



**TEXAS
FARM CREDIT
DISTRICT**

**2018 FIRST QUARTER REPORT
MARCH 31, 2018**



FIRST QUARTER 2018

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

(dollars in thousands, except as noted)

The following discussion reviews the combined financial condition and results of operations of the Farm Credit Bank of Texas (bank), its affiliated Federal Land Credit Association (FLCA) and affiliated Agricultural Credit Associations (ACAs) for the three months ended March 31, 2018. The FLCA and ACAs are collectively referred to as associations, and the bank and its affiliated associations are collectively referred to as the district. These comments should be read in conjunction with the accompanying combined financial statements and footnotes, along with the 2017 Annual Report to stockholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

During the third quarter of 2017, an association within the district determined the association's consolidated financial statements as of and for the year ended December 31, 2016, as well as the three months ended March 31, 2017, should no longer be relied upon and needed to be restated to correct misstatements in the association's consolidated financial statements. The association's restatements in 2016 decreased its consolidated other comprehensive income and members' equity previously reported by \$8.1 million. These additional losses were the result of the activities of a former loan officer who breached the association's policies and procedures and engaged in improper conduct that included improperly advancing funds without appropriate approvals, offering unauthorized loan terms to borrowers, originating loans to fictitious borrowers, and originating loans and advancing funds based on fabricated documentation.

The district's combined financial statements for the quarter ended March 31, 2017 include an out-of-period adjustment of \$8.1 million resulting from the association's restatement for 2016 related to this matter. In addition, the events and activities that resulted in the restatement of the association's consolidated financial statements at December 31, 2016 also impacted the financial results for the quarter ended March 31, 2017 by \$7.7 million, decreasing consolidated other comprehensive income and members' equity (see Note 2 to the accompanying combined financial information statements for additional information). Although the association restated their 2016 consolidated financial statements, the district has evaluated the quantitative and qualitative aspects of these misstatements in accordance with applicable accounting guidance and has determined that such misstatements are not material to the current and previously issued district combined financial statements.

RESULTS OF OPERATIONS

Net Income

Net income for the three months ended March 31, 2018, was \$130,032, an increase of \$34,143, or 35.6 percent, over the same period of 2017. The increase in net income consisted primarily of a \$7,433 increase in net interest income, an \$18,101 increase in noninterest income, an \$8,087 decrease in non-interest expense, and a \$670 decrease in provision for credit losses.

Net Interest Income

Net interest income for the three months ended March 31, 2018, was \$194,415, an increase of \$7,433, or 4.0 percent, over the same period of 2017. The increase was primarily the result of a \$1.63 billion increase in combined district average earning assets. The increase in earning assets was due to increases in association average loan volume, the bank's capital markets loan portfolio and the bank's investment portfolio. The net interest rate spread of 242 basis points decreased by 13 basis points compared to the same period of 2017, with a 37-basis-point increase in the yield of average interest earning assets offset

by a 50-basis-point increase in the cost of average interest-bearing liabilities. The district associations had an increase in average loan volume of \$1.03 billion compared to the same period of 2017, due mainly to improved general economic conditions.

Provision for Credit Losses

The district's provision for credit losses on loans, standby letters of credit and unfunded commitments for the three months ended March 31, 2018, totaled \$2,666, a decrease of \$670 from the \$3,336 provision for the same period of 2017.

Noninterest Income

Noninterest income for the three months ended March 31, 2018, was \$32,989, an increase of \$18,101, or 121.6 percent, from the same period of 2017. The increase was due primarily to a \$19,269 increase in refund distributions from the Farm Credit System Insurance Corporation (FCSIC), offset by a \$2,462 increase on losses on Rural Business Investment Companies (RBICs).

Noninterest Expense

Noninterest expense for the three months ended March 31, 2018, was \$94,782, a decrease of \$8,087, or 7.9 percent, over the same period of 2017. The decrease is primarily due to a \$7,802 decrease in other operating expense primarily due to expenses recorded in the first quarter of 2017 related to an association's expenses due to the breach of policies and procedures, offset by an increase of \$2,636 in salaries and employee benefits, and a \$2,890 decrease in Insurance Fund premiums. Insurance Fund premiums decreased due to a rate decrease on outstanding debt from 15 basis points in 2017 to 9 basis points in 2018.

Key results of operations comparisons:

	Annualized for the Three Months Ended March 31, 2018	Annualized for the Three Months Ended March 31, 2017
Return on average assets	1.69%	1.37%
Return on average members' equity	11.56%	9.26%
Net interest income as a percentage of average earning assets	2.70%	2.75%
Charge-offs, net of (recoveries), to average loans	< 0.01%	< (0.01)%
Operating expenses as a percentage of net interest income and noninterest income	41.85%	51.01%
Operating expenses as a percentage of average earning assets	1.32%	1.51%

Other Comprehensive Income

Other comprehensive income consists of certain gains, losses or costs for which values are included in assets or liabilities on the balance sheets, but which have not yet been recognized in earnings. In the balance sheets, they are included in accumulated other comprehensive (loss) income in the shareholders' equity section. For the district, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, amortization of certain pension and postretirement benefit elements and changes in the value of cash flow derivative instruments.

The table below summarizes changes in elements included in other comprehensive income:

	Three Months Ended March 31,	
	2018	2017
Change in unrealized losses on available-for-sale securities		
Net increase in unrealized losses on investment securities	\$ (29,374)	\$ (1,511)
Net change in unrealized losses on securities	(29,374)	(1,511)
Change in pension and postretirement benefit plans		
Amortization of prior service credits	(160)	(185)
Amortization of net losses	3,537	4,439
Net change in pension and postretirement benefit plans	3,377	4,254
Change in cash flow derivative instruments		
Unrealized gain on cash flow derivative instruments	5,072	180
Reclassification of loss recognized in interest expense	2	-
Net change in cash flow derivative instruments	5,074	180
Other comprehensive (loss) income	\$ (20,923)	\$ 2,923

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at March 31, 2018, was \$24.05 billion, an increase of \$300.0 million, or 1.3 percent, from \$23.75 billion at December 31, 2017. The increase in the loan portfolio during the first three months of 2018 was due to a \$288.7 million increase in the bank's capital market portfolio offset by a \$53.7 million decrease in the associations' loan portfolios.

The bank's capital markets loan portfolio predominantly includes participations, syndications and purchased whole loans, along with other financing structures within our lending authorities. The bank also refers to the capital markets portfolio as participations purchased. In addition to purchasing loans from our district associations, which may exceed their hold limits, the bank seeks the purchase of participations and syndications originated outside of the district's territory by other System institutions, commercial banks and other lenders. These loans may be held as earning assets of the bank or sub-participated to the associations or to other System entities.

Loans classified under the Farm Credit Administration's (FCA) Uniform Loan Classification System as "acceptable" or "special mention" as a percentage of total loans and accrued interest receivable were 98.6 percent at March 31, 2018, and 98.5 percent at December 31, 2017. Nonaccrual loans for the district were 0.6 percent of total loans at March 31, 2018, and 0.5 percent of total loans at December 31, 2017.

During the second quarter of 2017, the bank downgraded the direct loan to one of our affiliated associations to the special mention credit quality classification. This credit quality classification was affirmed by bank management prior to the issuance of this report. As of March 31, 2018, the direct note totaled \$880.7 million. The bank's loans to our affiliated associations are collateralized by substantially all of the association assets, and the earnings, capital and loan loss reserves of the association provide a buffer against losses in their retail portfolio. While the downgrade reflects control weaknesses at the affiliated association, the bank has not made any provision for loan loss or recorded any allowance for credit loss related to our

direct note to that affiliated association because of the collateralization of the direct loan and other mitigating factors.

Total district high-risk asset volume increased \$21.0 million, or 12.0 percent, to \$196.3 million at March 31, 2018.

Comparative balances of high-risk assets follow (in millions):

	March 31, 2018	Increase (Decrease)		December 31, 2017
		\$	%	
Nonaccrual loans	\$ 147.1	\$ 20.9	16.6 %	\$ 126.2
Accruing formally restructured loans	30.2	(0.3)	(1.0)	30.5
Loans 90 days past due and still accruing interest	5.1	2.1	70.0	3.0
Total impaired loans	182.4	22.7	14.2	159.7
Other property owned	13.9	(1.7)	(10.9)	15.6
Total high-risk assets	\$ 196.3	\$ 21.0	12.0 %	\$ 175.3

The \$20.9 million increase in nonaccrual loans from December 31, 2017, to March 31, 2018, is primarily the result of \$51.8 million in transfers to nonaccrual status, offset by \$35.3 million in repayments on nonaccrual loans. The decrease in other property owned (OPO) was primarily due to dispositions of \$3.5 million at district associations offset by \$1.3 million in additions to OPO at district associations.

At March 31, 2018, \$84.0 million, or 57.1 percent, of the district's nonaccrual loans were considered current as to principal and interest. Continued satisfactory payment performance on these loans may indicate potential for a return to accrual status. At March 31, 2018, the district had \$6.1 million in nonaccrual loans on which interest income is recognized upon cash receipts, compared to \$12.1 million at December 31, 2017. Impaired loans, consisting of nonaccrual loans, accruing formally restructured loans and loans past due 90 days or more and still accruing interest, constituted 0.8 percent of total loans at March 31, 2018, and December 31, 2017.

The allowance for loan losses at March 31, 2018, totaled \$84,816, or 0.4 percent of total loans, and was an increase of \$1,548, or 1.9 percent, from the allowance for loan losses at December 31, 2017. The increase includes a \$2,666 provision and \$470 million in recoveries, offset by \$1.5 million in charge-offs. Additional information about the allowance for loan losses is included in Note 3, "Loans and Reserves for Credit Losses." The allowance for loan losses as a percentage of impaired loans was 46.5 percent as of March 31, 2018, as compared to 52.1 percent as of December 31, 2017. The nature of the collateral supporting many of the impaired loans (primarily first lien real estate) is considered in the determination of necessary allowances for loan losses. The district also had reserves for credit losses on letters of credit and unfunded commitments totaling \$5.1 million at March 31, 2018.

Liquidity and Funding Sources

Cash and available-for-sale investment securities totaled \$5.44 billion, or 18.1 percent, of total assets at March 31, 2018, compared to \$5.48 billion, or 18.4 percent, at December 31, 2017, a decrease of \$40.1 million, or 0.7 percent. At March 31, 2018, the district's cash balance was \$13.2 million, a decrease of \$53.8 million from the balance at December 31, 2017. Starting in the second quarter of 2017, the bank reduced the cash balance and increased investments in federal funds sold in order to enhance liquidity management. Cash held at the Federal Reserve Bank at March 31, 2018, totaled \$5.4 million, compared to \$25.8 million at December 31, 2017. The bank maintains levels of cash and other highly liquid assets to meet loan demand, maturing debt and other liquidity needs. At March 31, 2018, the bank had 222 days of liquidity to cover maturing debt obligations, as compared to 227 days at December 31, 2017. Interest-

bearing liabilities, consisting of bonds and notes, increased by \$307.8 million, or 1.2 percent, from December 31, 2017, to March 31, 2018.

Investments

The district's investments at March 31, 2018, included the bank's available-for-sale portfolio with a fair value of \$5.19 billion and the district associations' held-to-maturity portfolio recorded at an amortized cost of \$17.4 million. The available-for-sale investments included a liquidity portfolio and a portfolio of other investments. The bank's available-for-sale liquidity portfolio consisted primarily of federal agency-guaranteed collateralized mortgage-backed securities (MBS), corporate debt, agency-guaranteed debt, U.S. Treasury securities and asset-backed securities (ABS). The majority of the liquidity portfolio's MBS includes Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities. The available-for-sale portfolio of other investments consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) held by the bank that had a fair value of \$41.2 million. The district associations' held-to-maturity portfolio consisted of Farmer Mac AMBS held by district associations which had an amortized cost and fair value of \$17.4 million.

