



FARM CREDIT
BANK OF TEXAS

2018 THIRD QUARTER REPORT
SEPTEMBER 30, 2018

THIRD QUARTER 2018

Table of Contents

| | |
|---|----|
| Management’s Discussion and Analysis of Financial Condition and Results of Operations..... | 2 |
| Controls and Procedures | 13 |
| Financial Statements: | |
| Balance Sheets | 16 |
| Statements of Comprehensive Income | 17 |
| Statements of Changes in Shareholders’ Equity..... | 18 |
| Statements of Cash Flows..... | 19 |
| Notes to Financial Statements..... | 20 |
| Additional Regulatory Information..... | 52 |

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

(dollars in thousands, except as noted)

The following discussion reviews the financial condition and results of operations of the Farm Credit Bank of Texas (bank) for the three and nine months ended September 30, 2018. These comments should be read in conjunction with the accompanying financial statements and footnotes, along with the 2017 Annual Report to shareholders. The accompanying financial statements were prepared under the oversight of the bank's audit committee.

The bank is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The United States is currently served by three Farm Credit Banks (FCBs), each of which has specific authority to fund affiliated associations and other financing institutions (OFIs) which make loans to agricultural producers, farm-related businesses and rural homeowners within a regional chartered territory (or district), and by one Agricultural Credit Bank (ACB), which has the lending authority of an FCB within its chartered territory and nationwide authority to finance agricultural cooperatives and rural utilities. The FCBs and the ACB are collectively referred to as "System banks." As FCBs, the primary purpose of the System banks is to serve as a source of funding for System associations within their districts. The System associations make loans to or for the benefit of borrowers for qualified purposes.

The bank and its affiliated associations collectively are referred to as the "district." At September 30, 2018, the bank provided financing to 14 district associations and certain OFIs.

RESULTS OF OPERATIONS

Net Income

Net income for the three months ended September 30, 2018, was \$52,737, a decrease of \$123, or 0.23 percent, over the same period of 2017. The decrease in net income primarily consisted of an \$843 decrease in noninterest income and an \$829 increase in noninterest expense, offset by a \$1,686 increase in net interest income.

Net income for the nine months ended September 30, 2018, was \$136,225, a decrease of \$8,967, or 6.2 percent, over the same period of 2017. The decrease in net income consisted of a \$6,587 increase in noninterest expense and a \$6,042 increase in the provision for credit losses, offset by a \$3,285 increase in noninterest income and a \$377 increase in net interest income.

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 10-year maturities for Farm Credit System debt, the yield differential has declined by 0.51 percent to a level of 0.57 percent as of September 30, 2018, as compared to 1.08 percent as of September 30, 2017.

Net interest income for the three months ended September 30, 2018, was \$65,213, an increase of \$1,686, or 2.7 percent, from the three months ended September 30, 2017. The increase in net interest income was attributable to a \$1.8 billion increase in the bank's average earning assets, offset by a 10-basis-point

decrease in the net interest rate spread from 105 basis points to 95 basis points. Effective interest rates on earning assets increased 45 basis points from the third quarter of 2017 to the third quarter of 2018, while the effective rates on interest-bearing liabilities increased 55 basis points. The increase in the bank's average earning assets included growth in its direct notes from associations, investment portfolio and capital markets loan portfolio.

Net interest income for the nine months ended September 30, 2018, was \$188,314, an increase of \$377, or 0.2 percent, from the nine months ended September 30, 2017. The increase in net interest income was attributable to a \$1.6 billion increase in the bank's average earning assets, offset by a 12-basis-point decrease in the net interest rate spread from 108 basis points to 96 basis points. Effective interest rates on earning assets increased 39 basis points from the nine months ended September 30, 2017 to the nine months ended September 30, 2018, while the effective rates on interest-bearing liabilities increased 51 basis points. The increase in the bank's average earning assets included growth in its direct notes from associations, investment portfolio and capital markets loan portfolio.

Provision for Credit Losses

The bank's provision for credit losses for the three months ended September 30, 2018, totaled \$108, an increase of \$137 from the \$29 negative provision for credit losses from the same period of 2017.

The bank's provision for credit losses for the nine months ended September 30, 2018, totaled \$4,954, an increase of \$6,042 from the \$1,088 negative provision for credit losses recorded in the first nine months of 2017. The \$4,954 provision for the nine months ended September 30, 2018, included a \$7,539 increase in required allowances related to loans individually evaluated for impairment, offset by a \$2,453 decrease in general reserves.

Noninterest Income

Noninterest income for the three months ended September 30, 2018, was \$12,716, a decrease of \$843, or 6.2 percent, over the same period of 2017. The decrease was due mainly to a \$1,259 decrease in other income and a \$987 decrease in fees for loan-related services, offset primarily by a \$1,229 increase in patronage income. The \$1,259 decrease in other income was primarily related to a \$3,576 decrease on a nonrecurring event associated with the gain on a sale of a loan in 2017, offset primarily by a \$2,402 increase in gains associated with debt extinguishments.

Noninterest income for the nine months ended September 30, 2018, was \$33,149, an increase of \$3,285, or 11.0 percent, over the same period of 2017. The increase was mainly due to a \$5,464 increase in other income related to an \$8,397 refund distribution from the Farm Credit System Insurance Corporation (FCSIC) and a \$2,402 increase in gains associated with debt extinguishments, offset primarily by a \$3,681 decrease on a nonrecurring event associated with the gain on a sale of a loan in 2017 and a \$1,587 increase primarily due to losses associated with updated fair values of portfolio investments on the Rural Business Investment Companies (RBICs).

Noninterest Expense

Noninterest expense for the three months ended September 30, 2018, was \$25,084, an increase of \$829, or 3.4 percent, over the same period of 2017. The increase was attributable to a \$1,885 increase in professional and contract services, offset by a \$1,087 decrease in Insurance Fund premiums. Insurance Fund premiums decreased primarily due to a rate decrease on outstanding debt from 15 basis points in 2017 to 9 basis points in 2018.

Noninterest expense for the nine months ended September 30, 2018, was \$80,284, an increase of \$6,587, or 8.9 percent, over the same period of 2017. The increase was primarily attributable to a \$6,662 increase

in professional and contract services, offset by a \$3,380 decrease in Insurance Fund premiums. Insurance Fund premiums decreased primarily due to a rate decrease on outstanding debt from 15 basis points in 2017 to 9 basis points in 2018.

Key results of operations comparisons:

| | Annualized for the Nine Months Ended September 30, 2018 | Annualized for the Nine Months Ended September 30, 2017 |
|---|--|---|
| Return on average assets | 0.78% | 0.89% |
| Return on average shareholders' equity | 10.48% | 11.50% |
| Net interest income as a percentage of average earning assets | 1.09% | 1.17% |
| (Recoveries), net of charge-offs to average loans | < (0.01)% | < (0.01)% |
| Operating expenses as a percentage of net interest income and noninterest income | 36.25% | 33.84% |
| Operating expenses as a percentage of average earning assets | 0.47% | 0.46% |

Other Comprehensive (Loss) Income

Other comprehensive (loss) 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 bank, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, elements of certain postretirement benefit changes and changes in the value of cash flow derivative instruments.

