18.90 | $17.30 | $20.40 |
| Broilers | $0.50 | $0.48 | $0.47 | $0.58 |
| Turkeys | $0.53 | $0.74 | $0.89 | $0.73 |
| Corn | $3.23 | $3.32 | $3.65 | $3.79 |
| Soybeans | $9.30 | $9.64 | $8.76 | $10.30 |
| Wheat | $4.51 | $3.90 | $4.75 | $6.14 |
| Beef Cattle | $118.00 | $111.00 | $122.00 | $164.00 |

The USDA's income outlook varies depending on farm size and commodity specialties. The USDA classifies all farms into four primary categories: small family farms (gross cash farm income (GCFI) less than $350 thousand), midsize family farms (GCFI between $350 thousand and under $1 million), large-scale family farms (GCFI of $1 million or more), and nonfamily farms (principal operator or individuals related to the operator do not own a majority of the business). Approximately 99 percent of U.S. farms is family farms and the remaining 1 percent is nonfamily farms. The family farms produce 90 percent of the value of agricultural output and the nonfamily farms produce the remaining 10 percent of agricultural output. The small family farms represent about 90 percent of all U.S. farms, hold 51 percent of farm land operated by farms and account for 23 percent of the value of production. Approximately 68 percent of production occurs on 9 percent of family farms classified as midsize or large-scale.

According to the USDA February 2018 forecast, farm sector equity (assets minus debt) is expected to rise 1.6 percent in 2018 to nearly $2.7 trillion. Farm sector assets are expected to rise 1.6 percent to $3.1 trillion in 2018, while farm sector debt is expected to rise 1.0 percent to $388.6 billion. Farm real estate accounts for about 84 percent of farm sector assets and the 2018 forecast anticipates a 2.1 percent increase in real estate values, continuing its long-term upward trend since the late 1980s.

Two measures of the financial health of the agricultural sector used by the USDA are the farm sector's debt-to-asset and debt-to-equity ratios. These ratios are forecast to move slightly downward in 2018 to 12.6 percent and 14.4 percent from 12.7 percent and 14.5 percent in 2017. These ratios remain well below the all-time highs of over 20 percent experienced during the 1980s.

As estimated by the USDA in February 2018, the System's market share of farm business debt (defined as debt incurred by those involved in on-farm agricultural production) increased slightly to 40.9 percent at December 31, 2016 (the latest available data), as compared with 40.6 percent at December 31, 2015.

In general, agriculture, during the past several years, experienced favorable economic conditions driven by high commodity and livestock prices and increased farmland values during this period. To date, the Association's financial results have remained favorable as a result of these favorable agricultural conditions. Production agriculture; however, remains a cyclical business that is heavily influenced by commodity prices and various other factors. In a prolonged period of less favorable economic conditions in agriculture, including extensive and extended drought conditions, and without sufficient government support programs, including USDA-sponsored crop insurance programs, the Association's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general economy remain more volatile given the state of the global economy. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

## CRITICAL ACCOUNTING POLICIES

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

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

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and

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

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

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

## ECONOMIC CONDITIONS

The economy in Southwest Georgia is made up of a multitude of varying industries – ranging from large industrial companies to farms and farm businesses, to small, family-owned operations. The Association's portfolio is impacted by two key economic factors: the local unemployment rate and the strength of the agricultural industry.

Unemployment rates have the greatest impact on the small and part-time farming sectors of the Association's portfolio. Essentially, these sectors of the portfolio have a larger dependence on non-farm income and are influenced to a greater extent by the general economy.

Georgia's economy is expected to remain stable. The unemployment rate for Georgia is estimated to be less than 5%, while, the U.S. unemployment rate is expected to drop to 3.8%. Unemployment rates for both Georgia and the U.S. are projected to improve in 2018. The improvements in the employment rates for our Local Service Area (LSA) could lead to growth in the demand for rural real estate.

Agriculture and Agri-business are the single largest industries in Georgia, which is indicative to our LSA. According to the 2017 farm income and expense, estimates released by the USDA's Economic Research Service, the U.S. and Georgia farm sectors have had a slight improvement in net cash receipts. Farm asset values continue to show little to no change. The stress in the agricultural sector will have an impact on both credit quality of the association's portfolio and loan demand. A significant amount of the loan demand in agriculture will come from the utilization of existing operating lines of credit and increases in operating needs.

Planted acreage for Georgia will remain primarily in peanuts and cotton. The overall strength of the 2018 agricultural industry will depend greatly on production yield and production cost management as market prices will be much lower than previous years.

Corn

Planted acreage for Georgia corn dropped 29% in 2017, which is 21% below the 10-year average. Market fundamentals for corn point to little change for the Georgia crop. Price estimates for the 2018 crop are at $4 per bushel after positive basis. The biggest drivers of continued corn production in Georgia at lower prices is the yield improvements over the last several years and positive basis.

Peanuts

The level of carryover will put significant pressure on prices for 2018. Estimates for peanut prices are $400 per ton down from $450 per ton in 2017. Peanut acres need to be reduced from a supply and rotation standpoint, but planting decisions will be difficult given cash flow challenges with other potential crops. To realize higher peanut prices, two things must occur: Additional demand must be created and/or supply must be constrained.

Poultry

The poultry industry for 2017 has seen moderate growth in production growth, exports, and domestic consumption. The result has been improved profit margins, predominately impacted by low feed cost and increased production. The price per pound is expected to decline in 2018 but increases in production should offset the decreased price. Movements in feed cost could ultimately have a large impact on profitability but no real increases in feed cost are expected in 2018.

Cotton

Regarding price, the 2017 crop year has been a better season for cotton growers as compared to 2016. Looking ahead to the 2018 crop year, the global cotton situation seems to indicate a more favorable economic footing. The improving supply-and-demand picture over the last year does, however, provide stability and a sense of optimism for the 2018 market. Prices for the 2018 crop are likely to be around $0.72/lb cents.

Timber
Demand for pine timber in Georgia is expected to improve in 2018. The primary drivers of demand will be increased housing starts, further declines in unemployment, and improvements in consumer spending. Unfortunately, timber inventory on the stump that is conserved and growing in the forest will likely dampen any significant movements in price.

**LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The diversification of the Association loan volume by type for each of the past three years is shown below.

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| **Loan Type** | **2017** | | **2016** | | **2015** | |
| | *(dollars in thousands)* | | | | | |
| Real estate mortgage | $ 230,267 | 55.57 % | $ 214,858 | 56.97 % | $ 242,580 | 60.75 % |
| Production and intermediate-term | 116,018 | 28.00 | 94,377 | 25.03 | 88,900 | 22.27 |
| Loans to cooperatives | 583 | .14 | 1,770 | 0.47 | – | – |
| Processing and marketing | 31,476 | 7.60 | 37,834 | 10.03 | 42,406 | 10.62 |
| Farm-related business | 19,123 | 4.62 | 19,060 | 5.05 | 18,140 | 4.54 |
| Communication | 8,649 | 2.09 | 4,801 | 1.27 | 3,721 | .94 |
| Power and water/ waste disposal | 3,940 | .95 | 911 | 0.24 | 932 | .23 |
| Rural residential real estate | 1,793 | .43 | 1,483 | 0.39 | 1,813 | .45 |
| International | 1,752 | .42 | 1,751 | 0.46 | – | – |
| Lease Receivables | 736 | .18 | 283 | 0.08 | 804 | .20 |
| Total | $ 414,337 | 100.00 % | $ 377,128 | 100.00 % | $ 399,296 | 100.00 % |

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified. The geographic distribution of the loan volume by county/branch for the past three years is as follows:

| | December 31, | | |
|---|---|---|---|
| **County/Branch** | **2017** | **2016** | **2015** |
| Baker | 1.24% | 1.38% | 2.04% |
| Calhoun | .27 | .41 | .63 |
| Chattahoochee | .07 | .06 | .15 |
| Clay | .07 | .08 | .45 |
| Decatur* | 12.40 | 13.87 | 11.49 |
| Doughtery | 4.26 | 3.33 | 5.04 |
| Early | 2.92 | 2.45 | 2.65 |
| Grady | 2.01 | 2.06 | 2.01 |
| Lee | 5.12 | 4.78 | 5.18 |
| Marion | 1.63 | 2.11 | 2.40 |
| Miller | 2.13 | 1.88 | 2.20 |
| Mitchell* | 8.70 | 8.74 | 9.65 |
| Randolph | 3.64 | 2.97 | 3.04 |
| Schley | .25 | .35 | .36 |
| Seminole | 4.85 | 5.81 | 4.95 |
| Stewart | .71 | .65 | .70 |
| Sumter* | 6.59 | 8.04 | 8.71 |
| Terrell* | 2.66 | 2.51 | 2.88 |
| Thomas* | 2.17 | 2.36 | 2.40 |
| Webster | 1.09 | 1.07 | 1.44 |
| Other** | 37.22 | 35.09 | 31.63 |
| | 100.00% | 100.00% | 100.00% |

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

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer. The major commodities in the Association's loan portfolio are shown below. The predominant commodities are timber, cotton, landlords, peanuts, fruit and nuts, row crops, farm supply and services, and livestock which constitute over 84.7 percent of the entire portfolio. The commodity group landlords is primarily on real estate purchased and leased for agriculture production.

| Commodity | December 31, | | | | | |
|---|---|---|---|---|---|---|
| **Group** | **2017** | | **2016** | | **2015** | |
| | *(dollars in thousands)* | | | | | |
| Timber | $ 106,677 | 26% | $ 88,137 | 23% | $ 86,286 | 22% |
| Cotton | 56,906 | 14 | 56,637 | 15 | 54,042 | 14 |
| Landlords | 52,069 | 12 | 45,845 | 12 | 51,997 | 13 |
| Peanuts | 29,856 | 7 | 24,196 | 6 | 36,527 | 9 |
| Fruit & Nut | 38,931 | 9 | 31,562 | 8 | 28,905 | 7 |
| Poultry | 14,909 | 4 | 21,324 | 6 | 25,067 | 6 |
| Farm Supply & Services | 20,519 | 5 | 23,431 | 6 | 25,068 | 6 |
| Livestock | 19,432 | 5 | 20,460 | 5 | 24,905 | 6 |
| Dairy | 13,177 | 3 | 14,342 | 4 | 13,923 | 3 |
| Vegetables | 9,885 | 2 | 6,198 | 2 | 7,013 | 2 |
| Row Crops | 26,520 | 6 | 18,506 | 5 | 19,880 | 5 |
| Rural Home | 1,923 | 1 | 1,645 | 1 | 2,159 | 1 |
| Horticulture | 2,625 | 1 | 1,752 | 1 | 3,222 | 1 |
| Other | 20,908 | 5 | 23,093 | 6 | 20,302 | 5 |
| Total | $ 414,337 | 100% | $ 377,128 | 100% | $ 399,296 | 100% |

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of timber, cotton, landlords, poultry, peanut, and livestock producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Within the timber

commodity group there are significant numbers of less than full time timber producers. As such, the risk in this group is more diversified than appears from the nominal percentage. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

In 2017 the Association continued to focus on leveraging capital and strengthening the earning position.

For the past few years, the Association has experienced a shift in loan assets. The long-term volume trend has been downward while the short and intermediate-term loan volume trend is upward. The short-term portfolio, which is heavily influenced by operating loans, normally reaches a peak balance in August and rapidly declines in the fall months as our primary agriculture commodities are converted to cash which is used to repay the debt.

During 2017, the Association continued activity in the buying and selling of loan participations within and outside of the System in order to leverage the balance sheet and improve the income producing potential.

| Loan Participations: | December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| | *(dollars in thousands)* | | |
| Participations Purchased – FCS Institutions | $ 72,195 | $ 65,719 | $ 60,488 |
| Participations Purchased – Non-FCS Institutions | 1,869 | 2,550 | 2,026 |
| Participations Sold | (292,946) | (300,938) | (225,881) |
| Total | $ (218,882) | $ (232,669) | $ (163,367) |

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2017.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2017, the Association originated loans for resale totaling $6 million, which were subsequently sold into the secondary market. The Association also utilizes the Farmer Mac Long Term Stand-By repurchase agreements. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2017, the Association had loans amounting to $26.1 million which were 100 percent guaranteed by Farmer Mac. The Association additionally has purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2017, the balance of these loans, including the unamortized premium, was $112, compared to $126 at December 31, 2016 and $139 at December 31, 2015.

**MISSION RELATED INVESTMENTS**

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

In October 2005, the FCA authorized AgFirst and the Association to make investments in Rural America Bonds. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds are classified as Loans or Investment Securities on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2017, December 31, 2016, and December 31, 2015, the Association had $11,596, $12,854, and $20,727, respectively, in Rural America Bonds.

| Mission Related Investments | December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| | *(dollars in thousands)* | | |
| Loans | $ 5,518 | $ 6,170 | 6,450 |
| Investment Securities | 6,078 | 6,684 | 14,277 |
| Total | $ 11,596 | $ 12,854 | $ 20,727 |

Effective December 31, 2015, the FCA concluded each pilot program approved as part of the Investment in Rural America program. Each institution participating in such programs may continue to hold its investment through the maturity dates for the investments, provided the institution continues to meet all approval conditions. Although the pilot programs are concluding, the FCA can consider future requests on a case-by-case basis.

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 $572. There are no outstanding commitments to make additional equity purchases beyond this amount.

A valuation analysis was conducted in 2014 and 2015. The analysis indicated that a decrease in value of the investment had occurred that was other than temporary, due to a series of losses and other factors. As a result, the Association recognized other-than-temporary impairment of $0 in 2017, $0 in 2016 and $91 in 2015 which is included in Impairment Losses on Investments in the Statements of Income. As of December 31, 2017 the equity investment value is $0 on the Association Balance Sheet.

## INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. Currently the Association holds no asset backed securities on its balance sheet.

## CREDIT RISK MANAGEMENT

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

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

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be advanced in amounts up to 85 percent of the appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loan originations of more than $250 thousand. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and overall risk level in a particular relationship. We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

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

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

| Credit Quality | 2017 | 2016 | 2015 |
|---|---|---|---|
| Acceptable & OAEM | 98.81% | 98.86% | 99.49% |
| Substandard | 1.19% | 1.14% | .51% |
| Doubtful | –% | –% | –% |
| Loss | –% | –% | –% |
| Total | 100% | 100% | 100% |

*Nonperforming Assets*

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

| | December 31, | | |
|---|---|---|---|
| **High-risk Assets** | **2017** | **2016** | **2015** |
| | *(dollars in thousands)* | | |
| Nonaccrual loans | $ 1,071 | $ 680 | $ 757 |
| Restructured loans | 1,407 | 1,459 | 1,538 |
| Accruing loans 90 days past due | – | – | – |
| Total Non-Performing Loans | 2,478 | 2,139 | 2,295 |
| Total high-risk loans | 2,478 | 2,139 | 2,295 |
| Other property owned | 129 | 823 | 1,449 |
| Total high-risk assets | $ 2,607 | $ 2,962 | $ 3,744 |
| **Ratios** | | | |
| Nonaccrual loans to total loans | .26% | .18% | .19% |
| High-risk assets to total assets | .57% | .71% | .51% |

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Over the last several years the Association

made concentrated efforts to reduce the high risk assets by setting attainable goals and timelines. Non-Performing loans increased $339 or 15.84 percent in 2017. Of the $1,071 in nonaccrual volume at December 31, 2017, $53 or 4.95 percent was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status. This compares to 76 percent and 35.8 percent at December 31, 2016 and 2015, respectively.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and its stockholders.