The Farmer Mac AMBS are backed by loans originated by the associations and previously held by the associations under Farmer Mac's long-term standby commitment to purchase agreements. Farmer Mac is a government-sponsored enterprise and is examined and regulated by FCA. It provides a secondary market for agricultural and rural home mortgage loans that meet certain underwriting standards. Farmer Mac is authorized to provide loan guarantees and to be a direct pooler of agricultural mortgage loans. Farmer Mac is owned by both System and non-System investors, and its board of directors has both System and non-System representation. Farmer Mac is not liable for any debt or obligation of any System institution, and no System institution other than Farmer Mac is liable for any debt or obligation of Farmer Mac.

The following table summarizes the bank's available-for-sale liquidity portfolio holdings:

	March 31, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Agency-guaranteed debt	\$ 192,725	\$ 189,001	\$ 198,246	\$ 195,248
Corporate debt	261,446	260,854	252,482	252,609
Federal agency collateralized mortgage-backed securities				
GNMA	2,168,179	2,124,097	2,012,484	1,984,662
FNMA and FHLMC	2,272,949	2,238,019	2,395,248	2,372,053
U.S. Treasury securities	324,486	324,062	249,860	249,207
Asset-backed securities	56,441	56,353	47,914	47,889
Total available-for-sale investments	<u>\$ 5,276,226</u>	<u>\$ 5,192,386</u>	<u>\$ 5,156,234</u>	<u>\$ 5,101,668</u>

The bank's available-for-sale other investments portfolio consisted of Farmer Mac AMBS securities as follows:

	March 31, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Agricultural mortgage-backed securities	\$ 43,498	\$ 41,151	\$ 45,564	\$ 43,317

FCA regulations define eligible investments by specifying credit rating criteria, final maturity limit, percentage of investment portfolio limit and certain other requirements for each investment type. At the time the investments are purchased, they must be highly rated by at least one Nationally Recognized Statistical

Rating Organization (NRSRO), such as Moody’s Investors Service, Standard & Poor’s or Fitch Ratings. U.S. Treasury securities, U.S. agency securities and other obligations fully insured or guaranteed by the U.S., its agencies, instrumentalities and corporations are considered eligible investments under the FCA’s regulations, even if downgraded. If an investment no longer meets the credit rating criteria, the investment becomes ineligible; however, FCA regulations do not require disposition of any of these securities.

At March 31, 2018, the bank did not hold any investments that were ineligible for liquidity purposes by FCA regulations due to credit ratings by all NRSROs.

Capital Resources

The district’s combined capital at March 31, 2018, totaled \$4.37 billion consisting of \$600,000 of Class B noncumulative perpetual preferred stock related to the bank and \$20,000 of cumulative perpetual preferred stock related to a district association, \$65,934 of capital stock and participation certificates, \$3.65 billion in retained earnings and \$224,625 in additional paid-in capital, offset by \$183,782 of accumulated other comprehensive loss. The district’s capital reflected an increase of \$95,749, or 2.2 percent, from December 31, 2017, to March 31, 2018, due to net income of \$130,032, patronage declarations of \$7,750, preferred stock dividends of \$5,562 and other comprehensive income changes of \$20,923.

During the first quarter of 2017 a district association issued 20 million shares of fixed-to-floating rate perpetual cumulative preferred stock with a par value of \$1.00 per share. The preferred stock will have a fixed rate dividend of 5 percent for 10 years, payable semi-annually. After 10 years, the dividend rate becomes a floating rate of 5 percent above 6-month LIBOR. On or after five years, the association may, at its option, redeem all or part of the preferred stock. The district association recognized \$136 in issuance costs as a reduction of retained earnings during the second quarter of 2017. During the first quarter of 2018, fixed-to-floating perpetual cumulative preferred stock dividends totaling \$500 were declared and paid by a district association.

FCA regulations require the bank and associations 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 (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of March 31, 2018, the bank and all district associations exceeded all regulatory capital requirements.

The following table reflects the bank and associations’ capital ratios as of March 31, 2018:

	Bank	FLCA	ACAs	Total Regulatory Requirement
Permanent capital ratio ranges	15.78%	16.94%	12.37%-22.33%	7.00%
Common equity tier 1 ratio ranges	9.82	16.88	11.95 - 22.20	7.00
Tier 1 capital ratio ranges	15.77	16.88	11.95 - 22.20	8.50
Total capital ratio ranges	15.86	17.20	12.64 - 22.76	10.50
Tier 1 leverage ratio ranges	7.00	17.51	10.65 - 20.89	5.00
UREE leverage ratio ranges	2.69	18.73	7.95 - 21.92	1.50

The following table reflects the key financial condition comparisons for the district as of:

	March 31, 2018	December 31, 2017
Members’ equity to assets	14.58%	14.40%
Total liabilities to members’ equity	5.86:1	5.95:1
Allowance for loan losses to total loans	0.35%	0.35%

OTHER

CONDITIONS IN THE DISTRICT

The district's non-farm economy remains strong. Increased oil prices have spurred additional activity in the Permian Basin of Texas and supported economic conditions in the largely rural areas of West Texas and southeastern New Mexico. According to the Federal Reserve Bank of Dallas, job growth in Texas will reach 3.4 percent in 2018, the highest rate in four years.

During 2017, beef production in the U.S. exceeded 26 billion pounds for the first time since 2011, and pork and chicken output both reached record highs. After earning relatively high returns in 2017, cattle feedlots have generally been operating at around breakeven through the first few months of 2018. The profitability of cattle ranchers is expected to decline marginally this year but should remain positive. Supported by continued increases in the size of the U.S. cattle herd, beef processors have fared well in recent quarters. Although the rate of expansion of the U.S. cattle herd slowed in 2017, beef production is expected to rise by about five percent this year. Absent a significant increase in export demand, the potential for cattle and beef prices to move higher during 2018 is likely to be limited. Commercial poultry producers have recently been earning net margins that are near the medium-term average. Producers in the U.S. are on high alert for potential avian influenza cases, as migratory birds travel northward across the country through early summer. Hog prices, which were relatively strong in the latter half of 2017, declined during the first quarter of 2018. The reduction in hog prices, which may lead to marginal losses for producers this year, was primarily due to instability in export markets and increased competition among processors. Prices for dairy products have trended lower during 2018, as seasonal factors and rising global production pressured markets. Feed prices remain at low to moderate levels, which has been supportive of profitability in many livestock-related industries despite lower revenues.

Worsening drought conditions across the Southwest, including throughout New Mexico and in much of Texas, have stressed pasture and row crop conditions. According to the U.S. Climate Prediction Center, dry weather is likely to continue in the affected areas through at least June 2018. If the drought intensifies, it could impact farmers' ability to plant spring crops in a timely fashion, reduce yield potential and cause premature liquidation of livestock. However, given the propensity for drought in the district, farmers in the region are adept at managing crop and livestock production with limited precipitation. Additionally, the U.S. Department of Agriculture estimates that there are over 4 million acres of irrigated farmland in Texas, which helps to mitigate the impact of reduced moisture on the state's agricultural sector.

In the district, planting season for most field crops is underway, with crop progress generally in line with the average pace observed during the most recent five years. According to the U.S. Department of Agriculture's Prospective Plantings Report, U.S. farmers are expected to increase farmland dedicated to cotton and wheat production in 2018, while decreasing cropland allocated to corn and soybeans. For the second consecutive year, cotton plantings are likely to increase significantly, as U.S. farmers look to take advantage of the crop's favorable pricing relative to alternatives and its yield potential in drier conditions. Texas cotton farmers are projected to plant about 7.3 million acres of cotton in 2018, the second-highest level observed since 1981. The district is a crucial driver of global cotton production, as it accounts for about two-thirds of all U.S. farmland dedicated to the crop. For the first time in U.S. history, farmers are expected to allocate more acreage to soybeans than corn in 2018. Increasing global demand for soybeans, which are used as a source of protein in many livestock feeds, is driving acreage higher. Stocks of most field crops remain historically high following several consecutive years of above average U.S. and global output. Barring a substantial yield-reducing event in one of the world's major growing regions, field crop prices are likely to be stable to declining in 2018. Farmers in the district continue to utilize risk management tools such as federally-sponsored crop insurance programs, forwards, futures and options contracts to mitigate risk and enhance margins.

According to the U.S. Department of Agriculture, the U.S. has had surpluses in agricultural trade for more than 60 years. Because about 20 percent of all U.S. agricultural production is exported, the prices of certain agricultural commodities might be susceptible to declines if export demand falls. Due to the geography of agricultural production and several other factors, the industry might also be selectively targeted by other countries during trade disputes. Commodities that are reliant on export markets for a relatively large share of total demand, such as tree nuts, cotton, soybeans, pork and dairy, may be particularly vulnerable. It should be noted, however, that exports have been strong year-to-date for many agricultural commodities, and the U.S. Department of Agriculture forecasted in February that the value of U.S. agricultural exports would be essentially unchanged in the 2018 fiscal year. Additionally, many of the district's borrowers employ hedging programs to protect against price volatility and secure profitability.

The district portfolio continues to be supported by strong credit quality, high levels of capital, low advance rates and diversification.

RATING AGENCY ACTIONS

Fitch Ratings Actions

On April 6, 2018, Fitch Ratings affirmed the bank's long-term and short-term issuer default ratings (IDRs) at "AA-" and "F1+," respectively, with a stable outlook. Fitch also affirmed the bank's noncumulative perpetual preferred stock rating at "BBB" and its support floor at "AA-." Fitch affirmed the Farm Credit System's long-term and short-term IDRs at "AAA" and "F1+," respectively, with a stable outlook, and its support floor at "AAA." As a government-sponsored entity, the System benefits from implicit government support. The ratings and rating outlook are directly linked to the U.S. sovereign rating. The affirmation of the System banks' IDRs reflect their prudent, conservative credit culture, their unique funding advantage and their structural second-loss position on the majority of their loan portfolio.

Moody's Investors Service Rating Actions

On November 17, 2017, Moody's Investors Service affirmed the bank's issuer rating at "Aa3" and its noncumulative preferred stock rating at "Baa1 (hyb)," with a stable outlook. The Aa3 issuer rating reflects the bank's "a1" baseline credit assessment (BCA), very high cooperative support from the other Federal Farm Credit Banks and moderate support from the U.S. government, which has an "Aaa," stable outlook. The bank's preferred stock rating incorporated the bank's BCA, very high cooperative support from the other Federal Farm Credit Banks and notching reflecting the debt's relative positions in the bank's capital structure. The bank's "a1" BCA incorporates its solid capital levels, adequate risk-adjusted profitability and liquidity, as well as the benefits associated with its lending to related associations and their strong capital levels. The "a1" BCA is one of Moody's highest assessments of any financial institution, both domestically and globally.

REGULATORY MATTERS

At March 31, 2018, there were no district associations under written agreements with the Farm Credit Administration.

On July 28, 2016, the Farm Credit Administration published a final regulation to modify the regulatory capital requirements for System banks and associations. The stated objectives of the rule were as follows:

- To modernize capital requirements while ensuring that the institutions continue to hold sufficient regulatory capital to fulfill their mission as government-sponsored enterprises,
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System,

- To make System regulatory capital requirements more transparent, and
- To meet the requirements of section 939A of the Dodd-Frank Act.