The table below summarizes the changes in elements included in other comprehensive loss:

| | Nine Months Ended September 30, | |
|--|------------------------------------|----------|
| | 2018 | 2017 |
| Change in unrealized (losses) gains on available-for-sale securities | | |
| Net increase in unrealized (losses) gains on investment securities | \$ (56,357) | \$ 4,315 |
| Net change in unrealized (losses) gains on securities | (56,357) | 4,315 |
| Change in postretirement benefit plans | | |
| Amounts amortized into net periodic expense: | | |
| Amortization of prior service credits | (35) | (139) |
| Net change in postretirement benefit plans | (35) | (139) |
| Change in cash flow derivative instruments | | |
| Unrealized gain (loss) on cash flow derivative instruments | 13,033 | (2,386) |
| Reclassification of loss (gain) recognized in interest expense | (207) | 836 |
| Net change in cash flow derivative instruments | 12,826 | (1,550) |
| Other comprehensive (loss) income | \$ (43,566) | \$ 2,626 |

FINANCIAL CONDITION

Loan Portfolio

Gross loan volume at September 30, 2018, was \$18.02 billion, an increase of \$939.5 million, or 5.5 percent, compared to \$17.09 billion at December 31, 2017. The increase in the loan portfolio is attributable to growth in the bank's direct notes from associations and the capital markets 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.

The bank has purchased loan participations and Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) from associations in Capitalized Participation Pool (CPP) transactions. As a condition of the transactions, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans purchased, and the associations bought bank stock equal to 8.0 percent of the purchased loans' par value and 1.6 percent of the AMBS' par value. During the month of September 2018, the bank purchased \$99.6 million in loan participations from an association, which resulted in a net stock issuance of \$6.0 million. CPP loans held at September 30, 2018, totaled \$128,475 and were included in "Loans" on the balance sheets. The balance of the AMBS CPP was \$37,305 at September 30, 2018, and is included in "Investment securities" on the balance sheet.

The bank may also purchase loans from district associations in Non-Capitalized Participation Pool (NCP) transactions. The loans purchased in these transactions represent up to 90.0 percent of the outstanding balances, all of which had credit quality ratings of 8 or better (acceptable classification) and are included in the capital markets' portfolio. As a condition of these transactions, the bank redeems common stock in the amount of 2.0 percent of the par value of the loans purchased. NCP purchases result in pay downs on the associations' direct notes at the time of purchase. During the month of February 2018, the bank purchased \$98.7 million in loan participations from a district association in NCP transactions which resulted in a net stock retirement of \$2.2 million. The NCP loans' balance was \$85.5 million at September 30, 2018 and were included in "Loans" on the balance sheet.

Loans classified under the Farm Credit Administration's Uniform Loan Classification System as "acceptable" or "other assets especially mentioned" were 99.8 percent of total loans and accrued interest at September 30, 2018, and 99.7 percent 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 September 30, 2018, the direct note totaled \$803.5 million. The bank's loans to our affiliated associations are collateralized by substantially all of the association assets, and the earnings, capital and loan loss reserves of the association provide a buffer against losses in their retail portfolio. While the downgrade reflected 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 table below summarizes the balances of the bank's high-risk assets at September 30, 2018, compared to the balances at December 31, 2017:

| | September 30, 2018 | Increase | | December 31, 2017 |
|--------------------------------------|---------------------------|------------------|----------|-------------------|
| | | \$ | % | |
| Nonaccrual loans | \$ 20,082 | \$ 16,689 | 491.87 % | \$ 3,393 |
| Accruing formally restructured loans | 2,571 | (36) | (1.38) | 2,607 |
| Total high-risk assets | <u>\$ 22,653</u> | <u>\$ 16,653</u> | 277.55 % | <u>\$ 6,000</u> |

The increase in nonaccrual loans was primarily related to credit deterioration of two loans in the energy and agribusiness sectors that moved to nonaccrual during March 2018. At September 30, 2018, and December 31, 2017, the bank did not have any nonaccrual loans on which cash payments are recognized as interest income and did not have any other property owned (OPO).

Impaired loans, consisting of nonaccrual loans and accruing formally restructured loans, and loans 90 days past due and still accruing interest, constituted 0.1 percent of gross loans at September 30, 2018, and December 31, 2017.

At September 30, 2018, the bank had reserves for credit losses totaling \$14,158, including an allowance for loan losses of \$12,321 and a reserve for credit losses on unfunded commitments of \$1,837 related to the bank's capital markets loan portfolio. The allowance for loan losses of \$12,321 equated to 0.1 percent of total loans outstanding and 0.2 percent of capital market loans outstanding. The \$1,837 reserve for losses on unfunded commitments predominantly included a general reserve for losses on unused loan commitments and for losses on letters of credit, representing management's estimate of probable credit losses related to unfunded commitments. Analysis indicates that an allowance on the association direct notes is not warranted, therefore the entire balance of the allowance and reserve for credit losses reflects reserves for risks identified in the bank's participation loans.

The allowance for loan losses as a percentage of impaired loans was 54.4 percent as of September 30, 2018, as compared to 127.3 percent as of December 31, 2017.

Liquidity and Funding Sources

The bank's primary source of liquidity comes from its ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. The bank continually raises funds in the debt markets to support its mission, to repay maturing Systemwide Debt Securities, and to meet other obligations. As a secondary source of liquidity, the bank maintains an investment portfolio composed primarily of high-quality liquid securities. The securities provide a stable source of income for the bank, and their high quality ensures the portfolio can quickly be converted to cash should the need arise.

Cash and investment securities totaled \$5.88 billion, or 24.2 percent, of total assets at September 30, 2018, compared to \$5.45 billion, or 23.9 percent, at December 31, 2017. At September 30, 2018, the bank's cash balance was \$27,419, of which \$9,514 was held at the Federal Reserve Bank.

FCA regulations require each bank to maintain a minimum of 90 days of liquidity coverage on a continuous basis. The days of liquidity measurement refers to the number of days that maturing debt could be funded with eligible cash and investment securities. At September 30, 2018, the bank exceeded all applicable regulatory liquidity requirements and had 226 days of liquidity.

Investments

The bank's investments are all considered available for sale, and include a liquidity portfolio and a portfolio of other investments. The liquidity portfolio had a fair value of \$5.67 billion at September 30, 2018, and 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 bank's other investments had a fair value of \$37,305 at September 30, 2018, and consisted of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS), purchased from district associations. The Farmer Mac securities are backed by loans originated by the associations.

Farmer Mac is a government-sponsored enterprise and is examined and regulated by the 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:

| | September 30, 2018 | | December 31, 2017 | |
|--|---------------------------|---------------------|---------------------|---------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Agency-guaranteed debt | \$ 179,002 | \$ 174,069 | \$ 198,246 | \$ 195,248 |
| Corporate debt | 365,403 | 364,789 | 252,482 | 252,609 |
| Federal agency collateralized mortgage-backed securities | | | | |
| GNMA | 2,547,784 | 2,486,967 | 2,012,484 | 1,984,662 |
| FNMA and FHLMC | 2,267,228 | 2,223,305 | 2,395,248 | 2,372,053 |
| U.S. Treasury securities | 298,470 | 298,055 | 249,860 | 249,207 |
| Asset-backed securities | 84,196 | 84,146 | 47,914 | 47,889 |
| Total liquidity investments | \$ 5,742,083 | \$ 5,631,331 | \$ 5,156,234 | \$ 5,101,668 |

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

| | September 30, 2018 | | December 31, 2017 | |
|---|---------------------------|-------------------|-------------------|------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Agricultural mortgage-backed securities | \$ 39,723 | \$ 37,305 | \$ 45,564 | \$ 43,317 |

FCA regulations also define eligible investments by specifying credit rating criteria, final maturity limit and percentage of investment portfolio limit for each investment type. Generally, the bank's investments must be highly rated by at least one Nationally Recognized Statistical Rating Organization, such as Moody's Investors Service, Standard & Poor's or Fitch Ratings. If an investment no longer meets eligibility criteria, the investment becomes ineligible. At September 30, 2018, the bank had no investments which were ineligible for liquidity purposes as a result of credit downgrading.