*Allowance for Loan Losses*

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb expected losses inherent to its loan portfolio for the next twelve month period.

The following table presents the activity in the allowance for loan losses for the most recent three years:

| **Allowance for Loan Losses Activity:** | **Year Ended December 31, 2017** | **2016** | **2015** |
|---|---|---|---|
| | *(dollars in thousands)* | | |
| Balance at beginning of year | $ 4,031 | $ 4,201 | $ 4,388 |
| Charge-offs: | | | |
| Agribusiness | – | – | – |
| Production and intermediate term | (19) | – | (49) |
| Real estate mortgage | (3) | (216) | – |
| Total charge-offs | (22) | (216) | (49) |
| Recoveries: | | | |
| Agribusiness | – | – | – |
| Real estate mortgage | 7 | 3 | 28 |
| Production and intermediate term | 27 | 225 | – |
| Total recoveries | 35 | 229 | 28 |
| Net (charge-offs) recoveries | 12 | 12 | (21) |
| Provision for (reversal of allowance for) loan losses | 14 | (183) | (166) |
| Balance at end of year | $ 4,057 | $ 4,031 | $ 4,201 |
| Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period | .003% | .003% | (.005)% |

The net loan recoveries were primarily associated with several bankruptcy payments and settlements during the year. Provisions to the allowance for loan losses were made to the general reserve after the allowance analysis and review of economic indicators.

The allowance for loan losses by loan type for the most recent three years is as follows:

| **Allowance for Loan Losses by Type** | **December 31, 2017** | **2016** | **2015** |
|---|---|---|---|
| | *(dollars in thousands)* | | |
| Real estate mortgage | $ 2,239 | $ 2,305 | $ 2,521 |
| Production and intermediate-term | 1,176 | 1,014 | 977 |
| Agribusiness | 484 | 616 | 623 |
| Power and Waste | 37 | 10 | 10 |
| Rural residential real estate | 17 | 15 | 24 |
| Communication | 81 | 50 | 38 |
| International | 16 | 18 | – |
| Lease Receivables | 7 | 3 | 8 |
| Total allowance | $ 4,057 | $ 4,031 | $ 4,201 |

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

| **Allowance for Loan Losses as a Percentage of:** | **December 31, 2017** | **2016** | **2015** |
|---|---|---|---|
| Total loans | .98% | 1.07% | 1.05% |
| Nonperforming loans | 163.72% | 188.45% | 183.03% |
| Nonaccrual loans | 378.80% | 592.79% | 554.63% |

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

## RESULTS OF OPERATIONS

*Net Interest Income*

Net interest income was $9.77 million, $9.76 million and $10.05 million in 2017, 2016 and 2015, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past two years are presented in the following table:

**Change in Net Interest Income:**

| | **Volume*** | **Rate** | **Nonaccrual Income** | **Total** |
|---|---|---|---|---|
| **12/31/17 - 12/31/16** | | | | |
| Interest income | $ 212 | $ 461 | $ – | $ 673 |
| Interest expense | 19 | 643 | – | 662 |
| Change in net interest income | $ 193 | $ (182) | $ – | $ 11 |
| **12/31/16 - 12/31/15** | | | | |
| Interest income | $ 87 | $ (404) | $ – | $ (317) |
| Interest expense | (58) | 26 | – | (32) |
| Change in net interest income | $ 145 | $ (430) | $ – | $ (285) |

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

*Noninterest Income*

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

| | For the Year Ended December 31, | | | Percentage Increase/(Decrease) | |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2017/ 2016 | 2016/ 2015 |
| | *(dollars in thousands)* | | | | |
| Loan fees | $ 609 | $ 679 | $ 750 | (10.31)% | (9.47)% |
| Fees for financially related services | 8 | 1 | 9 | 700 | (88.89) |
| Patronage refund from other Farm Credit Institutions | 11,815 | 9,586 | 8,177 | 23.25 | 17.23 |
| Gains (losses) on sales of rural home loans, net | – | – | – | – | – |
| Gains (losses) on sales of premises and equipment, net | 21 | 16 | 16 | 31.25 | – |
| Gains (losses) on sales of investment securities | – | – | – | – | – |
| Other than temporary impairment | – | – | (91) | – | 100 |
| Insurance Fund refund | – | – | – | – | – |
| Other noninterest income | 70 | 96 | 83 | (27.08) | 15.66 |
| Total noninterest income | $ 12,523 | $ 10,378 | $ 8,944 | 20.67% | 16.03% |

Patronage refund from other Farm Credit Institutions experienced significant increases in the last several years due to special Patronage distributions from AgFirst Farm Credit Bank. Other than temporary impairment losses shown for, 2014-2015, are attributed to a single venture capital equity investment. At this time the Association has recognized a loss totaling 100% of funds allocated for this investment. No additional funding is committed or planned towards the venture capital investment as of December 31, 2017. Competitive Pressures have compressed and degraded Loan fee income over the last couple years.

*Noninterest Expense*

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

| | For the Year Ended December 31, | | | Percentage Increase/(Decrease) | |
|---|---|---|---|---|---|
| **Noninterest Expense** | 2017 | 2016 | 2015 | 2017/ 2016 | 2016/ 2015 |
| | *(dollars in thousands)* | | | | |
| Salaries and employee benefits | $ 5,104 | $ 4,988 | $ 4,929 | (2.33)% | (1.20)% |
| Postretirement benefits (Note 2 and 9) | 157 | 1,463 | 1,500 | (89.27) | (2.47) |
| Occupancy and equipment | 598 | 568 | 600 | 5.28 | (5.33) |
| Insurance Fund premiums | 494 | 541 | 418 | (8.69) | 29.43 |
| (Gains) Losses on other property owned, net | 319 | 95 | 356 | 235.79 | (73.31) |
| Other operating expenses | 2,767 | 2,696 | 2,507 | 2.63 | 7.54 |
| Total noninterest expense | $ 9,439 | $ 10,351 | $ 10,310 | (8.81)% | .40% |

In 2017 Postretirement benefits decreased by $1,306 or 89 percent. During 2017, the method of recording expenses for the Association's defined benefit pension plan and other postretirement benefit plan was modified. This change resulted in the reduction of Other Assets by $1,648 and the reduction of Other Liabilities by $2,604 on the Association's Balance Sheets, and a corresponding reduction of postretirement benefit costs on the Association's Statements of Income of $956 during 2017. Refer to Note 9, Employee Benefit Plans, of the Notes to the Consolidated Financial Statements, for further information concerning postretirement benefit expenses. Postretirement benefits decreased by $546 thousand for the year ended December 31, 2016 compared to the prior year.

Insurance Fund premiums decreased slightly in 2017 due to a decrease in premium rates. The Farm Credit System Insurance Corporation (FCSIC) had reduced the insurance premiums primarily due to the 2017 beginning debt amount being $6 billion less than originally anticipated. The FCSIC decreased premiums to 15 basis points on adjusted insured debt outstanding for 2017. This was down from the 18 basis point premium in 2016. In addition there is a continued 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments.

*Income Taxes*

The Association recorded a provision for income taxes of $15 for the year ended December 31, 2017, as compared to a provision of $0 for 2016 and $0 for 2015. Refer to Note 2, *Summary of Significant Accounting Policies, Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

*Key Results of Operations Comparisons*

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

| **Key Results of Operations Comparisons** | For the 12 Months Ended 12/31/17 | 12/31/16 | 12/31/15 |
|---|---|---|---|
| Return on average assets | 2.90% | 2.28% | 1.99% |
| Return on average members' equity | 16.16% | 13.26% | 12.31% |
| Net interest income as a percentage of average earning assets | 2.34% | 2.37% | 2.38% |
| Net (charge-offs) recoveries to average loans | .003% | .003% | (.005)% |

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

## LIQUIDITY AND FUNDING SOURCES

*Liquidity and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds."

Total notes payable to the Bank at December 31, 2017, was $361,645 as compared to $327,863 at December 31, 2016 and $361,669 at December 31, 2015. The increase of 10.3 percent compared to December 31, 2016 was attributable to the sale of loan volume during the year to AgFirst FCB as part of the Capital Participation Pool. The sale put the Association in a position to strengthen Capital. The decrease of 9.35 percent in 2016 when compared to December 31, 2015, was attributable to an increase in equity. The average volume of outstanding notes payable to the Bank was $356,348, $355,620, and $366,917 for the years ended December 31, 2017, 2016, and 2015 respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in the Farmer Mac, stand by purchase program, investments, and other secondary market programs provides additional liquidity.

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

The Association had no lines available under lines of credit from third party financial institutions as of December 31, 2017.

*Funds Management*

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

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

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

*Relationship with the Bank*

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

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

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding Sources" section of this Management's Discussion & Analysis and in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, included in this Annual Report.

## CAPITAL RESOURCES

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

The Association's Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably.

Total members' equity at December 31, 2017, increased 8.53 percent to $83,014 from the December 31, 2016, total of $76,486. At December 31, 2016, total members' equity increased 4.88 percent from the December 31, 2015 total of $72,925. During 2017 and 2016 the Association experienced an increase in net income from the increase in average loan volume and the large special patronage distributions from AgFirst both events had a direct impact on the increase in member's equity.

Total capital stock and participation certificates were $1,271 on December 31, 2017, compared to $1,175 on December 31, 2016 and $1,154 on December 31, 2015. The increase is attributed to the purchase of protected stock and participation certificates on new loans in the normal course of business.

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

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

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

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets means the total dollar amount of the institution's assets are adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

| Ratio | Minimum Requirement | Capital Conservation Buffer* | Minimum Requirement with Capital Conservation Buffer | Capital Ratios as of December 31, 2017 |
|---|---|---|---|---|
| Risk-adjusted ratios: | | | | |
| CET1 Capital Ratio | 4.5% | 0.625% | 5.125% | 13.04% |
| Tier 1 Capital Ratio | 6.0% | 0.625% | 6.625% | 13.04% |
| Total Capital Ratio | 8.0% | 0.625% | 8.625% | 15.53% |
| Permanent Capital Ratio | 7.0% | 0.0% | 7.0% | 14.70% |
| Non-risk-adjusted: | | | | |
| Tier 1 Leverage Ratio | 4.0% | 1.0% | 5.0% | 12.26% |
| UREE Leverage Ratio | 1.5% | 0.0% | 1.5% | 14.45% |

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

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

| | Regulatory Minimum | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|
| Permanent Capital Ratio | 7.00% | 16.47% | 15.64% | 17.68% | 17.23% | 21.35% |
| Total Surplus Ration | 7.00% | 16.14% | 15.34% | 17.38% | 16.95% | 21.00% |
| Core Surplus Ratio | 3.50% | 14.75% | 14.22% | 15.52% | 14.57% | 17.39% |

The Association applied several tools during 2017 to help manage capital levels. The capital levels have stabilized between 2016 and 2017. The Association's analysis and business plan forecast does not indicate any trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements. The Association will continue to use several tools if necessary to manage capital levels such as guarantees for loans, participating with other institutions, and selling to the AgFirst Capital Participation Pool. See Note 7, *Members' Equity*, of the Consolidated Financial Statements, for further information concerning capital resources.

The Farm Credit Administration (the "FCA") approved new rules (the "New Capital Regulations") relating to regulatory capital requirements for Farm Credit System banks and associations, including Southwest Georgia Farm Credit (the "Association"), that were published in the Federal Register on July 28, 2016, with an effective date of January 1, 2017. The FCA required the Association to take a number of actions in preparation for this change.

The Association Board of Directors adopted a resolution in accordance to the provisions of the FCA New Capital Regulation. The board determined that the new regulations are consistent with the Association's capital management strategy and are in the Association's best interest.

**DIVIDEND PROGRAM**

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Dividend Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the dividend distributions. The Association distributed $3,955 of dividends in 2016 based on 2015 earnings, $4,743 of dividends in 2017 based on 2016 earnings and an estimated $5,000 in dividends based on 2017 earnings is expected to be distributed in 2018.

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

Southwest Georgia Farm Credit focuses on offering education, training, mentoring and sponsorship of young, beginning and small-scale producers in order to serve their credit and related needs. The definitions of young, beginning and small farmers and ranchers follow:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the loan transaction date.
- Small: A farmer, rancher or producer or harvester of aquatic products who normally generates less than $250,000 in annual gross sales of agricultural or aquatic products.

**Mission Statement**

To be the preeminent young, beginning and small farmer lender throughout Southwest Georgia by providing a competitive source of financing and offering programs designed to meet the needs of such applicants to the fullest extent of their credit worthiness.

**Board Policy to Complete Mission Statement**

The Southwest Georgia Farm Credit Board of Directors understands the importance of the development, education and financial success of young, beginning and small farmers, ranchers or harvesters of aquatic products is essential to the future of the Association, as well as the future of agriculture and the local economies in our territory. Therefore, in order to accomplish our YBS mission, it is imperative that we develop, execute, and evaluate a program that targets this specific group of borrowers.

There are several components to this plan, which include advertising, educational opportunities, scholarships and community events, as well as outreach via social media.

The following table outlines the Association's 2017 goals, loan volume and number of YBS loans in the loan portfolio for the Association:

| | As of December 31, 2017* | | | |
|---|---|---|---|---|
| | Number of Loans | | $ Amount of Loans | |
| | 2017 Goal | 2017 Actual | 2017 Goal | 2017 Actual |
| **Young** | 300 | 302 | $58,342 | $57,684 |
| **Beginning** | 681 | 653 | $114,799 | $106,749 |
| **Small** | 833 | 832 | $95,469 | $91,296 |

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

Each year, the Association establishes goals for the portfolio and for new loans to YBS borrowers. 2017 goals and accomplishments follow:

| | As of December 31, 2017* | | | |
|---|---|---|---|---|
| | Number of New Loans | | $ Amount of New Loans | |
| | 2017 Goal | 2017 Actual | 2017 Goal | 2017 Actual |
| **Young** | 93 | 116 | $20,354 | $24,714 |
| **Beginning** | 168 | 195 | $44,634 | $37,239 |
| **Small** | 191 | 255 | $31,325 | $33,499 |

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

The 2012 USDA Ag Census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties), there were 4,382 reported number of farms, with 1,750 having debt. Census data suggests that the total number of young and small farmers has seen modest gains since 2012, while the number of beginning farmers has risen as a percentage of the total Census. Since 2002, the percentage of

small and young farmers has dropped significantly, perhaps signaling the increase in the number of larger farms.

