# AgCountry Farm Credit Services, ACA

**Quarterly Report**
**September 30, 2017**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of AgCountry Farm Credit Services, ACA and its subsidiaries AgCountry Farm Credit Services, FLCA and AgCountry Farm Credit Services, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2016 (2016 Annual Report).

Due to the nature of our financial relationship with AgriBank, FCB (AgriBank), the financial condition and results of operations of AgriBank materially impact our members' investment. To request free copies of the AgriBank or the AgriBank District financial reports or additional copies of our report, contact us at:

AgCountry Farm Credit Services, ACA
Post Office Box 6020
Fargo, ND 58108-6020
(701) 282-9494
www.agcountry.com
acndinternet@agcountry.com

AgriBank, FCB
30 East 7th Street, Suite 1600
St. Paul, MN 55101
(651) 282-8800
www.agribank.com
financialreporting@agribank.com

## MERGER ACTIVITY

The merger between AgCountry Farm Credit Services, ACA (AgCountry) and United Farm Credit Services, ACA (United) was effective July 1, 2017. The merged entity, AgCountry Farm Credit Services, ACA, is headquartered in Fargo, ND. The merged entity now serves nearly 18,000 customers in 65 counties in Minnesota, North Dakota, and Wisconsin, and has assets over $7 billion.

The effects of the merger with United are included in our financial position, results of operations, and related metrics beginning July 1, 2017. Prior year results have not been restated to reflect the impact of the merger. Results of operations and equity reflect the results of AgCountry prior to July 1, 2017, and the merged Association after July 1, 2017. Upon the closing of the merger, loans increased $1.7 billion, assets increased by $1.8 billion, liabilities increased by $1.4 billion, and members' equity increased by $309.4 million. These amounts include adjustments to fair value, as required by accounting standards for business combinations.

## FORWARD-LOOKING INFORMATION

Any forward-looking statements in this Quarterly Report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2016 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

## AGRICULTURAL AND ECONOMIC CONDITIONS

World Gross Domestic Product (GDP) is projected to grow 2.9% in 2017 compared to 2.6% in 2016. Global economic growth in 2016 was relatively static due to lower commodity prices, weakening currency valuations for emerging market economies, slower growth in China, and uneven rates of growth in developed economies around the world. Emerging Asia is expected to continue to be the driver of the world economy although growth is expected to be slower in 2017 with projected growth of 6.4% compared to 6.6% in 2016. Growth is expected to remain relatively flat for 2017 due to softer global demand for many export dependent economies. Although still experiencing high levels of growth, the Chinese economy is expected to grow at a slower rate than in the past. Latin America's economy is projected to rebound in 2017 with growth of 0.9% compared to a contraction of 1.5% in 2016. Strong growth in agriculture due to a record harvest in soybeans seems to be pulling Brazil out of its 2016 recession while Venezuela is expected to continue in a recession through 2017. The United Kingdom's (UK) vote to leave the European Union (EU) is expected to slow growth for other EU countries, particularly those that have close trading relationships with the UK. The European Union's GDP is projected to grow 1.7% in 2017 compared to 1.8% in 2016.

U.S. GDP is projected to grow 2.3% in 2017 compared to 1.6% in 2016. Growth in 2016 was impacted by weak foreign demand and a strong dollar putting pressure on exports. The strength of the U.S. dollar is expected to continue to affect competitiveness of U.S. exports in 2017. Inflation is expected to increase with a rate of 2.0% in 2017 compared to 1.3% in 2016. Household spending has continued to rise moderately and business fixed investment has continued to expand.

The Federal Reserve decided to maintain the target range for the federal funds rate at 1.00% to 1.25% during its September meeting. The labor market has continued to strengthen and economic activity has been rising moderately throughout the year. The Federal Reserve expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate. The federal funds rate is likely to remain below levels that are expected to prevail in the longer run for some time. In determining the timing and size of future adjustments to the target range for the federal funds rate, the Federal Reserve will assess realized and expected economic conditions relative to its objectives of maximum employment and 2.00% inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. The Federal Reserve expects to begin implanting a balance sheet normalization program in 2017 to gradually reduce the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities. The unemployment rate increased slightly from the second quarter, with an estimated unemployment rate (seasonally adjusted) of 4.4% in August 2017. Inflation has decreased recently and is still below the Federal Reserve's 2.00% objective. The Federal Reserve's economic projections released during the December meeting projected three 0.25% rate increases in 2017 and three rate increases in 2018 with year-end target average rates of 1.38% and 2.13%, respectively.

Net farm income for 2017 is projected to decrease 8.7% from 2016 to $62.3 billion. If realized, 2017 net farm income would mark the fourth consecutive year of decline since 2013. The decrease in net farm income is primarily due to lower crop and livestock receipts. Production expenses are projected to remain unchanged from 2016 to 2017. Decreases in livestock/poultry purchases, feed, seed, and fertilizer are offset by increases in fuel, oil, labor, and interest expense. Farm asset values are projected to decline 1.1% in 2017 due to the value of farm real estate, animal/animal-product inventories, financial assets, and machinery.

**Specific Production Conditions**

Corn, soybeans, sugar beets, and wheat are the primary cash crops produced in our territory. A summary of each crop is presented below, along with a summary of the cattle, hog, dairy, and ethanol industries.

Average to above average crop production is expected throughout most of our territory in 2017. Minnesota areas will see average to above average production while most North Dakota areas will record above average production. Our southern and eastern territory experienced heavy rain this harvest season, which will limit production in those areas to an average crop. Harvest weather for small grains was very good overall. Fall rains added some challenges to the bean and sugar beet harvest. Overall, results similar to those of 2016 are anticipated.

**Corn:** As of the end of September, corn dented in North Dakota was estimated at 88%, a decrease of 6% from prior year and behind the 93% five-year average. Currently, 53% of the corn crop in North Dakota is rated good to excellent, 31% is rated fair, and 16% is rated poor to very poor. In Minnesota, 81% of the corn crop is rated good to excellent.