Capital Resources

At September 30, 2018, the bank's capital totaled \$1,821,726, and consisted of \$700,000 of Class B noncumulative subordinated perpetual preferred stock, \$304,842 of capital stock, \$912,352 in retained earnings and \$95,468 in accumulated other comprehensive loss. The balance in capital reflected an increase of \$153,842 from December 31, 2017, due primarily to net income of \$136,225, preferred stock issuance of \$100,000 and \$3,603 in net capital stock issued, offset by a \$43,566 increase in other comprehensive losses, \$33,115 in preferred stock dividends accrued, \$7,972 in patronage distributions and \$1,333 in issuance cost on preferred stock. The balance in accumulated other comprehensive loss of \$95,468 resulted from unrealized losses on investments of \$113,170 and \$1,850 in accumulated amortization of other postretirement benefits, offset by \$19,552 in unrealized gains on cash flow derivative instruments.

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, with issuance costs on preferred stock of \$1.3 million. Dividends accrued on the Class B-3 preferred stock were \$1.6 million as of September 30, 2018, and were 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 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 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 September 30, 2018, the bank exceeded all regulatory capital requirements.

The following table reflects the bank's capital ratios as of:

| | <u>September 30, 2018</u> | <u>December 31, 2017</u> | Total Regulatory Requirement |
|----------------------------|---------------------------|--------------------------|------------------------------------|
| Common equity tier 1 ratio | 10.08% | 10.52% | 7.00% |
| Tier 1 capital ratio | 16.67 | 16.59 | 8.50 |
| Total capital ratio | 16.67 | 16.68 | 10.50 |
| Permanent capital ratio | 16.55 | 16.60 | 7.00 |
| Tier 1 leverage ratio | 7.44 | 7.33 | 5.00 |
| UREE leverage ratio | 2.91 | 3.08 | 1.50 |

OTHER

CONDITIONS IN THE DISTRICT

During the quarter, the district continued to benefit from robust economic growth. From August 2017 through August 2018, the Texas economy added nearly 400,000 jobs, the most of any state in the country. This job growth has been broad, with virtually all segments of the Texas economy reporting gains in employment year-over-year. With West Texas Intermediate crude oil prices exceeding \$70 per barrel at the end of the quarter, companies have been incentivized to make additional investments in the highly productive Permian Basin, located in western Texas and southeast New Mexico. This trend is likely to continue, as the U.S. Energy Information Administration expects the Permian Basin to lead growth in U.S. oil production during 2019. In each of the five district states, Alabama, Louisiana, Mississippi, New Mexico and Texas, employment growth has been positive year-to-date through August. The unemployment rates in the five district states ranged from a low of 3.9 percent to a high of 5.0 percent as of August 2018.

In September 2018, the U.S. reached a trilateral trade agreement with Mexico and Canada to replace the 25-year-old North American Free Trade Agreement. Because it removes the short-term uncertainty associated with the ongoing renegotiations, the revised agreement should positively influence the near-term economic outlook for Texas, which leads the nation in exports.

The 2014 Farm Bill expired on September 30, 2018, as Congress was unable to reach an agreement on replacement legislation prior to its expiration. Although most agricultural programs will continue, certain programs, such as some pertaining to conservation, trade and rural development, will no longer be funded as of October 1. It is unlikely that Congress will produce a Farm Bill until after the November elections. This quarter, the U.S. Department of Agriculture announced several new programs aimed at supporting farmers that have been impacted by ongoing trade disputes. Soybean farmers are expected to be the primary beneficiary of these programs, but a wide variety of agricultural producers, including those who produce cotton, dairy products and pork, will also receive some support. In total, the U.S. Department of Agriculture is expected to authorize up to \$12 billion in support this year to compensate farmers for trade-related losses.

In 2018, U.S. beef production is expected to exceed 27 billion pounds for only the second time in history. Export growth, which has primarily been driven by increased demand for U.S. beef in several Asian countries, has kept cattle and beef prices relatively stable despite higher production. Consistent with typical seasonal patterns, feeder cattle prices are likely to decline during the fourth quarter. Cattle feedlots are generally expected to operate around breakeven for the remainder of the year. Milk prices have been lower during 2018 relative to those that were observed during the prior year, contributing to lower margins for dairy producers. The U.S. Department of Agriculture expects milk prices to improve during the upcoming months, thereby alleviating some of the pressure on profitability that has been observed throughout the industry. Due to large supplies of broiler meat, competition from other meats and seasonal trends, wholesale broiler prices declined during the third quarter. Broiler prices are expected to stabilize during the fourth quarter before improving in 2019.

Most of the district received above-average precipitation during the quarter, which has reduced the prevalence of drought conditions in the region. Although some improvement in crop and pasture conditions has been observed, dry weather early in the growing season negatively impacted row crop development in portions of the district. Farmers who experience losses due to adverse weather conditions will rely on government programs, such as multi-peril crop insurance, for financial support.

U.S. corn and soybean yields are expected to reach record levels during 2018. If realized, this would represent the fifth consecutive year of historically strong U.S. production of both crops. Elevated stocks following harvest are likely to pressure prices of these commodities as we approach 2019. In the U.S., cotton farmers are expected to abandon about one-fourth of total planted acres this year, well above the 10-year average rate. The high levels of abandonment are being driven by relatively poor crop conditions across several key growing areas, including in the Texas Panhandle. Robust exports have been supportive of cotton prices, however, and farmers who produce cotton on irrigated acreage or have otherwise been able to yield an adequate crop this year should earn favorable returns. Across the nation, the corn, soybean and cotton harvests have been progressing well, and, as of the end of the quarter, harvest progress was ahead of the five-year average for all three crops. Farmers in the district 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, low advance rates and diversification.

RATING AGENCY ACTIONS

Fitch Ratings Actions

On April 6, 2018, Fitch Ratings affirmed the bank's long-term and short-term issuer default ratings (IDRs) at "AA-" and "F1+," respectively, with a stable outlook. Fitch also affirmed the bank's noncumulative perpetual preferred stock rating at "BBB" and its support floor at "AA-." Fitch affirmed

the Farm Credit System's long-term and short-term IDRs at "AAA" and "F1+," respectively, with a stable outlook, and its support floor at "AAA." As a government-sponsored entity, the System benefits from implicit government support. The ratings and rating outlook are directly linked to the U.S. sovereign rating. The affirmation of the System banks' IDRs reflect their prudent, conservative credit culture, their unique funding advantage and their structural second-loss position on the majority of their loan portfolio.

Moody's Investors Service Rating Actions

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

REGULATORY MATTERS

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

On June 12, 2018, the Farm Credit Administration (FCA) published a final rule revising the requirements governing the eligibility of investments for System banks and associations. The stated objectives of the final 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 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 requirement of the regulations that do not promote these objectives.

