Texas Farm Credit District

2018 SECOND QUARTER REPORT

JUNE 30, 2018

SECOND QUARTER 2018

Table of Contents

Management's Discussion and Analysis of Combined Financial Condition and Results of Operations 2

Controls and Procedures 14

Combined Financial Statements:
- Combined Balance Sheets 15
- Combined Statements of Comprehensive Income 16
- Combined Statements of Changes in Members' Equity 17
- Combined Statements of Cash Flows 18

Notes to Combined Financial Statements 19

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 six months ended June 30, 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 previously reported consolidated other comprehensive income and members' equity 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.

Although the association restated their 2016 consolidated financial statements, the district has evaluated the quantitative and qualitative aspects of these misstatements in accordance with the applicable accounting guidance and has determined that such misstatements are not material to the current and previously issued district combined financial statements. The events and activities that resulted in the restatement of the association's consolidated financial statements at December 31, 2016 impacted the financial results for the quarter and six months ended June 30, 2017 by $262 thousand and $16.1 million respectively, decreasing consolidated other comprehensive income and members' equity.

RESULTS OF OPERATIONS

Net Income

Net income for the three months ended June 30, 2018, was $112,160, a decrease of $985, or 0.9 percent, over the same period of 2017. The decrease in net income consisted primarily of a $4,302 increase in net interest income, offset by a $3,345 increase in noninterest expense, and a $1,852 decrease in noninterest income.

Net income for the six months ended June 30, 2018, was $242,194, an increase of $33,160, or 15.9 percent, over the same period of 2017. The increase in net income consisted primarily of a $14,304 increase in noninterest income, an $11,735 increase in net interest income, offset by $6,689 decrease in noninterest expense.

Net Interest Income

Earning asset yields and liability costs are generally influenced by market interest rates and the "flattening" of the interest rate yield curve has contributed to the decline in the bank's net interest spread for the quarter and year-to-date. As measured by the difference between the two year and the ten year

maturities for Farm Credit debt, the yield differential has declined by 0.56 percent to a level of 0.65 percent as of June 30 2018, as compared to 1.21 percent as of June of the prior year 2017.

Net interest income for the three months ended June 30, 2018, was $196,869, an increase of $4,302, or 2.2 percent, over the same period of 2017. The increase was primarily the result of a $1.6 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 237 basis points decreased by 18 basis points compared to the same period of 2017, with a 40-basis-point increase in the yield of average interest earning assets offset by a 58-basis-point increase in the cost of average interest-bearing liabilities.

Net interest income for the six months ended June 30, 2018, was $391,284, an increase of $11,735, or 3.1 percent, over the same period of 2017. The increase was primarily the result of a $1.61 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 239 basis points decreased by 16 basis points compared to the same period of 2017, with a 38-basis-point increase in the yield of average interest earning assets offset by a 54-basis-point increase in the cost of average interest-bearing liabilities.

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 June 30, 2018, totaled $1,303, a decrease of $107 from the $1,196 provision for the same period of 2017.

The district's provision for credit losses on loans, standby letters of credit and unfunded commitments for the six months ended June 30, 2018, totaled $3,969, a decrease of $563 from the $4,532 provision for the same period of 2017.

Noninterest Income

Noninterest income for the three months ended June 30, 2018, was $9,297, a decrease of $1,852, or 16.6 percent, from the same period of 2017. The decrease was due primarily to a $1,233 decrease in patronage income.

Noninterest income for the six months ended June 30, 2018, was $40,341, an increase of $14,304, or 54.9 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 $1,558 increase on losses on Rural Business Investment Companies (RBICs) and a $1,371 decrease in patronage income.

Noninterest Expense

Noninterest expense for the three months ended June 30, 2018, was $92,660, an increase of $3,345, or 3.8 percent, over the same period of 2017. The increase is primarily due to a $5,177 increase in salaries and employee benefits, a $2,045 increase in other operating expense, offset by a $2,956 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.

Noninterest expense for the six months ended June 30, 2018, was $185,495, a decrease of $6,689, or 3.5 percent, over the same period of 2017. The decrease is primarily due to a $7,704 decrease in other operating expense, a $5,846 decrease in Insurance Fund premiums due to a rate decrease on outstanding debt from 15 basis points in 2017 to 9 basis points in 2018, offset by an increase of $9,404 in salaries and employee benefits. The decrease in other operating expense is primarily due to an association's expenses totaling $13,697 related to the breach of policies and procedures recorded in 2017, offset by a $5,102 decrease in professional fees.

Key results of operations comparisons:

	Annualized for the Six Months Ended June 30, 2018	Annualized for the Six Months Ended June 30, 2017
Return on average assets	**1.62%**	1.48%
Return on average members' equity	**11.06%**	10.04%
Net interest income as a percentage of average earning assets	**2.68%**	2.75%
(Recoveries), net of charge-offs, to average loans	**< 0.01%**	< (0.01)%
Operating expenses as a percentage of net interest income and noninterest income	**43.82%**	44.16%
Operating expenses as a percentage of average earning assets	**1.28%**	1.30%

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 (loss) income:

	Six Months Ended June 30,	
	2018	2017
Change in unrealized losses on available-for-sale securities		
Net increase in unrealized losses on investment securities	**$ (42,819)**	$ 6,224
Net change in unrealized losses on securities	**(42,819)**	6,224
Change in pension and postretirement benefit plans		
Amortization of prior service credits	**(319)**	(440)
Amortization of net losses	**7,075**	8,949
Net change in pension and postretirement benefit plans	**6,756**	8,509
Change in cash flow derivative instruments		
Unrealized gain on cash flow derivative instruments	**7,465**	(2,056)
Reclassification of loss recognized in interest expense	**(196)**	710
Net change in cash flow derivative instruments	**7,269**	(1,346)
Other comprehensive (loss) income	**$ (28,794)**	$ 13,387

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at June 30, 2018, was $24.39 billion, an increase of $642.8 million, or 2.7 percent, from $23.75 billion at December 31, 2017. The increase in the loan portfolio during the first six months of 2018 was primarily due to a $655.9 million increase in the bank's capital market loan portfolio.

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 98.7 percent at June 30, 2018, and 98.5 percent at December 31, 2017. Nonaccrual loans for the district were 0.6 percent of total loans at June 30, 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 June 30, 2018, the direct note totaled $839.3 million. The bank's loans to our affiliated associations are collateralized by substantially all of the association's assets, and the earnings, capital and loan loss reserves of the association provide a buffer against losses in it's 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. The direct loans to associations are eliminated in combination for purposes of the district's financial results.

Total district high-risk asset volume increased $7.0 million, or 4.0 percent, to $182.3 million at June 30, 2018.

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

	June 30, 2018	Increase (Decrease) $	Increase (Decrease) %	December 31, 2017
Nonaccrual loans	**$ 137.3**	$ 11.1	8.8 %	$ 126.2
Accruing formally restructured loans	**29.3**	(1.2)	(3.9)	30.5
Loans 90 days past due and still accruing interest	**4.5**	1.5	48.6	3.0
Total impaired loans	**171.0**	11.3	7.1	159.7
Other property owned	**11.3**	(4.3)	(27.4)	15.6
Total high-risk assets	**$ 182.3**	$ 7.0	4.0 %	$ 175.3

The $11.1 million increase in nonaccrual loans from December 31, 2017, to June 30, 2018, is primarily the result of $72.5 million in transfers to nonaccrual status, offset by $64.5 million in repayments on nonaccrual loans. The decrease in other property owned (OPO) was primarily due to dispositions of $7.3 million at district associations offset by $2.6 million in additions to OPO at district associations.

At June 30, 2018, $82.2 million, or 59.9 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 June 30, 2018, the district had $5.6 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 0.7 percent of total loans at June 30, 2018, and December 31, 2017.

The allowance for loan losses at June 30, 2018, totaled $81,736, or 0.3 percent of total loans, and was a decrease of $1,532, or 1.8 percent, from the allowance for loan losses at December 31, 2017. The decrease includes a $4.0 million provision and $1.5 million in recoveries, offset by $6.7 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 47.8 percent as of June 30, 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 $5.3 million at June 30, 2018.

