# AgCountry Farm Credit Services, ACA

**Quarterly Report**
**June 30, 2019**

## 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, 2018 (2018 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 AgriBank financial reports or additional copies of our report, contact us at:

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## 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 2018 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 3.2% in 2019 compared to 3.3% in 2018. The United States is expected to be the main driver of the world economy. GDP growth in China and India is forecast to be strong. However, China's GDP is forecast to continue to decline from 6.6% in 2018 to 6.2% in 2019 due to slowing international trade, a softening real estate market, and weaker domestic demand. India's GDP is forecast to grow 7.4% in 2019 compared with growth of 7.2% in 2018. GDP growth of 1.2% is forecast in Japan for 2019 compared with 0.8% in 2018. The Bank of Japan is likely to maintain its stimulus package and leave base interest rates unchanged. The strength of the Japanese economy over the medium term depends heavily on the outcome of trade talks between the United States and China along with Japan's ability to strike a U.S. trade deal of its own. GDP growth of 2.1% is forecast in Latin America. The Brazilian economy is forecast to grow 2.6% in 2019 based on increased consumption. Delayed by drought and a currency crisis in 2018, the Argentine economy is forecast to grow 0.1% in 2019. The Canadian economic growth rate is forecast to be 2.0% in 2019, a small increase over the 1.8% growth rate in 2018. Consumption appears to be leading growth and business spending is increasing but oil sector slowdowns are limiting growth. In Mexico, growth is forecast at 2.4% in 2019 compared with 2.0% in 2018. Growth in Mexico remains moderate due to tighter financing conditions and domestic policy-related uncertainty. GDP growth of 1.4% is forecast for the Eurozone compared with 1.8% in 2018.

United States economic fundamentals are expected to improve in 2019, with stronger growth of 3.0% compared with 2.9% in 2018. Uncertainty regarding trade policy actions under the current administration and trade retaliation continues. The unemployment rate remained at 3.6% in May, and the number of unemployed persons was relatively unchanged at 5.9 million.

Information received since the Federal Open Market Committee (Committee) met in May indicates the labor market remains strong and economic activity has been rising at a moderate rate. Job gains have been strong in recent months, and the unemployment rate has remained low. Although growth of household spending continues to grow, indicators of business fixed investment have been soft. On a 12-month basis, both overall inflation and inflation for items other than food and energy are running below 2.00%. Market-based measures of inflation compensation have declined and survey-based measures of longer-term inflation expectations are nearly unchanged.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2.25% to 2.50%. The Committee continues to view sustained expansion of economic activity, strong labor and market conditions, and inflation near the Committee's symmetric 2.00% objective as the most likely outcomes, but uncertainties about this outlook have increased. In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2.00% objective.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2.00% inflation objective. 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.

Farm profitability is forecast to increase in 2019, following a decline for farm sector profits in 2018. Net cash income for 2019 is forecast to increase by $4.3 billion to $95.7 billion, an increase of 4.7%. Net farm income is forecast at $69.4 billion in 2019, an increase of $6.3 billion or 10.0%. This would be the lowest in real terms since 2006.

Farm cash receipts for all commodities are forecast to increase $8.6 billion or 2.3% to $381.5 billion in 2019. Total animal/animal product receipts are forecast to increase $4.6 billion or 2.6% following forecast increases in milk and cattle/calf receipts. Total crop receipts are forecast to increase $4.0 billion or 2.0% from 2018 forecast levels due to forecast increases in corn and fruit/nut receipts.

**Specific Production Conditions**

Spring 2019 featured varying conditions across our association with cool temperatures being the only common theme. The far northern areas of the association were seeding into very dry soil conditions while southern and eastern areas of the association dealt with extreme wet conditions to the point of significant acres of potential preventive plant.

Corn, soybeans, wheat, and sugar beets continue to be the primary cash crops produced in our territory.

**Corn:** According to the June 28, 2019, Acreage Report from the United States Department of Agriculture (USDA), acres of corn planted for all purposes in 2019 are expected to be 91.7 million, an increase of 3% from the prior year. Planted acres are increased or unchanged in 40 of the 48 estimating states from the prior year. Area harvested for grain has increased 2% from the prior year at 83.6 million acres. As of June 23, 2019, 96% of the corn acreage had been planted with 89% emerged. Corn acreage rated in good to excellent condition is 56%, a decrease of 21% compared with the prior year. Corn stocks in all positions as of June 1, 2019, totaled 5.2 billion bushels, a decrease of 2% from prior year. The forecast season average corn price received by producers is $3.80 per bushel.