In 2017, the Association planned, executed, and evaluated the following tactics put in place to accomplish YBS goals:

**Marketing/Business Development**

- Networking/Relationship Building – The Association will focus on ensuring that our programs and services reach a wide range of farmers, and that opportunities to participate in education and networking are available beginning in high school with FFA and 4-H. Further, the Association advocates for agricultural education through the sponsorship of activities for youth, such as the Georgia Farm Credit Pig Show.
- Advertising and Social Media – The Association continues to invite YBS farmers to learn more about Farm Credit and its products and services with a range of advertising, in newspapers, magazines and specialty publications. Additionally, recognizing the importance of using technology to communicate with this market segment, the Association uses Social Media, such as Facebook, Twitter and Instagram, to generate messaging geared towards YBS farmers.
- SWGAFarmCredit.com – The Association's website serves as an informational resource for YBS farmers to find information related to educational opportunities, programs, and services. This site is updated periodically with relevant information.

**Credit/Underwriting/Guarantees**

- Southwest Georgia Farm Credit does have a Beginning Farmer Program in conjunction with USDA (Farm Service Agency, "FSA"). This program allows for as little as 5% down payment and financing from FSA and Farm Credit of 45% and 50% respectively. FSA financing is for 20 years with fixed interest rates as low as 1.5% and Farm Credit provides financing for 30 years (FSA requirement) with fixed rates at 1.50% over Cost of Funds supported by a 95% FSA Guarantee (FSA fees waived). The FSA FO loan is subordinate to the Farm Credit loan. While this program is available to all Beginning Farmers (less than 10 years experience), the majority of applicants will also meet the "Young" and "Small" definition. The Association understands and embraces the importance of these farmers to the longevity, and continued success, of the Association.
- Loan Guarantees – Risk within the Young, Beginning and Small Farms is mitigated through the use of FSA Guarantees. The Association encourages the use of FSA Guarantees in all categories of its portfolio but most particularly within its Young, Beginning and Small Farmer portfolio as evidenced by the level of guarantees overall and the new guarantees issued each year. In addition to the standard FSA guarantee and the Beginning Farmer guarantee (referenced above), the Association also promotes the 50/50 FSA Guarantee, a financing option in which FSA provides 50% of the financing through a Farm Ownership loan and Farm Credit provides the other 50% of financing, with an FSA 90% guarantee. The FSA FO loan is subordinate to the Farm Credit loan.

**Education/Outreach**

- TEPAP – The Executive Program for Agricultural Producers – The Association provides an opportunity for two YBS farmers to participate each year in a two-year course at Texas A&M University, with a focus on managing personnel, evaluating new market opportunities, negotiating mergers and acquisitions and adapting to regulatory and technology changes.
- FFA – The Association supports this organization in counties and schools throughout our territory, in an effort to promote leadership among middle school and high school students who express an interest in an ag-related career.
- 4-H – The Association supports and sponsors activities, in an effort to promote farming skills and leadership, beginning at an early age.
- Sunbelt Ag Expo – The Association works with other Farm Credit associations to sponsor a special dinner for young farmers at this event, which is the premier farm show in the southeast.
- Young Couples Cooperative Conference – As a member of the Georgia Cooperative Council, Southwest Georgia Farm Credit offers the opportunity for a YBS couple to participate in the annual, statewide conference. This conference provides YBS farmers with an opportunity to network, participate and learn about cooperative principles.
- Young Farmers Association Chapters – On a local and statewide level, the Association supports young farmer education, management contests, and the annual statewide convention.
- SWGA Farm Credit Scholarship Program – The Association provides four, $1,000 scholarships to high school seniors interested in pursuing a career in agriculture or a field that will enhance the quality of life in the rural communities served by the Association. A scholarship program also is available through Bainbridge State College
- Ag Biz Planner – Opportunity for YBS farmers to participate in an online Farm Credit University course stressing business management skills.
- Youth Leadership Conference – Offered by the Georgia Cooperative Council, the Association sponsors the annual Youth Leadership Conference. The Association sponsors students who attend the event, in order to help defray personal expenses.
- UGA Scholarships – Along with the other Farm Credit associations serving the state of Georgia, Southwest Georgia Farm Credit sponsors scholarships at UGA.
- Fresh From the Farm – Mini-grants designed to enhance awareness of locally grown fruits and vegetables.

## REGULATORY MATTERS

### Capital

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 2018. 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.

## FINANCIAL REGULATORY REFORM

Derivatives transactions are subject to myriad regulatory requirements including, among other things, clearing through a third-party central clearinghouse trading on regulated exchanges or other multilateral platforms. Margin is required for these transactions. Derivative transactions that are not subject to mandatory trading and clearing requirements may be subject to minimum margin and capital requirements.

The Commodity Futures Trading Commission and other federal banking regulators have exempted System institutions from certain, but not all, of these new requirements, including for swaps with members, mandatory clearing and minimum margin for non-cleared swaps.

Notwithstanding these exceptions, counterparties of System institutions may require margin or other forms of credit support as a condition to entering into non-cleared transactions because such transactions may subject these counterparties to more onerous capital, liquidity and other requirements absent such margin or credit support. Alternatively, these counterparties may pass on the capital and other costs associated with entering into transactions if insufficient margin or if other credit support is not provided.

The Dodd-Frank Act also created a new federal agency called the Consumer Financial Protection Bureau (CFPB). The CFPB is responsible for regulating the offering of consumer financial products or services under federal consumer financial laws. The Farm Credit Administration retains the responsibility to oversee and enforce compliance by System institutions with relevant rules adopted by the CFPB.

The regulatory requirements that apply to derivatives transactions could affect funding and hedging strategies and increase funding and hedging costs.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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

| Summary of Guidance | Adoption and Potential Financial Statement Impact |
|---|---|
| ***Accounting Standards Update (ASU) 2017-08 – Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*** | |
| • Requires amortization of premiums to the earliest call date on debt securities with call features that are explicit, noncontingent and callable at fixed prices and on preset dates.<br>• Does not impact securities held at a discount; the discount continues to be amortized to the contractual maturity.<br>• Requires adoption on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.<br>• Effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. | • The investment securities portfolio includes holdings of callable debt securities. The Association is currently evaluating the impact of the Update on the financial statements, which will be affected by any investments in callable debt securities carried at a premium at the time of adoption.<br>• The Association expects to adopt the guidance using the modified retrospective method with a cumulative effect adjustment to retained earnings as of the beginning of the year of adoption. |

<table>
<tr><th colspan="2">ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</th></tr>
<tr><td>• Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management's estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets.<br>• Changes the present incurred loss impairment guidance for loans to a CECL model.<br>• The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit.<br>• Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets.<br>• Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption.<br>• Effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.</td>
<td>• The Association has begun implementation efforts by establishing a cross-discipline governance structure. The Association is currently identifying key interpretive issues, and assessing existing credit loss forecasting models and processes against the new guidance to determine what modifications may be required.<br>• The Association expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including:<br>1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions,<br>2. An allowance will be established for estimated credit losses on debt securities,<br>3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans.<br>• The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Association's portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date.<br>• The Association expects to adopt the guidance in first quarter 2021.</td></tr>
<tr><th colspan="2">ASU 2016-02 – Leases (Topic 842)</th></tr>
<tr><td>• Requires lessees to recognize leases on the balance sheet with lease liabilities and corresponding right-of-use assets based on the present value of lease payments.<br>• Lessor accounting activities are largely unchanged from existing lease accounting.<br>• The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification.<br>• Also, expands qualitative and quantitative disclosures of leasing arrangements.<br>• Requires adoption using a modified cumulative effect approach wherein the guidance is applied to all periods presented.<br>• Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted.</td>
<td>• The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees.<br>• The Association has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities.<br>• As a lessee the Association is developing its methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments but does not expect a material change to the timing of expense recognition.<br>• Given the limited changes to lessor accounting, the Association does not expect material changes to recognition or measurement, but it is early in the implementation process and the impact will continue to be evaluated.<br>• The Association is evaluating existing disclosures and may need to provide additional information as a result of adopting the Update.<br>• The Association expects to adopt the guidance in first quarter 2019 using the modified retrospective method and practical expedients for transition.</td></tr>
<tr><th colspan="2">ASU 2016-01 – Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities</th></tr>
<tr><td>• The Update amends the presentation and accounting for certain financial instruments, including liabilities measured at fair value under the fair value option and equity investments.<br>• Requires certain equity instruments be measured at fair value, with changes in fair value recognized in earnings.<br>• The guidance also updates fair value presentation and disclosure requirements for financial instruments measured at amortized cost.<br>• Effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years.</td>
<td>• The Association is currently evaluating any impacts to the financial statements. The Association's implementation efforts include the identification of securities within the scope of the guidance, the evaluation of the measurement alternative available for equity securities without a readily determinable fair value, and the related impact to accounting policies, presentation, and disclosures.<br>• Any investments in nonmarketable equity investments accounted for under the cost method of accounting (except for other Farm Credit Institution stock) will be accounted for either at fair value with unrealized gains and losses reflected in earnings or, if elected, using an alternative method. The alternative method is similar to the cost method of accounting, except that the carrying value is adjusted (through earnings) for subsequent observable transactions in the same or similar investment. The Association is currently evaluating which method will be applied to these nonmarketable equity investments.<br>• Additionally, for purposes of disclosing the fair value of loans carried at amortized cost, the Association is evaluating valuation methods to determine the necessary changes to conform to an "exit price" notion as required by the Standard. Accordingly, the fair value amounts disclosed for such loans may change upon adoption.<br>• The Association expects to adopt the guidance in first quarter 2018 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption, except for changes related to nonmarketable equity investments, which is applied prospectively. The Association expects the primary accounting changes will relate to equity investments.</td></tr>
</table>

| ***ASU 2014-09 – Revenue from Contracts With Customers (Topic 606) and subsequent related Updates*** | |
|---|---|
| • Requires that revenue from contracts with customers be recognized upon transfer of control of a good or service, and transfers of nonfinancial assets, in an amount equaling the consideration expected to be received.<br>• Changes the accounting for certain contract costs, including whether they may be offset against revenue in the Consolidated Statements of Income, and requires additional disclosures about revenue and contract costs.<br>• May be adopted using a full retrospective approach or a modified, cumulative effect approach wherein the guidance is applied only to existing contracts as of the date of initial application, and to new contracts transacted after that date.<br>• Effective for reporting periods beginning after December 15, 2017. Early application is not permitted. | • The Association's revenue is the sum of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of the Association's revenues will not be affected.<br>• The Association is performing an assessment of revenue contracts as well as working with industry participants on matters of interpretation and application. Accounting policies will not change materially since the principles of revenue recognition from the Update are largely consistent with existing guidance and current business practices. The Association has not identified material changes to the timing or amount of revenue recognition.<br>• The Association expects a minor change to the presentation of costs for certain underwriting activities which will be presented in expenses rather than the current presentation against the related revenues. The Association will provide qualitative disclosures of performance obligations related to revenue recognition and will continue to evaluate disaggregation for significant categories of revenue in the scope of the guidance.<br>• The Association intends to adopt the guidance in first quarter 2018 using the modified retrospective method with a cumulative-effect adjustment to opening retained earnings. |

# Disclosure Required by Farm Credit Administration Regulations

**Description of Business**

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

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

**Unincorporated Business Entities**

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

| Entity Name | Entity Type | Equity Purpose |
|---|---|---|
| A-1 Ledges Wilder | LLC | Manage Acquired Property |
| A-1 Sequatchie Point | LLC | Manage Acquired Property |
| Pickens County Properties | LLC | Manage Acquired Property |

The Association also held an equity investment in CBF Holdings, LLC, a Limited Liability Company. The company was organized for the stated purpose of holding and managing unusual or complex collateral which was converted to Other Property Owned. Assets were subsequently sold pursuant to the terms of the operating agreement of the LLC. All remaining assets were charged-off in 2015.

**Description of Property**

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

| Location | Description | Form of Ownership |
|---|---|---|
| 305 Colquitt Highway<br>Bainbridge | Administrative Office | Owned |
| 40 E. Broad Street<br>Camilla | Office | Owned |
| 1037 E. Forsyth Street<br>Americus | Office | Owned |
| 937 Forrester Drive, SE<br>Dawson | Office | Owned |
| 137 E. Jackson Street<br>Thomasville | Office | Leased* |

**The Thomasville facility is leased by the Association. Lease payments were $1,455 per month.*

**Legal Proceedings**

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

**Description of Capital Structure**

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

**Description of Liabilities**

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

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

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

**Senior Officers**

The following represents certain information regarding the senior officers of the Association:

| Senior Officer | Position |
|---|---|
| Richard S. Monson | President/Chief Executive Officer |
| Richard H. Horn | Chief Credit Officer |
| Ryan G. Burtt | Chief Financial Officer |
| Tarrell Bennett | Chief Lending Officer |
| Paxton W. Poitevint | Chief Operating Officer |
| Liz Nogowski | Marketing and Administrative Officer |

***Richard S. Monson, President/Chief Executive Officer:***
The business experience for the past 31 years for Richard S. Monson is with the Farm Credit System. Prior to his Farm Credit employment, Mr. Monson worked in the Department of Agricultural Economics at Clemson University as a Research Analyst. He began his career in the Farm Credit System with AgFirst Farm Credit Bank. He then accepted a position at Farm Credit of Southwest Florida before beginning at Southwest Georgia Farm Credit in 2000. Mr. Monson received his Bachelor's degree in agricultural economics from West Virginia University and Master's degree in agricultural economics from Clemson University. Mr. Monson also attended the Graduate School of Banking at Louisiana State University. In addition, Mr. Monson has served on the Board of Trustees of Edison College in Ft. Myers, Florida, and Chairman of the AgFirst Presidents' Council, a collaboration of AgFirst district association leadership. Mr. Monson also served as the Chairman of the Georgia Cooperative Council, a collaborative organization dedicated to cooperative education and advancement.

***Richard H. Horn, Chief Credit Officer:***
Richard Horn is from a farming family – his family still farms 2,000 acres in Kentucky. Currently, Southwest Georgia Farm Credit's Chief Credit Officer, Mr. Horn began his career with Farm Credit in 1981 as a loan officer and has held nearly every credit position possible during the last 36 years. A graduate of the University of Kentucky with a Bachelor of Science degree in farm management, Mr. Horn has worked with Farm Credit associations in Kentucky, Indiana, South Carolina and Georgia. He was president of his class at the Graduate School of Banking at Louisiana State University.