Liquidity and Funding Sources

Cash and available-for-sale investment securities totaled $5.49 billion, or 18.1 percent, of total assets at June 30, 2018, compared to $5.48 billion, or 18.4 percent, at December 31, 2017, an increase of $13.5 million, or 0.2 percent. At June 30, 2018, the district's cash balance was $33.8 million, a decrease of $33.2 million from the balance at December 31, 2017. Cash held at the Federal Reserve Bank at June 30, 2018, totaled $6.7 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 June 30, 2018, the bank had 229 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 $616.2 million, or 2.5 percent, from December 31, 2017, to June 30, 2018.

Investments

The district's investments at June 30, 2018, included the bank's available-for-sale portfolio with a fair value of $5.24 billion and the district associations' held-to-maturity portfolio recorded at an amortized cost of $17.1 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 $39.4 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 $17.1 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:

	June 30, 2018		December 31, 2017	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agency-guaranteed debt	**$ 184,552**	**$ 179,902**	$ 198,246	$ 195,248
Corporate debt	**293,425**	**292,560**	252,482	252,609
Federal agency collateralized mortgage-backed securities				
GNMA	**2,167,260**	**2,115,110**	2,012,484	1,984,662
FNMA and FHLMC	**2,332,848**	**2,293,670**	2,395,248	2,372,053
U.S. Treasury securities	**298,403**	**298,060**	249,860	249,207
Asset-backed securities	**56,466**	**56,397**	47,914	47,889
Total available-for-sale investments	**$ 5,332,954**	**$ 5,235,699**	$ 5,156,234	$ 5,101,668

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

	June 30, 2018		December 31, 2017	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Agricultural mortgage-backed securities	**$ 41,804**	**$ 39,427**	$ 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 June 30, 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 June 30, 2018, totaled $4.55 billion consisting of $700,000 of Class B noncumulative perpetual preferred stock related to the bank and $20,000 of cumulative perpetual preferred stock related to a district association, $66,044 of capital stock and participation certificates, $3.73 billion in retained earnings and $224,625 in additional paid-in capital, offset by $191,654 of accumulated other comprehensive loss. The district's capital reflected an increase of $269,772, or 6.3 percent, from December 31, 2017, to June 30, 2018, due to net income of $242,194, preferred stock issuance of $100,000, offset by other comprehensive loss of $28,794, patronage declarations of $15,482 and preferred stock dividends of $27,003.

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.

On June 25, 2018, the bank issued $100.0 million of Class B noncumulative subordinated perpetual preferred stock, Series 3 (Class B-3 preferred stock), representing one hundred thousand shares at $1,000 per share par value, for net proceeds of $99.0 million with issuance costs on preferred stock of $1.2 million. Dividends accrued on the Class B-3 preferred stock were $1.4 million as of June 30, 2018 and included in "Preferred stock dividends payable" on the balance sheet. Dividends on the Class B-3 preferred stock, if declared by the board of directors at its sole discretion, are noncumulative and are payable quarterly in arrears on the fifteenth day of March, June, September and December in each year, commencing September 15, 2018, at an annual fixed rate of 6.20 percent of par value of $1,000 per share up to, but excluding June 15, 2028, from and after which date will be paid at an annual rate of the 3-Month USD LIBOR plus 3.22 percent. The Class B-3 preferred stock is not mandatorily redeemable at any time, but may be redeemed in whole or in part at the option of the bank on any dividend payment date on or after June 15, 2028. The Class B-3 preferred stock ranks pari passu with respect to the existing Class B-1 and Class B-2 preferred stock, and senior to all of the bank's other outstanding capital stock. For regulatory purposes, the Class B-3 preferred stock is included in permanent capital, total capital and tier 1 capital within certain limitations.

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 June 30, 2018, the bank and all district associations exceeded all regulatory capital requirements.

The following table reflects the bank and associations' capital ratios as of June 30, 2018:

	Bank	**FLCA**	**ACAs**	**Total Regulatory Requirement**
Permanent capital ratio ranges	15.90%	16.84%	12.82%-22.09%	7.00%
Common equity tier 1 ratio ranges	10.01	16.80	12.12 - 21.96	7.00
Tier 1 capital ratio ranges	15.88	16.80	12.12 - 21.96	8.50
Total capital ratio ranges	16.01	17.09	13.12 - 22.55	10.50
Tier 1 leverage ratio ranges	7.09	17.38	10.92 - 20.79	5.00
UREE leverage ratio ranges	2.84	18.57	8.48 - 21.81	1.50

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

	June 30, 2018	December 31, 2017
Members' equity to assets	**14.96%**	14.40%
Total liabilities to members' equity	**5.69:1**	5.95:1
Allowance for loan losses to total loans	**0.34%**	0.35%

OTHER

CONDITIONS IN THE DISTRICT

From January through May, non-farm employment in Texas increased at an annualized rate of 3.6 percent, according to data from the Federal Reserve Bank of Dallas. The pace of job creation observed in the state during 2018 has surpassed the rates reported during the first five months of the previous three years. In April, the Texas Leading Index, a summary statistic published by the Federal Reserve Bank of Dallas that projects future economic growth in Texas, reached the highest level observed since 2014. This indicates that employment growth in the state should continue at a robust pace through the end of 2018.

Texas led all U.S. states in terms of absolute and percentage-based population growth from 2010 through 2017, according to the U.S. Census Bureau. The healthy economy, business-friendly environment, diversity of employment opportunities and warm climate are likely to attract additional individuals to Texas this year. It should be noted that NAFTA has contributed to economic growth in Texas for more than two decades, and changes to this agreement might have an impact on the state's economy.

In May, the Bureau of Labor Statistics estimated that non-farm payroll growth has been positive year-over-year in each of the four other district states, Alabama, Louisiana, Mississippi and New Mexico. In New Mexico, the statewide unemployment rate fell from 6.0 percent as of December 2017 to an estimated 5.1 percent as of May 2018. The unemployment rates in Mississippi and Louisiana were estimated at 4.6 percent and 4.7 percent, respectively, in May. Employment conditions remained strong in Alabama, where the unemployment rate has been below 4 percent since September 2017.

Rising oil prices have supported increased economic activity throughout the oil-producing portions of the district. In the Permian Basin, based on the prolific oil field located in West Texas and southeastern New Mexico, the number of active oil rigs increased by about one-fourth year-over-year as of late June. The U.S. Energy Information Administration expects West Texas Intermediate crude oil prices to average about $65 per barrel during 2018, a level that should encourage further exploration and production growth in the region.

Agricultural commodity markets were broadly impacted during the quarter by concerns regarding trade disruptions. A relatively high percentage of the district's loan exposure is primarily dependent upon non-agricultural income sources for repayment. Also, the diversification of agricultural production within the district insulates the bank and the associations from significant exposure to trade-related issues impacting individual commodities. Moreover, export demand for key commodities produced in the district, such as cotton and beef, has been robust year-to-date and is unlikely to be materially affected by tariffs or restrictions that have been announced through the end of the second quarter. Many of the district's borrowers employ hedging programs to protect against price volatility and secure profitability in challenging environments.

U.S. beef production is expected to reach about 27.1 billion pounds in 2018, an increase of approximately 4 percent relative to 2017 and one of the highest levels on record. The U.S. Department of Agriculture expects steer prices to fall marginally year-over-year, which could lead to lower profitability for cattle producers. For much of 2018, beef processors have generated historically strong margins, and this trend is likely to continue as long as demand is well-supported. Wholesale composite broiler prices increased this quarter, leading to improved profitability for U.S. chicken producers. Consistent with typical seasonal patterns, broiler prices are expected to decline moderately during the third quarter. Commercial dairy exports reached historically high levels in March and April, as export prices for many U.S. dairy products compared favorably to global alternatives. Despite relatively strong export market performance

year-to-date, dairy prices are likely to fall in 2018 relative to the previous year, thereby putting pressure on dairy producers.

Drought conditions expanded this quarter across much of the Southwest, including in New Mexico and in portions of Texas, and in Louisiana. As of late June, the majority of land area in Texas and New Mexico was being impacted by moderate, severe, extreme or exceptional drought conditions, according to the National Drought Mitigation Center. In Alabama, Mississippi and Louisiana, where much of the district's grain and oilseeds are produced, moisture has generally been adequate. 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.