**Soybeans:** Soybean planted area for 2019 is forecast at 80.0 million acres, a decrease of 10% from prior year. The decrease represents the lowest soybean planted acreage in the United States since 2013. Planted acreage intentions have decreased in all 29 estimating states from the prior year. Estimated area for harvest, 79.3 million acres, has also decreased 10% from 2018. Soybeans stored in all positions on June 1, 2019, totaled 1.8 billion bushels, an increase of 47% from prior year. The forecast season average soybean price received by producers is $8.25 per bushel.

**Sugar Beets:** United States beet sugar production for 2019/20 is forecast at 5.2 million short tons, raw value (STRV) based on the larger sugar beet crop noted in the June 2019 World Agricultural Supply and Demand Estimates Report from the USDA. This represents an increase of 40,000 STRV from the May 2019 forecast due to a higher sugar beet yield than previously expected. The combination of higher beginning stocks, a net production increase, and no changes to imports or use, ending stocks are forecast at 1.5 million with a stocks-to-use ratio of 12.4%. Imports from Mexico for 2019/20 are currently holding steady at 1.4 million STRV. Forecast United States sugar exports remain unchanged in recent months at 35,000 STRV and deliveries for human consumption also remain unchanged at 12.2 million.

**Wheat:** All wheat planted area for 2019 is forecast at 45.6 million acres, a decrease of 5% from prior year. This represents the lowest all wheat planted area on record since records began in 1919. The 2019 winter wheat planted area, 31.8 million acres, has decreased 2% from the prior year. This is an increase of 1% from prior estimates. Of the total winter wheat planted acres forecast, 22.7 million acres are Hard Red Winter, 5.5 million acres are Soft Red Winter, and 3.6 million acres are White Winter. Area planted to other spring wheat for 2019 is forecast at 12.4 million acres for 2019, a decrease of 6% from the prior year. Of the total other spring wheat planted acres, 12.0 million acres are Hard Red Spring wheat. The Durum planted area for 2019 is forecast at 1.4 million acres, a decrease of 32% from prior year. Wheat stored in all positions on June 1, 2019, totaled 1.1 billion bushels, a decrease of 2% from the prior year. The 2019/20 forecast season average wheat price received by producers is $5.10 per bushel.

**Cattle:** The cost of feeding cattle is expected to rise this year, likely slowing the pace of placements in feedlots and reducing anticipated marketing. This results in decreased forecasts for beef production in 2019 and 2020 due to lower expected fed cattle slaughter. Cattle price forecasts were lowered to reflect current price weakness. Beef imports continue to exceed prior year levels and exports are behind in early 2019. Fed cattle prices are forecast to average $110 per cwt for the third quarter and $117 per cwt for the year.

**Hogs:** United States inventory of all hogs and pigs on June 1, 2019, was 75.5 million head, an increase of 4% from the prior year and 1% from the prior quarter. This is the highest June 1 inventory of all hogs and pigs since estimates began in 1964. Breeding inventory, 6.4 million head, increased 1% from the prior year and 1% from the prior quarter. Market hog inventory, 69.1 million head, increased 4% from the prior year and 1% from the prior quarter marking the highest June 1 market hog inventory since estimates began in 1964. United States hog producers intend to have 3.2 million sows farrow between June and August 2019, a slight decrease from actual farrowings during the same time period in 2018. Intended farrowings between September and November 2019 are 3.2 million sows, a slight increase from the same time period in 2018.

Hog prices for the second quarter are forecast to average $58 per cwt, an increase of more than 21% from second quarter 2018. Third and fourth quarter hog prices are forecast at $60 and $56 per cwt, respectively.

**Dairy:** Due to recent declines in milk cow numbers, relatively high slaughter levels, and higher expected feed prices, milk production forecasts have decreased for 2019 and 2020. Dairy exports were relatively weak in April and export forecasts have been lowered for both 2019 and 2020. The all-milk price forecast for 2019 is $18.00 per cwt.

**Ethanol:** The summer driving season has aided in decreasing ethanol stocks to around 21.6 million barrels for the week ending June 21, 2019. This compares to a record high in March 2019 of 24.4 million barrels. Ethanol production continues to remain high at over 1 million barrels per day as most plants are operating at or near full capacity. Margins in the second quarter of 2019 have remained close to breakeven for most producers.