***Ryan G. Burtt, Chief Financial Officer:***
Mr. Burtt has served Southwest Georgia Farm Credit for 13 years. As CFO, he is responsible for financial accounting, reporting, technology infrastructures, internal controls, and operations for the organization. He also serves as the Association's Standards of Conduct Officer. Previously, he served as the Association's Director of Credit Administration. Mr. Burtt received a Master's of Business Administration from Troy University in 2008 and graduated from the ABA Stonier Graduate School of Banking in partnership with Wharton in 2015.

***Tarrell Bennett, Chief Lending Officer*:**
Mr. Bennett has served Southwest Georgia Farm Credit for 45 years. During that time, he has served as the Association's Credit Manager and worked in the Special Assets Management Department. Mr. Bennett is a 1971 graduate of Valdosta State College with a double major in Business Management and Marketing.

***Paxton W. Poitevint, Chief Operating Officer:***
Paxton W. Poitevint serves Southwest Georgia Farm Credit as Chief Operating Officer. A 13-year veteran of the Farm Credit System, Mr. Poitevint most recently served as Chief Relationship Manager and was responsible for the Association's business development efforts. Mr. Poitevint has also spent time as the Association's Director of Special Assets and Director of Marketing. Prior to joining Farm Credit, Mr. Poitevint worked as a financial analyst in the textile industry. Mr. Poitevint earned a Bachelor's degree in finance from the University of Georgia, and a MBA from Georgia State University. He is also a graduate of the Graduate School of Banking of Louisiana State University.

***Liz Nogowski, Chief Marketing and Administrative Officer:***
Ms. Nogowski joined the Association in 2007, and currently manages the Association's Business Development, Marketing, and HR functions. In addition, Ms. Nogowski is the Corporate Secretary. Ms. Nogowski earned a Bachelor's degree in journalism, with a minor in political science, from Southern Connecticut State University, New Haven, CT. Prior to joining Southwest Georgia Farm Credit, Ms. Nogowski served as the Director of Marketing for the St. Joe Land Company, Florida's largest private land owner at the time, and Director of Public Relations and hospital spokesperson for Tallahassee Memorial HealthCare.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2017, 2016 and 2015, is as follows:

| Name of Individual or Number in Group | Year | Salary | Bonus | Deferred Comp. | *** Change in Pension Value | Per/ Other* | Total** |
|---|---|---|---|---|---|---|---|
| Richard S. Monson | 2017 | $ 299,591 | $ 107,853 | $ – | $ 113,908 | $ 8,892 | $ 530,244 |
| Richard S. Monson | 2016 | $ 285,325 | $ 82,853 | $ – | $ 214,631 | $ 7,812 | $ 590,621 |
| Richard S. Monson | 2015 | $ 270,519 | $ 94,682 | $ – | $ (57,178) | $ 7,250 | $ 315,273 |
| 6 | 2017 | $ 1,002,912 | $ 417,053 | $ - | $ 412,391 | $ 16,104 | $ 1,848,460 |
| 6 | 2016 | $ 948,297 | $ 301,800 | $ – | $ 558,102 | $ 15,890 | $ 1,824,089 |
| 5 | 2015 | $ 906,061 | $ 378,144 | $ – | $ 71.967 | $ 15,947 | $ 1,372,119 |

**Amounts in the above table classified as Perquisites/Other include items, i.e., group life insurance, and automobile compensation.*
***The disclosure of information on the total compensation paid to any senior officer or to any other employee included in the aggregate group total as reported in the table above is available and will be disclosed to the shareholders of the institution upon request.*
****The changes in pension values as reflected in the table above resulted primarily from changes in the actuarial assumptions for mortality and discount rate.*

*See further discussion in Note 9, Employee Benefit Plans, of the Financial Statements.*

*On February 4, 2015, the FCA Board approved the final rule, "Disclosure to Shareholders; Pension Benefit Disclosures." The rule amends FCA Regulations to exclude employee compensation from being reported in the Summary Compensation Table if the employee would be considered a "highly compensated employee" solely because of payments related to or change(s) in value of the employee's qualified pension plan provided that the plan was available to all similarly situated employees on the same basis at the time the employee joined the plan. System banks and associations must comply with the rule for compensation reported in the table for the fiscal year ending 2015, and may implement the rule retroactively for the fiscal years ended 2014.. The Association applied the rule for 2014 retroactively..*

The table below provides information on Pension Benefits provided to the CEO, senior officers, and other highly compensated employees as a group.

**Pension Benefits Table**
**As of December 31, 2017**

| Name of Individual or Number in Group | Year | Plan Name | Number of Years Credited Service | Actuarial Present Value of Accumulated Benefits | Payments During 2017 |
|---|---|---|---|---|---|
| **CEO:** | | | | | |
| Richard Monson | 2017 | AgFirst Retirement Plan | 33 | $ 2,806,047 | $ – |
| | | | | $ 2,806,047 | $ – |
| **Senior Officers and Highly Compensated Employees:** | | | | | |
| 3 Officers, excluding the CEO | 2017 | AgFirst Retirement Plan | 36.14 | $ 6,212,975 | $ – |
| 3 Officers, excluding the CEO | 2017 | AgFirst Cash Balance Retirement Plan | 11.52 | – | 98,800 |
| | | | | $ 6,212,975 | $ 98,800 |

*Additional information can be found in Note 9 of the Notes to the Combined Financial Statements of Southwest Georgia Farm Credit, ACA and District Associations' Annual Reports.*

In November 2014, the AgFirst Plan Sponsor Committee approved and executed amendments to the CB Plan that included the following changes:

(1) The Plan was closed to new participants effective as December 31, 2017. Based on the Plan's eligibility provisions, this change affected employees hired on or after November 4, 2014.
(2) No further employer contributions will be credited to participants in the Plan effective as of January 1, 2015.
(3) All participants who were not already fully vested in the Plan became fully vested as of December 31, 2017.
(4) The Plan will be terminated effective as of December 31, 2017.

Following the termination of the Plan, vested benefits will be distributed to participants. Participants will continue to receive interest credits to their hypothetical cash balance accounts following the termination of the Plan through the month immediately preceding the month in which the vested benefits are distributed from the Plan.

Curtailment accounting, as prescribed in ASC 715 "Compensation – Retirement Benefits," was initiated upon execution of the plan amendments and did not have a material impact on the Bank's financial condition or results of operations.

Beginning on January 1, 2015, for participants in the CB Plan and eligible employees hired on or after November 4, 2014, an additional employer contribution will be made to the 401(k) Plan equal to 3 percent of the participants' eligible compensation.

In addition to a base salary, certain employees may earn additional compensation under employee performance and profit sharing plans. Credit quality goals, the payment of dividend distributions to the Association's membership, and Association profit goals established in the incentive plan must be met before any incentive is paid. Employee profit sharing and incentives are shown in the year earned, which may be different than the year paid. Profits distributed under the employee performance and the Employee Profit Sharing Plans are paid in the first quarter of the year following the fiscal year in which they are earned. The Association's compensation

plans are designed to motivate employees and to help the Association meet and exceed the organizational objectives and financial goals, without taking undue risk.

Distributions under the Employee Profit Sharing Plan are awarded when the profits generated meet or exceed the targets, set by management and have been approved by the Board.

Incentives earned under the Discretionary Incentive Plan will be paid the first pay period following approval. Discretionary incentives may be recommended at any time by any member of the management team, including supervisors of one or more employees, on the behalf of any employee who has demonstrated meritorious performance. Payment under the Discretionary Incentive Plan cannot exceed $250 for any single instance and no more than two within a twelve month period. The plan operates on a calendar year and includes all supervised employees below a specific grade.

The Association's Relationship Manager Performance Plan is designed to focus on sales and marketing and recognizes each relationship manager on his or her individual sales goals as set by management. The goals set by management are designed to appropriately emphasize and recognize both quality and profitability of the business development effort. The primary goals include new customer volume, new volume and the quality and profitability of the transactions. The volume goals are set at the level necessary to meet projected financial performance. The four additional goals are: (1) Young, Beginning, and Small Farmer, (2) Guarantees, (3) Auto Draft/Online Payments, and (4) Loans to New Members. Each goal is assigned a separate rate of compensation and is aggregated for a total payment. The Relationship Manager Performance Plan is paid quarterly following the quarter in which they are earned.

Annually, the Compensation Committee (board representation) reviews the compensation plans for approval and funding. All Board Compensation Committee minutes are reviewed by the board of directors.

The Board Compensation Committee recommended approval of the Employee Performance and Profit Sharing Plans, Relationship Manager Performance Plan and Discretionary Incentive Plan to the Board, and the Board approved these plans on December 21, 2016.

Additionally, senior officers as well as all employees, are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Disclosure of information on the total compensation paid during 2017 to any senior officer, or to any other individual included in the aggregate, is available to shareholders upon request.

**Directors**

Directors and senior officers are reimbursed on an actual cost basis for all reasonable and necessary expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request. The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $75,738 for 2017, $55,986 for 2016 and $79,757 for 2015.

Subject to approval by the board, directors are compensated for board meeting attendance and special assignments. As of December 31, 2017, an honorarium of $700 is paid for attendance at board meetings. Audit Committee meetings are compensated at $800 for attendance and $400 for attendance at other committee meetings, and special assignments. Telephonic participation is compensated at $100. The Chairman of the Board receives an additional honorarium of $100 per board meeting. In addition, directors on the Executive Committee (Chairman and Vice Chairman) receive a quarterly fee up to $150 for incidental services and the Chairman of the Audit Committee receives an additional honorarium of $200 per Audit Committee meeting. Expenses incurred in connection with the attendance of the spouse of a director at a compensable function may be reimbursable upon a determination by the board chairman that the attendance of the spouse was or will be beneficial to the purpose of the meeting, and such reimbursement will not be reported as compensation. Total compensation paid to directors, as a group was $110,950. No Directors received any noncash compensation during 2017.

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

| | Days served | | | | |
|---|---|---|---|---|---|
| **Name of Director** | **Regular Board Meetings** | ***Other Official Activities** | **Committee Meetings Attended** | **Committee Assignments** | **Comp. Paid** |
| Kimbley D. Rentz, Chairman | 7 | 5 | 6 | Executive | $ 9,600 |
| James H. Dixon, Jr., Vice-Chairman | 7 | 19 | 21 | Building, Compensation, Executive, RIMCO (Risk Management) | 19,250 |
| John M. Bridges, Jr. | 6 | 10 | 10 | Governance, RIMCO (Risk Management) | 10,400 |
| Jeffrey A. Clark | 7 | 6 | 17 | Audit, Governance, RIMCO (Risk Management) | 13,800 |
| Clifford Dollar, Jr. | 7 | 9 | 9 | Audit, Governance | 12,200 |
| George T. Harrison, Jr. | 7 | 6 | 11 | Audit, Compensation | 12,600 |
| Robert L. Holden, Sr. | 7 | 25 | 19 | Audit, Building, Compensation, Executive, Governance | 22,700 |
| Edward D. Milliron | 5 | 10 | 11 | Compensation, RIMCO (Risk Management) | 10,400 |
| | | | | **Total** | **$110,950** |

** Other Official Activities include Miscellaneous Committee Meetings, Director Training, AgFirst Annual Meeting, FCC Annual Meeting, ACA Annual Meeting,*

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years:

***Kimbley D. Rentz***, Chairman, has farmed for 43 years. He joined the Board in 2013 and is presently serving a three-year term, which will expire in 2019. His farming operation includes approximately 3,000 acres, and he primarily produces cotton, peanuts, and sweet corn. He also owns a small cattle operation. A native of Miller County who currently resides in Colquitt, Mr. Rentz attended The University of Georgia for three years, where he majored in accounting. He currently serves on the board of the Decatur County Farm Bureau, an insurance and farm-related services provider; Three Notch EMC, an electric cooperative; Sweet Corn Coop, a sweet corn cooler; Decatur Gin, a cotton gin.

***James H. Dixon, Jr., Vice-Chairman,*** is a resident of Camilla in Mitchell County. He is a graduate of The University of Georgia with a bachelor's degree in Agricultural Economics. Mr. Dixon, who joined the Board in 2011, is a poultry producer and is presently serving a three-term, which will expire in 2020.

***John M. Bridges, Jr.,*** has farmed for more than 37 years. He currently produces cotton, peanuts, green beans and other vegetables. Mr. Bridges is a graduate of The University of Georgia with a degree in Animal Science. He serves on the boards of the Decatur County Farm Bureau, Southwest Georgia Academy, and AFG Feeds. Mr. Bridges resides in Brinson, Georgia. His term expires in 2018.

***Jeffrey A. Clark, Ph.D.,*** is a Professor of Finance at The Florida State University, Tallahassee, Florida where he teaches Financial Institutions Management and Financial Risk Management. He was appointed as an Association Outside Director in 2005. His term will expire in 2020. Mr. Clark serves as the Chairman of the Audit Committee, and Governance Committee and is a member of the Risk Management Committee (RIMCO). He resides in Tallahassee, Florida.

***Clifford Dollar, Jr.*** is a native of Bainbridge and attended Abraham Baldwin Agricultural College. A cotton, peanut and cattle farmer for the past 51 years, he has served the Association as a Board member since 1987. He is presently serving a three-year term, which will expire in 2018. Mr. Dollar also serves as president of the Board of SOWEGA Cotton, Inc., a cotton gin.

***George Thomas Harrison, Jr.,*** is a resident of Thomasville in Thomas County. He is a graduate of The Florida State University, Tallahassee, Florida with degrees in Accounting and Finance. Mr. Harrison joined the board in 2017. He is a Certified Public Accountant and Certified Financial Planner. Mr. Harrison, a partner in the CPA Firm, Lanigan & Associates P.C., where he practices as a tax partner specializing in taxation with special interest in timber, real estate investment and development, and pass through entities. Mr. Harrison's experience includes working with the accounting and agricultural sectors, specifically pertaining to forest products, farm machinery dealerships, financial planning, and accounting for timber, row crops, peanut and vegetable operations.

***Robert L. Holden, Sr.*** is a beef, poultry and row crop producer who lives near Whigham in Grady County and joined the board in 1987. His current term will expire in 2019. Mr. Holden, previously served as Director and Chairman of the Board of AgFirst Farm Credit Bank, the funding bank and service provider for associations in 15 states and the Commonwealth of Puerto Rico; Georgia Milk Producers as Director and Chairman of the Board of this organization, tasked with awareness and education for the dairy industry; Director and Chairman of the Board of the American Dairy Association of Georgia , an organization which educates consumers on the importance of consumption, nutrition, and marketing of milk and milk products; the board of the Grady County Farm Bureau, an insurance and farm related services provider; and as Director for the Sunshine State's Dairymen's Cooperative, a cooperative that markets its members' milk.

***Ted Milliron,*** is a resident of Randolph County and fifth generation crop and pecan farmer. He graduated from The University of Georgia with a degree in Agricultural Economics. His farm operation includes cotton, peanuts, corn, soybeans, oats, wheat, and pecans. Mr. Milliron currently serves on the boards of the Randolph County Farm Bureau, an insurance and farm related services provider, Randolph County Board of Assessors, and Milliron Farms. Mr. Milliron's term expires in 2018.