Texas cotton producers are expected to have planted 7.4 million acres of cotton in 2018, an increase of about 7 percent year-over-year. Due to unfavorable early-season conditions, as well as planting delays in some areas, Texas's cotton crop is in relatively poor condition compared to the previous year. On an international basis, world cotton consumption is expected to reach record levels in the coming months. Increasing global consumption should be supportive of domestic prices, potentially offsetting the decline in cotton yields per acre that may be observed relative to the previous year. The U.S. Department of Agriculture estimates that U.S. farmers allocated more cropland to soybean production than corn production during 2018. Through June, the corn and soybean crops in the Midwest have benefitted from timely precipitation and ideal temperatures. Above-average growing conditions, coupled with concerns regarding trade disruptions, have pushed prices lower for both crops. Farmers in the district continue to utilize risk management tools, such as federally-sponsored crop insurance programs and forward, futures and options contracts, to mitigate risk and enhance margins.

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

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 June 30, 2018, there were no district associations under written agreements with the Farm Credit Administration.

On June 12, 2018, the Farm Credit Administration published a final rule revising the requirements governing the eligibility of investments for System banks and associations. The stated objectives of the proposed rule are as follows:

- To strengthen investment practices at Farm Credit banks and associations to enhance their safety and soundness;
- To ensure that System banks hold sufficient high-quality liquid investments for liquidity purposes;
- To enhance the ability of the System banks to supply credit to agricultural and aquatic producers and their cooperatives in times of financial stress;
- To comply with the requirements of section 939A of the Dodd-Frank Act;
- To modernize the investment eligibility criteria for Farm Credit banks; and
- To revise the investment regulation for System associations to improve their investment management practices so that they are more resilient to risk.

The regulation becomes effective January 1, 2019.

On June 15, 2018, the FCA published a proposed rule to amend its regulations governing standards of conduct of directors and employees of System institutions and require every System bank and association to have a Standards of Conduct Program based on core principles to put into effect ethical values as part of corporate culture. The stated objectives of the proposed rule are to:

- Establish principles for ethical conduct and recognize each System institution's responsibility for promoting an ethical culture;
- Provide each System institution flexibility to develop specific guidelines on acceptable practices suitable for its business;
- Encourage each System institution to foster core ethical values and conduct as part of its corporate culture;
- Require each System institution to develop strategies and a System of internal controls to promote institution and individual accountability in ethical conduct, including by establishing a Standards of Conduct Program and adopting a Code of Ethics; and
- Remove prescriptive requirements of the regulations that do not promote these objectives.

The deadline for the submission of public comments is September 13, 2018.

OTHER

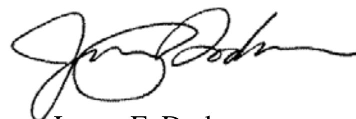
New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Acts of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA changed the federal corporate tax rate from 35 percent to 21 percent. The bank is exempt from federal and certain other income taxes as provided 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 quarter and six months ended June 30, 2018 reflect 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 June 30, 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
Senior Vice President, Chief Financial Officer

August 9, 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 senior vice president, chief financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. With management's input, the chief executive officer and senior vice president, 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
Senior Vice President, Chief Financial Officer

August 9, 2018

Combined Balance Sheets

(dollars in thousands)	**June 30, 2018 (Unaudited)**	December 31, 2017
Assets		
Cash	**$ 33,752**	$ 66,953
Federal funds sold and overnight investments	**165,144**	246,888
Investment securities	**5,292,219**	5,163,813
Loans (includes $9,602 and $16,311 at fair value, held under fair value option)	**24,388,504**	23,745,668
Less allowance for loan losses	**81,736**	83,268
Net loans	**24,306,768**	23,662,400
Accrued interest receivable	**215,315**	202,748
Other property owned	**11,333**	15,569
Premises and equipment, net	**147,513**	134,617
Other assets	**232,034**	224,134
Total assets	**$ 30,404,078**	$ 29,717,122
Liabilities and members' equity		
Liabilities		
Bonds and notes, net	**$ 25,417,454**	$ 24,801,223
Accrued interest payable	**84,601**	70,197
Patronage distributions payable	**8,795**	170,022
Preferred stock dividends payable	**21,440**	20,063
Other liabilities	**324,120**	377,721
Total liabilities	**25,856,410**	25,439,226
Commitments and contingencies (Note 4)		
Members' equity		
Preferred stock	**720,000**	620,000
Capital stock and participation certificates	**66,044**	65,982
Allocated retained earnings	**692,436**	685,506
Unallocated retained earnings	**3,036,217**	2,844,643
Additional paid-in-capital	**224,625**	224,625
Accumulated other comprehensive loss	**(191,654)**	(162,860)
Total members' equity	**4,547,668**	4,277,896
Total liabilities and members' equity	**$ 30,404,078**	$ 29,717,122

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

Combined Statements of Comprehensive Income
(unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
(dollars in thousands)	**2018**	2017	**2018**	2017
Interest Income				
Loans	**$ 296,355**	$ 259,975	**$ 577,649**	$ 506,362
Investment securities	**29,841**	20,608	**56,140**	39,656
Total interest income	**326,196**	280,583	**633,789**	546,018
Interest Expense				
Bonds and notes	**104,627**	71,892	**196,178**	136,524
Notes payable and other	**24,700**	16,124	**46,327**	29,945
Total interest expense	**129,327**	88,016	**242,505**	166,469
Net interest income	**196,869**	192,567	**391,284**	379,549
Provision for credit losses	**1,303**	1,196	**3,969**	4,532
Net interest income after provision for credit losses	**195,566**	191,371	**387,315**	375,017
Noninterest Income				
Patronage income	**3,591**	4,824	**8,598**	9,969
Fees for loan-related services	**5,249**	4,837	**11,369**	10,550
Refunds from Farm Credit System Insurance Corporation	**-**	-	**19,269**	-
Loss on loans held under fair value option	**(45)**	(46)	**(155)**	(146)
Other income, net	**502**	1,534	**1,260**	5,664
Total noninterest income	**9,297**	11,149	**40,341**	26,037
Noninterest Expense				
Salaries and employee benefits	**49,987**	44,810	**101,736**	92,332
Occupancy and equipment expense	**8,146**	7,422	**17,194**	16,222
Insurance Fund premiums	**4,998**	7,954	**9,681**	15,527
Gain on other property owned, net	**(534)**	(480)	**(916)**	(583)
Other components of net periodic pension and postretirement benefit costs	**3,528**	5,119	**7,057**	10,239
Other operating expenses	**26,535**	24,490	**50,743**	58,447
Total noninterest expense	**92,660**	89,315	**185,495**	192,184
Income before provision for income taxes	**112,203**	113,205	**242,161**	208,870
Benefit from (provision for) income taxes	**43**	60	**(33)**	(164)
Net Income	**112,160**	113,145	**242,194**	209,034
Other comprehensive income (loss)				
Change in unrealized loss on investments	**(13,445)**	7,735	**(42,819)**	6,224
Change in pension and postretirement benefit plans	**3,379**	4,255	**6,756**	8,509
Change in cash flow derivative instruments	**2,195**	(1,598)	**7,269**	(1,346)
Total other comprehensive (loss) income	**(7,871)**	10,392	**(28,794)**	13,387
Comprehensive Income	**$ 104,289**	$ 123,537	**$ 213,400**	$ 222,421