The final rule replaced existing core surplus and total surplus requirements with common equity tier 1, tier 1 and total capital risk-based capital ratio requirements. The final rule also replaced the existing net collateral ratio with a tier 1 leverage ratio and is applicable to all banks and associations. The permanent capital ratio will continue to remain in effect with the final rule.

The new capital requirements became effective January 1, 2017, with a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. The bank and its affiliated associations are in compliance with the required minimum capital standards and met the conservation buffers as of March 31, 2018.

On June 12, 2014, the Farm Credit Administration approved a proposed rule to revise the requirements governing the eligibility of investments for System banks and associations. The stated objectives of the proposed rule are as follows:

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

On May 10, 2018, the Farm Credit Administration adopted a final rule that primarily implements the requirements of Section 939A of the Dodd-Frank Act and grants associations greater flexibility regarding the risk management purposes for which they hold investments while establishing new limits on the amount and types of investments they may hold. The final rule will become effective January 1, 2019.


OTHER

New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Acts of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA changed the federal corporate tax rate from 35 percent to 21 percent. The bank is exempt from federal and certain other income taxes as provided by the Farm Credit Act of 1971; however, the change in federal corporate tax rate had a financial statement impact for year-end 2017 for district associations that required the revaluation of any deferred taxes (assets or liabilities), which resulted in either a tax expense or tax benefit to the income statement for the year ended December 31, 2017. The first quarter of 2018 reflects the federal corporate tax rate of 21 percent.

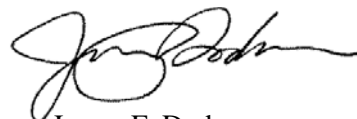
While the full impact of the TCJA is difficult to predict and may not be fully known for several years, changes that could affect the district's business and customers include, but are not limited to, modifications to deductions surrounding interest expense and equipment purchases, tax incentives related to renewable energy initiatives, deductions impacting agricultural producers who sell their products to cooperatives and the overall changes in the competitive environment impacting financial institutions.

Report of Management

The undersigned certify that we have reviewed the March 31, 2018, quarterly report of the Farm Credit Bank of Texas and district associations, that the report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information included herein is true, accurate, and complete to the best of our knowledge and belief.



Larry R. Doyle
Chief Executive Officer



James F. Dodson
Chairman of the Board



Amie Pala
Chief Financial Officer

May 30, 2018

Controls and Procedures

The Farm Credit Bank of Texas (bank) maintains a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. With management's input, the chief executive officer and chief financial officer evaluated our disclosure controls and procedures as of the end of and for the period covered by this quarterly report, and have concluded that our disclosure controls and procedures are effective as of that date. This evaluation relies upon the evaluations made by the individual associations and the related certifications they provide to the bank.

The bank also maintains a system of internal controls. The "internal controls" as defined by the American Institute of Certified Public Accountants' Codification of Statement on Auditing Standards, AU Section 319, means a process —effected by the board of directors, management and other personnel — designed to provide reasonable assurance regarding the achievement of objectives in the reliability of our financial reporting, the effectiveness and efficiency of operations, and of compliance with applicable laws and regulations. We continually assess the adequacy of our internal control over financial reporting and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations.



Larry R. Doyle
Chief Executive Officer



Amie Pala
Chief Financial Officer

May 30, 2018

Combined Balance Sheets

(dollars in thousands)	March 31, 2018 (Unaudited)	December 31, 2017
Assets		
Cash	\$ 13,184	\$ 66,953
Federal funds sold and overnight investments	173,435	246,888
Investment securities	5,250,931	5,163,813
Loans (includes \$9,908 and \$16,311 at fair value, held under fair value option)	24,045,703	23,745,668
Less allowance for loan losses	84,816	83,268
Net loans	23,960,887	23,662,400
Accrued interest receivable	207,515	202,748
Other property owned	13,874	15,569
Premises and equipment, net	140,693	134,617
Other assets	227,916	224,134
Total assets	\$ 29,988,435	\$ 29,717,122
Liabilities and members' equity		
Liabilities		
Bonds and notes, net	\$ 25,109,001	\$ 24,801,223
Accrued interest payable	78,804	70,197
Patronage distributions payable	12,882	170,022
Preferred stock dividends payable	20,063	20,063
Other liabilities	394,040	377,721
Total liabilities	25,614,790	25,439,226
Commitments and contingencies (Note 4)		
Members' equity		
Preferred stock	620,000	620,000
Capital stock and participation certificates	65,934	65,982
Allocated retained earnings	685,506	685,506
Unallocated retained earnings	2,961,363	2,844,643
Additional paid-in-capital	224,625	224,625
Accumulated other comprehensive loss	(183,783)	(162,860)
Total members' equity	4,373,645	4,277,896
Total liabilities and members' equity	\$ 29,988,435	\$ 29,717,122

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

Combined Statements of Comprehensive Income

(unaudited)

(dollars in thousands)	Quarter Ended March 31,	
	2018	2017
Interest Income		
Loans	\$ 281,294	\$ 246,387
Investment securities	26,299	19,048
Total interest income	307,593	265,435
Interest Expense		
Bonds and notes	91,551	64,632
Notes payable and other	21,627	13,821
Total interest expense	113,178	78,453
Net interest income	194,415	186,982
Provision for credit losses	2,666	3,336
Net interest income after provision for credit losses	191,749	183,646
Noninterest Income		
Patronage income	5,006	5,145
Fees for loan-related services	8,065	5,713
Refunds from Farm Credit System Insurance Corporation	19,269	-
Loss on loans held under fair value option	(110)	(100)
Other income, net	759	4,130
Total noninterest income	32,989	14,888
Noninterest Expense		
Salaries and employee benefits	51,749	47,522
Occupancy and equipment expense	9,048	8,800
Insurance Fund premiums	4,683	7,573
Gain on other property owned, net	(382)	(103)
Other components of net periodic pension and postretirement benefit costs	3,529	5,120
Other operating expenses	26,155	33,957
Total noninterest expense	94,782	102,869
Income before provision for income taxes	129,956	95,665
Benefit from income taxes	(76)	(224)
Net Income	130,032	95,889
Other comprehensive income (loss)		
Change in unrealized loss on investments	(29,374)	(1,511)
Change in pension and postretirement benefit plans	3,377	4,254
Change in cash flow derivative instruments	5,074	252
Total other comprehensive (loss) income	(20,923)	2,995
Comprehensive Income	\$ 109,109	\$ 98,884

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

Combined Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Preferred Stock	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Additional Paid-in-Capital	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2016	\$ 600,000	\$ 64,434	\$ 631,647	\$ 2,736,197	\$ 224,625	\$ (157,982)	\$ 4,098,921
Net income	-	-	-	95,889	-	-	95,889
Other comprehensive gain	-	-	-	-	-	2,995	2,995
Capital stock/participation certificates issued	-	2,420	-	-	-	-	2,420
Capital stock/participation certificates and allocated retained earnings retired	-	(2,119)	-	-	-	-	(2,119)
Preferred stock issued	20,000	-	-	-	-	-	20,000
Preferred stock dividends	-	-	-	(5,062)	-	-	(5,062)
Patronage distributions							
Cash	-	-	-	(9,092)	-	-	(9,092)
Members' equity	-	-	22	(22)	-	-	-
Balance at March 31, 2017	<u>\$ 620,000</u>	<u>\$ 64,735</u>	<u>\$ 631,669</u>	<u>\$ 2,817,910</u>	<u>\$ 224,625</u>	<u>\$ (154,987)</u>	<u>\$ 4,203,952</u>
Balance at December 31, 2017	\$ 620,000	\$ 65,982	\$ 685,506	\$ 2,844,643	\$ 224,625	\$ (162,860)	\$ 4,277,896
Net income	-	-	-	130,032	-	-	130,032
Other comprehensive loss	-	-	-	-	-	(20,923)	(20,923)
Capital stock/participation certificates issued	-	2,148	-	-	-	-	2,148
Capital stock/participation certificates and allocated retained earnings retired	-	(2,196)	-	-	-	-	(2,196)
Preferred stock dividends	-	-	-	(5,562)	-	-	(5,562)
Patronage distributions							
Cash	-	-	-	(7,750)	-	-	(7,750)
Members' equity	-	-	-	-	-	-	-
Balance at March 31, 2018	<u>\$ 620,000</u>	<u>\$ 65,934</u>	<u>\$ 685,506</u>	<u>\$ 2,961,363</u>	<u>\$ 224,625</u>	<u>\$ (183,783)</u>	<u>\$ 4,373,645</u>

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

Combined Statements of Cash Flows

(unaudited)

(dollars in thousands)	Three Months Ended March 31,	
	2018	2017
Operating activities		
Net income	\$ 130,032	\$ 95,889
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	2,666	3,336
Carrying value adjustment on other property owned	20	12
Depreciation and amortization on premises and equipment	4,105	4,062
Accretion of net premium on loans	860	1,959
Net change in fair value of concessions granted	-	4,134
Amortization and accretion on debt instruments	8,713	5,471
Accretion of yield related to loans and notes payable acquired in merger	(148)	(85)
Accretion of net premium on investments	1,071	1,265
Decrease in fair value of loans held under fair value option	110	100
Gain from sales of other property owned	(560)	(296)
Loss on sale of loans	109	-
Loss (gain) on other earning assets	482	(1,979)
Distributions less than cumulative equity earnings	-	113
Loss from sales of premises and equipment	867	783
Allocated equity patronage from System bank	(14,793)	(14,588)
(Increase) decrease in accrued interest receivable	(4,768)	2,941
Decrease in other assets, net	16,819	13,441
Increase in accrued interest payable	8,606	4,353
Increase (decrease) in other liabilities, net	3,413	(53,119)
Net cash provided by operating activities	157,604	67,792
Investing activities		
Net decrease in federal funds sold	73,453	812
Investment securities		
Purchases	(401,569)	(400,460)
Proceeds from maturities, calls and prepayments	284,006	289,636
Increase in loans, net	(338,139)	(446,097)
Proceeds from sale of loans	48,373	-
Proceeds from sales of other property owned	860	5,674
Proceeds from sales of premises and equipment	931	1,028
Expenditures for premises and equipment	(11,978)	(6,881)
Distributions in excess of cumulative equity earnings	82	-
Investment in other earning assets	(1,056)	(1,604)
Net cash used in investing activities	(345,037)	(557,892)
Financing activities		
Bonds and notes issued	2,517,065	2,973,223
Bonds and notes retired	(2,218,000)	(2,393,050)
Prepayments on debt extinguishment costs	-	28
(Decrease) increase in guaranteed obligations to government entities	(202)	1,388
Increase in advanced conditional payments	5,435	9,672
Preferred stock issued	-	20,000
Repayments on capital lease obligation	(133)	(134)
Capital stock and participation certificates issued	2,148	2,420
Capital stock and participation certificates retired	(2,196)	(2,119)
Cash dividends on preferred stock	(5,562)	(5,062)
Cash patronage distributions paid	(164,891)	(97,315)
Net cash provided by financing activities	133,664	509,051
Net (decrease) increase in cash	(53,769)	18,951
Cash at beginning of year	66,953	207,229
Cash at end of quarter	\$ 13,184	\$ 226,180
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	\$ 2,481	\$ 259
Loan assets transferred to other property owned	1,284	814
Undocumented advances expense, net	-	8,370
Net increase in unrealized losses on investment securities	(29,375)	(1,511)
Cash dividends or patronage distributions payable	12,882	68,877
Preferred stock dividend payable	20,063	20,063
Capital lease obligation	519	951
Supplemental information		
Cash paid for:		
Interest	\$ 104,571	\$ 74,100

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

Notes to Combined Financial Statements

Unaudited (dollar amounts in thousands unless otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying combined financial statements (financial statements) include the accounts of the Farm Credit Bank of Texas (bank) and the accounts of its affiliated Agricultural Credit Associations (ACAs) and Federal Land Credit Association (FLCA) in the Farm Credit System (System). The ACAs and FLCA are collectively referred to as associations, and the bank and its affiliated associations are collectively referred to as the district. The financial statements also reflect the investments in and allocated earnings of the service organizations in which the bank has a partial ownership interest. All significant transactions and balances between the bank and the associations have been eliminated in combination.