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

On August 24, 2018, the FCA published for public comment a proposed rule that would modify the existing outside director eligibility criteria to accomplish the following objectives:

- Amend the eligibility criteria for outside directors in § 611.220(a);
- Remove the definition of outside director in § 619.9225;
- Strengthen the safety and soundness of System institutions; and
- Incorporate best practices for corporate governance for System institutions.

The proposed regulation would expand the list of persons who would be excluded from nomination for an outside director's seat to ensure the independence of outside directors. The list would include borrowers of the institution, immediate family members of any director, officer, employee, agent, stockholder or borrower of any System institution, and anyone who has a controlling interest in an entity that borrows from any System institution or any affiliated organization of a System institution. The deadline for the submission of public comments was October 23, 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. Thus, the new laws had no impact on the bank's financial results.

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 bank'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 September 30, 2018, quarterly report of the Farm Credit Bank of Texas, 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

November 9, 2018

Controls and Procedures

As of September 30, 2018, management of the Farm Credit Bank of Texas (bank) carried out an evaluation with the participation of the bank's management, including the chief executive officer (CEO) and senior vice president, chief financial officer (CFO), of the effectiveness of the design and operation of the respective disclosure controls and procedures⁽¹⁾ with respect to this quarterly report. This evaluation is based on testing of the design and effectiveness of key internal controls, certifications and other information furnished by the principal executive officer and principal financial officer of the bank, as well as incremental procedures performed by the bank. Based upon and as of the date of the bank's evaluation, the CEO and the CFO concluded that the disclosure controls and procedures are effective in alerting them on a timely basis of any material information relating to the bank that is required to be disclosed by the bank in the annual and quarterly information statements it files or submits to the Farm Credit Administration.

There have been no significant changes in the bank's internal control over financial reporting⁽²⁾ that occurred during the quarter ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, the bank's internal control over financial reporting.



Larry R. Doyle
Chief Executive Officer



Amie Pala
Senior Vice President, Chief Financial Officer

November 9, 2018

⁽¹⁾ For purposes of this discussion, "disclosure controls and procedures" are defined as controls and procedures of the bank that are designed to ensure that the financial information required to be disclosed by the bank in this quarterly information statement is recorded, processed, summarized and reported within the time periods specified under the rules and regulations of the Farm Credit Administration.

⁽²⁾ For purposes of this discussion, "internal control over financial reporting" is defined as a process designed by, or under the supervision of, the bank's principal executive officer and principal financial officer, or persons performing similar functions, and effected by the bank's boards of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the bank's financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the bank's financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the bank are being made only in accordance with authorizations of management and directors of the bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the bank's assets that could have a material effect on the bank's financial statements.

CERTIFICATION

I, Larry R. Doyle, chief executive officer of Farm Credit Bank of Texas (bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

1. I have reviewed this quarterly report of the bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the bank as of, and for, the periods presented in this report;
4. The bank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the bank and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the bank is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the bank's internal control over financial reporting that occurred during the bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the bank's internal control over financial reporting; and
5. The bank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the bank's auditors and the audit committee of the bank's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the bank's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the bank's internal control over financial reporting.



Larry R. Doyle
Chief Executive Officer

November 9, 2018

CERTIFICATION

I, Amie Pala, senior vice president, chief financial officer of Farm Credit Bank of Texas (bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

1. I have reviewed this quarterly report of the bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the bank as of, and for, the periods presented in this report;
4. The bank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the bank and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the bank is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the bank's internal control over financial reporting that occurred during the bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the bank's internal control over financial reporting; and
5. The bank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the bank's auditors and the audit committee of the bank's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the bank's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the bank's internal control over financial reporting.



Amie Pala
Senior Vice President, Chief Financial Officer

November 9, 2018

Balance Sheets

| (dollars in thousands) | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|--------------------------------------|----------------------|
| Assets | | |
| Cash | \$ 27,419 | \$ 56,183 |
| Federal funds sold and overnight investments | 179,986 | 246,888 |
| Investment securities | 5,668,636 | 5,144,985 |
| Loans (includes \$9,475 and \$9,908 at fair value held under fair value option) | 18,024,664 | 17,085,177 |
| Less allowance for loan losses | 12,321 | 7,639 |
| Net loans | 18,012,343 | 17,077,538 |
| Accrued interest receivable | 72,302 | 58,330 |
| Premises and equipment, net | 65,126 | 49,405 |
| Other assets | 260,547 | 203,276 |
| Total assets | \$ 24,286,359 | \$ 22,836,605 |
| Liabilities and shareholders' equity | | |
| Liabilities | | |
| Bonds and notes, net | \$ 22,281,676 | \$ 20,951,223 |
| Accrued interest payable | 87,827 | 63,809 |
| Reserve for credit losses | 1,837 | 1,433 |
| Preferred stock dividends payable | 21,613 | 20,063 |
| Patronage payable | - | 31,418 |
| Other liabilities | 71,680 | 100,775 |
| Total liabilities | \$ 22,464,633 | \$ 21,168,721 |
| Commitments and contingencies (Note 4) | | |
| Shareholders' equity | | |
| Preferred stock | 700,000 | 600,000 |
| Capital stock | 304,842 | 301,239 |
| Allocated retained earnings | 39,144 | 39,144 |
| Unallocated retained earnings | 873,208 | 779,403 |
| Accumulated other comprehensive loss | (95,468) | (51,902) |
| Total shareholders' equity | 1,821,726 | 1,667,884 |
| Total liabilities and shareholders' equity | \$ 24,286,359 | \$ 22,836,605 |

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

Statements of Comprehensive Income

(unaudited)

| (dollars in thousands) | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|--------------------------------|------------|------------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| Interest Income | | | | |
| Loans | \$ 145,468 | \$ 118,993 | \$ 409,070 | \$ 340,819 |
| Investment securities | 33,739 | 22,038 | 89,416 | 61,146 |
| Total interest income | 179,207 | 141,031 | 498,486 | 401,965 |
| Interest Expense | | | | |
| Bonds and notes | 113,994 | 77,504 | 310,172 | 214,028 |
| Total interest expense | 113,994 | 77,504 | 310,172 | 214,028 |
| Net interest income | 65,213 | 63,527 | 188,314 | 187,937 |
| Provision for credit losses | | | | |
| Provision (negative provision) for credit losses | 108 | (29) | 4,954 | (1,088) |
| Net interest income after provision (negative provision) for credit losses | 65,105 | 63,556 | 183,360 | 189,025 |
| Noninterest Income | | | | |
| Patronage income | 5,582 | 4,354 | 13,199 | 13,800 |
| Fees for services to associations | 941 | 767 | 2,889 | 3,156 |
| Fees for loan-related services | 3,962 | 4,948 | 7,148 | 8,459 |
| Refunds from Farm Credit System Insurance Corporation | - | - | 8,397 | - |
| Loss on loans held under fair value option | (49) | (47) | (204) | (193) |
| Other income, net | 2,280 | 3,537 | 1,720 | 4,642 |
| Total noninterest income | 12,716 | 13,559 | 33,149 | 29,864 |
| Noninterest Expenses | | | | |
| Salaries and employee benefits | 8,548 | 9,106 | 30,135 | 28,246 |
| Occupancy and equipment | 4,739 | 4,184 | 14,516 | 13,202 |
| Insurance Fund premiums | 1,861 | 2,948 | 5,299 | 8,679 |
| Other components of net periodic postretirement benefit cost | 112 | 78 | 335 | 233 |
| Other operating expenses | 9,824 | 7,939 | 29,999 | 23,337 |
| Total noninterest expense | 25,084 | 24,255 | 80,284 | 73,697 |
| Net Income | 52,737 | 52,860 | 136,225 | 145,192 |
| Other comprehensive loss | | | | |
| Change in unrealized (loss) gain on investments | (13,538) | (1,908) | (56,357) | 4,315 |
| Change in postretirement benefit plans | (12) | (46) | (35) | (139) |
| Change in cash flow derivative instruments | 5,557 | (205) | 12,826 | (1,550) |
| Total other comprehensive (loss) gain | (7,993) | (2,159) | (43,566) | 2,626 |
| Comprehensive Income | \$ 44,744 | \$ 50,701 | \$ 92,659 | \$ 147,818 |