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	-	-	-	209,034	-	-	209,034
Other comprehensive gain	-	-	-	-	-	13,387	13,387
Capital stock/participation certificates issued	-	5,156	-	-	-	-	5,156
Capital stock/participation certificates and allocated retained earnings retired	-	(4,240)	-	-	-	-	(4,240)
Preferred stock issued	20,000	-	-	-	-	-	20,000
Issuance costs on preferred stock	-	-	-	(136)	-	-	(136)
Preferred stock dividends	-	-	-	(25,125)	-	-	(25,125)
Patronage distributions							
Cash	-	-	-	(8,951)	-	-	(8,951)
Members' equity	-	-	6,143	(6,143)	-	-	-
Balance at June 30, 2017	$ 620,000	$ 65,350	$ 637,790	$ 2,904,876	$ 224,625	$ (144,595)	$ 4,308,046
Balance at December 31, 2017	**$ 620,000**	**$ 65,982**	**$ 685,506**	**$ 2,844,643**	**$ 224,625**	**$ (162,860)**	**$ 4,277,896**
Net income	**-**	**-**	**-**	**242,194**	**-**	**-**	**242,194**
Other comprehensive loss	**-**	**-**	**-**	**-**	**-**	**(28,794)**	**(28,794)**
Capital stock/participation certificates issued	**-**	**4,633**	**-**	**-**	**-**	**-**	**-** **4,633**
Capital stock/participation certificates and allocated retained earnings retired	**-**	**(4,571)**	**-**	**-**	**-**	**-**	**(4,571)**
Preferred stock issued	**100,000**	**-**	**-**	**-**	**-**	**-**	**100,000**
Issuance costs on preferred stock	**-**	**-**	**-**	**(1,205)**	**-**	**-**	**(1,205)**
Preferred stock dividends	**-**	**-**	**-**	**(27,003)**	**-**	**-**	**(27,003)**
Patronage distributions							
Cash	**-**	**-**	**-**	**(15,482)**	**-**	**-**	**(15,482)**
Members' equity	**-**	**-**	**6,930**	**(6,930)**	**-**	**-**	**-**
Balance at June 30, 2018	**$ 720,000**	**$ 66,044**	**$ 692,436**	**$ 3,036,217**	**$ 224,625**	**$ (191,654)**	**$ 4,547,668**

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

Combined Statements of Cash Flows

(unaudited)

(dollars in thousands)	Six Months Ended June 30, 2018	2017
Operating activities		
Net income	**$ 242,194**	$ 209,034
Reconciliation of net income to net cash provided by operating activities		
Provision for loan losses	**3,969**	4,532
Carrying value adjustment on other property owned	**137**	60
Depreciation and amortization on premises and equipment	**8,418**	8,112
Accretion of net premium on loans	**1,357**	3,212
Net change in fair value of concessions granted	**-**	4,606
Amortization and accretion on debt instruments	**18,819**	11,648
Accretion of yield related to loans and notes payable acquired in merger	**14,041**	(216)
Accretion of net premium on investments	**1,905**	2,592
Decrease in fair value of loans held under fair value option	**155**	146
Gain from sales of other property owned	**(1,273)**	(515)
Gain on sale of loans	**344**	-
Loss (gain) on other earning assets	**1,312**	(1,744)
Distributions less than cumulative equity earnings	**-**	198
Loss from sales of premises and equipment	**1,841**	669
Allocated equity patronage from System bank	**(14,794)**	(14,588)
Increase in accrued interest receivable	**(12,567)**	(5,307)
Decrease in other assets, net	**17,224**	15,090
Increase in accrued interest payable	**14,403**	5,513
Decrease in other liabilities, net	**(46,236)**	(50,392)
Net cash provided by operating activities	**251,249**	192,650
Investing activities		
Net decrease (increase) in federal funds sold	**81,745**	(57,838)
Investment securities		
Purchases	**(909,567)**	(700,067)
Proceeds from maturities, calls and prepayments	**736,437**	557,427
Increase in loans, net	**(721,464)**	(639,998)
Proceeds from sale of loans	**60,438**	-
Proceeds from sales of other property owned	**3,185**	6,966
Proceeds from sales of premises and equipment	**1,479**	1,652
Expenditures for premises and equipment	**(24,627)**	(15,468)
Distributions in excess of cumulative equity earnings	**228**	-
Investment in other earning assets	**(4,015)**	(6,548)
Net cash used in investing activities	**(776,161)**	(853,874)
Financing activities		
Bonds and notes issued	**6,615,565**	5,935,244
Bonds and notes retired	**(6,018,153)**	(5,092,274)
Prepayments on debt extinguishment costs	**-**	788
(Decrease) increase in guaranteed obligations to government entities	**(1,061)**	1,507
Increase in advanced conditional payments	**443**	7,567
Preferred stock issued	**100,000**	20,000
Issuance costs on preferred stock	**(1,205)**	(136)
Repayments on capital lease obligation	**(227)**	(227)
Capital stock and participation certificates issued	**4,633**	5,156
Capital stock and participation certificates retired	**(4,571)**	(4,240)
Cash dividends on preferred stock	**(27,003)**	(25,125)
Cash patronage distributions paid	**(176,710)**	(165,769)
Net cash provided by financing activities	**491,711**	682,491
Net (decrease) increase in cash	**(33,201)**	21,267
Cash at beginning of year	**66,953**	207,229
Cash at end of quarter	**$ 33,752**	$ 228,496
Supplemental schedule of noncash investing and financing activities		
Financed sales of other property owned	**$ 3,619**	$ 345
Loan assets transferred to other property owned	**1,768**	3,969
Undocumented advances expense, net	**-**	9,019
Net increase in unrealized losses on investment securities	**(42,818)**	6,224
Cash dividends or patronage distributions payable	**8,795**	284
Preferred stock dividend payable	**21,440**	20,063
Capital lease obligation	**425**	857
Supplemental information		
Cash paid for:		
Interest	**$ 228,101**	$ 160,956
Income taxes	**12**	-

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 that 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.

Although the association restated their 2016 consolidated financial statements, the district has evaluated the quantitative and qualitative aspects of these misstatements in accordance with the applicable accounting guidance and has determined that such misstatements are not material to the current and previously issued district combined financial statements. The events and activities that resulted in the restatement of the association's consolidated financial statements at December 31, 2016 impacted the financial results for the quarter and six months ended June 30, 2017 by $262 thousand and $16.1 million respectively, decreasing consolidated other comprehensive income and members' equity.

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. In July 2018, the FASB issued an update entitled “Leases — Targeted Improvements,” which provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. An entity that elects this additional transition method must provide the required disclosures of the now current standard for all prior periods presented. The guidance and related amendments in this update become effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The district is evaluating the impact of adoption on the district’s financial condition and its 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 bank and 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 June 30, 2018, and December 31, 2017, is as follows:

Investments in the bank's available-for-sale liquidity portfolio at June 30, 2018:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agency-guaranteed debt	$ 184,552	$ 67	$ (4,717)	$ 179,902	2.16 %
Corporate debt	293,425	440	(1,305)	292,560	2.66
Federal agency-guaranteed collateralized mortgage-backed securities:					
GNMA	2,167,260	507	(52,657)	2,115,110	2.29
FNMA and FHLMC	2,332,848	1,884	(41,062)	2,293,670	2.23
U.S. Treasury securities	298,403	1	(344)	298,060	1.95
Asset-backed securities	56,466	9	(78)	56,397	2.20
Total available-for-sale liquidity investments	$ 5,332,954	$ 2,908	$ (100,163)	$ 5,235,699	2.26 %

Investments in the bank's available-for-sale other investments portfolio at June 30, 2018:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	**$ 41,804**	**$ -**	**$ (2,377)**	**$ 39,427**	**4.77 %**

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	$ 5,156,234	$ 3,371	$ (57,937)	$ 5,101,668	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 June 30, 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	**$ -**	**$ 16,481**	**$ 163,421**	**$ -**	**$ 179,902**
Corporate debt	**35,053**	**257,508**	**-**	**-**	**292,561**
Federal agency collateralized mortgage-backed securities					
GNMA	**16**	**-**	**70,250**	**2,044,843**	**2,115,109**
FNMA and FHLMC	**250**	**92,680**	**389,518**	**1,811,222**	**2,293,670**
U.S. Treasury securities	**199,092**	**98,968**	**-**	**-**	**298,060**
Asset-backed securities	**11,363**	**43,045**	**1,989**	**-**	**56,397**
Total fair value	**$ 245,774**	**$ 508,682**	**$ 625,178**	**$ 3,856,065**	**$ 5,235,699**
Total amortized cost	**$ 245,967**	**$ 512,031**	**$ 641,109**	**$ 3,933,847**	**$ 5,332,954**
Weighted average yield	**1.93%**	**2.35%**	**2.08%**	**2.30%**	**2.26%**