During the third quarter of 2017, an association within the district determined the association's consolidated financial statements as of and for the year ended December 31, 2016, as well as the three months ended March 31, 2017, should no longer be relied upon and needed to be restated to correct misstatements in the association's consolidated financial statements. The association's restatements in 2016 decreased its consolidated other comprehensive income and members' equity previously reported by \$8.1 million. These additional losses were the result of the activities of a former loan officer who breached the association's policies and procedures and engaged in improper conduct that included improperly advancing funds without appropriate approvals, offering unauthorized loan terms to borrowers, originating loans to fictitious borrowers, and originating loans and advancing funds based on fabricated documentation.

The district's combined financial statements for the quarter ended March 31, 2017 include an out-of-period adjustment of \$8.1 million resulting from the association's restatement for 2016 related to this matter. In addition, the events and activities that resulted in the restatement of the association's consolidated financial statements at December 31, 2016 also impacted the financial results for the quarter ended March 31, 2017 by \$7.7 million, decreasing consolidated other comprehensive income and members' equity. Although the association restated their 2016 financial statements, the district has evaluated the quantitative and qualitative aspects of these misstatements in accordance with applicable accounting guidance and has determined that such misstatements are not material to the current and previously issued district combined financial statements.

In the opinion of management, the accompanying unaudited financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations of the district, and conform to generally accepted accounting principles. The preparation of these financial statements requires the use of management's estimates. The results of operations for any interim period are not necessarily indicative of the results to be expected for the entire year.

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA), that lowered the federal corporate tax rate from 35 percent to 21 percent. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim

periods within those fiscal years. The adoption of this guidance did impact the district's financial condition and results of operations.

In August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance becomes effective for interim and annual periods beginning after December 15, 2018. The district is evaluating the impact of adoption on the district's financial condition and its results of operations.

In March 2017, the FASB issued guidance entitled "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the district's financial condition but did change the classification of certain items in the results of operations.

In August 2016, the FASB issued guidance entitled "Classification of Certain Cash Receipts and Cash Payments." The guidance addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the district's financial condition or its results of operations but did change the classification of certain items in the statement of cash flows.

In June 2016, the FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." 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. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The district is evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled "Leases." The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The district is evaluating the impact of adoption on their financial condition and results of operations.

In January 2016, the FASB issued guidance entitled “Recognition and Measurement of Financial Assets and Liabilities.” The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the district’s financial condition or their results of operations.

In May 2014, the FASB issued guidance entitled, “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. The guidance sets forth the requirement for new and enhanced disclosures. The district adopted the new standard effective January 1, 2018 using the modified retrospective approach. As the majority of the district associations revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial position or the results of operations.

NOTE 2 — INVESTMENTS**Investments Available-for-Sale**

The bank's available-for-sale investments include a liquidity portfolio and a portfolio of other investments. The majority of the liquidity portfolio's mortgage-backed securities were federal agency-guaranteed collateralized mortgage-backed securities, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities. The other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS). A summary of the amortized cost and fair value of investment securities designated as available-for-sale at March 31, 2018, and December 31, 2017, is as follows:

Investments in the bank's available-for-sale liquidity portfolio at March 31, 2018:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	\$ 192,725	\$ 69	\$ (3,793)	\$ 189,001	2.06 %
Corporate debt	261,446	504	(1,096)	260,854	2.22
Federal agency-guaranteed collateralized mortgage-backed securities:					
GNMA	2,168,179	589	(44,671)	2,124,097	2.19
FNMA and FHLMC	2,272,949	1,792	(36,722)	2,238,019	2.08
U.S. Treasury securities	324,486	-	(424)	324,062	1.14
Asset-backed securities	56,441	15	(103)	56,353	2.01
Total available-for-sale liquidity investments	<u>\$ 5,276,226</u>	<u>\$ 2,969</u>	<u>\$ (86,809)</u>	<u>\$ 5,192,386</u>	2.07 %

Investments in the bank's available-for-sale other investments portfolio at March 31, 2018:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 43,498	\$ -	\$ (2,347)	\$ 41,151	4.55 %

Investments in the bank's available-for-sale liquidity portfolio at December 31, 2017:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	\$ 198,246	\$ 30	\$ (3,028)	\$ 195,248	1.94 %
Corporate debt	252,482	556	(429)	252,609	1.84
Federal agency-guaranteed collateralized mortgage-backed securities:					
GNMA	2,012,484	706	(28,528)	1,984,662	1.99
FNMA and FHLMC	2,395,248	2,061	(25,256)	2,372,053	1.91
U.S. Treasury securities	249,860	-	(653)	249,207	0.90
Asset-backed securities	47,914	18	(43)	47,889	1.61
Total available-for-sale liquidity investments	<u>\$ 5,156,234</u>	<u>\$ 3,371</u>	<u>\$ (57,937)</u>	<u>\$ 5,101,668</u>	1.88 %

Investments in the bank's available-for-sale other investments portfolio at December 31, 2017:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 45,564	\$ -	\$ (2,247)	\$ 43,317	4.46 %

The following tables summarize the contractual maturity, fair value, amortized cost and weighted average yield of available-for-sale investments at March 31, 2018:

Investments in the bank's available-for-sale liquidity portfolio:

	Due in one year or less	Due after one year through five years	Due after five years through 10 years	Due after 10 years	Total
Agency-guaranteed debt	\$ -	\$ 18,432	\$ 170,569	\$ -	\$ 189,001
Corporate debt	35,065	225,789	-	-	260,854
Federal agency collateralized mortgage-backed securities:					
GNMA	47	-	75,419	2,048,631	2,124,097
FNMA and FHLMC	708	105,361	396,064	1,735,886	2,238,019
U.S. Treasury securities	299,304	24,758	-	-	324,062
Asset-backed securities	-	54,170	2,183	-	56,353
Total fair value	<u>\$ 335,124</u>	<u>\$ 428,510</u>	<u>\$ 644,235</u>	<u>\$ 3,784,517</u>	<u>\$ 5,192,386</u>
Total amortized cost	\$ 335,471	\$ 431,355	\$ 657,669	\$ 3,851,731	\$ 5,276,226
Weighted average yield	1.18%	2.05%	2.01%	2.16%	2.07%

Investments in the bank's available-for-sale other investments portfolio:

	Due after one year through five years	Due after five years through 10 years	Total
Fair value of agricultural mortgage-backed securities	\$ 12,663	\$ 28,488	\$ 41,151
Total amortized cost	\$ 13,011	\$ 30,487	\$ 43,498
Weighted average yield	4.46%	4.59%	4.55%

Other-Than-Temporarily Impaired Investments Evaluation

The following table shows the bank's available-for-sale liquidity portfolio investments by gross unrealized losses and fair value, aggregated by investment category and length of time, for the securities that have been in a continuous unrealized loss position at March 31, 2018. The continuous loss position is based on the date the impairment was first identified:

	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Agency-guaranteed debt	\$ 79,494	\$ (995)	\$ 91,314	\$ (2,797)	\$ 170,808	\$ (3,792)
Corporate debt	117,946	(1,096)	-	-	117,946	(1,096)
Federal agency collateralized mortgage-backed securities						
GNMA	873,222	(15,489)	980,304	(29,183)	1,853,526	(44,672)
FNMA and FHLMC	698,256	(10,922)	981,286	(25,800)	1,679,542	(36,722)
U.S. Treasury securities	74,483	(52)	249,578	(372)	324,061	(424)
Asset-backed securities	42,808	(95)	4,044	(8)	46,852	(103)
Total	<u>\$ 1,886,209</u>	<u>\$ (28,649)</u>	<u>\$ 2,306,526</u>	<u>\$ (58,160)</u>	<u>\$ 4,192,735</u>	<u>\$ (86,809)</u>

The district evaluates investment securities for other-than-temporary impairment (OTTI) on a quarterly basis. Impairment is considered to be other than temporary if an entity (i) intends to sell the security, (ii) is more likely than not to be required to sell the security before recovering its cost or (iii) does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell).

In the event of an investment being designated OTTI, to measure the amount related to credit loss in the determination of OTTI, the bank utilizes a third-party vendor's services for cash flow modeling and projection of credit losses for specific non-agency residential mortgage-backed securities and subprime asset-backed securities. Significant inputs utilized in the methodology of the modeling include assumptions surrounding market data (interest rates and home prices) and the applicable securities' loan-level data. Loan-level data evaluated includes loan status, coupon and resets, FICO scores, loan-to-value, geography, property type, etc. Loan-level data is then combined with assumptions surrounding future behavior of home prices, prepayment rates, default rates and loss severity to arrive at cash flow projections for the underlying collateral. Default rate assumptions are generally estimated using historical loss and performance information to estimate future defaults. The present value of these cash flow projections is then evaluated against the specific security's structure and credit enhancement to determine if the bond will absorb losses. For the three months ended March 31, 2018, the district did not recognize any other-than-temporary impairment credit losses and no securities were identified as OTTI at March 31, 2018 and December 31, 2017.

Held-to-Maturity Investments

The district's held-to-maturity investments consist of Farmer Mac guaranteed agricultural mortgage-backed securities and are held by district associations. A summary of the amortized cost and fair value of held-to-maturity investment securities at March 31, 2018, is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 17,394	\$ 12	\$ (170)	\$ 17,236	5.09%

The following table summarizes the contractual maturity, fair value, amortized cost and weighted average yield of the district's held-to-maturity investments at March 31, 2018:

	Due after one year through five years	Due after five years through 10 years	Total
Fair value of agricultural mortgage-backed securities	\$ 10,989	\$ 6,247	\$ 17,236
Total amortized cost	\$ 11,048	\$ 6,346	\$ 17,394
Weighted average yield	5.41%	4.53%	5.09%

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

A summary of the district's loans are as follows:

	March 31, 2018	December 31, 2017
Real estate mortgage	\$ 14,420,294	\$ 14,351,578
Production and intermediate term Agribusiness	2,876,640	3,014,067
Loans to cooperatives	578,639	429,535
Processing and marketing	3,552,799	3,428,261
Farm-related business	226,097	206,441
Communication	476,777	437,066
Energy (rural utilities)	1,375,861	1,352,129
Water and waste disposal	124,706	117,177
Rural residential real estate	234,040	234,379
Lease receivables	30,436	25,009
Loans to other financing institutions	41,873	40,107
Mission-related	107,541	109,919
	\$ 24,045,703	\$ 23,745,668

The bank's capital markets loan portfolio of \$5,853, which is included in the summary above, predominantly includes participations, syndications and purchased whole loans, along with other financing structures within our lending authorities. The bank also refers to the capital markets portfolio as participations purchased. In addition to purchasing loans from our district associations, which may exceed their hold limits, the bank seeks the purchase of participations and syndications originated outside of the district's territory by other System institutions, commercial banks and other lenders. These loans may be held as earning assets of the bank or sub-participated to the associations or to other System entities. The

bank and associations purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration (FCA) regulations.