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

Statement of Changes in Shareholders' Equity

(unaudited)

| (dollars in thousands) | Preferred Stock | Capital Stock | Retained Earnings | | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|--------------------------|--------------------------|-------------------------|--------------------------|---|----------------------------------|
| | | | Allocated | Unallocated | | |
| Balance at December 31, 2016 | \$ 600,000 | \$ 284,038 | \$ 33,171 | \$ 737,622 | \$ (32,579) | \$ 1,622,252 |
| Net income | - | - | - | 145,192 | - | 145,192 |
| Other comprehensive income | - | - | - | - | 2,626 | 2,626 |
| Capital stock and allocated retained earnings issued | - | 260 | - | - | - | 260 |
| Capital stock and allocated retained earnings retired | - | (65) | - | - | - | (65) |
| Preferred stock dividends | - | - | - | (30,188) | - | (30,188) |
| Patronage distributions | | | | | | |
| Cash | - | - | - | (4,517) | - | (4,517) |
| Balance at September 30, 2017 | <u>\$ 600,000</u> | <u>\$ 284,233</u> | <u>\$ 33,171</u> | <u>\$ 848,109</u> | <u>\$ (29,953)</u> | <u>\$ 1,735,560</u> |
| | | | | | | |
| Balance at December 31, 2017 | \$ 600,000 | \$ 301,239 | \$ 39,144 | \$ 779,403 | \$ (51,902) | \$ 1,667,884 |
| Net income | - | - | - | 136,225 | - | 136,225 |
| Other comprehensive loss | - | - | - | - | (43,566) | (43,566) |
| Capital stock and allocated retained earnings issued | - | 7,967 | - | - | - | 7,967 |
| Capital stock and allocated retained earnings retired | - | (4,364) | - | - | - | (4,364) |
| Preferred stock issued | 100,000 | - | - | - | - | 100,000 |
| Issuance cost on preferred stock | - | - | - | (1,333) | - | (1,333) |
| Preferred stock dividends | - | - | - | (33,115) | - | (33,115) |
| Patronage distributions | | | | | | |
| Cash | - | - | - | (7,972) | - | (7,972) |
| Balance at September 30, 2018 | <u>\$ 700,000</u> | <u>\$ 304,842</u> | <u>\$ 39,144</u> | <u>\$ 873,208</u> | <u>\$ (95,468)</u> | <u>\$ 1,821,726</u> |

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

Statements of Cash Flows

(unaudited)

| (dollars in thousands) | Nine Months Ended September 30, | |
|--|---------------------------------|--------------------|
| | 2018 | 2017 |
| Operating activities | | |
| Net income | \$ 136,225 | \$ 145,192 |
| Reconciliation of net income to net cash provided by operating activities | | |
| Provision (negative provision) for credit losses | 4,954 | (1,088) |
| Depreciation and amortization on premises and equipment | 5,945 | 5,118 |
| Accretion of net premium on loans | 775 | 1,754 |
| Amortization and accretion on debt instruments | 30,108 | 18,196 |
| Amortization of net premium on investments | 2,199 | 4,039 |
| Decrease in fair value on loans under fair value option | 204 | 193 |
| Loss on sale of loans | 106 | (3,575) |
| Loss (gain) on other earning assets | 859 | (728) |
| Distributions less than cumulative equity earnings | - | 47 |
| Gain on sales of premises and equipment | (78) | (41) |
| Allocated equity patronage from System bank | (14,789) | (14,583) |
| Increase in accrued interest receivable | (13,972) | (9,944) |
| (Increase) decrease in other assets, net | (28,075) | 17,089 |
| Increase in accrued interest payable | 24,018 | 10,698 |
| Decrease in other liabilities, net | (17,066) | (13,638) |
| Net cash provided by operating activities | <u>131,413</u> | <u>158,729</u> |
| Investing activities | | |
| Net decrease (increase) in federal funds sold | 66,901 | (205,212) |
| Investment securities | | |
| Purchases | (1,640,026) | (1,119,911) |
| Proceeds from maturities, calls and prepayments | 1,057,821 | 866,266 |
| Increase in loans, net | (1,011,136) | (790,223) |
| Proceeds from sales of loans | 60,446 | 23,658 |
| Proceeds from sales of premises and equipment | 183 | 82 |
| Expenditures for premises and equipment | (21,770) | (13,108) |
| Distributions in excess of cumulative equity earnings | 114 | 120 |
| Investment in other earning assets | (2,539) | (3,740) |
| Net cash used in investing activities | <u>(1,490,006)</u> | <u>(1,242,068)</u> |
| Financing activities | | |
| Bonds and notes issued | 10,319,384 | 8,917,380 |
| Bonds and notes retired | (9,019,153) | (7,926,274) |
| Prepayments on debt extinguishment costs | 114 | 1,708 |
| Repayments on capital lease obligations | (281) | (281) |
| Preferred stock issued | 100,000 | - |
| Issuance costs on preferred stock | (1,333) | - |
| Capital stock issued | 7,967 | 260 |
| Capital stock retired and allocated retained earnings distributed | (4,364) | (65) |
| Cash dividends on preferred stock | (33,115) | (30,188) |
| Cash patronage distributions paid | (39,390) | (33,917) |
| Net cash provided by financing activities | <u>1,329,829</u> | <u>928,623</u> |
| Net (decrease) increase in cash | (28,764) | (154,716) |
| Cash at beginning of year | 56,183 | 195,479 |
| Cash at end of quarter | <u>\$ 27,419</u> | <u>\$ 40,763</u> |
| Supplemental schedule of noncash investing and financing activities | | |
| Net (increase) decrease in unrealized losses on investment securities | \$ (56,356) | \$ 4,315 |
| Preferred stock dividend payable | 21,613 | 20,063 |
| Capital lease obligation | - | 374 |
| Supplemental information | | |
| Interest paid | \$ 286,154 | \$ 203,330 |

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

Notes to Financial Statements

Unaudited (dollar amounts in thousands unless otherwise noted)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the accounts of the Farm Credit Bank of Texas (bank). The significant accounting policies followed and the financial condition and results of operations of the bank as of and for the year ended December 31, 2017, are contained in the 2017 Annual Report to shareholders (Annual Report). These unaudited third quarter 2018 financial statements should be read in conjunction with the Annual Report.

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 bank, 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.

The bank and its affiliated associations (district) are part of the federally chartered Farm Credit System (System). The bank provides funding to district associations, which, in turn, provide credit to their borrower-members. At September 30, 2018, the bank provided financing to 14 district associations and certain other financing institutions.