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	$ 12,313	$ 27,114	$ 39,427
Total amortized cost	$ 12,690	$ 29,114	$ 41,804
Weighted average yield	4.84%	4.73%	4.77%

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 June 30, 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	$ 75,848	$ (1,565)	$ 81,350	$ (3,152)	$ 157,198	$ (4,717)
Corporate debt	157,894	(1,305)	-	-	157,894	(1,305)
Federal agency collateralized mortgage-backed securities						
GNMA	903,547	(18,718)	980,482	(33,939)	1,884,029	(52,657)
FNMA and FHLMC	675,343	(11,599)	984,111	(29,463)	1,659,454	(41,062)
U.S. Treasury securities	223,316	(204)	49,848	(140)	273,164	(344)
Asset-backed securities	37,803	(77)	1,683	(1)	39,486	(78)
Total	$ 2,073,751	$ (33,468)	$ 2,097,474	$ (66,695)	$ 4,171,225	$ (100,163)

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 six months ended June 30, 2018, the district did not recognize any other-than-temporary impairment credit losses and no securities were identified as OTTI at June 30, 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 June 30, 2018, is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	**$ 17,093**	**$ 3**	**$ (146)**	**$ 16,950**	**5.26%**

The following table summarizes the contractual maturity, fair value, amortized cost and weighted average yield of the district's held-to-maturity investments at June 30, 2018:

	Due after one year through five years	Due after five years through 10 years	Total
Fair value of agricultural mortgage-backed securities	**$ 10,777**	**$ 6,173**	**$ 16,950**
Total amortized cost	**$ 10,841**	**$ 6,252**	**$ 17,093**
Weighted average yield	**5.54%**	**4.77%**	**5.26%**

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

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

	June 30, 2018	December 31, 2017
Real estate mortgage	**$ 14,656,636**	$ 14,351,578
Production and intermediate term	**2,941,019**	3,014,067
Agribusiness		
Loans to cooperatives	**469,273**	429,535
Processing and marketing	**3,671,669**	3,428,261
Farm-related business	**219,333**	206,441
Communication	**499,707**	437,066
Energy (rural utilities)	**1,379,811**	1,352,129
Water and waste disposal	**135,504**	117,177
Rural residential real estate	**237,062**	234,379
Lease receivables	**29,671**	25,009
Loans to other financing institutions	**44,543**	40,107
Mission-related	**104,276**	109,919
	$ 24,388,504	$ 23,745,668

The bank's capital markets loan portfolio of $5.7 billion, 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 June 30, 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	$ 202,493	$ 351,611	$ 300,694	$ 2,523	$ 503,187	$ 354,134
Production and intermediate term	594,316	656,832	26,099	59,686	620,415	716,518
Agribusiness	2,151,546	45,433	1,703	-	2,153,249	45,433
Communication	497,698	-	-	-	497,698	-
Energy (rural utilities)	1,378,241	-	-	-	1,378,241	-
Water and waste disposal	135,780	-	-	-	135,780	-
Lease receivables	29,578	-	-	-	29,578	-
Mission-related	4,572	-	4,105	-	8,677	-
Direct note receivable from district associations	-	3,850,000	-	-	-	3,850,000
Total	**$ 4,994,224**	**$ 4,903,876**	**$ 332,601**	**$ 62,209**	**$ 5,326,825**	**$ 4,966,085**

The bank and associations are authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent that 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 June 30, 2018, ACPs netted against borrowers' related loan balances totaled $203,770 and ACPs included in other liabilities totaled $16,651, 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 $9,602 at June 30, 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 six months ended June 30, 2018:

Balance at January 1, 2018	**$ 9,908**
Net loss on financial instruments under fair value option	**(155)**
Premium amortization	**(151)**
Balance at June 30, 2018	**$ 9,602**

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

	June 30, 2018	December 31, 2017
Nonaccrual loans:		
Real estate mortgage	**$ 84,835**	$ 85,488
Production and intermediate term	**23,629**	34,700
Agribusiness	**11,733**	3,175
Energy	**14,554**	-
Rural residential real estate	**998**	1,178
Lease receivables	**41**	58
Mission-related	**1,496**	1,636
Total nonaccrual loans	**137,286**	126,235
Accruing restructured loans:		
Real estate mortgage	**15,327**	18,496
Production and intermediate term	**8,333**	6,236
Rural residential real estate	**155**	160
Mission-related	**5,483**	5,641
Total accruing restructured loans	**29,298**	30,533
Accruing loans 90 days or more past due:		
Real estate mortgage	**3,644**	108
Production and intermediate term	**815**	2,897
Agribusiness	**-**	20
Total accruing loans 90 days or more past due	**4,459**	3,025
Total nonperforming loans	**171,043**	159,793
Other property owned	**11,333**	15,569
Total nonperforming assets	**$ 182,376**	$ 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:

	June 30, 2018	December 31, 2017
Real estate mortgage:		
Acceptable	**97.2 %**	96.9 %
OAEM	**1.5**	1.6
Substandard/Doubtful	**1.3**	1.5
	100.0 %	100.0 %
Production and intermediate term:		
Acceptable	**93.3 %**	92.3 %
OAEM	**3.9**	4.3
Substandard/Doubtful	**2.7**	3.4
	100.0 %	100.0 %
Agribusiness:		
Acceptable	**99.2 %**	99.2 %
OAEM	**0.1**	0.1
Substandard/Doubtful	**0.7**	0.7
	100.0 %	100.0 %
Energy and water/waste disposal:		
Acceptable	**98.2 %**	98.0 %
OAEM	**0.8**	0.9
Substandard/Doubtful	**1.0**	1.1
	100.0 %	100.0 %
Communication:		
Acceptable	**95.1 %**	100.0 %
OAEM	**4.9**	-
Substandard/Doubtful	**-**	-
	100.0 %	100.0 %
Rural residential real estate:		
Acceptable	**98.6 %**	98.1 %
OAEM	**0.7**	0.8
Substandard/Doubtful	**0.7**	1.1
	100.0 %	100.0 %
Lease receivables:		
Acceptable	**99.9 %**	99.6 %
OAEM	**-**	0.2
Substandard/Doubtful	**0.1**	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	**97.1 %**	96.9 %
OAEM	**1.6**	1.6
Substandard/Doubtful	**1.3**	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:

June 30, 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	**$ 56,572**	**$ 37,386**	**$ 93,958**	**$14,701,072**	**$14,795,030**	**$ 3,644**
Production and intermediate term	**11,831**	**13,315**	**25,146**	**2,953,331**	**2,978,477**	**815**
Agribusiness	**807**	**-**	**807**	**4,378,307**	**4,379,114**	**-**
Communication	**-**	**-**	**-**	**500,103**	**500,103**	**-**
Energy and water/waste disposal	**-**	**-**	**-**	**1,523,043**	**1,523,043**	**-**
Rural residential real estate	**2,354**	**63**	**2,417**	**235,466**	**237,883**	**-**
Lease receivables	**-**	**41**	**41**	**29,772**	**29,813**	**-**
Loans to other financing institutions	**-**	**-**	**-**	**44,644**	**44,644**	**-**
Mission-related	**-**	**1,496**	**1,496**	**103,547**	**105,043**	**-**
Total	**$ 71,564**	**$ 52,301**	**$ 123,865**	**$24,469,285**	**$24,593,150**	**$ 4,459**