On May 31, 2019, the Environmental Protection Agency (EPA) announced that E15 (15% ethanol) may be blended for year-round use in the United States. E15 had been restricted by EPA's application of fuel volatility regulations. The year-round sale of E15 will greatly expand market opportunities for the higher blend ethanol. There are currently 1,575 stations across 30 states selling E15 and this will continue to grow with this recent announcement for the ethanol industry.

## LOAN PORTFOLIO

### Loan Portfolio

Total loans were $7.5 billion at June 30, 2019, an increase of $246.9 million from December 31, 2018. The increase was primarily due to growth in our real estate mortgage and agribusiness portfolios.

### Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2018. Adversely classified loans increased to 2.9% of the portfolio at June 30, 2019, from 2.6% of the portfolio at December 31, 2018. 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, Federal Agricultural Mortgage Corporation and other government agency guarantee programs are used to reduce the risk of loss. At June 30, 2019, $318.7 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: | **June 30<br>2019** | December 31<br>2018 |
|---|---|---|
| Loans: | | |
| Nonaccrual | **$ 36,372** | $ 29,490 |
| Accruing restructured | **459** | 503 |
| Accruing loans 90 days or more past due | **4,502** | 6,661 |
| Total risk loans | **41,333** | 36,654 |
| Other property owned | **240** | 274 |
| Total risk assets | **$ 41,573** | $ 36,928 |
| Total risk loans as a percentage of total loans | **0.5%** | 0.5% |
| Nonaccrual loans as a percentage of total loans | **0.5%** | 0.4% |
| Current nonaccrual loans as a percentage of total nonaccrual loans | **52.0%** | 70.4% |
| Total delinquencies as a percentage of total loans | **0.5%** | 0.3% |

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased $4.6 million from December 31, 2018, and have remained at acceptable levels. 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 three customers moving to nonaccrual in our real estate portfolio during the first six months of 2019. Nonaccrual loans remained at an acceptable level at June 30, 2019, and December 31, 2018.

The decrease in accruing loans 90 days or more past due was primarily due to three customers moving to nonaccrual. 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, accruing loans 90 days or more past due were eligible to remain in accruing status.

### Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans inherent 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: | **June 30<br>2019** | December 31<br>2018 |
|---|---|---|
| Allowance as a percentage of: | | |
| Loans | **0.3%** | 0.2% |
| Nonaccrual loans | **70.9%** | 60.3% |
| Total risk loans | **62.3%** | 48.6% |

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at June 30, 2019.

## RESULTS OF OPERATIONS

**Profitability Information**

| (dollars in thousands)<br>For the six months ended June 30 | **2019** | 2018 |
|---|---|---|
| Net income | **$ 63,190** | $ 67,828 |
| Return on average assets | **1.7%** | 1.8% |
| Return on average members' equity | **7.3%** | 8.5% |

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 six months ended June 30 | **2019** | 2018 | **Increase (decrease) in net income** |
|---|---|---|---|
| Net interest income | **$ 95,832** | $ 96,050 | **$ (218)** |
| Provision for credit losses | **8,130** | 2,441 | **(5,689)** |
| Patronage income | **19,453** | 14,127 | **5,326** |
| Other income, net | **12,786** | 16,856 | **(4,070)** |
| Operating expenses | **58,021** | 56,663 | **(1,358)** |
| (Benefit from) provision for income taxes | **(1,270)** | 101 | **1,371** |
| Net income | **$ 63,190** | $ 67,828 | **$ (4,638)** |

**Changes in Net Interest Income**

| (in thousands)<br>For the six months ended June 30 | **2019 vs 2018** |
|---|---|
| Changes in volume | **$ 3,828** |
| Changes in interest rates | **(3,394)** |
| Changes in nonaccrual income and other | **(652)** |
| Net change | **$ (218)** |

The change in the provision for credit losses was primarily related to weaker loss given default rates within our PCA portfolio.