The following table presents information regarding the district's balances of participations purchased and sold, excluding syndications, at March 31, 2018:

	Other Farm Credit Institutions (Outside of the Texas District)		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 179,104	\$ 354,305	\$ 292,961	\$ 2,569	\$ 472,065
Production and intermediate term	642,606	665,995	21,637	59,481	664,243	725,476
Agribusiness	2,243,570	47,290	3,923	-	2,247,493	47,290
Communication	477,609	-	-	-	477,609	-
Energy (rural utilities)	1,376,246	-	-	-	1,376,246	-
Water and waste disposal	124,999	-	-	-	124,999	-
Lease receivables	30,198	-	-	-	30,198	-
Mission-related	4,701	-	4,105	-	8,806	-
Loans to other financing institutions	-	1,500	-	-	-	1,500
Direct note receivable from district associations	-	3,850,000	-	-	-	3,850,000
Total	\$ 5,079,033	\$ 4,919,090	\$ 322,626	\$ 62,050	\$ 5,401,659	\$ 4,981,140

The bank and associations are authorized under the Farm Credit Act to accept “advance conditional payments” (ACPs) from borrowers. To the extent the borrower’s access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower’s related loan balance. ACPs which are held by the district but cannot be used to reduce outstanding loan balances, except at the direction of the borrower, are classified as other liabilities in the combined balance sheets. ACPs are not insured, and interest is generally paid by the associations on such balances. At March 31, 2018, ACPs netted against borrowers’ related loan balances totaled \$207,910 and ACPs included in other liabilities totaled \$21,642, compared to \$198,180 and \$16,207, respectively, at December 31, 2017.

The bank has elected the fair value option for certain callable loans purchased on the secondary market at a significant premium. The fair value option provides an irrevocable option to elect fair value as an alternative measurement for selected financial assets. The fair value of loans held under the fair value option totaled \$9,723 at March 31, 2018. Fair value is used for both the initial and subsequent measurement of the designated instrument, with the changes in fair value recognized in net income. On these instruments, the related contractual interest income and premium amortization are recorded as Interest Income in the Statements of Comprehensive Income. The remaining changes in fair value on these instruments are recorded as net gains (losses) in Noninterest Income on the Statements of Comprehensive Income. The fair value of these instruments is included in Level 2 in the fair value hierarchy for assets recorded at fair value on a recurring basis.

The following is a summary of the transactions on loans for which the fair value option has been elected for the three months ended March 31, 2018:

Balance at January 1, 2018	\$ 9,908
Net loss on financial instruments under fair value option	(110)
Premium amortization	(75)
Balance at March 31, 2018	<u>\$ 9,723</u>

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

	March 31, 2018	December 31, 2017
Nonaccrual loans:		
Real estate mortgage	\$ 88,402	\$ 85,488
Production and intermediate term	28,765	34,700
Agribusiness	11,057	3,175
Energy	16,485	-
Rural residential real estate	782	1,178
Lease receivables	57	58
Mission-related	1,571	1,636
Total nonaccrual loans	147,119	126,235
Accruing restructured loans:		
Real estate mortgage	17,172	18,496
Production and intermediate term	7,118	6,236
Rural residential real estate	157	160
Mission-related	5,724	5,641
Total accruing restructured loans	30,171	30,533
Accruing loans 90 days or more past due:		
Real estate mortgage	3,892	108
Production and intermediate term	1,220	2,897
Agribusiness	-	20
Total accruing loans 90 days or more past due	5,112	3,025
Total nonperforming loans	182,402	159,793
Other property owned	13,874	15,569
Total nonperforming assets	\$ 196,276	\$ 175,362

One credit quality indicator utilized by the bank and associations is the FCA Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

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

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	March 31, 2018	December 31, 2017
Real estate mortgage:		
Acceptable	97.1 %	96.9 %
OAEM	1.5	1.6
Substandard/Doubtful	1.4	1.5
	100.0 %	100.0 %
Production and intermediate term:		
Acceptable	93.2 %	92.3 %
OAEM	3.8	4.3
Substandard/Doubtful	3.0	3.4
	100.0 %	100.0 %
Agribusiness:		
Acceptable	99.1 %	99.2 %
OAEM	0.1	0.1
Substandard/Doubtful	0.8	0.7
	100.0 %	100.0 %
Energy and water/waste disposal:		
Acceptable	98.1 %	98.0 %
OAEM	0.8	0.9
Substandard/Doubtful	1.1	1.1
	100.0 %	100.0 %
Communication:		
Acceptable	94.7 %	100.0 %
OAEM	5.3	-
Substandard/Doubtful	-	-
	100.0 %	100.0 %
Rural residential real estate:		
Acceptable	98.4 %	98.1 %
OAEM	0.8	0.8
Substandard/Doubtful	0.8	1.1
	100.0 %	100.0 %
Lease receivables:		
Acceptable	99.7 %	99.6 %
OAEM	0.1	0.2
Substandard/Doubtful	0.2	0.2
	100.0 %	100.0 %
Loans to other financing institutions:		
Acceptable	100.0 %	100.0 %
OAEM	-	-
Substandard/Doubtful	-	-
	100.0 %	100.0 %
Mission-related:		
Acceptable	98.6 %	98.5 %
OAEM	-	-
Substandard/Doubtful	1.4	1.5
	100.0 %	100.0 %
Total loans:		
Acceptable	97.0 %	96.9 %
OAEM	1.6	1.6
Substandard/Doubtful	1.4	1.5
	100.0 %	100.0 %

The following tables provide an age analysis of past due loans (including accrued interest) for the entire loan portfolio (including nonaccrual loans) as of:

March 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 Loans	Recorded Investment > 90 Days and Accruing
Real estate mortgage	\$ 77,669	\$ 29,435	\$ 107,104	\$14,450,056	\$14,557,160	\$ 3,892
Production and intermediate term	27,543	13,635	41,178	2,866,036	2,907,214	1,220
Agribusiness	1,238	-	1,238	4,375,399	4,376,637	-
Communication	-	-	-	477,333	477,333	-
Energy and water/waste disposal	40	-	40	1,509,105	1,509,145	-
Rural residential real estate	2,844	159	3,003	231,895	234,898	-
Lease receivables	128	-	128	30,437	30,565	-
Loans to other financing institutions	-	-	-	41,964	41,964	-
Mission-related	-	1,571	1,571	106,850	108,421	-
Total	\$ 109,462	\$ 44,800	\$ 154,262	\$24,089,075	\$24,243,337	\$ 5,112

December 31, 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 Loans	Recorded Investment > 90 Days and Accruing
Real estate mortgage	\$ 68,437	\$ 27,282	\$ 95,719	\$ 14,389,960	\$ 14,485,679	\$ 108
Production and intermediate term	17,208	13,255	30,463	3,017,492	3,047,955	2,897
Agribusiness	9,837	20	9,857	4,070,021	4,079,878	20
Communication	-	-	-	437,666	437,666	-
Energy and water/waste disposal	-	-	-	1,476,998	1,476,998	-
Rural residential real estate	1,273	253	1,526	233,627	235,153	-
Lease receivables	-	59	59	25,087	25,146	-
Loans to other financing institutions	-	-	-	40,187	40,187	-
Mission-related	98	1,636	1,734	108,988	110,722	-
Total	\$ 96,853	\$ 42,505	\$ 139,358	\$ 23,800,026	\$ 23,939,384	\$ 3,025

Additional impaired loan information is as follows:

	At March 31, 2018			At December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans with a related allowance for loan losses:						
Real estate mortgage	\$ 5,742	\$ 5,818	\$ 971	\$ 5,530	\$ 5,620	\$ 1,075
Production and intermediate term	8,836	10,922	2,497	4,969	6,255	1,738
Loans to cooperative	7,739	7,739	4,046	-	-	-
Processing and marketing	2,715	2,715	368	2,736	2,735	368
Farm-related business	447	4,374	220	308	4,232	111
Energy and water/waste disposal	16,335	16,335	4,260	-	-	-
Rural residential real estate	69	69	25	39	39	5
Mission-related	438	425	183	429	429	198
Total	\$ 42,321	\$ 48,397	\$ 12,570	\$ 14,011	\$ 19,310	\$ 3,495
Impaired loans with no related allowance for loan losses:						
Real estate mortgage	\$ 103,725	\$ 107,465	\$ -	\$ 98,562	\$ 102,071	\$ -
Production and intermediate term	28,267	44,301	-	38,864	54,124	-
Processing and marketing	131	9,326	-	151	9,345	-
Farm-related business	24	100	-	-	89	-
Energy and water/waste disposal	150	7,773	-	-	7,623	-
Rural residential real estate	870	1,176	-	1,299	1,572	-
Lease receivables	57	80	-	58	82	-
Mission-related	6,857	6,726	-	6,848	6,848	-
Total	\$ 140,081	\$ 176,947	\$ -	\$ 145,782	\$ 181,754	\$ -
Total impaired loans:						
Real estate mortgage	\$ 109,467	\$ 113,283	\$ 971	\$ 104,092	\$ 107,691	\$ 1,075
Production and intermediate term	37,103	55,223	2,497	43,833	60,379	1,738
Loans to cooperative	7,739	7,739	4,046	-	-	-
Processing and marketing	2,846	12,041	368	2,887	12,080	368
Farm-related business	471	4,474	220	308	4,321	111
Energy and water/waste disposal	16,485	24,108	4,260	-	7,623	-
Rural residential real estate	939	1,245	25	1,338	1,611	5
Lease receivables	57	80	-	58	82	-
Mission-related	7,295	7,151	183	7,277	7,277	198
Total	\$ 182,402	\$ 225,344	\$ 12,570	\$ 159,793	\$ 201,064	\$ 3,495

	For the Three Months Ended			
	March 31, 2018		March 31, 2017	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:				
Real estate mortgage	\$ 5,308	\$ 41	\$ 8,684	\$ 49
Production and intermediate term	8,474	71	14,034	7
Loans to cooperative	172	3	-	-
Processing and marketing	2,722	92	2,854	67
Farm-related business	473	-	806	-
Energy and water/waste disposal	578	5	-	-
Rural residential real estate	49	1	86	2
Mission-related	427	12	2,482	56
Total	<u>\$ 18,203</u>	<u>\$ 225</u>	<u>\$ 28,946</u>	<u>\$ 181</u>
Impaired loans with no related allowance for loan losses:				
Real estate mortgage	\$ 101,114	1,311	\$ 111,512	\$ 1,236
Production and intermediate term	34,026	564	30,355	333
Loans to cooperative	-	-	-	-
Processing and marketing	131	-	602	-
Farm-related business	28	10	-	7
Energy and water/waste disposal	10	-	-	-
Rural residential real estate	1,049	4	2,170	5
Lease receivables	57	-	89	-
Mission-related	6,758	117	8,591	59
Total	<u>\$ 143,173</u>	<u>\$ 2,006</u>	<u>\$ 153,319</u>	<u>\$ 1,640</u>
Total impaired loans:				
Real estate mortgage	\$ 106,422	\$ 1,352	\$ 120,196	\$ 1,285
Production and intermediate term	42,500	635	44,389	340
Loans to cooperative	-	-	-	-
Processing and marketing	2,853	92	3,456	67
Farm-related business	501	10	806	7
Energy and water/waste disposal	588	5	-	-
Rural residential real estate	1,098	5	2,256	7
Lease receivables	57	-	89	-
Mission-related	7,185	129	11,073	115
Total	<u>\$ 161,204</u>	<u>\$ 2,228</u>	<u>\$ 182,265</u>	<u>\$ 1,821</u>

At March 31, 2018, impaired loans of \$42.3 million had a related specific allowance of \$12.6 million, while the remaining \$140.1 million of impaired loans had no related specific allowance as a result of adequate collateralization.