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 June 30, 2018			At December 31, 2017		
Impaired loans with a related allowance for loan losses:	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	Recorded Investment	Unpaid Principal Balance	Related Allowance
Real estate mortgage	**$ 8,062**	**$ 8,421**	**$ 1,113**	$ 5,530	$ 5,620	$ 1,075
Production and intermediate term	**9,847**	**10,894**	**2,216**	4,969	6,255	1,738
Loans to cooperative	**8,588**	**8,588**	**3,403**	-	-	-
Processing and marketing	**2,694**	**2,694**	**368**	2,736	2,735	368
Farm-related business	**295**	**4,221**	**220**	308	4,232	111
Energy and water/waste disposal	**14,554**	**14,554**	**3,947**	-	-	-
Rural residential real estate	**184**	**231**	**78**	39	39	5
Mission-related	**393**	**388**	**135**	429	429	198
Total	**$ 44,617**	**$ 49,991**	**$ 11,480**	$ 14,011	$ 19,310	$ 3,495
Impaired loans with no related allowance for loan losses:						
Real estate mortgage	**$ 95,744**	**$ 99,968**	**$ -**	$ 98,562	$ 102,071	$ -
Production and intermediate term	**22,930**	**39,863**	**-**	38,864	54,124	-
Processing and marketing	**131**	**9,326**	**-**	151	9,345	-
Farm-related business	**24**	**96**	**-**	-	89	-
Energy and water/waste disposal	**-**	**7,623**	**-**	-	7,623	-
Rural residential real estate	**969**	**1,229**	**-**	1,299	1,572	-
Lease receivables	**41**	**64**	**-**	58	82	-
Mission-related	**6,586**	**6,535**	**-**	6,848	6,848	-
Total	**$ 126,425**	**$ 164,704**	**$ -**	$ 145,782	$ 181,754	$ -
Total impaired loans:						
Real estate mortgage	**$ 103,806**	**$ 108,389**	**$ 1,113**	$ 104,092	$ 107,691	$ 1,075
Production and intermediate term	**32,777**	**50,757**	**2,216**	43,833	60,379	1,738
Loans to cooperative	**8,588**	**8,588**	**3,403**	-	-	-
Processing and marketing	**2,825**	**12,020**	**368**	2,887	12,080	368
Farm-related business	**319**	**4,317**	**220**	308	4,321	111
Energy and water/waste disposal	**14,554**	**22,177**	**3,947**	-	7,623	-
Rural residential real estate	**1,153**	**1,460**	**78**	1,338	1,611	5
Lease receivables	**41**	**64**	**-**	58	82	-
Mission-related	**6,979**	**6,923**	**135**	7,277	7,277	198
Total	**$ 171,042**	**$ 214,695**	**$ 11,480**	$ 159,793	$ 201,064	$ 3,495

	For the Six Months Ended			
	June 30, 2018		June 30, 2017	
Impaired loans with a related allowance for loan losses:	**Average Impaired Loans**	**Interest Income Recognized**	Average Impaired Loans	Interest Income Recognized
Real estate mortgage	**$ 7,724**	**$ 81**	$ 10,089	$ 58
Production and intermediate term	**9,625**	**150**	8,671	17
Loans to cooperative	**8,125**	**5**	-	126
Processing and marketing	**2,701**	**158**	2,833	-
Farm-related business	**386**	**-**	685	-
Energy and water/waste disposal	**14,864**	**6**	-	-
Rural residential real estate	**117**	**2**	87	-
Mission-related	**393**	**21**	2,441	51
Total	**$ 43,935**	**$ 423**	$ 24,806	$ 252
Impaired loans with no related allowance for loan losses:				
Real estate mortgage	**$ 98,405**	**2,048**	$ 108,588	$ 3,781
Production and intermediate term	**23,421**	**753**	30,135	193
Loans to cooperative	**-**	**2**	1,529	-
Processing and marketing	**131**	**-**	602	21
Farm-related business	**24**	**29**	-	6
Energy and water/waste disposal	**456**	**9**	-	-
Rural residential real estate	**915**	**7**	2,117	6
Lease receivables	**47**	**-**	86	8
Mission-related	**6,628**	**209**	8,497	53
Total	**$ 130,027**	**$ 3,057**	$ 151,554	$ 4,068
Total impaired loans:				
Real estate mortgage	**$ 106,129**	**$ 2,129**	$ 118,677	$ 3,839
Production and intermediate term	**33,046**	**903**	38,806	210
Loans to cooperative	**8,125**	**2**	1,529	126
Processing and marketing	**2,832**	**158**	3,435	21
Farm-related business	**410**	**29**	685	6
Energy and water/waste disposal	**15,320**	**15**	-	-
Rural residential real estate	**1,032**	**9**	2,204	6
Lease receivables	**47**	**-**	86	8
Mission-related	**7,021**	**230**	10,938	104
Total	**$ 173,962**	**$ 3,475**	$ 176,360	$ 4,320

At June 30, 2018, impaired loans of $44.6 million had a related specific allowance of $11.5 million, while the remaining $126.4 million of impaired loans had no related specific allowance as a result of adequate collateralization.

The average recorded investment in impaired loans for the six months ended June 30, 2018, was $174.0 million. The district recognized interest income of $3.5 million on impaired loans during the six months ended June 30, 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 March 31, 2018	$ 40,676	$ 21,547	$ 13,760	$ 855	$ 7,155	$ 493	$ -	$ 140	$ -	$ 190	$ 84,816
Charge-offs	(942)	(4,213)	-	-	-	(48)	-	-	-	-	(5,203)
Recoveries	82	841	78	(0)	-	8	-	-	-	-	1,009
Provision for credit losses (loan loss reversal)	(1,434)	3,498	(214)	(85)	(369)	20	-	(53)	-	(59)	1,304
Other*	(4)	(274)	(1)	(2)	78	3	-	-	-	11	(190)
Balance at June 30, 2018	$ 38,378	$ 21,398	$ 13,623	$ 768	$ 6,864	$ 476	$ -	$ 87	$ -	$ 141	$ 81,736
Balance at December 31, 2017	$ 41,630	$ 23,212	$ 10,994	$ 826	$ 5,839	$ 532	$ -	$ 35	$ -	$ 200	$ 83,268
Charge-offs	(1,021)	(5,623)	-	-	-	(48)	-	-	-	-	(6,692)
Recoveries	194	954	162	161	-	9	-	-	-	-	1,480
Provision for credit losses (loan loss reversal)	(2,471)	2,751	2,826	(220)	1,129	(19)	-	52	-	(79)	3,969
Other *	46	105	(359)	1	(104)	2	-	-	-	20	(289)
Balance at June 30, 2018	$ 38,378	$ 21,399	$ 13,623	$ 768	$ 6,864	$ 476	$ -	$ 87	$ -	$ 141	$ 81,736
Individually evaluated for impairment	$ 1,496	$ 2,347	$ 3,876	$ -	$ 3,947	$ 100	$ -	$ -	$ -	$ 135	$ 11,900
Collectively evaluated for impairment	36,882	19,053	9,747	768	2,917	376	-	87	-	6	69,836
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at June 30, 2018	$ 38,378	$ 21,399	$ 13,623	$ 768	$ 6,864	$ 476	$ -	$ 87	$ -	$ 141	$ 81,736
Balance at December 31, 2016	$ 35,559	$ 25,341	$ 13,036	$ 1,393	$ 5,686	$ 479	$ -	$ 42	$ -	$ 201	81,737
Charge-offs	(183)	(1,742)	-	-	-	(6)	-	-	-	-	(1,931)
Recoveries	489	201	292	-	1,420	2	-	-	-	-	2,404
Provision for credit losses (loan loss reversal)	5,116	590	(867)	(164)	(137)	(10)	-	1	-	3	4,532
Other*	1,170	130	(1,187)	(342)	64	75	-	(21)	-	-	(111)
Balance at June 30, 2017	$ 42,151	$ 24,520	$ 11,274	$ 887	$ 7,033	$ 540	$ -	$ 22	$ -	$ 204	$ 86,631
Individually evaluated for impairment	$ 1,776	$ 2,843	$ 479	$ -	$ -	$ 57	$ -	$ -	$ -	$ 192	$ 5,347
Collectively evaluated for impairment	40,375	21,677	10,795	887	7,033	483	-	22	-	12	81,284
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Balance at June 30, 2017	$ 42,151	$ 24,520	$ 11,274	$ 887	$ 7,033	$ 540	$ -	$ 22	$ -	$ 204	$ 86,631
Recorded Investments in Loans Outstanding:											
Ending balance at June 30, 2018	$ 14,795,030	$ 2,978,477	$ 4,379,114	$ 500,103	$ 1,523,043	$ 237,883	$ -	$ 29,813	$ 44,644	$ 105,043	$ 24,593,150
Individually evaluated for impairment	$ 110,017	$ 32,728	$ 11,733	$ -	$ 14,554	$ 1,429	$ -	$ 41	$ -	$ 6,949	$ 177,451
Collectively evaluated for impairment	$ 14,685,013	$ 2,945,749	$ 4,367,381	$ 500,103	$ 1,508,489	$ 236,454	$ -	$ 29,772	$ 44,644	$ 98,094	$ 24,415,699
Ending balance at June 30, 2017	$ 14,075,354	$ 2,856,610	$ 3,917,386	$ 507,317	$ 1,501,364	$ 225,365	$ -	$ 7,476	$ 38,845	$ 118,190	$ 23,247,907
Individually evaluated for impairment	$ 120,955	$ 40,140	$ 5,504	$ -	$ -	$ 2,287	$ 86	$ -	$ -	$ 10,875	$ 179,847
Collectively evaluated for impairment	$ 13,954,399	$ 2,816,470	$ 3,911,882	$ 507,317	$ 1,501,364	$ 223,078	$ (86)	$ 7,476	$ 38,845	$ 107,315	$ 23,068,060