As of September, corn production for 2017/18 is now estimated at 14.2 billion bushels, an increase of 32 million bushels from previous estimates. The projected 2017/18 season-average farm price for corn is at $2.80 to $3.60 per bushel. Projected ending stocks increased 62 million bushels with supply increasing and demand falling.

**Soybeans:** As of the end of September, 88% of the soybean crop was dropping leaves in North Dakota. This is similar to prior year and the five-year average. Currently, 52% of the crop is rated good to excellent. In Minnesota, 64% of the soybean crop was dropping leaves with 7% of the crop harvested. Currently, 71% of the Minnesota soybean crop is rated good to excellent.

U.S. soybean production is projected at a record 4,431 million bushels, an increase from the 50 million bushels on a projected higher yield forecast from the prior month. Projected yield is estimated at 49.9 bushels per acre. The September 2017 United States Department of Agriculture (USDA) World Agricultural Supply and Demand Estimates (WASDE) report forecasted the 2017/18 national season-average price for soybeans at $8.35 to $10.35 per bushel.

**Sugar Beets:** Pre-pile harvest began in August and September at all three regional sugar beet cooperatives. A potential record crop is anticipated this harvest season with some yields predicted to reach in excess of 32 tons per acre, contingent on late-season weather. Although total sugar beet acres planted decreased in 2017, with the strong yields growers will be required to leave some percentage of planted acres unharvested to keep storage in line with processing capacity. Cercospora leaf spot disease, which was widespread in 2016 resulting in lower sugar production and grower payments, has been aggressively managed this year. Due to this, an estimated improvement to sugar content and beet quality is anticipated resulting in an increase to grower payments.

In early June 2017, Mexico and the U.S. reached a deal regarding the Suspension Agreement that addressed the issue of Mexico dumping subsidized sugar into the U.S. Under this deal, Mexico has agreed to ship a higher ratio of raw sugar versus refined sugar into the U.S. and will be responsible for enforcing and accepting penalties for violations of the agreement. The U.S. must give Mexico first right of refusal for sugar needs identified by the USDA.

The amended suspension agreements with Mexico should help stabilize the U.S. sugar markets. Refined beet sugar price has steadily increased to 32.13 cents per pound in August, 2017, an increase from 28.50 cents per pound at the end of 2016.

The impacts of hurricanes Harvey and Irma on the sugar industry may not be fully realized for months. However, they could provide some upside price support. Florida's sugar cane crop, which accounts for nearly a quarter of U.S. produced sugar, was heavily damaged during the storms. Sugar futures are indicating a strong trend after September.

**Wheat:** All wheat production totaled 1.7 billion bushels in 2017, a 25% decrease from the revised 2016 total of 2.3 billion bushels. Harvested acres totaled 37.6 million acres, a decrease of 14% from the prior year. The U.S. yield is estimated at 46.3 bushels per acre, down 6.4 bushels from the previous year. Winter wheat production totaled 1.3 billion bushels, a decrease of 24% from 2015. Other spring wheat production totaled 416 million bushels, a decrease of 22% from 2015. Durum wheat production totaled 54.9 million bushels down 47% from 2015. The September 2017 USDA WASDE report estimates the season-average farm price for wheat at $4.30 to $4.90 per bushel.

**Cattle:** The forecast for 2017 commercial beef production is 26.6 billion pounds. This is a decrease of 140 million pounds due to slower expected marketing pace for fed cattle through the remainder of the year despite heavier cattle dressed weights and higher cow slaughter. For 2018, the commercial beef production forecast is lowered from the previous month as a slower rate of placements during the second half of 2017 is likely to result in reduced steer and heifer slaughter in the first half of 2018.

Price forecast for feeder steers in the fourth quarter is $140-$146 per cwt, reducing in the first quarter of 2018 to $132-$140 per cwt. Price forecast for fed steers in the fourth quarter is $107-$113 per cwt with a seasonal rebound to $110-$120 per cwt in the first quarter of 2018.

**Hogs:** The September Quarterly Hogs and Pigs report from USDA indicated that there were 73.5 million hogs and pigs on U.S. farms on September 1, an increase of 2% from the prior year and an increase of 3% from June 1. Of the 73.5 million hogs and pigs, 67.5 million were market hogs while 6.1 million were kept for breeding. Between June 2017 and August 2017, 33 million pigs were weaned on U.S. farms, an increase of 2% from the same time frame one year earlier.

U.S. hog producers intend to have 3.1 million sows farrow between September and November 2017 and 3.0 million sows farrow between December 2017 and February 2018. While these estimates are higher than expected, it is not anticipated that this increase will alter price expectations.

**Dairy:** Milk production forecast for 2017 is higher than earlier estimates as milk per cow has increased despite a decrease in milk cow expansion. Fat basis exports are reduced for 2017 due to slowing cheese shipments while fat basis imports are raised due to increased butterfat purchases. The 2018 milk production forecast is reduced from previous estimates due to slower growth in cow inventories. The all-milk price forecast is reduced to $17.70-$17.90 per cwt for 2017 and $17.75-$18.55 per cwt for 2018.

**Ethanol:** With stocks of ethanol high, all eyes continue to be on the export market. In August, Brazil imposed a two year tariff for ethanol imports. Under the new rule, a 20% tariff will be applied to purchases from the U.S. over approximately 158.5 million gallons per year. Through July, exports to Brazil totaled 310 million gallons. Ethanol supporters have called for action from the U.S. government to develop a response to the tariff. In September, to reduce smog and boost demand for corn, China announced a new plan to have ethanol in its gasoline by 2020. China does not have enough ethanol production at this point and will likely need to import ethanol to meet these new goals.