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Cost." The guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The bank is evaluating the impact of adoption on the bank's financial condition and its results of operations.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans." The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The bank is evaluating the impact of adoption on the bank's financial condition and its results of operations.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement." The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional

disclosures until their effective date. The bank is evaluating the impact of adoption on the bank's financial condition and its results of operations.

In February 2018, the 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 bank is exempt from federal and certain other income taxes as provided by the Farm Credit Act of 1971. Thus, the new standard will have no impact on the bank's financial results.

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 bank is evaluating the impact of adoption on the bank'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 materially impact the bank'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 materially impact the bank'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 bank is evaluating the impact of adoption on the bank's financial condition and its results of operations.

In February 2016, the FASB issued guidance entitled "Leases." This guidance is intended to improve financial reporting about leasing transactions and affects all organizations that lease assets. The guidance will require organizations that lease assets, referred to as lessees, to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The accounting for organizations that own the assets leased by the lessee, also known as lessor accounting, will remain largely unchanged from current GAAP. In July 2018, the FASB issued additional guidance which allows entities a new and optional transition method. Under this transition method, an entity initially applies the leasing standard at the adoption date and recognizes a cumulative-effect adjustment to opening retained earnings. The leasing standard and this additional guidance become effective for interim and annual periods beginning after December 15, 2018, and early application is permitted. Based on the bank's preliminary review and analysis, the new lease accounting guidance will have an insignificant impact on the bank's financial condition and results of operations, and will have no impact on the bank's statement of cash flows.

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 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the bank's financial condition or its 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 bank adopted the new standard effective January 1, 2018, using the modified retrospective approach. As the majority of the bank's revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial position, results of operations, equity or cash flows.

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 liquidity portfolio consists primarily of 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 were federal agency-guaranteed collateralized MBS, including Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) securities. The bank's other investments portfolio consists of Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) purchased from district associations. A summary of the amortized cost and fair value of investment securities available-for-sale at September 30, 2018, and December 31, 2017, is included in the following tables.

Investments in the available-for-sale liquidity portfolio at September 30, 2018:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
|---|---------------------|------------------------------|-------------------------------|---------------------|------------------------------|
| Agency-guaranteed debt | \$ 179,002 | \$ 105 | \$ (5,038) | \$ 174,069 | 2.16 % |
| Corporate debt | 365,403 | 665 | (1,279) | 364,789 | 2.65 |
| Federal agency collateralized mortgage-backed securities | | | | | |
| GNMA | 2,547,784 | 424 | (61,241) | 2,486,967 | 2.61 |
| FNMA and FHLMC | 2,267,228 | 1,387 | (45,310) | 2,223,305 | 2.34 |
| U.S. Treasury securities | 298,470 | - | (415) | 298,055 | 2.25 |
| Asset-backed securities | 84,196 | 8 | (58) | 84,146 | 2.47 |
| Total available-for-sale liquidity investments | <u>\$ 5,742,083</u> | <u>\$ 2,589</u> | <u>\$(113,341)</u> | <u>\$ 5,631,331</u> | 2.47 % |

Investments in the available-for-sale other investments portfolio at September 30, 2018:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Weighted Average Yield |
|---|-------------------|------------------------------|-------------------------------|---------------|------------------------------|
| Agricultural mortgage-backed securities | \$ 39,723 | \$ - | \$ (2,418) | \$ 37,305 | 4.83 % |

Investments in the 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 collateralized mortgage-backed securities | | | | | |
| GNMA | 2,012,484 | 706 | (28,528) | 1,984,662 | 1.99 |
| FNMA and FHLMC | 2,395,248 | 2,061 | (25,256) | 2,372,053 | 1.91 |
| U.S. Treasury securities | 249,860 | - | (653) | 249,207 | 0.90 |
| Asset-backed securities | 47,914 | 18 | (43) | 47,889 | 1.61 |
| Total available-for-sale liquidity investments | <u>\$ 5,156,234</u> | <u>\$ 3,371</u> | <u>\$ (57,937)</u> | <u>\$ 5,101,668</u> | 1.88 % |

Investments in the 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 September 30, 2018:

Investments in the 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 | \$ - | \$ 16,451 | \$ 157,618 | \$ - | \$ 174,069 |
| Corporate debt | 20,027 | 344,762 | - | - | 364,789 |
| Federal agency collateralized mortgage-backed securities | | | | | |
| GNMA | - | - | 80,640 | 2,406,327 | 2,486,967 |
| FNMA and FHLMC | 15 | 97,792 | 419,132 | 1,706,366 | 2,223,305 |
| U.S. Treasury securities | 248,686 | 49,369 | - | - | 298,055 |
| Asset-backed securities | 19,103 | 63,229 | 1,814 | - | 84,146 |
| Total fair value | <u>\$ 287,831</u> | <u>\$ 571,603</u> | <u>\$ 659,204</u> | <u>\$ 4,112,693</u> | <u>\$ 5,631,331</u> |
| Total amortized cost | \$ 288,054 | \$ 574,642 | \$ 677,409 | \$ 4,201,978 | \$ 5,742,083 |
| Weighted average yield | 2.28% | 2.45% | 2.18% | 2.53% | 2.47% |

Investments in the 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 | \$ 14,946 | \$ 22,359 | \$ 37,305 |
| Total amortized cost | \$ 15,874 | \$ 23,849 | \$ 39,723 |
| Weighted average yield | 4.70% | 4.92% | 4.83% |

Other-Than-Temporarily Impaired Investments Evaluation

The following table shows available-for-sale liquidity portfolio investments by gross unrealized losses and fair value, aggregated by investment category and length of time, for securities that have been in a continuous unrealized loss position at September 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 | \$ 28,474 | \$ (749) | \$ 110,837 | \$ (4,289) | \$ 139,311 | \$ (5,038) |
| Corporate debt | 66,844 | (354) | 24,053 | (925) | 90,897 | (1,279) |
| Federal agency collateralized mortgage-backed securities | | | | | | |
| GNMA | 1,058,670 | (12,694) | 1,244,467 | (48,547) | 2,303,137 | (61,241) |
| FNMA and FHLMC | 586,555 | (5,850) | 1,180,257 | (39,460) | 1,766,812 | (45,310) |
| U.S. Treasury securities | 298,055 | (415) | - | - | 298,055 | (415) |
| Asset-backed securities | 71,081 | (58) | - | - | 71,081 | (58) |
| Total | <u>\$ 2,109,679</u> | <u>\$ (20,120)</u> | <u>\$ 2,559,614</u> | <u>\$ (93,221)</u> | <u>\$ 4,669,293</u> | <u>\$ (113,341)</u> |

The bank 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 nine months ended September 30, 2018 and 2017, the bank did not recognize any other-than-temporary impairment credit losses and no securities were identified as OTTI at September 30, 2018 and 2017.