**Patronage Income**

| (in thousands)<br>For the six months ended June 30 | **2019** | 2018 |
|---|---|---|
| Wholesale patronage: | | |
| Cash | **$ 5,475** | $ 10,108 |
| Stock | **9,130** | -- |
| Pool program patronage | **4,848** | 3,836 |
| Other Farm Credit Institutions | **--** | 183 |
| Total patronage income | **$ 19,453** | $ 14,127 |

The increase in patronage income was primarily due to an increase in wholesale patronage. In total wholesale patronage increased primarily as a result of a higher patronage rate for the first six months of 2019 compared to the same period of 2018. Wholesale patronage may be paid in cash or AgriBank stock. All pool program patronage is paid in cash.

The change in other income, net was primarily due to our share of the Allocated Insurance Reserve Accounts (AIRA) distribution received from the Farm Credit System Insurance Corporation (FCSIC) of $1.7 million in 2019 compared to $4.1 million in 2018. The AIRA was established by FCSIC when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. Refer to the 2018 Annual Report for additional information about the FCSIC.

The change in operating expenses was primarily related to an increase in furniture and equipment expense and an increase in salaries and benefits expense.

The change in (benefit from) provision for income taxes was primarily related to our estimate of taxable income and book tax differences.

## FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on June 30, 2021, at which time the note will be renegotiated. 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 because we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable 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 AgriBank profit, and
- a risk premium component, if applicable.

We were not subject to a risk premium at June 30, 2019, or December 31, 2018.

Total members' equity increased $40.9 million from December 31, 2018, primarily due to net income for the period partially offset by patronage distribution accruals. Accumulated other comprehensive loss is the impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan and an equity adjustment of our investment in FPI, Inc. also related to pension activities. Refer to Note 9 in our 2018 Annual Report for more information on the Pension Restoration Plan.

The Farm Credit Administration (FCA) Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents leverage. Refer to Note 7 in our 2018 Annual Report for a more complete description of these ratios.

**Regulatory Capital Requirements and Ratios**

| As of: | **June 30 2019** | December 31 2018 | Regulatory Minimums | Capital Conservation Buffer | Total |
|---|---|---|---|---|---|
| Risk-adjusted: | | | | | |
| Common equity tier 1 ratio | **18.6%** | 18.2% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | **18.6%** | 18.2% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | **18.8%** | 18.5% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | **18.6%** | 18.3% | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | | |
| Tier 1 leverage ratio | **20.7%** | 20.5% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | **21.8%** | 21.3% | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in over three years under the FCA capital requirements. The phase in period ends on December 31, 2019.

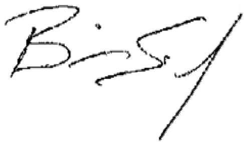
The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section.

## CERTIFICATION

The undersigned have reviewed the June 30, 2019, 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.

Leif Aakre
Chairperson of the Board
AgCountry Farm Credit Services, ACA

Marcus L. Knisely
Chief Executive Officer
AgCountry Farm Credit Services, ACA



Brian S. McKay
Chief Financial Officer
AgCountry Farm Credit Services, ACA

August 5, 2019

# CONSOLIDATED STATEMENTS OF CONDITION

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

| As of: | | June 30 2019 | | December 31 2018 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Loans | **$** | **7,496,684** | $ | 7,249,804 |
| Allowance for loan losses | | **25,771** | | 17,796 |
| Net loans | | **7,470,913** | | 7,232,008 |
| Investment in AgriBank, FCB | | **193,858** | | 184,727 |
| Accrued interest receivable | | **84,203** | | 92,671 |
| Premises and equipment, net | | **38,537** | | 42,612 |
| Other property owned | | **240** | | 274 |
| Assets held for lease, net | | **896** | | 1,815 |
| Deferred tax assets, net | | **1,363** | | 82 |
| Other assets | | **71,279** | | 86,997 |
| Total assets | **$** | **7,861,289** | $ | 7,641,186 |
| **LIABILITIES** | | | | |
| Note payable to AgriBank, FCB | **$** | **6,022,650** | $ | 5,820,678 |
| Accrued interest payable | | **41,115** | | 38,304 |
| Patronage distribution payable | | **22,500** | | 42,500 |
| Other liabilities | | **30,943** | | 36,507 |
| Total liabilities | | **6,117,208** | | 5,937,989 |
| Contingencies and commitments (Note 4) | | | | |
| **MEMBERS' EQUITY** | | | | |
| Capital stock and participation certificates | | **12,575** | | 12,587 |
| Additional paid-in capital | | **304,385** | | 304,385 |
| Unallocated surplus | | **1,431,543** | | 1,390,854 |
| Accumulated other comprehensive loss | | **(4,422)** | | (4,629) |
| Total members' equity | | **1,744,081** | | 1,703,197 |
| Total liabilities and members' equity | **$** | **7,861,289** | $ | 7,641,186 |