According to the U.S. Energy Information Administration data for the week ending September 22, 2017, ethanol production averaged 996,000 barrels per day. This is a decrease of 36,000 barrels per day or 3.6% from the prior week, the largest percentage output decline in 66 weeks and a 14 week low. The four week average for ethanol production decreased to 1.0 million barrels per day for an annualized rate of 15.9 billion gallons. Stocks of ethanol were 20.7 million barrels, a decrease of 1.9% from the prior week and the lowest volume of reserve in 37 weeks. There were zero imports recorded for the second week in a row. These factors should help keep ethanol prices stable.

## LOAN PORTFOLIO

### Loan Portfolio

Total loans were $7.0 billion at September 30, 2017, an increase of $1.9 billion from December 31, 2016. The increase was primarily due to the merger with United.

### Portfolio Credit Quality

The credit quality of our portfolio showed a slight improvement from December 31, 2016. Adversely classified loans decreased to 2.9% of the portfolio at September 30, 2017, from 3.0% of the portfolio at December 31, 2016. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At September 30, 2017, $301.3 million of our loans were, to some level, guaranteed under these government programs.

## Risk Assets

**Components of Risk Assets**

| (dollars in thousands)<br>As of: | **September 30**<br>**2017** | December 31<br>2016 |
|---|---|---|
| Loans: | | |
| Nonaccrual | **$ 27,464** | $ 12,246 |
| Accruing restructured | **16** | 1,765 |
| Accruing loans 90 days or more past due | **2,520** | 59 |
| Total risk loans | **30,000** | 14,070 |
| Other property owned | **88** | -- |
| Total risk assets | **$ 30,088** | $ 14,070 |
| Total risk loans as a percentage of total loans | **0.4%** | 0.3% |
| Nonaccrual loans as a percentage of total loans | **0.4%** | 0.2% |
| Current nonaccrual loans as a percentage of total nonaccrual loans | **71.9%** | 64.9% |
| Total delinquencies as a percentage of total loans | **0.2%** | 0.2% |

Note: Accruing loans include accrued interest receivable.

Our risk assets increased from December 31, 2016, primarily due to the merger with United, but remained at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans were well within our established risk management guidelines.

The increase in nonaccrual loans was primarily due to the merger with United**.** Nonaccrual loans remained at an acceptable level at September 30, 2017, and December 31, 2016.

The decrease in accruing restructured loans was primarily due to communication loans, which are included in the other loan category, being refinanced at market terms during the first quarter of 2017.

The increase in accruing loans 90 days or more past due was primarily due to several loans in our production and intermediate term loan category becoming more than 90 days past due during the nine months ended September 30, 2017. Our accounting policy requires loans past due 90 days or more to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, the loans 90 days or more past due and accruing were eligible to remain in accrual status.

## Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

**Allowance Coverage Ratios**

| As of: | **September 30**<br>**2017** | December 31<br>2016 |
|---|---|---|
| Allowance as a percentage of: | | |
| Loans | **0.3%** | 0.3% |
| Nonaccrual loans | **63.9%** | 116.6% |
| Total risk loans | **58.5%** | 101.5% |

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at September 30, 2017.

## RESULTS OF OPERATIONS

**Profitability Information**

| (dollars in thousands)<br>For the nine months ended September 30 | **2017** | 2016 |
|---|---|---|
| Net income | **$ 81,520** | $ 70,233 |
| Return on average assets | **1.8%** | 1.8% |
| Return on average members' equity | **8.4%** | 8.4% |

Changes in the chart above relate directly to:

- Changes in income discussed below,
- Changes in assets discussed in the Loan Portfolio section, and
- Changes in capital discussed in the Funding, Liquidity, and Capital section.

**Changes in Significant Components of Net Income**

| (in thousands)<br>For the nine months ended September 30 | 2017 | 2016 | Increase (decrease) in net income |
|---|---|---|---|
| Net interest income | $ 115,703 | $ 98,161 | $ 17,542 |
| Provision for credit losses | 4,108 | 3,892 | (216) |
| Patronage income | 19,540 | 12,243 | 7,297 |
| Other income, net | 22,504 | 23,830 | (1,326) |
| Operating expenses | 69,684 | 59,348 | (10,336) |
| Provision for income taxes | 2,435 | 761 | (1,674) |
| Net income | $ 81,520 | $ 70,233 | $ 11,287 |

**Changes in Net Interest Income**

| (in thousands)<br>For the nine months ended September 30 | 2017 vs 2016 |
|---|---|
| Changes in volume | $ 16,053 |
| Changes in interest rates | 1,437 |
| Changes in nonaccrual income and other | 52 |
| Net change | $ 17,542 |

The increase in net interest income was largely due to earnings on merged assets coupled with increased loan volume.

The change in patronage income was primarily related to an increase in patronage received from AgriBank due to a higher average balance on our note payable, a higher patronage rate compared to the prior year and an increase in the wholesale spread on our note payable.

The change in other income was primarily related to a decline in operating lease income as we sold a significant portion of our leasing portfolio effective January 1, 2017, to Farm Credit Leasing (FCL). See further discussion in the Relationship with Other Farm Credit Institutions section. In addition, we had increased merger related expenses, which are included in miscellaneous income (loss) net on the Consolidated Statements of Income.

The change in operating expenses was primarily related to increased staffing levels due to the merger and other operating costs.

The change in provision for income taxes was primarily related to an increase in income on our taxable entity.

## FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Effective July 1, 2017, our note payable with AgriBank was for $7.0 billion with a maturity date of June 30, 2019. The note payable is currently in the process of being renegotiated with a maturity date of July 1, 2019. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of funds is from unallocated surplus.

The components of cost of funds associated with our note payable include:

- A marginal cost of debt component,
- A spread component, which includes cost of servicing, cost of liquidity, and bank profit, and
- A risk premium component, if applicable.