The average recorded investment in impaired loans for the three months ended March 31, 2018, was \$161.2 million. The district recognized interest income of \$2.2 million on impaired loans during the three months ended March 31, 2018.

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

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communi- cations	Energy and Water/Waste Disposal	Rural Residential Real Estate	Agricultural Export Finance	Lease Receivables	Loans to OFIs	Mission- Related	Total
Allowance for Credit Losses											
Balance at December 31, 2017	\$ 41,630	\$ 23,212	\$ 10,994	\$ 826	\$ 5,839	\$ 532	\$ -	\$ 35	\$ -	\$ 200	\$ 83,268
Charge-offs	(79)	(1,410)	-	-	-	-	-	-	-	-	(1,489)
Recoveries	112	113	85	161	-	(1)	-	-	-	-	470
Provision for credit losses (loan loss reversal)	(1,037)	(747)	3,040	(135)	1,498	(39)	-	105	-	(19)	2,666
Other *	50	379	(358)	3	(182)	1	-	-	-	9	(99)
Balance at March 31, 2018	<u>\$ 40,676</u>	<u>\$ 21,547</u>	<u>\$ 13,760</u>	<u>\$ 855</u>	<u>\$ 7,155</u>	<u>\$ 493</u>	<u>\$ -</u>	<u>\$ 140</u>	<u>\$ -</u>	<u>\$ 190</u>	<u>\$ 84,816</u>
Individually evaluated for impairment	\$ 1,332	\$ 2,614	\$ 3,875	\$ -	\$ 4,327	\$ 47	\$ -	\$ -	\$ -	\$ 174	\$ 12,369
Collectively evaluated for impairment	39,344	18,933	9,885	855	2,828	446	-	140	-	16	72,447
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at March 31, 2018	<u>\$ 40,676</u>	<u>\$ 21,547</u>	<u>\$ 13,760</u>	<u>\$ 855</u>	<u>\$ 7,155</u>	<u>\$ 493</u>	<u>\$ -</u>	<u>\$ 140</u>	<u>\$ -</u>	<u>\$ 190</u>	<u>\$ 84,816</u>
Balance at December 31, 2016	\$ 35,559	\$ 25,341	\$ 13,036	\$ 1,393	\$ 5,686	\$ 479	\$ -	\$ 42	\$ -	\$ 201	\$ 81,737
Charge-offs	(18)	(1,511)	-	-	-	-	-	-	-	-	(1,529)
Recoveries	92	151	190	-	1,381	1	-	-	-	-	1,815
Provision for credit losses (loan loss reversal)	5,161	(214)	(637)	(143)	(778)	(56)	-	-	-	3	3,336
Other*	1,200	155	(1,101)	(362)	9	76	-	(21)	-	-	(44)
Balance at March 31, 2017	<u>\$ 41,994</u>	<u>\$ 23,922</u>	<u>\$ 11,488</u>	<u>\$ 888</u>	<u>\$ 6,298</u>	<u>\$ 500</u>	<u>\$ -</u>	<u>\$ 21</u>	<u>\$ -</u>	<u>\$ 204</u>	<u>\$ 85,315</u>
Individually evaluated for impairment	\$ 1,588	\$ 2,502	\$ 573	\$ -	\$ -	\$ 58	\$ -	\$ -	\$ -	\$ 105	\$ 4,826
Collectively evaluated for impairment	40,406	21,419	10,916	887	6,298	442	-	22	-	99	80,489
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at March 31, 2017	<u>\$ 41,994</u>	<u>\$ 23,921</u>	<u>\$ 11,489</u>	<u>\$ 887</u>	<u>\$ 6,298</u>	<u>\$ 500</u>	<u>\$ -</u>	<u>\$ 22</u>	<u>\$ -</u>	<u>\$ 204</u>	<u>\$ 85,315</u>
Recorded Investments in Loans Outstanding:											
Ending balance at March 31, 2018	<u>\$ 14,557,160</u>	<u>\$ 2,907,214</u>	<u>\$ 4,376,637</u>	<u>\$ 477,333</u>	<u>\$ 1,509,145</u>	<u>\$ 234,898</u>	<u>\$ -</u>	<u>\$ 30,565</u>	<u>\$ 41,964</u>	<u>\$ 108,421</u>	<u>\$ 24,243,337</u>
Individually evaluated for impairment	\$ 115,424	\$ 37,123	\$ 11,057	\$ -	\$ 16,500	\$ 1,452	\$ -	\$ 57	\$ -	\$ 7,218	\$ 188,831
Collectively evaluated for impairment	\$ 14,441,736	\$ 2,870,091	\$ 4,365,580	\$ 477,333	\$ 1,492,645	\$ 233,446	\$ -	\$ 30,508	\$ 41,964	\$ 101,203	\$ 24,054,506
Loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance at March 31, 2017	<u>\$ 13,770,027</u>	<u>\$ 2,699,780</u>	<u>\$ 4,156,371</u>	<u>\$ 476,534</u>	<u>\$ 1,560,398</u>	<u>\$ 218,920</u>	<u>\$ 6,153</u>	<u>\$ 87</u>	<u>\$ 40,822</u>	<u>\$ 124,455</u>	<u>\$ 23,053,547</u>
Individually evaluated for impairment	\$ 120,050	\$ 42,922	\$ 4,204	\$ -	\$ -	\$ 2,353	\$ -	\$ 87	\$ -	\$ 11,128	\$ 180,744
Collectively evaluated for impairment	\$ 13,649,670	\$ 2,656,846	\$ 4,152,167	\$ 476,534	\$ 1,560,398	\$ 216,567	\$ 6,153	\$ -	\$ 40,822	\$ 113,327	\$ 22,872,484
Loans acquired with deteriorated credit quality	\$ 307	\$ 12	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 319

*Includes reserve for losses on standby letters of credit that are recorded in other liabilities and an association prior year adjustment.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. TDRs are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of March 31, 2018, the total recorded investment of TDR loans was \$44,803, including \$13,946 classified as nonaccrual and \$30,857 classified as accrual, with specific allowance for loan losses of \$1,543. Additional commitments to lend to borrowers whose loan terms have been modified in TDRs were \$468 at March 31, 2018, and \$330 at December 31, 2017.

The following table summarizes TDR loan balances by loan type:

	Loans Modified as TDRs		TDRs in Nonaccrual Status	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
Real estate mortgage	\$ 27,531	\$ 27,175	\$ 10,393	\$ 8,679
Production and intermediate term	8,241	7,998	1,123	1,762
Agribusiness	579	406	579	406
Rural residential real estate	437	449	280	289
Mission-related	7,295	7,277	1,571	1,636
Total	<u>\$ 44,083</u>	<u>\$ 43,305</u>	<u>\$ 13,946</u>	<u>\$ 12,772</u>

The following tables present additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the three months ended March 31, 2018, and March 31, 2017. The premodification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring.

For the three months ended March 31, 2018:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	\$ 738	\$ 756
Production and intermediate term	1,479	1,208
Agribusiness	141	200
Total	<u>\$ 2,358</u>	<u>\$ 2,164</u>

For the three months ended March 31, 2017:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	\$ 1,419	\$ 1,382
Production and intermediate term	2,999	2,542
Total	<u>\$ 4,418</u>	<u>\$ 3,924</u>

The predominant form of concession granted for troubled debt restructuring includes extension of the term and delayed payments. Other types of modifications include interest rate and principal reductions.

A payment default is defined as a payment that is 30 days past due after the date the loan was restructured. The following table presents information regarding troubled debt restructurings that occurred within the previous 12 months and for which there was a payment default during the period:

Troubled debt restructurings that subsequently defaulted:	Recorded Investment at March 31, 2018	Recorded Investment at March 31, 2017
Real estate mortgage	<u>\$ -</u>	<u>\$ 88</u>
Total	<u><u>\$ -</u></u>	<u><u>\$ 88</u></u>

NOTE 4 — COMMITMENTS AND CONTINGENCIES

The bank is primarily liable for its portion of Systemwide debt obligations. Additionally, the bank is jointly and severally liable for the consolidated Systemwide bonds and notes of the other System banks. Total consolidated bank and Systemwide obligations of the System at March 31, 2018, were approximately \$269.40 billion.

In the normal course of business, the district has various outstanding commitments and contingencies, including the possibility of actions against the district in which claims for monetary damages may be asserted. Management and legal counsel are not aware of any other pending lawsuits or actions. Upon the basis of current information, management and legal counsel are of the opinion that the ultimate liability, if any, resulting from lawsuits or other pending actions will not be material in relation to the financial position, results of operations or cash flows of the district.

NOTE 5 — FAIR VALUE MEASUREMENTS

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 2, “Summary of Significant Accounting Policies,” of the 2017 Annual Report for a more complete description.

Assets and liabilities recorded at fair value on a recurring basis at March 31, 2018, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at March 31, 2018			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Federal funds	\$ 173,435	\$ -	\$ 173,435	\$ -
Investments available for sale:				
Agency-guaranteed debt	189,001	-	189,001	-
Corporate debt	260,854	-	260,854	-
Mortgage-backed securities	4,362,116	-	4,270,460	91,656
U.S. Treasury securities	324,062	-	324,062	-
Asset-backed securities	56,353	-	56,353	-
Mission-related and other available-for-sale investments	41,151	-	-	41,151
Loans valued under the fair value option	9,723	-	9,723	-
Derivative assets	13,883	-	13,883	-
Assets held in nonqualified benefit trusts	8,275	8,275	-	-
Total assets	<u>\$ 5,438,853</u>	<u>\$ 8,275</u>	<u>\$ 5,297,771</u>	<u>\$ 132,807</u>
Liabilities:				
Derivative liabilities	\$ 121	\$ -	\$ 121	\$ -
Letters of credit	1,084	-	-	1,084
Total liabilities	<u>\$ 1,205</u>	<u>\$ -</u>	<u>\$ 121</u>	<u>\$ 1,084</u>

The following table represents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period from January 1, 2018, to March 31, 2018:

	Assets		Liabilities	Net
	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Letters of Credit	
Balance at January 1, 2018	\$ -	\$ 43,317	\$ 1,038	\$ 42,279
Net gains (losses) included in other comprehensive income	95	(101)	-	(6)
Purchases, issuances and settlements	91,561	(2,065)	46	89,450
Balance at March 31, 2018	<u>\$ 91,656</u>	<u>\$ 41,151</u>	<u>\$ 1,084</u>	<u>\$ 131,723</u>

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the three months ended March 31, 2018. Agricultural mortgage-backed securities (AMBS) are included in Level 3 due to limited activity or less transparency around inputs to their valuation. Mortgage-backed securities (or MBS) are included in Level 3 due to the fact that their valuation was based on Level 3 criteria (broker quotes). The liability for letters of credit is included in Level 3 due to a determination that their valuation, based on fees currently charged for similar agreements, may not closely correlate to a fair value for instruments that are not regularly traded in the secondary market.