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

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| *For the period ended June 30* | **2019** | 2018 | **2019** | 2018 |
| **Interest income** | **$ 89,478** | $ 82,313 | **$ 176,271** | $ 160,169 |
| **Interest expense** | **41,147** | 34,034 | **80,439** | 64,119 |
| Net interest income | **48,331** | 48,279 | **95,832** | 96,050 |
| **Provision for credit losses** | **4,685** | 1,103 | **8,130** | 2,441 |
| Net interest income after provision for credit losses | **43,646** | 47,176 | **87,702** | 93,609 |
| **Other income** | | | | |
| Patronage income | **11,699** | 7,205 | **19,453** | 14,127 |
| Financially related services income | **2,287** | 2,060 | **6,448** | 6,564 |
| Fee income | **1,740** | 1,797 | **3,406** | 3,769 |
| Allocated Insurance Reserve Accounts distribution | **--** | -- | **1,679** | 4,094 |
| Miscellaneous income, net | **609** | 1,837 | **1,253** | 2,429 |
| Total other income | **16,335** | 12,899 | **32,239** | 30,983 |
| **Operating expenses** | | | | |
| Salaries and employee benefits | **16,578** | 16,842 | **34,975** | 33,992 |
| Other operating expenses | **11,064** | 10,679 | **23,046** | 22,671 |
| Total operating expenses | **27,642** | 27,521 | **58,021** | 56,663 |
| Income before income taxes | **32,339** | 32,554 | **61,920** | 67,929 |
| **(Benefit from) provision for income taxes** | **(1,209)** | (563) | **(1,270)** | 101 |
| Net income | **$ 33,548** | $ 33,117 | **$ 63,190** | $ 67,828 |
| **Other comprehensive income** | | | | |
| Employee benefit plans activity | **$ 106** | $ 117 | **$ 207** | $ 234 |
| Total other comprehensive income | **106** | 117 | **207** | 234 |
| Comprehensive income | **$ 33,654** | $ 33,234 | **$ 63,397** | $ 68,062 |

*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 | Accumulated Other Comprehensive Loss | Total Members' Equity |
|---|---|---|---|---|---|
| Balance at December 31, 2017 | $ 12,451 | $ 304,385 | $ 1,263,212 | $ (3,779) | $ 1,576,269 |
| Net income | -- | -- | 67,828 | -- | 67,828 |
| Other comprehensive income | -- | -- | -- | 234 | 234 |
| Unallocated surplus designated for patronage distributions | -- | -- | (13,965) | -- | (13,965) |
| Capital stock and participation certificates issued | 413 | -- | -- | -- | 413 |
| Capital stock and participation certificates retired | (445) | -- | -- | -- | (445) |
| Balance at June 30, 2018 | $ 12,419 | $ 304,385 | $ 1,317,075 | $ (3,545) | $ 1,630,334 |
| Balance at December 31, 2018 | $ 12,587 | $ 304,385 | $ 1,390,854 | $ (4,629) | $ 1,703,197 |
| Net income | **--** | **--** | **63,190** | **--** | **63,190** |
| Other comprehensive income | **--** | **--** | **--** | **207** | **207** |
| Unallocated surplus designated for patronage distributions | **--** | **--** | **(22,501)** | **--** | **(22,501)** |
| Capital stock and participation certificates issued | **363** | **--** | **--** | **--** | **363** |
| Capital stock and participation certificates retired | **(375)** | **--** | **--** | **--** | **(375)** |
| **Balance at June 30, 2019** | **$ 12,575** | **$ 304,385** | **$ 1,431,543** | **$ (4,422)** | **$ 1,744,081** |

*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 Statements of Condition and Consolidated Statements of Comprehensive Income. 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 six months ended June 30, 2019, are not necessarily indicative of the results to be expected for the year ending December 31, 2019. 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, 2018 (2018 Annual Report).

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

#### Significant Accounting Policies

**Leases:** We are the lessee in operating leases. Leases with an initial term of 12 months or less are not recorded on the balance sheet with lease expense recognized on a straight-line basis over the lease term. For operating leases with terms greater than 12 months, the right-of-use (ROU) assets are included in “Other assets” in the Consolidated Statements of Condition and the lease liabilities are included in “Other liabilities” in the Consolidated Statements of Condition.

The ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized based on the present value of lease payments over the lease term. Because most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate when readily determinable. Our lease terms may include options to extend or terminate the lease. The length of the lease term is modified to include the option when it is reasonably certain that we will exercise that option. Operating lease expense for lease payments is recognized on a straight-line basis over the lease term.

#### 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 performance of the combined Farm Credit System. Therefore, we typically adopt accounting pronouncements on the public business entities effective date or aligned with other System institutions, whichever is earlier.

| Standard and effective date | Description | Adoption status and financial statement impact |
| --- | --- | --- |
| In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02 “Leases.” In July 2018, the FASB issued ASU 2018-11 “Leases (Topic 842): Targeted Improvements.” The guidance is effective for public business entities in its first quarter of 2019 and early adoption is permitted. | 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. Upon adoption, a liability for lease obligations and a corresponding right-of-use asset is recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months. The guidance includes an optional transition method where an entity is permitted to apply the guidance as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. | We adopted this guidance on January 1, 2019. We elected the package of practical expedients permitted under the transition guidance, which among other things, allowed us to carry forward the historical lease classification. We also elected the hindsight practical expedient to determine the lease term for existing leases. The adoption of this guidance did not have a material impact on our financial condition, results of operations, and financial statement disclosures, and had no impact on cash flows. |
| In June 2016, the FASB issued ASU 2016-13 “Financial Instruments – Credit Losses.” This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted. | 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. | We have no plans to early adopt this guidance. We have reviewed the accounting standard, selected our system, and are in the process of drafting disclosures. Significant implementation matters yet to be addressed include system development and testing, drafting of accounting policies, and designing processes and controls. We are currently unable to estimate the impact on the financial statements. |

## NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

**Loans by Type**

(dollars in thousands)

| As of: | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Real estate mortgage | **$ 3,153,850** | **42.0%** | $ 3,079,351 | 42.4% |
| Production and intermediate-term | **2,073,481** | **27.7%** | 2,049,893 | 28.3% |
| Agribusiness | **1,709,303** | **22.8%** | 1,594,142 | 22.0% |
| Other | **560,050** | **7.5%** | 526,418 | 7.3% |
| Total | **$ 7,496,684** | **100.0%** | $ 7,249,804 | 100.0% |

The other category is primarily composed of energy and communication related loans.

### Delinquency

**Aging Analysis of Loans**

| (in thousands)<br>**As of June 30, 2019** | 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 | **$ 10,897** | **$ 13,653** | **$ 24,550** | **$ 3,176,667** | **$ 3,201,217** | **$ 3,357** |
| Production and intermediate-term | **8,639** | **6,076** | **14,715** | **2,086,058** | **2,100,773** | **1,145** |
| Agribusiness | **--** | **41** | **41** | **1,717,278** | **1,717,319** | **--** |
| Other | **--** | **13** | **13** | **561,565** | **561,578** | **--** |
| Total | **$ 19,536** | **$ 19,783** | **$ 39,319** | **$ 7,541,568** | **$ 7,580,887** | **$ 4,502** |

| As of December 31, 2018 | 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 | $ 3,651 | $ 10,269 | $ 13,920 | $ 3,114,920 | $ 3,128,840 | $ 6,661 |
| Production and intermediate-term | 6,773 | 4,105 | 10,878 | 2,074,539 | 2,085,417 | -- |
| Agribusiness | 225 | 41 | 266 | 1,600,412 | 1,600,678 | -- |
| Other | -- | 16 | 16 | 527,524 | 527,540 | -- |
| Total | $ 10,649 | $ 14,431 | $ 25,080 | $ 7,317,395 | $ 7,342,475 | $ 6,661 |

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: | **June 30 2019** | December 31 2018 |
|---|---|---|
| Volume with specific allowance | **$ 13,475** | $ 14,331 |
| Volume without specific allowance | **27,858** | 22,323 |
| Total risk loans | **$ 41,333** | $ 36,654 |
| Total specific allowance | **$ 7,365** | $ 6,389 |
| For the six months ended June 30 | **2019** | 2018 |
| Income on accrual risk loans | **$ 74** | $ 63 |
| Income on nonaccrual loans | **570** | 1,222 |
| Total income on risk loans | **$ 644** | $ 1,285 |
| Average risk loans | **$ 37,264** | $ 34,345 |

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 classified as risk loans at June 30, 2019.