We were not subject to a risk premium at September 30, 2017, or December 31, 2016.

Total members' equity increased $376.6 million from December 31, 2016, primarily due to capital acquired through the merger with United**,** net income for the period and an increase in capital stock and participation certificates, partially offset by patronage distribution accruals**.**

The Farm Credit Administration (FCA) Regulations require us to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations.

The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section. Refer to Note 6 of the accompanying Consolidated Financial Statements for additional detail regarding the capital ratios effective as of September 30, 2017. Refer to Note10 in our 2016 Annual Report for a more complete description of the ratios effective as of December 31, 2016.

## RELATIONSHIP WITH AGRIBANK

### Patronage

AgriBank has amended its capital plan effective July 1, 2017, to provide for adequate capital at AgriBank under the new capital regulations as well as to create a path to long-term capital optimization within the AgriBank District. The plan optimizes capital at AgriBank; distributing available AgriBank earnings in the form of patronage, either cash or stock. A key part of these changes involves maintaining capital adequacy such that sufficient earnings will be retained in the form of unallocated retained earnings and allocated stock to meet the leverage ratio target and other regulatory or policy constraints prior to any cash patronage distributions.

### Purchased Services

During 2016, District associations and AgriBank conducted research related to the creation of a separate service entity to provide many of the business services offered by AgriBank. A separate service entity allows District associations and AgriBank to develop and maintain long-term, cost effective technology and business services. The service entity would be owned by certain District associations and AgriBank and will be named SunStream Business Services (SunStream). An application to form the service entity was submitted in May 2017 to the FCA for approval with an intended first quarter of 2018 effective date. The SunStream interim board named Steve Jensen as President, effective November 13, 2017.

## RELATIONSHIP WITH OTHER FARM CREDIT INSTITUTIONS

Effective January 1, 2017, we sold $69.7 million of our finance lease volume and $79.0 million of our equipment/operating lease volume to FCL. We simultaneously purchased approximately 66% interest in the cash flows of the leases sold. This transaction resulted in a gain of $1.2 million during 2016 as a result of writing up the leases to fair value. On the basis of the sale agreement, the fair value of assets relating to the sale was classified as held for sale on the Consolidated Statements of Condition at December 31, 2016. This arrangement provides our members with a broad selection of product offerings and enhanced lease expertise.

## CERTIFICATION

The undersigned have reviewed the September 30, 2017, Quarterly Report of AgCountry Farm Credit Services, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Greg Nelson

Greg Nelson
Chairperson of the Board
AgCountry Farm Credit Services, ACA

Robert C. Bahl

Robert C. Bahl
President/Chief Executive Officer
AgCountry Farm Credit Services, ACA

Jeremy W. Oliver

Jeremy W. Oliver
Chief Financial Officer
AgCountry Farm Credit Services, ACA

November 6, 2017

# CONSOLIDATED STATEMENTS OF CONDITION

*AgCountry Farm Credit Services, ACA*
*(in thousands)*
*(Unaudited)*

| As of: | | **September 30 2017** | | December 31 2016 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Loans | **$** | **6,997,947** | $ | 5,049,534 |
| Allowance for loan losses | | **17,539** | | 14,284 |
| Net loans held to maturity | | **6,980,408** | | 5,035,250 |
| Finance leases held for sale | | **--** | | 70,356 |
| Net loans | | **6,980,408** | | 5,105,606 |
| Investment in AgriBank, FCB | | **156,408** | | 111,196 |
| Investment securities | | **7,059** | | 7,059 |
| Accrued interest receivable | | **100,968** | | 62,041 |
| Premises and equipment, net | | **45,600** | | 36,109 |
| Other property owned | | **88** | | -- |
| Assets held for lease, net | | **10,150** | | 19,646 |
| Leased assets held for sale | | **--** | | 79,623 |
| Other assets | | **69,923** | | 41,190 |
| Total assets | **$** | **7,370,604** | $ | 5,462,470 |
| **LIABILITIES** | | | | |
| Note payable to AgriBank, FCB | **$** | **5,730,726** | $ | 4,201,744 |
| Accrued interest payable | | **26,956** | | 15,398 |
| Deferred tax liabilities, net | | **2,782** | | 26,211 |
| Patronage distribution payable | | **17,780** | | 21,000 |
| Other liabilities | | **47,017** | | 29,401 |
| Total liabilities | | **5,825,261** | | 4,293,754 |
| Contingencies and commitments (Note 7) | | | | |
| **MEMBERS' EQUITY** | | | | |
| Capital stock and participation certificates | | **12,343** | | 7,370 |
| Additional paid-in capital | | **304,385** | | -- |
| Unallocated surplus | | **1,228,615** | | 1,161,346 |
| Total members' equity | | **1,545,343** | | 1,168,716 |
| Total liabilities and members' equity | **$** | **7,370,604** | $ | 5,462,470 |

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF INCOME

*AgCountry Farm Credit Services, ACA*
*(in thousands)*
*(Unaudited)*

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| *For the period ended September 30* | **2017** | 2016 | **2017** | 2016 |
| **Interest income** | **$ 76,163** | $ 48,284 | **$ 177,620** | $ 142,056 |
| **Interest expense** | **27,086** | 15,070 | **61,917** | 43,895 |
| Net interest income | **49,077** | 33,214 | **115,703** | 98,161 |
| **Provision for (reversal of) credit losses** | **1,687** | (1,420) | **4,108** | 3,892 |
| Net interest income after provision for (reversal of) credit losses | **47,390** | 34,634 | **111,595** | 94,269 |
| **Other income** | | | | |
| Patronage income | **10,312** | 4,028 | **19,540** | 12,243 |
| Financially related services income | **11,759** | 9,274 | **17,398** | 14,585 |
| Fee income | **2,090** | 1,840 | **5,561** | 5,216 |
| Miscellaneous income (loss), net | **491** | 1,750 | **(455)** | 4,029 |
| Total other income | **24,652** | 16,892 | **42,044** | 36,073 |
| **Operating expenses** | | | | |
| Salaries and employee benefits | **16,735** | 11,588 | **41,036** | 34,978 |
| Other operating expenses | **10,889** | 8,789 | **28,648** | 24,370 |
| Total operating expenses | **27,624** | 20,377 | **69,684** | 59,348 |
| Income before income taxes | **44,418** | 31,149 | **83,955** | 70,994 |
| **Provision for income taxes** | **822** | 97 | **2,435** | 761 |
| Net income | **$ 43,596** | $ 31,052 | **$ 81,520** | $ 70,233 |