**Transactions with Senior Officers and Directors**

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

**Involvement in Certain Legal Proceedings**

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

**Relationship with Independent Auditors**

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

Aggregate fees incurred by the Association for services rendered by its Independent Auditors for the year ended December 31, 2017 were as follows:

| | 2017 |
|---|---|
| ***Independent Auditors*** | |
| PricewaterhouseCoopers LLP - | $ 71,157 |
| Audit services | $ 71,157 |

Audit service fees were for the annual audit of the Consolidated Financial Statements.

**Relationship with Third Party Service Provider**

| | | 2017 |
|---|---|---|
| ***3rd Party Service Provider*** | | |
| Harper, Rains, Knight & Company | | |
| Nonaudit services | $ | 124,192 |
| Tax services | | 20,195 |
| Total | $ | 144,387 |

Nonaudit services included internal credit reviews, internal operation review, Sarbanes Oxley compliance review and other miscellaneous reviews as needed.

**Consolidated Financial Statements**

The Consolidated Financial Statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 13 2018 and the report of management, which appear in this Annual Report, are incorporated herein by reference.

Copies of the Association's Annual and Quarterly Reports are available upon request free of charge by calling 1-229-246-0384 or toll free 1-866-304-3276, or writing Southwest Georgia Farm Credit, ACA, 305 Colquitt Highway, Bainbridge, Georgia 39817, Attention: Chief Financial Officer, or accessing the web site, ***www.swgafarmcredit.com***. The Association prepares an electronic version of the Annual Report which is available on the Association's web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly Report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution. Should you have questions concerning the financial reports or any other information contained within this Annual Report please contact the Stockholder Relations Department by calling 1-866-304-3276, extension 1149.

**Borrower Information Regulations**

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

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

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

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

**Shareholder Investment**

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

# Report of the Audit Committee

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

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

PricewaterhouseCoopers LLP (PwC), the Association's Independent Auditors for 2017, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 *(The Auditor's Communication With Those Charged With Governance)*. The Committee discussed with PwC its independence from the Association. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2017. The foregoing report is provided by the following independent directors, who constitute the Committee:

Jeffrey A. Clark
Chairman of the Audit Committee

**Members of Audit Committee**

George T. Harrison, Jr.
Robert L. Holden, Sr.
Clifford Dollar, Jr.

March 13 2018

## Report of Independent Auditors

To the Board of Directors and Management of
Southwest Georgia Farm Credit, ACA

We have audited the accompanying consolidated financial statements of Southwest Georgia Farm Credit, ACA and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2017, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in members' equity and cash flows for the years then ended.

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

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

### *Auditors' Responsibility*

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

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

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southwest Georgia Farm Credit, ACA and its subsidiaries as of December 31, 2017, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP
Certified Public Accountants
Miami, Florida

March 13, 2018

*PricewaterhouseCoopers LLP, 333 SE 2nd Avenue, Suite 3000, Miami, FL 33131*
*T: (305) 375 7400, F:(305) 375 6221,* www.pwc.com/us

# Consolidated Balance Sheets

| *(dollars in thousands)* | December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| **Assets** | | | |
| Cash | **$ 4,617** | $ 2,041 | $ 3,250 |
| Investment securities: | | | |
| Held to maturity (fair value of $6,425, $6,993, and $14,444, respectively) | **6,078** | 6,684 | 14,276 |
| Loans | **414,337** | 377,128 | 399,296 |
| Allowance for loan losses | **(4,057)** | (4,031) | (4,201) |
| Net loans | **410,280** | 373,097 | 395,095 |
| Loans held for sale | **—** | 200 | — |
| Accrued interest receivable | **5,814** | 5,437 | 5,775 |
| Investments in other Farm Credit institutions | **15,761** | 15,103 | 12,713 |
| Premises and equipment, net | **3,078** | 3,116 | 3,271 |
| Other property owned | **129** | 823 | 1,449 |
| Accounts receivable | **11,757** | 9,560 | 8,140 |
| Other assets | **47** | 1,692 | 2,228 |
| Total assets | **$ 457,561** | $ 417,753 | $ 446,197 |
| **Liabilities** | | | |
| Notes payable to AgFirst Farm Credit Bank | **$ 361,645** | $ 327,863 | $ 361,669 |
| Accrued interest payable | **861** | 689 | 772 |
| Patronage refunds payable | **5,044** | 4,796 | 4,028 |
| Accounts payable | **588** | 660 | 1,719 |
| Other liabilities | **6,409** | 7,259 | 5,084 |
| Total liabilities | **374,547** | 341,267 | 373,272 |
| Commitments and contingencies (Note 11) | | | |
| **Members' Equity** | | | |
| Protected borrower stock | **—** | 1 | 7 |
| Capital stock and participation certificates | **1,271** | 1,174 | 1,147 |
| Retained earnings | | | |
| Allocated | **16,037** | 17,434 | 19,124 |
| Unallocated | **65,706** | 57,877 | 52,647 |
| Total members' equity | **83,014** | 76,486 | 72,925 |
| Total liabilities and members' equity | **$ 457,561** | $ 417,753 | $ 446,197 |

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

# Consolidated Statements of Comprehensive Income

| (dollars in thousands) | For the year ended December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| **Interest Income** | | | |
| Loans | **$ 19,091** | $ 18,144 | $ 18,341 |
| Investments | **376** | 650 | 770 |
| Total interest income | **19,467** | 18,794 | 19,111 |
| **Interest Expense** | | | |
| Notes payable to AgFirst Farm Credit Bank | **9,693** | 9,031 | 9,063 |
| Net interest income | **9,774** | 9,763 | 10,048 |
| Provision for (reversal of allowance for) loan losses | **14** | (183) | (166) |
| Net interest income after provision for (reversal of allowance for) loan losses | **9,760** | 9,946 | 10,214 |
| **Noninterest Income** | | | |
| Loan fees | **609** | 679 | 750 |
| Fees for financially related services | **8** | 1 | 9 |
| Patronage refunds from other Farm Credit institutions | **11,815** | 9,586 | 8,177 |
| Gains (losses) on sales of premises and equipment, net | **21** | 16 | 16 |
| Total other-than-temporary impairment losses on investments | **—** | — | (91) |
| Other noninterest income | **70** | 96 | 83 |
| Total noninterest income | **12,523** | 10,378 | 8,944 |
| **Noninterest Expense** | | | |
| Salaries and employee benefits | **5,104** | 4,988 | 4,929 |
| Postretirement benefits (Notes 2 and 9) | **157** | 1,463 | 1,500 |
| Occupancy and equipment | **598** | 568 | 600 |
| Insurance Fund premiums | **494** | 541 | 418 |
| (Gains) losses on other property owned, net | **319** | 95 | 356 |
| Other operating expenses | **2,767** | 2,696 | 2,507 |
| Total noninterest expense | **9,439** | 10,351 | 10,310 |
| Income before income taxes | **12,844** | 9,973 | 8,848 |
| Provision for income taxes | **15** | — | — |
| Net income | **12,829** | 9,973 | 8,848 |
| Other comprehensive income | **—** | — | — |
| Comprehensive income | **$ 12,829** | $ 9,973 | $ 8,848 |

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

# Consolidated Statements of Changes in Members' Equity

| *(dollars in thousands)* | Protected Borrower Stock | Capital Stock and Participation Certificates | Retained Earnings Allocated | Retained Earnings Unallocated | Total Members' Equity |
|---|---|---|---|---|---|
| Balance at December 31, 2014 | $ 11 | $ 1,080 | $ 22,631 | $ 47,750 | $ 71,472 |
| Comprehensive income | | | | 8,848 | 8,848 |
| Protected borrower stock issued/(retired), net | (4) | | | | (4) |
| Capital stock/participation certificates | | | | | |
| issued/(retired), net | | 67 | | | 67 |
| Patronage distribution | | | | | |
| Cash | | | | (3,955) | (3,955) |
| Retained earnings retired | | | (3,510) | | (3,510) |
| Patronage distribution adjustment | | | 3 | 4 | 7 |
| Balance at December 31, 2015 | $ 7 | $ 1,147 | $ 19,124 | $ 52,647 | $ 72,925 |
| Comprehensive income | | | | 9,973 | 9,973 |
| Protected borrower stock issued/(retired), net | (6) | | | | (6) |
| Capital stock/participation certificates | | | | | |
| issued/(retired), net | | 27 | | | 27 |
| Patronage distribution | | | | | |
| Cash | | | | (4,743) | (4,743) |
| Retained earnings retired | | | (1,690) | | (1,690) |
| Balance at December 31, 2016 | $ 1 | $ 1,174 | $ 17,434 | $ 57,877 | $ 76,486 |
| **Comprehensive income** | | | | **12,829** | **12,829** |
| **Protected borrower stock issued/(retired), net** | **(1)** | | | | **(1)** |
| **Capital stock/participation certificates** | | | | | |
| **issued/(retired), net** | | **97** | | | **97** |
| **Patronage distribution** | | | | | |
| **Cash** | | | | **(5,000)** | **(5,000)** |
| **Retained earnings retired** | | | **(1,397)** | | **(1,397)** |
| **Balance at December 31, 2017** | **$ —** | **$ 1,271** | **$ 16,037** | **$ 65,706** | **$ 83,014** |

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

# Consolidated Statements of Cash Flows

| (dollars in thousands) | For the year ended December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net income | **$ 12,829** | $ 9,973 | $ 8,848 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation on premises and equipment | **278** | 278 | 276 |
| Amortization (accretion) of net deferred loan costs (fees) | **36** | (57) | 41 |
| Premium amortization (discount accretion) on investments | **(1)** | (3) | — |
| Provision for (reversal of allowance for) loan losses | **14** | (183) | (166) |
| (Gains) losses on other property owned | **244** | 25 | 222 |
| Net impairment losses on investments | **—** | — | 91 |
| (Gains) losses on sales of premises and equipment, net | **(21)** | (16) | (16) |
| Changes in operating assets and liabilities: | | | |
| Origination of loans held for sale | **(8,858)** | (200) | — |
| Proceeds from sales of loans held for sale, net | **9,058** | — | — |
| (Increase) decrease in accrued interest receivable | **(377)** | 338 | (576) |
| (Increase) decrease in accounts receivable | **(2,197)** | (1,420) | 1,059 |
| (Increase) decrease in other assets | **1,645** | 536 | (2) |
| Increase (decrease) in accrued interest payable | **172** | (83) | 66 |
| Increase (decrease) in accounts payable | **(72)** | (1,059) | 1,148 |
| Increase (decrease) in other liabilities | **(850)** | 2,175 | (1,096) |
| Total adjustments | **(929)** | 331 | 1,047 |
| Net cash provided by (used in) operating activities | **11,900** | 10,304 | 9,895 |
| **Cash flows from investing activities:** | | | |
| Proceeds from maturities of or principal payments received on investment securities, held to maturity | **607** | 7,595 | 327 |
| Net (increase) decrease in loans | **(37,233)** | 21,662 | (14,667) |
| (Increase) decrease in investment in other Farm Credit institutions | **(658)** | (2,390) | (1,342) |
| Purchases of premises and equipment | **(240)** | (123) | (94) |
| Proceeds from sales of premises and equipment | **21** | 16 | 18 |
| Proceeds from sales of other property owned | **450** | 1,177 | 786 |
| Net cash provided by (used in) investing activities | **(37,053)** | 27,937 | (14,972) |
| **Cash flows from financing activities:** | | | |
| Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net | **33,782** | (33,806) | 14,720 |
| Protected borrower stock retired | **(1)** | (6) | (4) |
| Capital stock and participation certificates issued/(retired), net | **97** | 27 | 67 |
| Patronage refunds and dividends paid | **(4,752)** | (3,975) | (4,515) |
| Retained earnings retired | **(1,397)** | (1,690) | (3,510) |
| Net cash provided by (used in) financing activities | **27,729** | (39,450) | 6,758 |
| Net increase (decrease) in cash | **2,576** | (1,209) | 1,681 |
| Cash, beginning of period | **2,041** | 3,250 | 1,569 |
| Cash, end of period | **$ 4,617** | $ 2,041 | $ 3,250 |
| | | | |
| **Supplemental schedule of non-cash activities:** | | | |
| Receipt of property in settlement of loans | **$ —** | $ 576 | $ 456 |
| Estimated cash dividends or patronage distributions declared or payable | **5,000** | 4,743 | 3,955 |
| **Supplemental information:** | | | |
| Interest paid | **9,521** | 9,114 | 8,997 |
| Taxes (refunded) paid, net | **11** | — | — |

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

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)*

**Note 1 — Organization and Operations**

A. **Organization:** Southwest Georgia Farm Credit, ACA (the Association or ACA) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in the counties of Baker, Calhoun, Chattahoochee, Clay, Decatur, Dougherty, Early, Grady, Lee, Marion, Miller, Mitchell, Quitman, Randolph, Schley, Seminole, Stewart, Sumter, Terrell, Thomas, and Webster in the state of Georgia.

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

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

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

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

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation at its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure base amount to System institutions. However, it must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

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

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

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

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

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

Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

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

**Note 2 — Summary of Significant Accounting Policies**

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

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

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

A. **Cash:** Cash represents cash on hand and on deposit at banks.

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

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

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and could include loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

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

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

Loans are charged off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

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

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

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

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

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

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

C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.

D. **Other Property Owned:** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) from Other Property Owned, Net in the Consolidated Statements of Comprehensive Income.

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

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

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

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

   Securities for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity (HTM) and carried at amortized cost. Investment securities classified as available-for-sale (AFS) are carried at fair value with net unrealized gains and losses included as a component of Other Comprehensive Income (OCI). Purchase premiums and discounts are amortized or accreted ratably over the term of the respective security using the interest method.

   The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. As mentioned above, changes in the fair value of AFS investments are reflected in OCI, unless the investment is deemed to be other-than-temporarily impaired (OTTI). Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as

a "credit loss"). If the Association intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but the Association does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and is separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is charged to current earnings, with the remainder of the loss amount recognized in other comprehensive income.

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

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

***Other Investments***
The Association holds minority equity interests in a Rural Business Investment Company (RBIC). This investment is accounted for under the cost method and is carried at the lower of cost or fair value.

***Investment in Other Farm Credit Institutions***
The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock, as presented on the Consolidated Balance Sheets as Investments in Other Farm Credit Institutions. Accounting for this investment is on the cost plus allocated equities basis.

G. **Voluntary Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as other liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

H. **Employee Benefit Plans:** The Association participates in District and multi-District sponsored benefit plans. These plans may include defined benefit final average pay retirement, defined benefit cash balance retirement, defined benefit other postretirement benefits, and defined contribution plans.