Assets and liabilities measured at fair value on a nonrecurring basis at March 31, 2018, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans	\$ 29,702	\$ -	\$ -	\$ 29,702
Other property owned	15,416	-	-	15,416
Total assets	<u>\$ 45,118</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 45,118</u>

Assets and liabilities recorded at fair value on a recurring basis at December 31, 2017, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Federal funds	\$ 246,888	\$ -	\$ 246,888	\$ -
Investments available for sale:				
Agency-guaranteed debt	195,248	-	195,248	-
Corporate debt	252,609	-	252,609	-
U.S. Treasury securities	249,207	-	249,207	-
Mortgage-backed securities	4,356,715	-	4,356,715	-
Asset-backed securities	47,889	-	47,889	-
Mission-related and other available-for-sale investments	43,317	-	-	43,317
Loans valued under the fair value option	9,908	-	9,908	-
Derivative assets	8,932	-	8,932	-
Assets held in nonqualified benefit trusts	8,084	8,084	-	-
Total assets	\$ 5,418,797	\$ 8,084	\$ 5,367,396	\$ 43,317
Liabilities:				
Derivative liabilities	\$ 248	\$ -	\$ 248	\$ -
Letters of credit	1,038	-	-	1,038
Total liabilities	\$ 1,286	\$ -	\$ 248	\$ 1,038

The following table represents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period from January 1, 2017, to March 31, 2017:

	Assets	Liabilities	
	Agricultural Mortgage- Backed Securities	Letters of Credit	Net
Balance at January 1, 2017	\$ 53,335	\$ 711	\$ 52,624
Net gains included in other comprehensive income	2	-	2
Purchases, issuances and settlements	(3,387)	(90)	(3,297)
Transfers out of Level 3	-	-	-
Balance at March 31, 2017	<u>\$ 49,950</u>	<u>\$ 621</u>	<u>\$ 49,329</u>

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the three months ended March 31, 2017. Agricultural mortgage-backed securities (AMBS) are included in Level 3 due to limited activity or less transparency around inputs to their valuation. The liability for letters of credit is included in Level 3 due to a determination that their valuation, based on fees currently charged for similar agreements, may not closely correlate to a fair value for instruments that are not regularly traded in the secondary market.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2017, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans	\$ 10,516	\$ -	\$ -	\$ 10,516
Other property owned	17,298	-	-	17,298
Total assets	<u>\$ 27,814</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 27,814</u>

Financial assets and financial liabilities measured at carrying amounts and not measured at fair value on the Balance Sheet for each of the fair value hierarchy values are summarized as follows:

March 31, 2018:

	Fair Value Measurements Using				Total Fair Value
	Total Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:					
Cash	\$ 13,184	\$ 13,184	\$ -	\$ -	\$ 13,184
Mission-related and other held-to-maturity investments	17,394	-	-	17,236	17,236
Net loans	23,960,887	-	-	23,594,524	23,594,524
Total assets	\$ 23,991,465	\$ 13,184	\$ -	\$ 23,611,760	\$ 23,624,944
Liabilities:					
Systemwide debt securities and other notes	\$ 25,109,001	\$ -	\$ -	\$ 24,935,031	\$ 24,935,031
Total liabilities	\$ 25,109,001	\$ -	\$ -	\$ 24,935,031	\$ 24,935,031

December 31, 2017:

	Fair Value Measurements Using				Total Fair Value
	Total Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:					
Cash	\$ 66,953	\$ 66,953	\$ -	\$ -	\$ 66,953
Mission-related and other held-to-maturity investments	18,828	-	-	18,606	18,606
Net loans	23,662,400	-	-	23,517,247	23,517,247
Total assets	\$ 23,748,181	\$ 66,953	\$ -	\$ 23,535,853	\$ 23,602,806
Liabilities:					
Systemwide debt securities and other notes	\$ 24,801,223	\$ -	\$ -	\$ 24,745,299	\$ 24,745,299
Total liabilities	\$ 24,801,223	\$ -	\$ -	\$ 24,745,299	\$ 24,745,299

Valuation Techniques

As more fully discussed in Note 1, "Organization and Significant Accounting Policies," authoritative accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used by the bank and associations for assets and liabilities:

Cash

For cash, the carrying amount is a reasonable estimate of fair value.

Investment Securities

Where quoted prices are available in an active market, available-for-sale securities would be classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Generally, these securities would be classified as Level 2. Among other securities, this would include certain mortgage-backed securities and asset-backed securities. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. At March 31, 2018, there was one agency MBS investment in Level 3. Level 3 assets at March 31, 2018, also included the bank's AMBS portfolio, which is valued by the bank using a model that incorporates underlying rates and current yield curves.

As permitted under FCA regulations, the banks are authorized to hold eligible investments. The regulations define eligible investments by specifying credit rating criteria, final maturity limit and percentage of portfolio limit for each investment type. At the time of purchase, mortgage-backed and asset-backed securities must be triple-A rated by at least one Nationally Recognized Statistical Rating Organization. The triple-A rating requirement puts the banks in a position to hold the senior tranches of securitizations. The underlying loans for mortgage-backed securities are residential mortgages, while the underlying loans for asset-backed securities are home equity lines of credit, small business loans, equipment loans or student loans.

To estimate the fair value of the majority of the investments held, the bank obtains prices from third-party pricing services.

Assets Held in Nonqualified Benefits Trusts

Assets held in trust funds related to deferred compensation are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

Derivatives

Exchange-traded derivatives valued using quoted prices would be classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the majority of the derivative positions are valued using internally developed models that use as their basis readily observable market parameters and are classified within Level 2 of the valuation hierarchy. Such derivatives include interest rate caps and cash flow interest rate swaps.

The models used to determine the fair value of derivative assets and liabilities use an income approach based on observable market inputs, primarily the LIBOR swap curve and volatility assumptions about future interest rate movements.

Letters of Credit

The fair value of letters of credit approximates the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

Loans

Fair value is estimated by discounting the expected future cash flows using the banks' and/or the associations' current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the banks' and/or the associations' current loan origination rates as

well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

For purposes of estimating fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

The fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral-dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral.

Loans Evaluated for Impairment

For certain loans evaluated for impairment under accounting impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

The bank has elected the fair value option for certain callable loans purchased on the secondary market at a significant premium. The fair value option provides an irrevocable option to elect fair value as an alternative measurement for selected financial assets. Fair value is used for both the initial and subsequent measurement of the designated instrument, with the changes in fair value recognized in net income. The fair value of securities is estimated using pricing models that utilize observable inputs, quoted prices for similar securities received from pricing services or discounted cash flows. Accordingly, these assets are classified within Level 2.

Bonds and Notes

Systemwide debt securities are not all traded in the secondary market and those that are traded may not have readily available quoted market prices. Therefore, the fair value of the instruments is estimated by calculating the discounted value of the expected future cash flows. The discount rates used are based on the sum of quoted market yields for the Treasury yield curve and an estimated yield-spread relationship between System debt instruments and Treasury securities. We estimate an appropriate yield-spread, taking into consideration selling group member (banks and securities dealers) yield indications, observed new government-sponsored enterprise debt security pricing and pricing levels in the related U.S. dollar interest rate swap market.

For other notes, fair value is estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the current loan origination rates as well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

Other Property Owned

Other property owned is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of other property owned involves the use of independent appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

Sensitivity to Changes in Significant Unobservable Inputs

For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the significant unobservable inputs used in the fair value measurement of the mortgage-backed securities are prepayment rates, probability of default and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement.

Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

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

Information About Recurring and Nonrecurring Level 3 Fair Value Measurements

	Valuation Technique(s)	Unobservable Input	Range of Inputs
Mortgage-backed securities	Discounted cash flow	Prepayment rate Probability of default Loss severity	-
Mission-related investments	Discounted cash flow	Prepayment rates	2.1%-41.6%

With regard to impaired loans and OPO, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and OPO and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

Information About Recurring and Nonrecurring Level 2 Fair Value Measurements

	Valuation Technique(s)	Input
Federal funds sold	Carrying value	Par/principal
Investment securities available for sale	Quoted prices Discounted cash flow	Price for similar security Constant prepayment rate Appropriate interest rate yield curve
Loans held under the fair value option	Quoted prices Discounted cash flow	Price for similar security Constant prepayment rate Appropriate interest rate yield curve
Interest rate caps	Discounted cash flow	Appropriate interest rate yield curve Annualized volatility
Interest rate swaps	Discounted cash flow	Benchmark yield curve Counterparty credit risk Volatility

Information About Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying value	Actual balance
Loans	Discounted cash flow	Prepayment forecasts Appropriate interest rate yield curve Probability of default Loss severity
Systemwide debt securities	Discounted cash flow	Benchmark yield curve Derived yield spread Own credit risk

NOTE 6 — DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The bank maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not adversely affected by movements in interest rates. The bank considers the strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The bank may enter into derivative transactions to lower funding costs, diversify sources of funding, alter interest rate exposures arising from mismatches between assets and liabilities, or better manage liquidity. Interest rate swaps allow the bank to raise long-term borrowings at fixed rates and swap them into floating rates to better match the repricing characteristics of earning assets. Under interest rate swap arrangements, the bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating-rate index. The bank may purchase interest rate options, such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt. The bank has interest rate caps and pay fixed swaps in order to reduce the impact of rising interest rates on its floating-rate assets.

The primary types of derivative instruments used and the amount of activity (notional amounts derivatives) during the three months ended March 31, 2018, are summarized in the following table:

	Pay-Fixed Swaps	Interest Rate Caps	Total
Balance at January 1, 2018	\$ 250,000	\$ 195,000	\$ 445,000
Additions	25,000	-	25,000
Maturities/Amortizations	-	-	-
Balance at March 31, 2018	\$ 275,000	\$ 195,000	\$ 470,000

To minimize the risk of credit losses, the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing and levels of exposure to individual counterparties. In addition, substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to another are reached, which thresholds may vary, depending on the counterparty's credit rating. The bank does not anticipate nonperformance by any of these counterparties. However, derivative contracts are reflected in the financial statements on a gross basis

regardless of the netting agreement. At March 31, 2018, and December 31, 2017, the bank's exposure to counterparties was \$13,762 and \$8,684, respectively. At March 31, 2018, and December 31, 2017, the bank had posted no securities as collateral, nor had any counterparty been required to post collateral.

Derivative - Counterparty Exposure

The following table represents the credit ratings of counterparties to which the bank has credit exposure at March 31, 2018:

	Remaining Years to Maturity			Maturity		Collateral Held	Exposure Net of Collateral
	Less than One to Five Years	More Than Five Years	Total	Distribution Netting	Exposure		
Moody's Credit Rating							
A1	\$ -	\$ 43	\$ 43	\$ -	\$ 43	\$ -	\$ 43
Aa3	-	385	385	-	385	-	385
Aa3	4,662	3,808	8,470	-	8,470	-	8,470
Aa3	-	4,985	4,985	-	4,985	-	4,985
Total	\$ 4,662	\$ 9,221	\$ 13,883	\$ -	\$ 13,883	\$ -	\$ 13,883

Cash Flow Hedges

The bank's derivative instruments at March 31, 2018, and December 31, 2017, which are designated and qualify as a cash flow hedge, all meet the standards for accounting treatment that presume full effectiveness. Thus, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income.

	Balance Sheet	Fair Value	Fair Value	Balance Sheet	Fair Value	Fair Value
	Location	March 31, 2018	December 31, 2017	Location	March 31, 2018	December 31, 2017
Interest rate caps	Other assets	\$ 517	\$ 396	Other liabilities	\$ -	\$ -
Pay fixed swaps	Other assets	13,366	8,536	Other liabilities	(121)	248
	Gain (Loss) Recognized in OCI/OCL on (Effective Portion) at March 31,			Amount of (Loss) Gain Reclassified From AOCI/AOCL Into Income (Effective Portion) at March 31,		
		2018	2017		2018	2017
Interest rate caps	\$	121	(82)	Interest expense	\$ (30)	\$ 72
Pay fixed swaps		4,951	(66)	Interest expense	28	327

NOTE 7 — CAPITAL

Effective January 1, 2017, the regulatory capital requirements for 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.