**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 six months ended June 30, 2019, and 2018. Our recorded investment in these loans just prior to and immediately following the restructuring was $61 thousand and $73 thousand during the six months ended June 30, 2019, and 2018, respectively. The recorded investment in the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, acquisition costs, and unamortized adjustments to fair value on loans acquired through merger and may also reflect a previous direct charge-off of the investment.

The primary types of modification were extension of maturity and interest rate reduction below market.

There were no TDRs that defaulted during the six months ended June 30, 2019, in which the modification was within twelve months of the respective reporting period.

We had TDRs in the production and intermediate-term loan category of $117 thousand that defaulted during the six months ended June 30, 2018, in which the modifications were within twelve months of the respective reporting period.

**TDRs Outstanding**

| (in thousands)<br>As of: | **June 30<br>2019** | December 31<br>2018 |
|---|---|---|
| Accrual status: | | |
| Real estate mortgage | **$ 444** | $ 472 |
| Production and intermediate-term | **15** | 31 |
| Total TDRs in accrual status | **$ 459** | $ 503 |
| Nonaccrual status: | | |
| Real estate mortgage | **$ 3,056** | $ 3,200 |
| Production and intermediate-term | **379** | 440 |
| Agribusiness | **3,691** | 3,784 |
| Total TDRs in nonaccrual status | **$ 7,126** | $ 7,424 |
| Total TDRs: | | |
| Real estate mortgage | **$ 3,500** | $ 3,672 |
| Production and intermediate-term | **394** | 471 |
| Agribusiness | **3,691** | 3,784 |
| Total TDRs | **$ 7,585** | $ 7,927 |

There were no commitments to lend to borrowers whose loans have been modified in a TDR at June 30, 2019.

**Allowance for Loan Losses**

**Changes in Allowance for Loan Losses**

| (in thousands)<br>Six months ended June 30 | **2019** | 2018 |
|---|---|---|
| Balance at beginning of period | **$ 17,796** | $ 15,818 |
| Provision for loan losses | **7,869** | 2,438 |
| Loan recoveries | **106** | 242 |
| Loan charge-offs | **--** | (283) |
| Balance at end of period | **$ 25,771** | $ 18,215 |

The "Provision for credit losses" in the Consolidated Statements of Comprehensive 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 six months ended June 30 | | 2019 | | 2018 |
|---|---|---|---|---|
| Provision for credit losses | **$** | **261** | $ | 3 |

| As of: | | June 30<br>2019 | | December 31<br>2018 |
|---|---|---|---|---|
| Accrued credit losses | **$** | **2,323** | $ | 2,062 |

## NOTE 3: OTHER INVESTMENTS

We and other Farm Credit Institutions are among the limited partners for Rural Business Investment Companies (RBICs). Our total commitment is $14.0 million with varying commitment end dates through November 2023. Certain commitments may have an option to extend under certain circumstances. Our investment in the RBICs are recorded in “Other assets” in the Consolidated Statements of Condition, and totaled $8.8 million at June 30, 2019, and $7.4 million at December 31, 2018.

The investments were evaluated for impairment. No investments were impaired as of June 30, 2019, or December 31, 2018.

## NOTE 4: 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 5: 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 input levels that may be used to measure fair value. Refer to Note 2 in our 2018 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 June 30, 2019, or December 31, 2018.

### 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 June 30, 2019 | | | |
|---|---|---|---|---|
| | Fair Value Measurement Using | | | Total Fair |
| | Level 1 | Level 2 | Level 3 | Value |
| Impaired loans | **$ --** | **$ --** | **$ 6,416** | **$ 6,416** |
| Other property owned | **--** | **--** | **250** | **250** |
| | As of December 31, 2018 | | | |
| | Fair Value Measurement Using | | | Total Fair |
| | Level 1 | Level 2 | Level 3 | Value |
| Impaired loans | $ -- | $ -- | $ 8,339 | $ 8,339 |
| Other property owned | -- | -- | 285 | 285 |

### Valuation Techniques

**Impaired loans:** Represents the carrying amount and related write-downs of loans that 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 observable 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 foreclosed assets 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 observable 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 6: SUBSEQUENT EVENTS**

We have evaluated subsequent events through August 5, 2019, 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.