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

Additional information for the above may be found in Note 9 and the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report.

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

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

Since the foregoing plans are multi-employer, the Association does not apply the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations for the pension plan and in the Annual Information Statement of the Farm Credit System for the other postretirement benefits plan.

Additional information for the above may be found in Note 9 and in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report and in the Notes to the Annual Information Statement of the Farm Credit System.

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

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

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

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

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

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

K. **Valuation Methodologies:** FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It prescribes three levels of inputs that may be used to measure fair value.

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

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

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

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

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

Please see further discussion in Note 8.

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

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

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

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

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

In February 2017, the FASB issued ASU 2017-05 Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The Update clarifies whether certain transactions are within the scope of the guidance on derecognition and the accounting for partial sales of nonfinancial assets, and defines the term in substance nonfinancial asset. The amendments conform the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. The amendments will be effective for reporting periods beginning after December 15, 2017 for public business entities. The Association does not expect these amendments to have a material effect on its financial statements.

In October 2016, the FASB issued ASU 2016-16 Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This Update requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. For public business entities, the amendments are effective, on a modified retrospective basis, for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. The Association does not expect these amendments to have a material effect on its financial statements.

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). This Update eliminates 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 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. 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. The Association elected retrospective early adoption of this guidance. The criteria of the standard were not significantly different from the Association's policy in place at adoption. Application of the guidance had no impact on the Association's Statements of Cash Flows.

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

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

In January 2016, the FASB issued ASU 2016-01 Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The Update is intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP. The ASU will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years for public business entities. The Association does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance changes the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. This guidance also includes expanded disclosure requirements that result in an entity providing users of financial

statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Based on input received from stakeholders, the FASB has issued several additional Updates that generally provide clarifying guidance where there was the potential for diversity in practice, or address the cost and complexity of applying Topic 606. The guidance and all related updates will be effective for reporting periods beginning after December 15, 2017 for public business entities. The amendments are to be applied retrospectively. The Association has identified ancillary revenues that will be affected by this Update. However, because financial instruments are not within the scope of the guidance, it is expected that adoption will not have a material impact on the Association's financial condition or results of operations. The Association expects to adopt the guidance in first quarter 2018 using the modified retrospective method and that adoption will result in additional disclosures.

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

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

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

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

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

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

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.
- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.
- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.
- Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.
- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.
- Communication loans — loans primarily to finance rural communication providers.
- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.
- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.
- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.
- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans outstanding at period end follows:

| | December 31, 2017 | December 31, 2016 | December 31, 2015 |
|---|---|---|---|
| Real estate mortgage | $ 230,267 | $ 214,858 | $ 242,579 |
| Production and intermediate-term | 116,018 | 94,377 | 88,900 |
| Loans to cooperatives | 583 | 1,770 | – |
| Processing and marketing | 31,476 | 37,834 | 42,406 |
| Farm-related business | 19,123 | 19,060 | 18,141 |
| Communication | 8,649 | 4,801 | 3,721 |
| Power and water/waste disposal | 3,940 | 911 | 932 |
| Rural residential real estate | 1,793 | 1,483 | 1,813 |
| International | 1,752 | 1,751 | – |
| Lease receivables | 736 | 283 | 804 |
| Total loans | $ 414,337 | $ 377,128 | $ 399,296 |

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

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

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

| December 31, 2017 | Within AgFirst District | | Within Farm Credit System | | Outside Farm Credit System | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $ 18,193 | $ 145,983 | $ 3,362 | $ – | $ 1,869 | $ – | $ 23,424 | $ 145,983 |
| Production and intermediate-term | 14,549 | 81,402 | 1,046 | – | – | – | 15,595 | 81,402 |
| Loans to cooperatives | 586 | – | – | – | – | – | 586 | – |
| Processing and marketing | 19,340 | 52,446 | – | 405 | – | – | 19,340 | 52,851 |
| Farm-related business | – | 12,376 | – | 334 | – | – | – | 12,710 |
| Communication | 8,676 | – | – | – | – | – | 8,676 | – |
| Power and water/waste disposal | 3,953 | – | – | – | – | – | 3,953 | – |
| International | 1,754 | – | – | – | – | – | 1,754 | – |
| Lease receivables | – | – | 736 | – | – | – | 736 | – |
| Total | $ 67,051 | $ 292,207 | $ 5,144 | $ 739 | $ 1,869 | $ – | $ 74,064 | $ 292,946 |

| December 31, 2016 | Within AgFirst District | | Within Farm Credit System | | Outside Farm Credit System | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Real estate mortgage | $ 19,538 | $ 141,157 | $ – | $ – | $ 1,950 | $ – | $ 21,488 | $ 141,157 |
| Production and intermediate-term | 15,191 | 75,534 | – | – | 600 | – | 15,791 | 75,534 |
| Loans to cooperatives | 1,773 | – | – | – | – | – | 1,773 | – |
| Processing and marketing | 20,315 | 70,255 | 1,137 | 476 | – | – | 21,452 | 70,731 |
| Farm-related business | – | 13,126 | – | 390 | – | – | – | 13,516 |
| Communication | 4,812 | – | – | – | – | – | 4,812 | – |
| Power and water/waste disposal | 916 | – | – | – | – | – | 916 | – |
| International | 1,754 | – | – | – | – | – | 1,754 | – |
| Lease receivables | – | – | 283 | – | – | – | 283 | – |
| Total | $ 64,299 | $ 300,072 | $ 1,420 | $ 866 | $ 2,550 | $ – | $ 68,269 | $ 300,938 |

| | 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 | $ 13,930 | $ 123,313 | $ – | $ – | $ 2,026 | $ – | $ 15,956 | $ 123,313 |
| Production and intermediate-term | 9,652 | 61,233 | – | 444 | – | – | 9,652 | 61,677 |
| Processing and marketing | 27,786 | 27,687 | 419 | 900 | – | – | 28,205 | 28,587 |
| Farm-related business | 3,234 | 12,304 | – | – | – | – | 3,234 | 12,304 |
| Communication | 3,726 | – | – | – | – | – | 3,726 | – |
| Power and water/waste disposal | 937 | – | – | – | – | – | 937 | – |
| Lease receivables | – | – | 804 | – | – | – | 804 | – |
| Total | $ 59,265 | $ 224,537 | $ 1,223 | $ 1,344 | $ 2,026 | $ – | $ 62,514 | $ 225,881 |

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

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Due less than 1 year | Due 1 Through 5 years | Due after 5 years | Total |
| Real estate mortgage | $ 396 | $ 27,841 | $ 202,030 | $ 230,267 |
| Production and intermediate-term | 33,676 | 63,093 | 19,249 | 116,018 |
| Loans to cooperatives | – | 583 | – | 583 |
| Processing and marketing | 325 | 17,081 | 14,070 | 31,476 |
| Farm-related business | 2,149 | 11,659 | 5,315 | 19,123 |
| Communication | – | 4,921 | 3,728 | 8,649 |
| Power and water/waste disposal | – | – | 3,940 | 3,940 |
| Rural residential real estate | – | 90 | 1,703 | 1,793 |
| International | – | 1,404 | 348 | 1,752 |
| Lease receivables | – | 640 | 96 | 736 |
| Total loans | $ 36,546 | $ 127,312 | $ 250,479 | $ 414,337 |
| Percentage | 8.82% | 30.73% | 60.45% | 100.00% |

The recorded investment in a receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.
The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

| | December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **Real estate mortgage:** | | | |
| Acceptable | 98.27% | 99.11% | 99.45% |
| OAEM | 1.25 | 0.70 | 0.23 |
| Substandard/doubtful/loss | 0.48 | 0.19 | 0.32 |
| | 100.00% | 100.00% | 100.00% |
| **Production and intermediate-term:** | | | |
| Acceptable | 97.86% | 98.19% | 96.40% |
| OAEM | 1.02 | 0.68 | 2.38 |
| Substandard/doubtful/loss | 1.12 | 1.13 | 1.22 |
| | 100.00% | 100.00% | 100.00% |
| **Loans to cooperatives:** | | | |
| Acceptable | 100.00% | 100.00% | –% |
| OAEM | – | – | – |
| Substandard/doubtful/loss | – | – | – |
| | 100.00% | 100.00% | –% |
| **Processing and marketing:** | | | |
| Acceptable | 100.00% | 100.00% | 100.00% |
| OAEM | – | – | – |
| Substandard/doubtful/loss | – | – | – |
| | 100.00% | 100.00% | 100.00% |
| **Farm-related business:** | | | |
| Acceptable | 87.72% | 85.92% | 86.27% |
| OAEM | – | – | 13.73 |
| Substandard/doubtful/loss | 12.28 | 14.08 | – |
| | 100.00% | 100.00% | 100.00% |

| | December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **Communication:** | | | |
| Acceptable | 100.00% | 100.00% | 100.00% |
| OAEM | – | – | – |
| Substandard/doubtful/loss | – | – | – |
| | 100.00% | 100.00% | 100.00% |
| **Power and water/waste disposal:** | | | |
| Acceptable | 100.00% | 100.00% | 100.00% |
| OAEM | – | – | – |
| Substandard/doubtful/loss | – | – | – |
| | 100.00% | 100.00% | 100.00% |
| **Rural residential real estate:** | | | |
| Acceptable | 90.70% | 88.44% | 80.17% |
| OAEM | – | – | 10.01 |
| Substandard/doubtful/loss | 9.30 | 11.56 | 9.82 |
| | 100.00% | 100.00% | 100.00% |
| **International:** | | | |
| Acceptable | 100.00% | 100.00% | –% |
| OAEM | – | – | – |
| Substandard/doubtful/loss | – | – | – |
| | 100.00% | 100.00% | –% |
| **Lease receivables:** | | | |
| Acceptable | 100.00% | 100.00% | 100.00% |
| OAEM | – | – | – |
| Substandard/doubtful/loss | – | – | – |
| | 100.00% | 100.00% | 100.00% |
| **Total Loans:** | | | |
| Acceptable | 97.83% | 98.29% | 98.16% |
| OAEM | 0.98 | 0.57 | 1.33 |
| Substandard/doubtful/loss | 1.19 | 1.14 | 0.51 |
| | 100.00% | 100.00% | 100.00% |

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

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | 30 Through 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans | Recorded Investment 90 Days or More Past Due and Accruing Interest |
| Real estate mortgage | $ 1,474 | $ 119 | $ 1,593 | $ 231,935 | $ 233,528 | $ – |
| Production and intermediate-term | 314 | 899 | 1,213 | 116,720 | 117,933 | – |
| Loans to cooperatives | – | – | – | 586 | 586 | – |
| Processing and marketing | – | – | – | 31,865 | 31,865 | – |
| Farm-related business | 267 | – | 267 | 19,015 | 19,282 | – |
| Communication | – | – | – | 8,679 | 8,679 | – |
| Power and water/waste disposal | – | – | – | 3,942 | 3,942 | – |
| Rural residential real estate | – | – | – | 1,800 | 1,800 | – |
| International | – | – | – | 1,754 | 1,754 | – |
| Lease receivables | – | – | – | 739 | 739 | – |
| Total | $ 2,055 | $ 1,018 | $ 3,073 | $ 417,035 | $ 420,108 | $ – |

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | 30 Through 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans | Recorded Investment 90 Days or More Past Due and Accruing Interest |
| Real estate mortgage | $ 29 | $ – | $ 29 | $ 218,176 | $ 218,205 | $ – |
| Production and intermediate-term | – | 163 | 163 | 95,696 | 95,859 | – |
| Loans to cooperatives | – | – | – | 1,779 | 1,779 | – |
| Processing and marketing | – | – | – | 38,213 | 38,213 | – |
| Farm-related business | – | – | – | 19,212 | 19,212 | – |
| Communication | – | – | – | 4,802 | 4,802 | – |
| Power and water/waste disposal | – | – | – | 913 | 913 | – |
| Rural residential real estate | 172 | – | 172 | 1,318 | 1,490 | – |
| International | – | – | – | 1,753 | 1,753 | – |
| Lease receivables | – | – | – | 284 | 284 | – |
| Total | $ 201 | $ 163 | $ 364 | $ 382,146 | $ 382,510 | $ – |

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | 30 Through 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans | Recorded Investment 90 Days or More Past Due and Accruing Interest |
| Real estate mortgage | $ 440 | $ – | $ 440 | $ 245,996 | $ 246,436 | $ – |
| Production and intermediate-term | 308 | 315 | 623 | 89,619 | 90,242 | – |
| Processing and marketing | – | – | – | 42,744 | 42,744 | – |
| Farm-related business | – | – | – | 18,267 | 18,267 | – |
| Communication | – | – | – | 3,721 | 3,721 | – |
| Power and water/waste disposal | – | – | – | 932 | 932 | – |
| Rural residential real estate | 176 | – | 176 | 1,645 | 1,821 | – |
| Lease receivables | – | – | – | 806 | 806 | – |
| Total | $ 924 | $ 315 | $ 1,239 | $ 403,730 | $ 404,969 | $ – |

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

| | December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| **Nonaccrual loans:** | | | |
| Real estate mortgage | $ 117 | $ 177 | $ 199 |
| Production and intermediate-term | 954 | 503 | 558 |
| Total | $ 1,071 | $ 680 | $ 757 |
| **Accruing restructured loans:** | | | |
| Real estate mortgage | $ 1,394 | $ 1,443 | $ 1,492 |
| Production and intermediate-term | 13 | 16 | 46 |
| Total | $ 1,407 | $ 1,459 | $ 1,538 |
| **Accruing loans 90 days or more past due:** | | | |
| Total | $ – | $ – | $ – |
| Total nonperforming loans | $ 2,478 | $ 2,139 | $ 2,295 |
| Other property owned | 129 | 823 | 1,449 |
| Total nonperforming assets | $ 2,607 | $ 2,962 | $ 3,744 |
| Nonaccrual loans as a percentage of total loans | 0.26% | 0.18% | 0.19% |
| Nonperforming assets as a percentage of total loans and other property owned | 0.63% | 0.78% | 0.93% |
| Nonperforming assets as a percentage of capital | 3.14% | 3.87% | 5.13% |

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

| Impaired loans: | December 31, 2017 | 2016 | 2015 |
|---|---|---|---|
| **Nonaccrual loans:** | | | |
| Current as to principal and interest | $ 53 | $ 517 | $ 271 |
| Past due | 1,018 | 163 | 486 |
| Total | 1,071 | 680 | 757 |
| **Accrual loans:** | | | |
| Restructured | 1,407 | 1,459 | 1,538 |
| 90 days or more past due | – | – | – |
| Total | 1,407 | 1,459 | 1,538 |
| Total impaired loans | $ 2,478 | $ 2,139 | $ 2,295 |
| Additional commitments to lend | $ – | $ – | $ – |