The bank's ratios were as follows:

As of March 31, 2018				Regulatory	Conservation	Total
Risk-adjusted	Bank	FLCA	ACAs	Minimums	Buffers	Regulatory Requirement
Permanent capital ratio ranges	15.78%	16.94%	12.37% - 22.33%	7.00%	0.00%	7.00%
Common equity tier 1 ratio ranges	9.82	16.88	11.95 - 22.20	4.50	2.50 *	7.00
Tier 1 capital ratio ranges	15.77	16.88	11.95 - 22.20	6.00	2.50 *	8.50
Total capital ratio ranges	15.86	17.20	12.64 - 22.76	8.00	2.50 *	10.50
Non-risk-adjusted						
Tier 1 leverage ratio ranges	7.00	17.51	10.65 - 20.89	4.00	1.00	5.00
UREE leverage ratio ranges	2.69	18.73	7.95 - 21.92	1.50	0.00	1.50

* The 2.5 percent capital conservation buffer for the risk-adjusted ratios will be phased in over a three-year period ending on December 31, 2019

As of December 31, 2017				Regulatory	Conservation	Total
Risk-adjusted	Bank	FLCA	ACAs	Minimums	Buffers	Regulatory Requirement
Permanent capital ratio ranges	16.60%	17.15%	13.20% - 23.00%	7.00%	0.00%	7.00%
Common equity tier 1 ratio ranges	10.52	17.10	12.27 - 22.81	4.50	2.50 *	7.00
Tier 1 capital ratio ranges	16.59	17.10	12.27 - 22.81	6.00	2.50 *	8.50
Total capital ratio ranges	16.68	17.41	13.53 - 23.63	8.00	2.50 *	10.50
Non-risk-adjusted						
Tier 1 leverage ratio ranges	7.33	17.74	10.76 - 21.68	4.00	1.00	5.00
UREE leverage ratio ranges	3.08	18.86	9.23 - 22.76	1.50	0.00	1.50

* The 2.5 percent capital conservation buffer for the risk-adjusted ratios will be phased in over a three-year period ending on December 31, 2019

Risk-adjusted assets have been defined by 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 less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Risk-adjusted assets are 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 deduction of the allowance for loan losses from risk-adjusted assets for the permanent capital ratio.

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of seven years, allocated equities held for a minimum of seven years or not subject to revolving, unallocated retained earnings, 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 noncumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required borrower stock held for a minimum of five years, allocated equities held for a minimum of five years, subordinated debt and limited-life preferred stock greater than five years to maturity at issuance subject to certain limitations, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain 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, paid-in capital, allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

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

During the third quarter of 2017, the association Class A Common Stockholders approved an amendment to the bank's Capitalization Bylaws. The amended bylaws became effective September 15, 2017, and were made to conform to the FCA's updated capital adequacy regulations, which were effective January 1, 2017. The amendment included the following updates:

- The bank's board of directors must adopt an annual capital resolution and obtain prior approval by the FCA prior to a distribution of allocated surplus. The distribution of allocated surplus must also meet the minimum permanent capital adequacy standards of the FCA capital adequacy regulation.
- A distribution of attributed unallocated surplus must obtain prior approval by the FCA.
- Preferred stock dividends would be declared in accordance with the applicable provisions of the FCA's capital adequacy regulations.
- The retirement of Class A voting common stock shall be made in accordance with the minimum holding periods set forth in the bank's board of directors' annual capital resolution and with prior approval by the FCA.
- The definition of patrons has been added to include associations, OFIs and other System institutions doing business with the bank on a patronage basis.
- No patronage distributions will be paid to any patrons if any stock is in violation of the annual resolution adopted by the board or FCA's capital adequacy regulations.

The amendments did not result in significant changes to the regulatory capital requirements as of March 31, 2018.

NOTE 8 — EMPLOYEE BENEFIT PLANS

Employees of the bank and district associations participate in either the defined benefit retirement plan or a defined contribution plan (DC Plan) and are eligible to participate in the district's 401(k) plan. Employer contributions to the DC Plan and 401(k) plan are expensed as incurred. The multiemployer structure of the district's defined benefit pension plan results in the recording of this plan only upon combination.

The following table summarizes the components of net periodic benefit costs for the district's defined benefit pension plan and for other postretirement benefits plan for the three months ended March 31, 2018:

	Defined Benefit Pension		Other Postretirement Benefits	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Service cost	\$ 989	\$ 1,011	\$ 354	\$ 322
Interest cost	3,632	4,075	758	768
Expected return on plan assets	(4,240)	(3,968)	-	-
Amortization of prior service cost	-	-	(159)	(220)
Amortization of net loss	<u>3,369</u>	<u>4,430</u>	<u>169</u>	<u>35</u>
Net periodic benefit cost	<u>\$ 3,750</u>	<u>\$ 5,548</u>	<u>\$ 1,122</u>	<u>\$ 905</u>

As of March 31, 2018, contributions of \$11.6 million have been made to the defined benefit pension plan. The district presently anticipates no additional contributions to fund its pension plan in 2018.

NOTE 9 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive loss (AOCL) includes the accumulated balance of certain gains, losses or costs for which values are included in assets or liabilities on the balance sheets, but which have not yet been recognized in earnings. For the district, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, elements of certain pension and retirement benefit changes, and changes in the value of cash flow derivative instruments.

The following table summarizes the changes in the balance of the components of AOCL for the nine months ended March 31, 2018:

	Total	Unrealized Gain (Loss) on Securities	Pension and Other Post- Retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2018	\$ (162,860)	\$ (56,812)	\$ (112,774)	\$ 6,726
Change in unrealized losses on available-for-sale securities				
Net change in unrealized losses on investment securities	(29,374)	(29,374)		
Net change in unrealized losses on securities	(29,374)	(29,374)		
Change in pension and postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(160)		(160)	
Amortization of net losses	3,537		3,537	
Net change in pension and postretirement benefit plans	3,377		3,377	
Change in cash flow derivative instruments				
Unrealized losses on cash flow derivative instruments	5,072			5,072
Reclassification of loss recognized in interest expense	2			2
Net change in cash flow derivative instruments	5,074			5,074
Total other comprehensive (loss) income	(20,923)	(29,374)	3,377	5,074
Balance, March 31, 2018	\$ (183,783)	\$ (86,186)	\$ (109,397)	\$ 11,800

The following table summarizes the changes in the balance of the components of AOCL for the three months ended March 31, 2017:

	Total	Unrealized Gain (Loss) on Securities	Pension and Other Post- Retirement Benefit Plans	Cash Flow Derivative Instruments
Balance, January 1, 2017	\$ (157,982)	\$ (38,529)	\$ (125,874)	\$ 6,421
Change in unrealized losses on available-for-sale securities				
Net change in unrealized losses on investment securities	(1,511)	(1,511)		
Net change in unrealized losses on securities	(1,511)	(1,511)		
Change in pension and postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(185)		(185)	
Amortization of net losses	4,439		4,439	
Net change in pension and postretirement benefit plans	4,254		4,254	
Change in cash flow derivative instruments				
Unrealized losses on cash flow derivative instruments	180			180
Reclassification of loss recognized in interest expense	72			72
Net change in cash flow derivative instruments	252			252
Total other comprehensive income (loss)	2,995	(1,511)	4,254	252
Balance, March 31, 2017	\$ (154,987)	\$ (40,040)	\$ (121,620)	\$ 6,673

The following table summarizes reclassifications from AOCL to the Combined Statements of Comprehensive Income for the three months ended March 31:

Component of AOCL	Amount Reclassified from AOCL		Affected Line in the Statement of Comprehensive Income
	2018	2017	
Amortization of net charges on pension and postretirement benefit plans	\$ 3,377	\$ 4,254	Salaries and employee benefits
Amortization on cash flow hedges	2	72	Interest expense
Total reclassifications	<u>\$ 3,379</u>	<u>\$ 4,326</u>	

NOTE 10 — INCOME TAXES

New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Acts of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA changed the federal corporate tax rate from 35 percent to 21 percent. The bank is exempt from federal and certain other income taxes as provided by the Farm Credit Act of 1971; however, the change in federal corporate tax rate had a financial statement impact for year-end 2017 for district associations that required the revaluation of any deferred taxes (assets or liabilities), which resulted in either a tax expense or tax benefit to the income statement for the year ended December 31, 2017. The first quarter of 2018 reflects the federal corporate tax rate of 21 percent.

While the full impact of the TCJA is difficult to predict and may not be fully known for several years, changes that could affect the district’s business and customers include, but are not limited to, modifications to deductions surrounding interest expense and equipment purchases, tax incentives related to renewable energy initiatives, deductions impacting agricultural producers who sell their products to cooperatives and the overall changes in the competitive environment impacting financial institutions.

NOTE 11 — SUBSEQUENT EVENTS

The district has evaluated subsequent events through May 30, 2018, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of May 30, 2018.

NOTE 12 — BANK-ONLY FINANCIAL DATA

Condensed financial information for the bank follows. All significant transactions and balances between the bank and associations are eliminated in combination.

Balance sheet data	March 31, 2018	December 31, 2017
	(Unaudited)	
Cash	\$ 9,213	\$ 56,183
Federal funds sold and overnight investments	173,435	246,888
Investment securities	5,233,537	5,144,985
Loans	17,373,900	17,085,177
Less allowance for loan losses	11,880	7,639
Net loans	<u>17,362,020</u>	<u>17,077,538</u>
Accrued interest receivable	65,988	58,330
Premises and equipment, net	53,750	49,405
Other assets	186,148	203,276
Total assets	<u>\$ 23,084,091</u>	<u>\$ 22,836,605</u>
Bonds and notes, net	\$ 21,259,001	\$ 20,951,223
Accrued interest payable	71,474	63,809
Reserve for credit losses	2,169	1,433
Preferred stock dividends payable	20,063	20,063
Patronage payable	-	31,418
Other liabilities	52,226	100,775
Total liabilities	<u>21,404,933</u>	<u>21,168,721</u>
Preferred stock	600,000	600,000
Capital stock	299,046	301,239
Retained earnings	856,326	818,547
Accumulated other comprehensive loss	(76,214)	(51,902)
Total shareholders' equity	<u>1,679,158</u>	<u>1,667,884</u>
Total liabilities and shareholders' equity	<u>\$ 23,084,091</u>	<u>\$ 22,836,605</u>
	Three Months Ended March 31,	
	2018	2017
	(Unaudited)	(Unaudited)
Statement of income data		
Interest income	\$ 152,765	\$ 126,369
Interest expense	91,551	64,632
Net interest income	61,214	61,737
Provision (negative provision) for credit losses	4,857	(944)
Net interest income after provision (negative provision) for credit losses	56,357	62,681
Noninterest income	15,009	8,907
Noninterest expense	26,754	24,816
Net income	<u>44,612</u>	<u>46,772</u>
Other comprehensive income (loss):		
Change in fair value of investments	(29,374)	(1,511)
Change in postretirement benefit plans	(12)	(47)
Change in cash flow derivative instruments	5,074	252
Total other comprehensive loss	<u>(24,312)</u>	<u>(1,306)</u>
Comprehensive income	<u>\$ 20,300</u>	<u>\$ 45,466</u>