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

*AgCountry Farm Credit Services, ACA*
*(in thousands)*
*(Unaudited)*

| | Capital Stock and Participation Certificates | Additional Paid-in Capital | Unallocated Surplus | Total Members' Equity |
|---|---|---|---|---|
| Balance at December 31, 2015 | $ 7,516 | $ -- | $ 1,076,726 | $ 1,084,242 |
| Net income | -- | -- | 70,233 | 70,233 |
| Unallocated surplus designated for patronage distributions | -- | -- | (12,000) | (12,000) |
| Capital stock and participation certificates issued | 268 | -- | -- | 268 |
| Capital stock and participation certificates retired | (369) | -- | -- | (369) |
| Balance at September 30, 2016 | $ 7,415 | $ -- | $ 1,134,959 | $ 1,142,374 |
| Balance at December 31, 2016 | $ 7,370 | $ -- | $ 1,161,346 | $ 1,168,716 |
| Net income | **--** | **--** | **81,520** | **81,520** |
| Unallocated surplus designated for patronage distributions | **--** | **--** | **(14,251)** | **(14,251)** |
| Equity issued in connection with merger | **5,037** | **304,385** | **--** | **309,422** |
| Capital stock and participation certificates issued | **284** | **--** | **--** | **284** |
| Capital stock and participation certificates retired | **(348)** | **--** | **--** | **(348)** |
| **Balance at September 30, 2017** | **$ 12,343** | **$ 304,385** | **$ 1,228,615** | **$ 1,545,343** |

*The accompanying notes are an integral part of these Consolidated Financial Statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. Our accounting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. This interim Quarterly Report is prepared based upon statutory and regulatory requirements and in accordance with GAAP. However, certain disclosures required by GAAP are omitted. The results of the nine months ended September 30, 2017, are not necessarily indicative of the results to be expected for the year ending December 31, 2017. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report for the year ended December 31, 2016 (2016 Annual Report).

**Merger Activity**

Effective July 1, 2017, United Farm Credit Services, ACA (United) merged into AgCountry Farm Credit Services, ACA (AgCountry). AgCountry acquired 100% of the assets and liabilities of United. The merged entity, AgCountry Farm Credit Services, ACA, is headquartered in Fargo, North Dakota. The primary reason for the merger was to strategically position the associations to best serve member needs. The effects of the merger are included in the Association's results of operations, statement of condition, average balances and related metrics beginning July 1, 2017.

The acquisition method of accounting requires the financial statement presentation of combined balances as of the date of merger, but not for previous periods. The Consolidated Statements of Condition reflects the merged balances as of September 30, 2017. The Consolidated Statements of Income and the Consolidated Statements of Changes in Members' Equity, reflect the results of AgCountry prior to July 1, 2017, and the merged Association after July 1, 2017. Information in the Notes to the Consolidated Financial Statements for 2017 reflects balances of the merged Association as of September 30, or in the case of transactional activity, of the merged Association for the period July 1 to September 30.

As cooperative organizations, Farm Credit associations operate for the mutual benefit of their borrowers and other customers and not for the benefit of equity investors. As such, their capital stock provides no significant interest in corporate earnings or growth. Specifically, due to restrictions in applicable regulations and the bylaws, the associations can issue stock only at its par value of $5 per share, the stock is not tradable, and the stock can be retired only for the lesser of par value or book value. The shares of United stock were converted in the merger into shares of AgCountry stock with identical rights and attributes. For this reason the conversion of United stock pursuant to the merger occurred at a one-for-one exchange ratio (i.e., each United share was converted into one share of AgCountry stock with an equal par value).

Management believes that because the stock in each association is fixed in value (although subject to impairment), the AgCountry stock issued pursuant to the merger provided no basis for estimating the fair value of the consideration transferred pursuant to the merger. In the absence of a purchase price determination, AgCountry undertook a process to identify and estimate the acquisition-date fair value of United's equity interests instead of the acquisition-date fair value of AgCountry's equity interests transferred as consideration. The fair value of the assets acquired, including specific intangible assets and liabilities assumed from United, were measured based on various estimates using assumptions that management believes are reasonable utilizing information currently available. Use of different estimate and judgments could yield materially different results.

The merger was accounted for under the acquisition method of accounting, as prescribed by Accounting Standards Codification (ASC 805, Business Combinations (ASC 805)). Pursuant to these rules, AgCountry acquired the assets and assumed the liabilities of United at their acquisition-date fair value. The fair value of the net identifiable assets acquired ($309.4 million) was substantially equal to the fair value of the equity interest exchanged in the merger. In addition, no material amounts of intangible assets were acquired. As a result, no goodwill was recorded. An increase of $309.4 million was recorded in fair value of net assets acquired related to the merger.

The following condensed statement of net assets acquired reflects the fair value assigned to United's net assets as of the acquisition date. There were no subsequent changes to these fair values.