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

| | December 31, 2017 | | | Year Ended December 31, 2017 | |
|---|---|---|---|---|---|
| **Impaired loans:** | **Recorded Investment** | **Unpaid Principal Balance** | **Related Allowance** | **Average Impaired Loans** | **Interest Income Recognized on Impaired Loans** |
| **With a related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 1,287 | $ 1,273 | $ 53 | $ 1,276 | $ 27 |
| Production and intermediate-term | 709 | 732 | 73 | 704 | 15 |
| Total | $ 1,996 | $ 2,005 | $ 126 | $ 1,980 | $ 42 |
| **With no related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 224 | $ 271 | $ – | $ 222 | $ 5 |
| Production and intermediate-term | 258 | 324 | – | 256 | 5 |
| Total | $ 482 | $ 595 | $ – | $ 478 | $ 10 |
| **Total impaired loans:** | | | | | |
| Real estate mortgage | $ 1,511 | $ 1,544 | $ 53 | $ 1,498 | $ 32 |
| Production and intermediate-term | 967 | 1,056 | 73 | 960 | 20 |
| Total | $ 2,478 | $ 2,600 | $ 126 | $ 2,458 | $ 52 |

| Impaired loans: | December 31, 2016<br>Recorded Investment | Unpaid Principal Balance | Related Allowance | Year Ended December 31, 2016<br>Average Impaired Loans | Interest Income Recognized on Impaired Loans |
|---|---|---|---|---|---|
| **With a related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 1,318 | $ 1,305 | $ 51 | $ 1,410 | $ 22 |
| Production and intermediate-term | 120 | 120 | 22 | 128 | 2 |
| Total | $ 1,438 | $ 1,425 | $ 73 | $ 1,538 | $ 24 |
| **With no related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 302 | $ 380 | $ – | $ 322 | $ 4 |
| Production and intermediate-term | 399 | 489 | – | 427 | 7 |
| Total | $ 701 | $ 869 | $ – | $ 749 | $ 11 |
| **Total impaired loans:** | | | | | |
| Real estate mortgage | $ 1,620 | $ 1,685 | $ 51 | $ 1,732 | $ 26 |
| Production and intermediate-term | 519 | 609 | 22 | 555 | 9 |
| Total | $ 2,139 | $ 2,294 | $ 73 | $ 2,287 | $ 35 |

| Impaired loans: | December 31, 2015<br>Recorded Investment | Unpaid Principal Balance | Related Allowance | Year Ended December 31, 2015<br>Average Impaired Loans | Interest Income Recognized on Impaired Loans |
|---|---|---|---|---|---|
| **With a related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 1,351 | $ 1,337 | $ 33 | $ 1,550 | $ 17 |
| Production and intermediate-term | 238 | 262 | 55 | 273 | 3 |
| Total | $ 1,589 | $ 1,599 | $ 88 | $ 1,823 | $ 20 |
| **With no related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 340 | $ 410 | $ – | $ 390 | $ 4 |
| Production and intermediate-term | 366 | 414 | – | 420 | 5 |
| Total | $ 706 | $ 824 | $ – | 810 | $ 9 |
| **Total impaired loans:** | | | | | |
| Real estate mortgage | $ 1,691 | $ 1,747 | $ 33 | $ 1,940 | $ 21 |
| Production and intermediate-term | 604 | 676 | 55 | 693 | 8 |
| Total | $ 2,295 | $ 2,423 | $ 88 | $ 2,633 | $ 29 |

Interest income recognized on nonaccrual and accruing restructured loans was $52, $35, and $29 for 2017, 2016, and 2015, respectively.

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

| | Real Estate Mortgage | Production and Intermediate-term | Agribusiness* | Communication | Power and Water/Waste Disposal | Rural Residential Real Estate | International | Lease Receivables | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Activity related to the allowance for credit losses:** | | | | | | | | | |
| Balance at December 31, 2016 | $ 2,305 | $ 1,014 | $ 616 | $ 50 | $ 10 | $ 15 | $ 18 | $ 3 | $ 4,031 |
| Charge-offs | (3) | (19) | – | – | – | – | – | – | (22) |
| Recoveries | 7 | 27 | – | – | – | – | – | – | 34 |
| Provision for loan losses | (70) | 154 | (132) | 31 | 27 | 2 | (2) | 4 | 14 |
| Balance at December 31, 2017 | $ 2,239 | $ 1,176 | $ 484 | $ 81 | $ 37 | $ 17 | $ 16 | $ 7 | $ 4,057 |
| Balance at December 31, 2015 | $ 2,521 | $ 976 | $ 623 | $ 38 | $ 10 | $ 25 | $ – | $ 8 | $ 4,201 |
| Charge-offs | – | (216) | – | – | – | – | – | – | (216) |
| Recoveries | 3 | 226 | – | – | – | – | – | – | 229 |
| Provision for loan losses | (219) | 28 | (7) | 12 | – | (10) | 18 | (5) | (183) |
| Balance at December 31, 2016 | $ 2,305 | $ 1,014 | $ 616 | $ 50 | $ 10 | $ 15 | $ 18 | $ 3 | $ 4,031 |
| Balance at December 31, 2014 | $ 2,677 | $ 1,062 | $ 558 | $ 38 | $ 11 | $ 26 | $ – | $ 16 | $ 4,388 |
| Charge-offs | – | (49) | – | – | – | – | – | – | (49) |
| Recoveries | – | 28 | – | – | – | – | – | – | 28 |
| Provision for loan losses | (156) | (65) | 65 | – | (1) | (1) | – | (8) | (166) |
| Balance at December 31, 2015 | $ 2,521 | $ 976 | $ 623 | $ 38 | $ 10 | $ 25 | $ – | $ 8 | $ 4,201 |
| **Allowance on loans evaluated for impairment:** | | | | | | | | | |
| Individually | $ 53 | $ 73 | $ – | $ – | $ – | $ – | $ – | $ – | $ 126 |
| Collectively | 2,186 | 1,103 | 484 | 81 | 37 | 17 | 16 | 7 | 3,931 |
| Balance at December 31, 2017 | $ 2,239 | $ 1,176 | $ 484 | $ 81 | $ 37 | $ 17 | $ 16 | $ 7 | $ 4,057 |
| Individually | $ 51 | $ 22 | $ – | $ – | $ – | $ – | $ – | $ – | $ 73 |
| Collectively | 2,254 | 992 | 616 | 50 | 10 | 15 | 18 | 3 | 3,958 |
| Balance at December 31, 2016 | $ 2,305 | $ 1,014 | $ 616 | $ 50 | $ 10 | $ 15 | $ 18 | $ 3 | $ 4,031 |
| Individually | $ 33 | $ 55 | $ – | $ – | $ – | $ – | $ – | $ – | $ 88 |
| Collectively | 2,488 | 921 | 623 | 38 | 10 | 25 | – | 8 | 4,113 |
| Balance at December 31, 2015 | $ 2,521 | $ 976 | $ 623 | $ 38 | $ 10 | $ 25 | $ – | $ 8 | $ 4,201 |
| **Recorded investment in loans evaluated for impairment:** | | | | | | | | | |
| Individually | $ 1,511 | $ 967 | $ – | $ – | $ – | $ – | $ – | $ – | $ 2,478 |
| Collectively | 232,017 | 116,966 | 51,733 | 8,679 | 3,942 | 1,800 | 1,754 | 739 | 417,630 |
| Balance at December 31, 2017 | $ 233,528 | $ 117,933 | $ 51,733 | $ 8,679 | $ 3,942 | $ 1,800 | $ 1,754 | $ 739 | $ 420,108 |
| Individually | $ 1,620 | $ 519 | $ – | $ – | $ – | $ – | $ – | $ – | $ 2,139 |
| Collectively | 216,585 | 95,340 | 59,204 | 4,802 | 913 | 1,490 | 1,753 | 284 | 380,371 |
| Balance at December 31, 2016 | $ 218,205 | $ 95,859 | $ 59,204 | $ 4,802 | $ 913 | $ 1,490 | $ 1,753 | $ 284 | $ 382,510 |
| Individually | $ 1,691 | $ 604 | $ – | $ – | $ – | $ – | $ – | $ – | $ 2,295 |
| Collectively | 244,745 | 89,638 | 61,011 | 3,721 | 932 | 1,821 | – | 806 | 402,674 |
| Balance at December 31, 2015 | $ 246,436 | $ 90,242 | $ 61,011 | $ 3,721 | $ 932 | $ 1,821 | $ – | $ 806 | $ 404,969 |

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

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. The guaranteed balance of designated loans under these agreements was $47,723, $57,264, and $67,313 at December 31, 2017, 2016, and 2015, respectively. Fees paid for such guarantee commitments totaled $124, $153, and $166 for 2017, 2016, and 2015, respectively. These amounts are classified as noninterest expense.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented. There were no new TDRs that occurred during 2015.

| | Year Ended December 31, 2017 | | | | |
|---|---|---|---|---|---|
| **Outstanding Recorded Investment** | **Interest Concessions** | **Principal Concessions** | **Other Concessions** | **Total** | **Charge-offs** |
| **Pre-modification:** | | | | | |
| Production and intermediate-term | $ – | $ 22 | $ – | $ 22 | |
| Total | $ – | $ 22 | $ – | $ 22 | |
| **Post-modification:** | | | | | |
| Production and intermediate-term | $ – | $ 13 | $ – | $ 13 | $ – |
| Total | $ – | $ 13 | $ – | $ 13 | $ – |

| Outstanding Recorded Investment | Interest Concessions | Principal Concessions | Other Concessions | Total | Charge-offs |
|---|---|---|---|---|---|
| | Year Ended December 31, 2016 | | | | |
| **Pre-modification:** | | | | | |
| Production and intermediate-term | $ – | $ 173 | $ – | $ 173 | |
| Total | $ – | $ 173 | $ – | $ 173 | |
| **Post-modification:** | | | | | |
| Production and intermediate-term | $ – | $ 173 | $ – | $ 173 | $ – |
| Total | $ – | $ 173 | $ – | $ 173 | $ – |

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 | | |
|---|---|---|---|---|---|---|
| | December 31, | | | December 31, | | |
| | 2017 | 2016 | 2015 | 2017 | 2016 | 2015 |
| Real estate mortgage | $ 1,394 | $ 1,443 | $ 1,492 | $ – | $ – | $ – |
| Production and intermediate-term | 149 | 142 | 48 | 136 | 126 | 2 |
| Total loans | $ 1,543 | $ 1,585 | $ 1,540 | $ 136 | $ 126 | $ 2 |
| Additional commitments to lend | $ – | $ – | $ – | | | |

The following table presents information as of period end:

| | December 31, 2017 |
|---|---|
| Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession | $ – |
| Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process | $ – |

## Note 4 — Investments

***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. At December 31, 2017, the Association held one RAB totaling $852 whose credit quality has deteriorated beyond the program limits.

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

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| RABs | $ 6,078 | $ 452 | $ (105) | $ 6,425 | 6.03% |

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| RABs | $ 6,684 | $ 404 | $ (95) | $ 6,993 | 5.96% |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| RABs | $ 14,276 | $ 469 | $ (301) | $ 14,444 | 5.32% |

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

| | December 31, 2017 | | |
|---|---|---|---|
| | Amortized Cost | Fair Value | Weighted Average Yield |
| In one year or less | $ 1,304 | $ 1,311 | 5.75% |
| After one year through five years | – | – | – |
| After five years through ten years | – | – | – |
| After ten years | 4,774 | 5,114 | 6.11 |
| Total | $ 6,078 | $ 6,425 | 6.03% |

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.

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| RABs | $ – | $ – | $ 660 | $ (105) |

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| RABs | $ 1,955 | $ (82) | $ 67 | $ (13) |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| RABs | $ 8,691 | $ (301) | $ – | $ – |

The recording of an impairment loss is predicated on: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, and (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the Association intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the full difference between amortized cost and fair value of the security. When the Association does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment (OTTI) 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 OTTI analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the credit worthiness of bond insurers, and (7) volatility of the fair value changes.

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

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

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

***Investments in Other Farm Credit Institutions***

Investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. Accounting for this investment is on the cost plus allocated equities basis.

The Association's investment in the Bank totaled $14,655 for 2017, $13,931 for 2016 and $11,355 for 2015. The Association owns 5.48 percent of the issued stock of the Bank as of December 31, 2017 net of any reciprocal investment. As of that date, the Bank's assets totaled $32.5 billion and shareholders' equity totaled $2.2 billion. The Bank's earnings were $345 million for 2017. In addition, the Association had an investment of $1,106 related to other Farm Credit institutions at December 31, 2017.

***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 $572. 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 ultimately wrote the investment value down to $0.

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

***Premises and Equipment***
Premises and equipment consists of the following:

| | December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Land | $ 655 | $ 650 | $ 650 |
| Buildings and improvements | 3,583 | 3,538 | 3,513 |
| Furniture and equipment | 1,460 | 1,447 | 1,416 |
| | 5,698 | 5,635 | 5,579 |
| Less: accumulated depreciation | 2,620 | 2,519 | 2,308 |
| Total | $ 3,078 | $ 3,116 | $ 3,271 |

***Other Property Owned***
Net (gains) losses on other property owned consist of the following:

| | December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| (Gains) losses on sale, net | $ (4) | $ – | $ (2) |
| Carrying value unrealized (gains) losses | 248 | 25 | 224 |
| Operating (income) expense, net | 75 | 70 | 134 |
| (Gains) losses on other property owned, net | $ 319 | $ 95 | $ 356 |

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2017, 2016, and 2015.

**Note 6 — Debt**

***Notes Payable to AgFirst Farm Credit Bank***
Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2017, the Association's notes payable were within the specified limitations.

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

The weighted average interest rates on the variable rate notes were 2.55 percent for LIBOR-based loans and 2.72 percent for Prime-based loans, and the weighted average remaining maturities were 3.9 years and 5.2 years, respectively, at December 31, 2017. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 2.91 percent and the weighted average remaining maturity was 9.6 years at December 31, 2017. The weighted average interest rate on all interest-bearing notes payable was 2.82 percent and the weighted average remaining maturity was 8.2 years at December 31, 2017. Variable rate and fixed rate notes payable represent approximately 14.50 percent and 85.50 percent, respectively, of total notes payable at December 31, 2017. The weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

**Note 7 — Members' Equity**

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

A. **Protected Borrower Equity:** Protection of certain borrower equity is provided under the Farm Credit Act which requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

B. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm-related business loans, as a condition of borrowing. The initial

borrower investment, through either purchase or transfer, must be in an amount equal to the lesser of $1 thousand or two percent of the amount of the loan. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

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

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

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

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

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

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

| Ratio | Minimum Requirement | Capital Conservation Buffer* | Minimum Requirement with Capital Conservation Buffer | Capital Ratios as of December 31, 2017 |
|---|---|---|---|---|
| Risk-adjusted ratios: | | | | |
| CET1 Capital Ratio | 4.5% | 0.625% | 5.125% | 13.04% |
| Tier 1 Capital Ratio | 6.0% | 0.625% | 6.625% | 13.04% |
| Total Capital Ratio | 8.0% | 0.625% | 8.625% | 15.53% |
| Permanent Capital Ratio | 7.0% | 0.0% | 7.0% | 14.70% |
| Non-risk-adjusted: | | | | |
| Tier 1 Leverage Ratio | 4.0% | 1.0% | 5.0% | 12.26% |
| UREE Leverage Ratio | 1.5% | 0.0% | 1.5% | 14.45% |

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

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

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

The Association had the following shares outstanding at December 31, 2017:

| | | Shares Outstanding | |
|---|---|---|---|
| **Class** | **Protected** | **Number** | **Aggregate Par Value** |
| A Common/Nonvoting | Yes | 76 | $ – |
| C Common/Voting | No | 240,024 | 1,200 |
| C Participation Certificates/Nonvoting | No | 14,150 | 71 |
| Total Capital Stock and Participation Certificates | | 254,250 | $ 1,271 |

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

*Retained Earnings*

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

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

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

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2017, allocated members' equity consisted of $6,330 of nonqualified allocated surplus and $9,707 of nonqualified retained surplus.