*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 June 30, 2018, the total recorded investment of TDR loans was $49,259, including $19,960 classified as nonaccrual and $29,299 classified as accrual, with specific allowance for loan losses of $5,465. Additional commitments to lend to borrowers whose loan terms have been modified in TDRs were $1,870 at June 30, 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	
	June 30, 2018	December 31, 2017	**June 30, 2018**	December 31, 2017
Real estate mortgage	**$ 23,495**	$ 27,175	**$ 8,168**	$ 8,679
Production and intermediate term	**9,345**	7,998	**1,012**	1,762
Agribusiness	**9,014**	406	**9,014**	406
Rural residential real estate	**426**	449	**271**	289
Mission-related	**6,979**	7,277	**1,496**	1,636
Total	**$ 49,259**	$ 43,305	**$ 19,961**	$ 12,772

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 and six months ended June 30, 2018, and June 30, 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 June 30, 2018:

Troubled debt restructurings:	**Premodification Outstanding Recorded Investment**	**Postmodification Outstanding Recorded Investment**
Real estate mortgage	$ 1,756	$ 1,623
Production and intermediate term	89	83
Agribusiness	7,598	8,388
Total	**$ 9,443**	**$ 10,094**

For the three months ended June 30, 2017:

Troubled debt restructurings:	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Real estate mortgage	$ 1,404	$ 1,380
Production and intermediate term	2,652	2,681
Rural residential real estate	141	140
Total	$ 4,056	$ 4,061

For the six months ended June 30, 2018:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 2,494	$ 2,379
Production and intermediate term	1,568	1,291
Agribusiness	7,739	8,588
Total	$ 11,801	$ 12,258

For the six months ended June 30, 2017:

	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Real estate mortgage	$ 2,823	$ 2,762
Production and intermediate term	5,651	5,223
Total	$ 8,474	$ 7,985

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. As of June 30, 2018, and June 30, 2017, there were no payment defaults.

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 June 30, 2018, were approximately $268.88 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 June 30, 2018, for each of the fair value hierarchy levels are summarized below:

	Fair Value Measurements at June 30, 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	**$ 165,144**	$ -	$ 165,144	$ -
Investments available for sale:				
Agency-guaranteed debt	**179,902**	-	179,902	-
Corporate debt	**292,560**	-	292,560	-
Mortgage-backed securities	**4,408,780**	-	4,408,780	-
U.S. Treasury securities	**298,060**	-	298,060	-
Asset-backed securities	**56,397**	-	56,397	-
Mission-related and other available-for-sale investments	**43,187**	-	-	43,187
Loans valued under the fair value option	**9,602**	-	9,602	-
Derivative assets	**15,982**	-	15,982	-
Assets held in nonqualified benefit trusts	**8,582**	8,582	-	-
Total assets	**$ 5,478,196**	$ 8,582	$ 5,426,427	$ 43,187
Liabilities:				
Letters of credit	**$ 827**	$ -	$ -	$ 827
Total liabilities	**$ 827**	$ -	$ -	$ 827

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 March 31, 2018, to June 30, 2018:

	Assets		Liabilities	
	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Letters of Credit	Net
Balance at March 31, 2018	$ 91,656	$ 41,151	$ 1,084	$ 131,723
Net gains (losses) included in other comprehensive income	-	(29)	-	(29)
Purchases, issuances and settlements	-	2,065	(257)	2,322
Transfers out of Level 3	(91,656)	-	-	(91,656)
Balance at June 30, 2018	$ -	$ 43,187	$ 827	$ 42,360

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 June 30, 2018:

	Assets		Liabilities	
	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Letters of Credit	Net
Balance at January 1, 2018	$ -	$ 43,317	$ 1,038	$ 42,279
Net gains (losses) included in other comprehensive income	95	(130)	-	(35)
Purchases, issuances and settlements	91,561	-	(212)	91,773
Transfers out of Level 3	(91,656)	-	-	(91,656)
Balance at June 30, 2018	$ -	$ 43,187	$ 827	$ 42,360

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the six months ended June 30, 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) were 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 June 30, 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	**$ 32,991**	$ -	$ -	$ 32,991
Other property owned	**12,592**	-	-	12,592
Total assets	**$ 45,583**	$ -	$ -	$ 45,583

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)a for the period from March 31, 2017, to June 30, 2017:

	Assets		Liabilities	
	Mortgage-Backed Securities	Agricultural Mortgage-Backed Securities	Letters of Credit	Net
Balance at March 31, 2017	$ -	$ 49,950	$ 621	$ 49,329
Net gains included in other comprehensive income	(324)	308	-	(16)
Purchases, issuances and settlements	41,124	(2,597)	350	38,177
Balance at June 30, 2017	$ 40,800	$ 47,661	$ 971	$ 87,490

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 June 30, 2017:

	Assets		Liabilities	
	Mortgage-Backed Securities	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	(324)	310	-	(14)
Purchases, issuances and settlements	41,124	(5,984)	260	34,880
Balance at June 30, 2017	$ 40,800	$ 47,661	$ 971	$ 87,490

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the six months ended June 30, 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	$ 27,814	$ -	$ -	$ 27,814

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:

June 30, 2018:

	Total Carrying Amount	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets:					
Cash	**$ 33,752**	**$ 33,752**	**$ -**	**$ -**	**$ 33,752**
Mission-related and other held-to-maturity investments	**17,093**	**-**	**-**	**16,950**	**16,950**
Net loans	**24,306,768**	**-**	**-**	**23,859,525**	**23,859,525**
Total assets	**$ 24,357,613**	**$ 33,752**	**$ -**	**$ 23,876,475**	**$ 23,910,227**
Liabilities:					
Bonds and notes	**$ 25,417,454**	**$ -**	**$ -**	**$ 25,197,461**	**$ 25,197,461**
Total liabilities	**$ 25,417,454**	**$ -**	**$ -**	**$ 25,197,461**	**$ 25,197,461**

December 31, 2017:

	Total Carrying Amount	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets:					
Cash	$ 66,953	$ 66,953	$ -	$ -	$ 66,953
Mission-related and other held-to-maturity investments	18,827	-	-	18,606	18,606
Net loans	23,662,400	-	-	23,517,247	23,517,247
Total assets	$ 23,748,180	$ 66,953	$ -	$ 23,535,853	$ 23,602,806
Liabilities:					
Bonds and 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. Level 3 assets at June 30, 2018, 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.

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.

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.