**Condensed Statement of Net Assets Acquired**

| (in thousands)<br>As of July 1, 2017 | United |
|---|---|
| **Assets** | |
| Net loans | $ 1,666,361 |
| Accrued interest receivable | 15,813 |
| Other assets | 69,997 |
| Total assets | $ 1,752,171 |
| **Liabilities** | |
| Notes payable | $ 1,420,902 |
| Accrued interest payable | 6,747 |
| Other liabilities | 15,100 |
| Total liabilities | $ 1,442,749 |
| Fair value of net assets acquired | $ 309,422 |

Fair value adjustments to United's assets and liabilities included a $3.4 million decrease to loans and a $2.9 million decrease to notes payable to reflect credit discounts and changes in interest rates and other market conditions since the time these instruments were issued. These differences will be accreted or amortized into net interest income over the remaining life of the respective loans and debt instruments on an effective yield basis. The Association expects to collect the substantial majority of the contractual amounts of the acquired loans not considered to be purchased credit impaired, which totaled $1.7 billion at July 1, 2017.

### Significant Accounting Policies

**Purchased Credit-Impaired (PCI) Loans:** Loans acquired through merger with evidence of credit deterioration since their origination and when it is probable that we will not collect all contractually required principal and interest payments are PCI loans. PCI loans are written down at acquisition to estimated fair value and an accretable yield may be established. The excess of cash flows expected to be collected over the carrying value is referred to as the accretable yield and is recognized in interest income using the effective yield method over the remaining life of the loan.

Evidence of credit quality deterioration as of the purchase date may include statistics such as past due and nonaccrual status. Acquired loans that meet our definition of risk loans are generally considered to be credit-impaired and are accounted for as individual loans. Accounting for PCI loans involves estimating fair value at acquisition using the cash flows expected to be collected. As we generally are unable to estimate the timing and amount of future cash flows, measurement is based on the net realizable value of the collateral underlying these loans.

**Allowance for Loan Losses:** For purchased loans acquired that are not deemed impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value. Subsequent to the purchase date, the methods utilized to estimate the required allowance for credit losses for these loans is similar to originated loans; however, we record a provision for credit losses only when the required allowance exceeds any remaining credit discounts. The remaining differences between the purchase price and the unpaid principal balance at the date of acquisition are recorded in interest income over the life of the loans.

### Principles of Consolidation

The Consolidated Financial Statements present the consolidated financial results of AgCountry Farm Credit Services, ACA and its subsidiaries AgCountry Farm Credit Services, FLCA and AgCountry Farm Credit Services, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

### Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business. While we are a nonpublic entity, our financial results are closely related to the Farm Credit Funding Corporation and performance of the Farm Credit System. Therefore, we typically adopt accounting pronouncements on the public effective date or aligned with other System institutions, whichever is earlier.

| Standard | Description | Effective date and financial statement impact |
|---|---|---|
| In March 2017, the FASB issued Accounting Standards Update (ASU) 2017-07 "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." | This guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. Specifically, the guidance requires non-service cost components of net benefit cost to be recognized in a non-operating income line item of the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. | The guidance is effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within those annual periods. For other entities, the amendments in this update are effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted with certain restrictions. We are currently evaluating the impact of the guidance on our results of operations and financial statement disclosures. The guidance will have no impact on the financial condition or cash flows. |
| In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13 "Financial Instruments – Credit Losses." | The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. | The guidance is effective for non-U.S. Securities Exchange Commission filers for annual reporting periods beginning after December 15, 2020, including interim periods within those annual periods. The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2020, and interim periods within annual periods beginning after December 15, 2021. Early adoption is permitted as of annual reporting periods beginning after December 15, 2018, including interim periods within those annual periods. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures. |

| Standard | Description | Effective date and financial statement impact |
|---|---|---|
| In February 2016, the FASB issued ASU 2016-02 "Leases." | The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. | The guidance is effective for public entities for annual reporting periods beginning after December 15, 2018, including interim periods within that year. The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2019, and interim periods the subsequent year. Early adoption is permitted and modified retrospective adoption is required. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures. |
| In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities." | The guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial statements. | The guidance is effective for public entities for annual reporting periods beginning after December 15, 2017, including interim periods within that year. The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Certain disclosure changes are permitted to be immediately adopted for annual reporting periods that have not yet been made available for issuance. Nonpublic entities are no longer required to include certain fair value of financial instruments disclosures as part of these disclosure changes. We have immediately adopted this guidance and have excluded such disclosures from our Notes to Consolidated Financial Statements. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2017, for other applicable sections of the guidance. We are currently evaluating the impact of the remaining guidance on our financial condition, results of operations, cash flows, and financial statement disclosures. |
| In May 2014, the FASB issued ASU 2014-09 "Revenue from Contracts with Customers." | The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. | The guidance is effective for public entities for the first interim reporting periods within the annual reporting periods beginning after December 15, 2017. The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. In March 2016, the FASB issued ASUs 2016-08 and 2016-10 which provided further clarifying guidance on the previously issued standard. We are in the process of reviewing contracts to determine the effect, if any, on our financial condition and results of operations. |

## NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

As a result of the merger we acquired $1.7 billion in loans, of which 96.4% were categorized as having acceptable credit quality and 99.6% were current in payment status. A portion of the acquired loans were considered to be credit-impaired. However, they are not significant to the financial statements as a whole.

**Loans by Type**

(dollars in thousands)

| As of: | **September 30, 2017** | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | | Amount | % | | Amount | % |
| Real estate mortgage | **$** | **2,835,372** | **40.6%** | $ | 1,959,692 | 38.8% |
| Production and intermediate term | | **2,259,615** | **32.3%** | | 1,671,230 | 33.1% |
| Agribusiness | | **1,466,049** | **20.9%** | | 1,119,744 | 22.2% |
| Other | | **436,911** | **6.2%** | | 298,868 | 5.9% |
| Total | **$** | **6,997,947** | **100.0%** | $ | 5,049,534 | 100.0% |

The other category is primarily comprised of energy, communication, and agricultural export finance, and rural residential real estate related loans, as well as finance leases and bonds originated under our mission related investment authority.