*Dividend Distributions*

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

If the Association meets its capital adequacy standards after making the dividend distributions, the dividend distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Dividend distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified dividend distribution to any borrower for any fiscal year shall always be paid in cash. Amounts not distributed are retained as unallocated members' equity.

*Dividends*

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

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

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

*Transfer*

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

*Impairment*

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Assistance preferred Stock
2. Allocated Retained Earnings in its entirety
3. Class C Common Stock and Class C Participation Certificates
4. Classes A and B Common Stock and Class B Participation Certificates
5. Classes A and D Preferred Stock

*Liquidation*

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

1. Classes A and D Preferred Stock
2. Classes A and B Common Stock and Class B Participation Certificates
3. Class C Common Stock and Class C Participation Certificates
4. Allocated surplus evidenced by qualified written notices of allocation on the basis of oldest allocations first
5. Allocated surplus evidenced by nonqualified notices of allocation on the basis of oldest allocations first
6. All Unallocated Retained Earnings issued after January 1, 1995 shall be distributed to the holders of Class C Stock and Class C Participation Certificates from January 1, 1995 through the date of liquidation on a dividend basis; and
7. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to the number of shares or units of such class of stock or participation certificates held by such holders.

## Note 8 — Fair Value Measurement

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

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

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

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

**Level 1**
The Association had no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 2017. For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

**Level 2**
The Association had no Level 2 assets or liabilities measured at fair value.

**Level 3**
Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

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

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

earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

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

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

There are no observable market values for the Association's RBIC investments. Management must estimate the fair value based on an assessment of the operating performance of the company and available capital to operate the venture. This analysis requires significant judgment and actual sales values could differ materially from those estimated.

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

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

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | Total Carrying Amount | Level 1 | Level 2 | Level 3 | Total Fair Value |
| **Recurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Recurring Assets | $ – | $ – | $ – | $ – | $ – |
| **Liabilities:** | | | | | |
| Recurring Liabilities | $ – | $ – | $ – | $ – | $ – |
| **Nonrecurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Impaired loans | $ 1,870 | $ – | $ – | $ 1,870 | $ 1,870 |
| Other property owned | 129 | – | – | 142 | 142 |
| Nonrecurring Assets | $ 1,999 | $ – | $ – | $ 2,012 | $ 2,012 |
| **Other Financial Instruments** | | | | | |
| **Assets:** | | | | | |
| Cash | $ 4,617 | $ 4,617 | $ – | $ – | $ 4,617 |
| Investment securities, held-to-maturity | 6,078 | – | – | 6,425 | 6,425 |
| Loans | 408,410 | – | – | 399,660 | 399,660 |
| Other Financial Assets | $ 419,105 | $ 4,617 | $ – | $ 406,085 | $ 410,702 |
| **Liabilities:** | | | | | |
| Notes payable to AgFirst Farm Credit Bank | $ 361,645 | $ – | $ – | $ 358,408 | $ 358,408 |
| Other Financial Liabilities | $ 361,645 | $ – | $ – | $ 358,408 | $ 358,408 |

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Total Carrying Amount | Level 1 | Level 2 | Level 3 | Total Fair Value |
| **Recurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Recurring Assets | $ – | $ – | $ – | $ – | $ – |
| **Liabilities:** | | | | | |
| Recurring Liabilities | $ – | $ – | $ – | $ – | $ – |
| **Nonrecurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Impaired loans | $ 1,365 | $ – | $ – | $ 1,365 | $ 1,365 |
| Other property owned | 823 | – | – | 926 | 926 |
| Nonrecurring Assets | $ 2,188 | $ – | $ – | $ 2,291 | $ 2,291 |
| **Other Financial Instruments** | | | | | |
| **Assets:** | | | | | |
| Cash | $ 2,041 | $ 2,041 | $ – | $ – | $ 2,041 |
| Investment securities, held-to-maturity | 6,684 | – | – | 6,993 | 6,993 |
| Loans | 371,932 | – | – | 363,164 | 363,164 |
| Other Financial Assets | $ 380,657 | $ 2,041 | $ – | $ 370,157 | $ 372,198 |
| **Liabilities:** | | | | | |
| Notes payable to AgFirst Farm Credit Bank | $ 327,863 | $ – | $ – | $ 323,757 | $ 323,757 |
| Other Financial Liabilities | $ 327,863 | $ – | $ – | $ 323,757 | $ 323,757 |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Total Carrying Amount | Level 1 | Level 2 | Level 3 | Total Fair Value |
| **Recurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Recurring Assets | $ – | $ – | $ – | $ – | $ – |
| **Liabilities:** | | | | | |
| Recurring Liabilities | $ – | $ – | $ – | $ – | $ – |
| **Nonrecurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Impaired loans | $ 1,501 | $ – | $ – | $ 1,501 | $ 1,501 |
| Other property owned | 1,449 | – | – | 1,689 | 1,689 |
| Nonrecurring Assets | $ 2,950 | $ – | $ – | $ 3,190 | $ 3,190 |
| **Other Financial Instruments** | | | | | |
| **Assets:** | | | | | |
| Cash | $ 3,250 | $ 3,250 | $ – | $ – | $ 3,250 |
| Investment securities, held-to-maturity | 14,276 | – | – | 14,444 | 14,444 |
| Loans | 393,594 | – | – | 390,806 | 390,806 |
| Other Financial Assets | $ 411,120 | $ 3,250 | $ – | $ 405,250 | $ 408,500 |
| **Liabilities:** | | | | | |
| Notes payable to AgFirst Farm Credit Bank | $ 361,669 | $ – | $ – | $ 360,449 | $ 360,449 |
| Other Financial Liabilities | $ 361,669 | $ – | $ – | $ 360,449 | $ 360,449 |

## 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 |
|---|---|---|---|---|
| Other investments-RBIC | $ – | Third party evaluation | Income, expense, capital | Not applicable |
| Impaired loans and other property owned | $ 2,012 | Appraisal | Income and expense | * |
| | | | Comparable sales | * |
| | | | Replacement costs | * |
| | | | Comparability adjustments | * |

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

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

| | Valuation Technique(s) | Input |
|---|---|---|
| Cash | Carrying Value | Par/Principal and appropriate interest yield |
| Loans | Discounted cash flow | Prepayment forecasts |
| | | Probability of default |
| | | Loss severity |
| 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 9 — Employee Benefit Plans**

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

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

The Association previously participated in a separate multi-employer plan, the AgFirst Farm Credit Cash Balance Retirement Plan which is a cash balance plan (CB Plan). In November 2014, the AgFirst Plan Sponsor Committee approved and executed amendments to the CB Plan that included the following changes:

1. The CB Plan was closed to new participants effective as of December 31, 2014. Based on the plan's eligibility provisions, this change affected employees hired on or after November 4, 2014.
2. Employer contributions were discontinued effective as of January 1, 2015.
3. All participants who were not already fully vested in the CB Plan became fully vested as of December 31, 2014.
4. The CB Plan was terminated effective as of December 31, 2015.

Curtailment accounting, as prescribed in ASC 715 "Compensation – Retirement Benefits", was initiated upon execution of the plan amendments and did not have a material impact on the Association's financial condition or results of operations.

A favorable determination letter was received from the Internal Revenue Service, and as a result of the termination of the CB Plan, vested benefits were distributed to participants in 2017.

Beginning on January 1, 2015, for participants in the CB Plan and eligible employees hired on or after November 4, 2014, additional employer contributions are made to the 401(k) Plan equal to 3.00 percent of the participants' eligible compensation.

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

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

During 2017, the method of recording expenses at participating District entities for the FAP and OPEB Plans was modified. Prior to 2017, expense was recorded based on allocations of actuarially-determined costs and any differences between recorded expense and actual contributions were recorded in Other Assets or Other Liabilities on the Consolidated Balance Sheets. For 2017 and future years, participating entities will record employee benefit costs based on the actual contributions to the Plans. This change caused the Association to modify its accounting estimates recorded in Other Assets and Other Liabilities since the assets and liabilities do not impact future contributions to the Plans. The change in estimate resulted in the reduction of Other Assets by $1,648 and the reduction of Other Liabilities by $2,604 on the Association's Balance Sheets, and a total reduction of employee benefit costs on the Association's Statements of Income of $956 during 2017.

The FAP Plan includes other District employees that are not employees of the Association and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Balance Sheets for the AgFirst District. FAP Plan expenses included in employee benefit costs on the Association's Statements of Income were $776 for 2017, $1,008 for 2016, and $1,003 for 2015. At December 31, 2017, 2016, and 2015, the total liability balance for the FAP Plan presented in the District Combined Balance Sheets is $139,104, $119,000, and $123,902, respectively. The FAP Plan is 86.41%, 86.96%, and 85.73% percent funded to the projected benefit obligation as of December 31, 2017, 2016, and 2015, respectively.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. The OPEB Plan includes other Farm Credit System employees that are not employees of the Association or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Statement of Condition for the Farm Credit System. The OPEB Plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs on the Association's Statements of Income were $89 for 2017, $228 for 2016, and $275 for 2015. At December 31, 2017, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition is $216,259.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan , which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association contributes $0.50 for each $1.00 of the employee's first 6.00 percent of contribution (based on total compensation) up to the maximum employer contribution of 3.00 percent of total compensation. For employees hired on or after January 1, 2003, the Association contributes $1.00 for each $1.00 of the employee's first 6.00 percent of contribution up to the maximum employer contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were $247, $227, and $222 for the years ended December 31, 2017, 2016, and 2015, respectively. Beginning in 2015, contributions include additional amounts related to the discontinuation of the CB Plan as discussed above.

Additional information for the above may be found in Note 9 in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report and the Notes to the Annual Information Statement of the Farm Credit System.

**Note 10 — Related Party Transactions**

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates,

amortization schedule, and collateral, as those prevailing at the time for comparable transactions with unaffiliated borrowers.

Total loans to such persons at December 31, 2017 amounted to $11,940. During 2017, $6,858 of new loans were made and repayments totaled $8,242. In the opinion of management, none of these loans outstanding at December 31, 2017 involved more than a normal risk of collectibility.

**Note 11 — Commitments and Contingencies**

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

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

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

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2017, $98,810 of commitments to extend credit and no commercial letters of credit were outstanding. There were no reserves for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets at December 31, 2017.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2017, standby letters of credit outstanding totaled $1,712 with expiration dates ranging from January 2, 2018 to May 1, 2022. The maximum potential amount of future payments that may be required under these guarantees was $1,712.

**Note 12 — Income Taxes**

The provision (benefit) for income taxes follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Current: | | | |
| Federal | $ 15 | $ – | $ – |
| State | – | – | – |
| | 15 | – | – |
| Deferred: | | | |
| Federal | – | – | – |
| State | – | – | – |
| | – | – | – |
| Total provision (benefit) for income taxes | $ 15 | $ – | $ – |

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

| | December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Federal tax at statutory rate | $ 4,495 | $ 3,491 | $ 3,097 |
| State tax, net | – | – | – |
| Dividend distributions | (1,750) | (1,660) | (1,384) |
| Tax-exempt FLCA earnings | (2,640) | (1,477) | (2,050) |
| Change in valuation allowance | (1,928) | (406) | 115 |
| Future tax rate change | 1,832 | – | – |
| Other | 6 | 52 | 222 |
| Provision (benefit) for income taxes | $ 15 | $ – | $ – |

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

| | December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Deferred income tax assets: | | | |
| Allowance for loan losses | $ 599 | $ 841 | $ 981 |
| Pensions and other postretirement benefits | 108 | 557 | 516 |
| Loss carryforwards | 2,876 | 4,344 | 4,794 |
| Gross deferred tax assets | 3,583 | 5,742 | 6,291 |
| Less: valuation allowance | (3,583) | (5,512) | (5,918) |
| Gross deferred tax assets, net of valuation allowance | – | 230 | 373 |
| Deferred income tax liabilities: | | | |
| Loan fees | – | – | – |
| Depreciation | – | – | (13) |
| Pensions and other postretirement benefits | – | (230) | (360) |
| Gross deferred tax liability | – | (230) | (373) |
| Net deferred tax asset (liability) | $ – | $ – | $ – |

At December 31, 2017, deferred income taxes have not been provided by the Association on approximately $2 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of $3,583, $5,512, and $5,918 as of December 31, 2017, 2016 and 2015, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2017 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2014 and forward.

**Note 13 — Additional Financial Information**

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

| | 2017 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 2,206 | $ 2,421 | $ 2,582 | $ 2,565 | $ 9,774 |
| Provision for (reversal of allowance for) loan losses | – | – | 19 | (5) | 14 |
| Noninterest income (expense), net | (288) | (371) | (343) | 4,071 | 3,069 |
| Net income | $ 1,918 | $ 2,050 | $ 2,220 | $ 6,641 | $ 12,829 |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 2,441 | $ 2,509 | $ 2,484 | $ 2,329 | $ 9,763 |
| Provision for (reversal of allowance for) loan losses | – | – | (237) | 54 | (183) |
| Noninterest income (expense), net | (684) | (541) | (583) | 1,835 | 27 |
| Net income | $ 1,757 | $ 1,968 | $ 2,138 | $ 4,110 | $ 9,973 |

| | 2015 | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| Net interest income | $ 2,378 | $ 2,541 | $ 2,660 | $ 2,469 | $ 10,048 |
| Provision for (reversal of allowance for) loan losses | – | – | – | (166) | (166) |
| Noninterest income (expense), net | (742) | (1,058) | (715) | 1,149 | (1,366) |
| Net income | $ 1,636 | $ 1,483 | $ 1,945 | $ 3,784 | $ 8,848 |

**Note 14 — Subsequent Events**

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 13, 2018, which was the date the financial statements were issued.

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