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 (OPO) 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 six months ended June 30, 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 June 30, 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 that 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 June 30, 2018, and December 31, 2017, the bank's exposure to counterparties was $15,982 and $8,684, respectively. At June 30, 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 June 30, 2018:

	Remaining Years to Maturity							
	Less Than One to Five Years	**Less Than One to Five Years**	**More Than Five Years**	**Total**	**Maturity Distribution Netting**	**Exposure**	**Collateral Held**	**Exposure Net of Collateral**
Moody's Credit Rating								
A1		$ -	$ 45	$ 45	$ -	$ 45	$ -	$ 45
A2		1	221	222	-	222	-	222
Aa3		8,486	1,028	9,514	-	9,514	-	9,514
Aa3		4,727	1,065	5,792	-	5,792	-	5,792
Aa3		-	409	409	-	409	-	409
Total		**$ 13,214**	**$ 2,768**	**$ 15,982**	**$ -**	**$ 15,982**	**$ -**	**$ 15,982**

Cash Flow Hedges

The bank's derivative instruments at June 30, 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 Location	**Fair Value June 30, 2018**	Fair Value December 31, 2017	**Balance Sheet Location**	**Fair Value June 30, 2018**	Fair Value December 31, 2017
Interest rate caps	Other assets	**$ 548**	$ 396	Other liabilities	**$ -**	$ -
Pay fixed swaps	Other assets	**15,434**	8,536	Other liabilities	**-**	248

	Gain (Loss) Recognized in OCI/OCL on (Effective Portion) at June 30,			**Amount of (Loss) Gain Reclassified From AOCI/AOCL Into Income (Effective Portion) at June 30,**	
	2018	2017		**2018**	2017
Interest rate caps	**$ 152**	$ 274	Interest expense	**$ (67)**	$ (151)
Pay fixed swaps	**7,313**	1,782	Interest expense	**263**	(559)

NOTE 7 — CAPITAL

On June 25, 2018, the bank issued $100.0 million of Class B noncumulative subordinated perpetual preferred stock, Series 3 (Class B-3 preferred stock), representing one hundred thousand shares at $1,000 per share par value, for net proceeds of $99.0 million with issuance costs on preferred stock of $1.2 million. Dividends accrued on the Class B-3 preferred stock were $1.4 million as of June 30, 2018, and included in "Preferred stock dividends payable" on the balance sheet. Dividends on the Class B-3 preferred stock, if declared by the board of directors at its sole discretion, are noncumulative and are payable quarterly in arrears on the fifteenth day of March, June, September and December in each year, commencing September 15, 2018, at an annual fixed rate of 6.20 percent of par value of $1,000 per share up to, but excluding June 15, 2028, from and after which date will be paid at an annual rate of the 3-Month USD LIBOR plus 3.22 percent. The Class B-3 preferred stock is not mandatorily redeemable at any time, but may be redeemed in whole or in part at the option of the bank on any dividend payment date on or after June 15, 2028. The Class B-3 preferred stock ranks pari passu with respect to the existing Class B-1 and Class B-2 preferred stock, and senior to all of the bank's other outstanding capital stock. For regulatory purposes, the Class B-3 preferred stock is included in permanent capital, total capital and tier 1 capital within certain limitations.

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 June 30, 2018						Total
				Regulatory	Conservation	Regulatory
Risk-adjusted	**Bank**	**FLCA**	**ACAs**	**Minimums**	**Buffers**	**Requirement**
Permanent capital ratio ranges	15.90%	16.84%	12.82% - 22.09%	7.00%	0.00%	7.00%
Common equity tier 1 ratio ranges	10.01	16.80	12.12 - 21.96	4.50	2.50 *	7.00
Tier 1 capital ratio ranges	15.88	16.80	12.12 - 21.96	6.00	2.50 *	8.50
Total capital ratio ranges	16.01	17.09	13.12 - 22.55	8.00	2.50 *	10.50
Non-risk-adjusted						
Tier 1 leverage ratio ranges	7.09	17.38	10.92 - 20.79	4.00	1.00	5.00
UREE leverage ratio ranges	2.84	18.57	8.48 - 21.81	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						Total
				Regulatory	Conservation	Regulatory
Risk-adjusted	**Bank**	**FLCA**	**ACAs**	**Minimums**	**Buffers**	**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 revolvement, 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.

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 six months ended June 30:

	Defined Benefit Pension		Other Postretirement Benefits	
	2018	2017	**2018**	2017
Service cost	**$ 1,977**	$ 2,023	**$ 708**	$ 644
Interest cost	**7,264**	8,149	**1,517**	1,535
Expected return on plan assets	**(8,480)**	(7,936)	**-**	-
Amortization of prior service cost	**-**	-	**(319)**	(440)
Amortization of net loss	**6,738**	8,860	**337**	71
Net periodic benefit cost	**$ 7,499**	$ 11,096	**$ 2,243**	$ 1,810

As of June 30, 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 six months ended June 30, 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	(42,819)	(42,819)		
Net change in unrealized losses on securities	(42,819)	(42,819)		
Change in pension and postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(319)		(319)	
Amortization of net losses	7,075		7,075	
Net change in pension and postretirement benefit plans	6,756		6,756	
Change in cash flow derivative instruments				
Unrealized losses on cash flow derivative instruments	7,465			7,465
Reclassification of loss recognized in interest expense	(196)			(196)
Net change in cash flow derivative instruments	7,269			7,269
Total other comprehensive (loss) income	**(28,794)**	**(42,819)**	**6,756**	**7,269**
Balance, June 30, 2018	**$ (191,654)**	**$ (99,631)**	**$ (106,018)**	**$ 13,995**

The following table summarizes the changes in the balance of the components of AOCL for the six months ended June 30, 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	6,224	6,224		
Net change in unrealized losses on securities	6,224	6,224		
Change in pension and postretirement benefit plans				
Amounts amortized into net periodic expense:				
Amortization of prior service credits	(440)		(440)	
Amortization of net losses	8,949		8,949	
Net change in pension and postretirement benefit plans	8,509		8,509	
Change in cash flow derivative instruments				
Unrealized losses on cash flow derivative instruments	(2,056)			(2,056)
Reclassification of loss recognized in interest expense	710			710
Net change in cash flow derivative instruments	(1,346)			(1,346)
Total other comprehensive income (loss)	13,387	6,224	8,509	(1,346)
Balance, June 30, 2017	$ (144,595)	$ (32,305)	$ (117,365)	$ 5,075

The following table summarizes reclassifications from AOCL to the Combined Statements of Comprehensive Income for the six months ended June 30:

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	**$ 6,756**	$ 8,509	Salaries and employee benefits
Amortization on cash flow hedges	**(196)**	710	Interest expense
Total reclassifications	**$ 6,560**	$ 9,219	

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 quarter and six months ended June 30, 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 August 9, 2018, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of August 9, 2018.

NOTE 12 — BANK-ONLY FINANCIAL DATA

The following financial information is presented for the bank only. For the other financial results within this report, the data reflects district combined financial results with all significant transactions and balances between the bank and associations eliminated upon combination.

Balance sheet data	June 30, 2018 (Unaudited)	December 31, 2017
Cash	$ 25,004	$ 56,183
Federal funds sold and overnight investments	165,144	246,888
Investment securities	5,275,126	5,144,985
Loans	17,741,107	17,085,177
Less allowance for loan losses	11,934	7,639
Net loans	17,729,173	17,077,538
Accrued interest receivable	67,535	58,330
Premises and equipment, net	58,496	49,405
Other assets	194,080	203,276
Total assets	$ 23,514,558	$ 22,836,605
Bonds and notes, net	$ 21,567,454	$ 20,951,223
Accrued interest payable	76,243	63,809
Reserve for credit losses	2,111	1,433
Preferred stock dividends payable	21,440	20,063
Patronage payable	-	31,418
Other liabilities	65,299	100,775
Total liabilities	21,732,547	21,168,721
Preferred stock	700,000	600,000
Capital stock	298,867	301,239
Retained earnings	870,619	818,547
Accumulated other comprehensive loss	(87,475)	(51,902)
Total shareholders' equity	1,782,011	1,667,884
Total liabilities and shareholders' equity	$ 23,514,558	$ 22,836,605

	Six Months Ended June 30,	
Statement of income data	2018 (Unaudited)	2017 (Unaudited)
Interest income	$ 319,281	$ 260,934
Interest expense	196,178	136,524
Net interest income	123,103	124,410
Provision (negative provision) for credit losses	4,846	(1,059)
Net interest income after provision (negative provision) for credit losses	118,257	125,469
Noninterest income	20,432	16,305
Noninterest expense	55,200	49,442
Net income	83,489	92,332
Other comprehensive income (loss):		
Change in fair value of investments	(42,819)	6,224
Change in postretirement benefit plans	(23)	(93)
Change in cash flow derivative instruments	7,269	(1,346)
Total other comprehensive loss	(35,573)	4,785
Comprehensive income	$ 47,916	$ 97,117