## Delinquency

**Aging Analysis of Loans**

| (in thousands)<br>**As of September 30, 2017** | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | **$ 1,968** | **$ 3,563** | **$ 5,531** | **$ 2,887,874** | **$ 2,893,405** | **$ 1,460** |
| Production and intermediate term | **4,605** | **6,059** | **10,664** | **2,285,620** | **2,296,284** | **1,060** |
| Agribusiness | **--** | **304** | **304** | **1,470,933** | **1,471,237** | **--** |
| Other | **--** | **--** | **--** | **437,974** | **437,974** | **--** |
| Total | **$ 6,573** | **$ 9,926** | **$ 16,499** | **$ 7,082,401** | **$ 7,098,900** | **$ 2,520** |

| As of December 31, 2016 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less than 30 Days Past Due | Total | Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 513 | $ 1,315 | $ 1,828 | $ 1,987,776 | $ 1,989,604 | $ -- |
| Production and intermediate term | 5,624 | 1,934 | 7,558 | 1,690,657 | 1,698,215 | 59 |
| Agribusiness | -- | -- | -- | 1,124,149 | 1,124,149 | -- |
| Other | 482 | 216 | 698 | 298,897 | 299,595 | -- |
| Total | $ 6,619 | $ 3,465 | $ 10,084 | $ 5,101,479 | $ 5,111,563 | $ 59 |

Note: Accruing loans include accrued interest receivable.

## Risk Loans

Risk loans are loans for which all principal and interest may not be collected according to the contractual terms.

**Risk Loan Information**

| (in thousands)<br>As of: | **September 30 2017** | December 31 2016 |
|---|---|---|
| Volume with specific allowance | **$ 8,318** | $ 6,180 |
| Volume without specific allowance | **21,682** | 7,890 |
| Total risk loans | **$ 30,000** | $ 14,070 |
| Total specific allowance | **$ 2,829** | $ 1,586 |
| For the nine months ended September 30 | **2017** | 2016 |
| Income on accrual risk loans | **$ 83** | $ 117 |
| Income on nonaccrual loans | **864** | 812 |
| Total income on risk loans | **$ 947** | $ 929 |
| Average risk loans | **$ 28,921** | $ 17,458 |

Note: Accruing loans include accrued interest receivable. In addition, risk loans include purchased credit-impaired loans.

We did not have any material commitments to lend additional money to borrowers whose loans were at risk at September 30, 2017.

## Troubled Debt Restructurings (TDRs)

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a restructured loan. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as TDRs are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.

We completed TDRs of certain production and intermediate term loans during the nine months ended September 30, 2017, and 2016. Our recorded investment in these loans just prior to restructuring was $274 thousand and $15 thousand during the nine months ended September 30, 2017, and 2016, respectively. Our recorded investment in these loans immediately following the restructuring was $274 thousand and $16 thousand during the nine months ended September 30, 2017, and 2016, respectively. The recorded investment of the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off. The primary type of modification was extension of maturity.

We had TDRs in the production and intermediate term loan category of $33 thousand and $25 thousand that defaulted during the nine months ended September 30, 2017, and 2016, respectively in which the modifications were within twelve months of the respective reporting period.

**TDRs Outstanding**

| (in thousands)<br>As of: | **September 30<br>2017** | December 31<br>2016 |
|---|---|---|
| Accrual status: | | |
| Real estate mortgage | **$ --** | $ -- |
| Production and intermediate term | **16** | 9 |
| Agribusiness | **--** | -- |
| Other | **--** | 1,756 |
| Total TDRs in accrual status | **$ 16** | $ 1,765 |
| Nonaccrual status: | | |
| Real estate mortgage | **$ 3,783** | $ 3,996 |
| Production and intermediate term | **515** | 252 |
| Agribusiness | **--** | 540 |
| Other | **--** | -- |
| Total TDRs in nonaccrual status | **$ 4,298** | $ 4,788 |
| Total TDRs: | | |
| Real estate mortgage | **$ 3,783** | $ 3,996 |
| Production and intermediate term | **531** | 261 |
| Agribusiness | **--** | 540 |
| Other | **--** | 1,756 |
| Total TDRs | **$ 4,314** | $ 6,553 |

The decrease in TDRs outstanding from December 31, 2016, was primarily due to communication loans, which are included in the other loan category, being refinanced at market terms during the first quarter of 2017.

There were no commitments to lend to borrowers whose loans have been modified in a TDR at September 30, 2017.

## Allowance for Loan Losses

**Changes for Allowance for Loan Losses**

| (in thousands)<br>Nine months ended September 30 | **2017** | 2016 |
|---|---|---|
| Balance at beginning of period | **$ 14,284** | $ 13,394 |
| Provision for loan losses | **3,056** | 3,640 |
| Loan recoveries | **458** | 341 |
| Loan charge-offs | **(259)** | (2,771) |
| Balance at end of period | **$ 17,539** | $ 14,604 |

The “Provision for (reversal of) credit losses” in the Consolidated Statements of Income includes a provision for loan losses as presented in the previous chart, as well as a provision for credit losses on unfunded commitments. The accrued credit losses on unfunded commitments are recorded in “Other liabilities” in the Consolidated Statements of Condition.

**Credit Loss Information on Unfunded Commitments**

| (in thousands)<br>For the nine months ended September 30 | **2017** | 2016 |
|---|---|---|
| Provision for credit losses | **$ 1,052** | $ 252 |
| As of: | **September 30<br>2017** | December 31<br>2016 |
| Accrued credit losses | **$ 2,748** | $ 1,593 |

## NOTE 3: INVESTMENT IN AGRIBANK, FCB

Effective July 1, 2017, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on association growth in excess of a targeted growth rate, if the District is also growing above a targeted growth rate. From January 1 to June 30, 2017, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on growth in excess of a sustainable growth rate. Previously, the required investment was equal to 2.25% of the average quarterly balance of our note payable to AgriBank plus an additional 1.0% on growth that exceeded a targeted rate.

The balance of our investment in AgriBank, all required stock, was $156.4 million at September 30, 2017, and $111.2 million at December 31, 2016.

## NOTE 4: INVESTMENT SECURITIES

We held investment securities of $7.1 million at September 30, 2017, and December 31, 2016. Our investment securities consisted of Agricultural and Rural Community bonds.

The investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

The amortized cost and fair value of the investment securities was $7.1 million at September 30, 2017, and December 31, 2016. The weighted average yield of the investment securities was 2.4% and 2.0% at September 30, 2017, and December 31, 2016, respectively.

Investment income is recorded in “Interest income” in the Consolidated Statements of Income and totaled $205 thousand and $104 thousand for the nine months ended September 30, 2017, and 2016, respectively.

## NOTE 5: OTHER INVESTMENT

We and other Farm Credit Institutions are among the limited partners for a $154.5 million Rural Business Investment Company (RBIC), Advantage Capital Agribusiness Partners, L.P., established in October 2014. The RBIC facilitates equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. Our total commitment is $7.0 million through October 2019. Our investment in the RBIC is recorded in “Other assets” in the Consolidated Statements of Condition, and totaled $5.4 million at September 30, 2017, and $2.6 million at December 31, 2016. The increase in our commitment and investment in the RBIC is a result of the merger with United.

The investment was evaluated for impairment. To date, we have not recognized any impairment on this investment.

## NOTE 6: MEMBERS’ EQUITY

On July 1, 2017, United merged into AgCountry. All members of United received capital stock in AgCountry in exchange for their stock, which was then canceled. This exchange was made at the stock’s par value and 1.0 million shares of capital stock were issued.

### Regulatory Capitalization Requirements

**Select Capital Ratios**

| | **As of September 30, 2017** | Regulatory Minimums | Capital Conservation Buffer | Total |
|---|---|---|---|---|
| Risk-adjusted: | | | | |
| Common equity tier 1 ratio | **16.9%** | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | **16.9%** | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | **17.1%** | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | **16.9%** | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | |
| Tier 1 leverage ratio | **19.3%** | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | **20.1%** | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums will be phased in over three years under the FCA capital requirements.

Effective January 1, 2017, the regulatory capital requirements for Farm Credit System banks and associations were modified. The new regulations replaced existing core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect, with some modifications, to align with the new regulations.

Risk-adjusted assets have been defined by Farm Credit Administration (FCA) Regulations as the Statement of Condition 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 impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

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

Risk-adjusted assets is calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the inclusion of the allowance for loan losses as a deduction to risk-adjusted assets for the permanent capital ratio.

These ratios are based on a three-month average daily balance in accordance with FCA Regulations and are calculated as follows (not all items below may be applicable to our Association):

- Common equity tier 1 ratio is statutory minimum purchased member stock, other required member stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to retirement, unallocated retained earnings as regulatorily prescribed, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required member stock held for a minimum of 5 years, allocated equities 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 credit losses subject to certain limitations, less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings as regulatorily prescribed, paid-in capital, subordinated debt, and preferred stock subject to certain limitations, less certain allocated and purchased investments in other System institutions divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.
- UREE leverage ratio is unallocated retained earnings as regulatorily prescribed, paid-in capital, allocated surplus not subject to retirement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

If the capital ratios fall below the total 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.

Effective January 1, 2017, the regulatory capital requirements allow for allotment agreements for only the permanent capital ratio and, as such, any stock in excess of our AgriBank required investment was not included in the common equity tier 1, tier 1 capital, total capital, or leverage ratios. We had no allocated excess stock at September 30, 2017, or December 31, 2016.

Refer to Note 10 in our 2016 Annual Report for a more complete description of the ratios effective as of December 31, 2016.

## NOTE 7: CONTINGENCIES AND COMMITMENTS

In the normal course of business, we have various contingent liabilities and commitments outstanding, primarily commitments to extend credit, which may not be reflected in the Consolidated Financial Statements. We do not anticipate any material losses because of these contingencies or commitments.

We may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these Consolidated Financial Statements, our management team was not aware of any material actions. However, management cannot ensure that such actions or other contingencies will not arise in the future.

## NOTE 8: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Note 2 in our 2016 Annual Report for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at September 30, 2017, or December 31, 2016.

**Non-Recurring**

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis.

**Assets Measured at Fair Value on a Non-recurring Basis**

| (in thousands) | **As of September 30, 2017** | | | | **Nine months ended September 30, 2017** |
|---|---|---|---|---|---|
| | Fair Value Measurement Using | | | Total Fair | Total |
| | Level 1 | Level 2 | Level 3 | Value | Losses |
| Impaired loans | **$ --** | **$ 5,619** | **$ 144** | **$ 5,763** | **$ (1,502)** |
| Other property owned | **--** | **--** | **92** | **92** | **--** |
| | As of December 31, 2016 | | | | Nine months ended September 30, 2016 |
| | Fair Value Measurement Using | | | Total Fair | Total |
| | Level 1 | Level 2 | Level 3 | Value | Losses |
| Impaired loans | $ -- | $ 1,117 | $ 3,707 | $ 4,824 | $ (1,656) |
| Other property owned | -- | -- | -- | -- | -- |

**Valuation Techniques**

**Impaired loans:** Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses independent appraisals and other market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they are classified as Level 3.

**Other property owned:** Represents the fair value and related losses of assets acquired in collection of debt obligations that were measured at fair value based on the collateral value, which is generally determined using appraisals, or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses independent appraisals and other market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the property and other matters, they are classified as Level 3.

**NOTE 9: SUBSEQUENT EVENTS**

We have evaluated subsequent events through November 6, 2017, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.