NOTE 3 — LOANS AND RESERVES FOR CREDIT LOSSES

Loans, including direct notes to district associations and other financing institutions (OFIs), participations purchased and other bank-owned loans, comprised the following categories at:

| | September 30, 2018 | December 31, 2017 |
|---|---------------------------|----------------------|
| Direct notes receivable from district associations and OFIs | \$ 11,946,870 | \$ 11,584,236 |
| Participations purchased | 6,077,542 | 5,500,659 |
| Other bank-owned loans | 252 | 282 |
| Total loans | \$ 18,024,664 | \$ 17,085,177 |

A summary of the bank's loans by type follows:

| | September 30, 2018 | December 31, 2017 |
|--|---------------------------|----------------------|
| Direct notes receivable from district associations | \$ 11,910,519 | \$ 11,544,129 |
| Real estate mortgage | 621,636 | 445,116 |
| Production and intermediate term Agribusiness | 705,489 | 631,148 |
| Loans to cooperatives | 338,443 | 332,664 |
| Processing and marketing | 2,589,904 | 2,361,426 |
| Farm-related business | 76,427 | 79,879 |
| Communication | 395,870 | 326,297 |
| Energy (rural utilities) | 1,181,453 | 1,188,465 |
| Water and waste disposal | 138,556 | 104,920 |
| Lease receivables | 13,739 | 14,675 |
| Loans to other financing institutions | 36,351 | 40,107 |
| Mission-related | 16,277 | 16,351 |
| Total loans | \$ 18,024,664 | \$ 17,085,177 |

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.

The bank purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations.

The following table presents information regarding the balances of participations purchased and sold, excluding syndications, at September 30, 2018.

| | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|--------------------------------|---------------------|------------------------------|------------------|---------------------|---------------------|
| | Participations | Participations | Participations | Participations | Participations | Participations |
| | Purchased | Sold | Purchased | Sold | Purchased | Sold |
| Real estate mortgage | \$ 942,389 | \$ 337,337 | \$ - | \$ 2,476 | \$ 942,389 | \$ 339,813 |
| Production and intermediate term | 1,445,606 | 779,102 | 24,320 | 12,043 | 1,469,926 | 791,145 |
| Agribusiness | 2,095,267 | 933,974 | - | - | 2,095,267 | 933,974 |
| Communication | 501,138 | 104,804 | - | - | 501,138 | 104,804 |
| Energy (rural utilities) | 1,337,142 | 155,527 | - | - | 1,337,142 | 155,527 |
| Water and waste disposal | 153,339 | 14,566 | - | - | 153,339 | 14,566 |
| Lease receivables | 15,594 | 1,870 | - | - | 15,594 | 1,870 |
| Mission-related | 2,485 | - | - | - | 2,485 | - |
| Direct note receivable from district associations | - | 3,850,000 | - | - | - | 3,850,000 |
| Total | \$ 6,492,960 | \$ 6,177,180 | \$ 24,320 | \$ 14,519 | \$ 6,517,280 | \$ 6,191,699 |

The bank has purchased loan participations and Federal Agricultural Mortgage Corporation (Farmer Mac) guaranteed agricultural mortgage-backed securities (AMBS) from associations in Capitalized Participation Pool (CPP) transactions. As a condition of the transactions, the bank redeemed stock in the amount of 2.0 percent of the par value of the loans purchased, and the associations bought bank stock equal to 8.0 percent of the purchased loans' par value and 1.6 percent of the AMBS' par value. During the month of September 2018, the bank purchased \$99.6 million in loan participations from an association, which resulted in a net stock issuance of \$6.0 million. CPP loans held at September 30, 2018, totaled \$128.5 million and were included in "Loans" on the balance sheets. The balance of the AMBS CPP was \$37.3 million at September 30, 2018, and is included in "Investment securities" on the balance sheet.

The bank may also purchase loans from district associations in Non-Capitalized Participation Pool (NCPP) transactions. The loans purchased in these transactions represent up to 90.0 percent of the outstanding balances, all of which had credit quality ratings of 8 or better (acceptable classification) and are included in the capital markets' portfolio. As a condition of these transactions, the bank redeems common stock in the amount of 2.0 percent of the par value of the loans purchased. NCPP purchases result in pay downs on the associations' direct notes at the time of purchase. During the month of February 2018, the bank purchased \$98.7 million in loan participations from a district association in NCPP transactions which resulted in a net stock retirement of \$2.2 million. The NCPP loans' balance was \$85.5 million at September 30, 2018, and were included in "Loans" on the balance sheet.

The bank is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the bank on such balances. There were no significant balances of ACPs at September 30, 2018, or December 31, 2017.

During 2012, the bank 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 \$9,475 at September 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 nine months ended September 30, 2018:

| | |
|-----------------------------------|------------------------|
| Balance at January 1, 2018 | \$ 9,908 |
| Net loss on financial instruments | |
| under fair value option | (204) |
| Premium amortization | (229) |
| Balance at September 30, 2018 | <u><u>\$ 9,475</u></u> |

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

| | September 30, 2018 | December 31, 2017 |
|-------------------------------------|---------------------------|------------------------|
| Nonaccrual loans: | | |
| Energy & water/waste disposal | \$ 10,277 | \$ - |
| Agribusiness | 8,601 | - |
| Real estate mortgage | 1,204 | 3,393 |
| Total nonaccrual loans | <u>20,082</u> | <u>3,393</u> |
| Accruing restructured loans: | | |
| Mission-related | 2,571 | 2,607 |
| Total accruing restructured loans | <u>2,571</u> | <u>2,607</u> |
| Total high-risk assets | <u><u>\$ 22,653</u></u> | <u><u>\$ 6,000</u></u> |

One credit quality indicator utilized by the bank and associations is the Farm Credit Administration 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:

| | September 30, 2018 | December 31, 2017 |
|---|--------------------|-------------------|
| Real estate mortgage: | | |
| Acceptable | 97.2 % | 94.2 % |
| OAEM | 2.6 | 3.0 |
| Substandard/Doubtful | 0.2 | 2.8 |
| | 100.0 % | 100.0 % |
| Production and intermediate term: | | |
| Acceptable | 95.1 % | 93.4 % |
| OAEM | 3.7 | 5.7 |
| Substandard/Doubtful | 1.2 | 0.9 |
| | 100.0 % | 100.0 % |
| Agribusiness: | | |
| Acceptable | 99.7 % | 99.5 % |
| OAEM | - | - |
| Substandard/Doubtful | 0.3 | 0.5 |
| | 100.0 % | 100.0 % |
| Energy & water/waste disposal: | | |
| Acceptable | 98.8 % | 98.6 % |
| OAEM | 0.5 | 0.5 |
| Substandard/Doubtful | 0.8 | 0.9 |
| | 100.0 % | 100.0 % |
| Communication: | | |
| Acceptable | 96.2 % | 100.0 % |
| OAEM | 3.8 | - |
| Substandard/Doubtful | - | - |
| | 100.0 % | 100.0 % |
| Direct notes to associations: | | |
| Acceptable | 93.3 % | 92.3 % |
| OAEM | 6.7 | 7.7 |
| Substandard/Doubtful | - | - |
| | 100.0 % | 100.0 % |
| Loans to other financing institutions: | | |
| Acceptable | 100.0 % | 100.0 % |
| OAEM | - | - |
| Substandard/Doubtful | - | - |
| | 100.0 % | 100.0 % |
| Mission-related: | | |
| Acceptable | 100.0 % | 100.0 % |
| OAEM | - | - |
| Substandard/Doubtful | - | - |
| | 100.0 % | 100.0 % |
| Lease receivables: | | |
| Acceptable | 100.0 % | 100.0 % |
| OAEM | - | - |
| Substandard/Doubtful | - | - |
| | 100.0 % | 100.0 % |
| Total loans: | | |
| Acceptable | 95.0 % | 94.2 % |
| OAEM | 4.8 | 5.5 |
| Substandard/Doubtful | 0.2 | 0.3 |
| | 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:

September 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 | \$ 409 | \$ 1,252 | \$ 1,661 | \$ 624,480 | \$ 626,141 | \$ - |
| Production and intermediate term | - | - | - | 709,434 | 709,434 | - |
| Agribusiness | - | - | - | 3,020,671 | 3,020,671 | - |
| Energy & water/waste disposal | - | - | - | 1,327,858 | 1,327,858 | - |
| Communication | - | - | - | 396,065 | 396,065 | - |
| Lease receivables | - | - | - | 13,781 | 13,781 | - |
| Direct notes to associations | - | - | - | 11,937,943 | 11,937,943 | - |
| Loans to OFIs | - | - | - | 36,444 | 36,444 | - |
| Mission-related | - | - | - | 16,416 | 16,416 | - |
| Total | \$ 409 | \$ 1,252 | \$ 1,661 | \$ 18,083,092 | \$ 18,084,753 | \$ - |

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 | \$ - | \$ 3,393 | \$ 3,393 | \$ 445,621 | \$ 449,014 | \$ - |
| Production and intermediate term | - | - | - | 633,330 | 633,330 | - |
| Agribusiness | - | - | - | 2,785,593 | 2,785,593 | - |
| Energy & water/waste disposal | - | - | - | 1,300,418 | 1,300,418 | - |
| Communication | - | - | - | 326,705 | 326,705 | - |
| Lease receivables | - | - | - | 14,717 | 14,717 | - |
| Direct notes to associations | - | - | - | 11,568,693 | 11,568,693 | - |
| Loans to OFIs | - | - | - | 40,187 | 40,187 | - |
| Mission-related | - | - | - | 16,596 | 16,596 | - |
| Total | \$ - | \$ 3,393 | \$ 3,393 | \$ 17,131,860 | \$ 17,135,253 | \$ - |

Additional impaired loan information is as follows:

| | At September 30, 2018 | | | At December 31, 2017 | | |
|--|------------------------|-----------------------------|----------------------|------------------------|-----------------------------|----------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired loans with a related allowance for credit losses: | | | | | | |
| Energy & water/waste disposal | \$ 10,277 | \$ 10,277 | \$ 2,779 | \$ - | \$ - | \$ - |
| Loans to cooperatives | 8,601 | 8,601 | 3,842 | - | - | - |
| Mission-related | 176 | 170 | 52 | 200 | 200 | 82 |
| Total | \$ 19,054 | \$ 19,048 | \$ 6,673 | \$ 200 | \$ 200 | \$ 82 |
| Impaired loans with no related allowance for credit losses: | | | | | | |
| Real estate mortgage | \$ 1,252 | \$ 1,252 | \$ - | \$ 3,393 | \$ 3,393 | \$ - |
| Production and intermediate term | - | - | - | - | 3,035 | - |
| Processing and marketing | - | 1,192 | - | - | 1,192 | - |
| Energy & water/waste disposal | - | 7,623 | - | - | 7,623 | - |
| Mission-related | 2,396 | 2,337 | - | 2,407 | 2,407 | - |
| Total | \$ 3,648 | \$ 12,404 | \$ - | \$ 5,800 | \$ 17,650 | \$ - |
| Total impaired loans: | | | | | | |
| Real estate mortgage | \$ 1,252 | \$ 1,252 | \$ - | \$ 3,393 | \$ 3,393 | \$ - |
| Production and intermediate term | - | - | - | - | 3,035 | - |
| Processing and marketing | - | 1,192 | - | - | 1,192 | - |
| Energy & water/waste disposal | 10,277 | 17,900 | 2,779 | - | 7,623 | - |
| Loans to cooperatives | 8,601 | 8,601 | 3,842 | - | - | - |
| Mission-related | 2,572 | 2,507 | 52 | 2,607 | 2,607 | 82 |
| Total | \$ 22,702 | \$ 31,452 | \$ 6,673 | \$ 6,000 | \$ 17,850 | \$ 82 |

| | For the Three Months Ended | | | | For the Nine Months Ended | | | |
|--|----------------------------|----------------------------|------------------------|----------------------------|---------------------------|----------------------------|------------------------|----------------------------|
| | September 30, 2018 | | September 30, 2017 | | September 30, 2018 | | September 30, 2017 | |
| | Average Impaired Loans | Interest Income Recognized | Average Impaired Loans | Interest Income Recognized | Average Impaired Loans | Interest Income Recognized | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for credit losses: | | | | | | | | |
| Energy & water/waste disposal | \$ 10,905 | \$ - | \$ - | \$ - | \$ 7,470 | - | \$ - | \$ - |
| Loans to cooperatives | 8,495 | - | - | - | 5,628 | - | - | - |
| Mission-related | 170 | 4 | 203 | 3 | 180 | 11 | 206 | 11 |
| Total | \$ 19,570 | \$ 4 | \$ 203 | \$ 3 | \$ 13,278 | \$ 11 | \$ 206 | \$ 11 |
| Impaired loans with no related allowance for credit losses: | | | | | | | | |
| Real estate mortgage | \$ 1,208 | \$ - | \$ 3,850 | \$ 594 | \$ 2,107 | \$ - | \$ 4,460 | \$ 624 |
| Energy & water/waste disposal | - | - | - | - | 14 | - | - | - |
| Mission-related | 2,337 | 36 | 4,163 | 36 | 2,359 | 108 | 4,251 | 110 |
| Total | \$ 3,545 | \$ 36 | \$ 8,013 | \$ 630 | \$ 4,480 | \$ 108 | \$ 8,711 | \$ 734 |
| Total impaired loans: | | | | | | | | |
| Real estate mortgage | \$ 1,208 | \$ - | \$ 3,850 | \$ 594 | \$ 2,107 | \$ - | \$ 4,460 | \$ 624 |
| Energy & water/waste disposal | 10,905 | - | - | - | 7,484 | - | - | - |
| Loans to cooperatives | 8,495 | - | - | - | 5,628 | - | - | - |
| Mission-related | 2,507 | 40 | 4,366 | 39 | 2,539 | 119 | 4,457 | 121 |
| Total | \$ 23,115 | \$ 40 | \$ 8,216 | \$ 633 | \$ 17,758 | \$ 119 | \$ 8,917 | \$ 745 |

At September 30, 2018, impaired loans of \$19.1 million had a related specific allowance of \$6.7 million, while the remaining \$3.6 million of impaired loans had no related specific allowance as a result of adequate collateralization.

The average recorded investment in impaired loans for the three months ended September 30, 2018, was \$23.1 million. The bank recognized interest income of \$40 on impaired loans during the three months ended September 30, 2018.

The average recorded investment in impaired loans for the nine months ended September 30, 2018, was \$17.8 million. The bank recognized interest income of \$119 on impaired loans during the nine months ended September 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 | Communications | Energy and Water/Waste Disposal | Lease Receivables | Direct Notes to Associations | Loans to OFIs | Mission- Related | Total |
|--|-------------------------|--|--------------|----------------|---------------------------------------|----------------------|---------------------------------|------------------|---------------------|---------------|
| Allowance for Credit Losses | | | | | | | | | | |
| Balance at June 30, 2018 | \$ 87 | \$ 967 | \$ 5,582 | \$ 390 | \$ 4,823 | \$ 31 | \$ - | \$ - | \$ 54 | \$ 11,934 |
| Charge-offs | - | - | - | - | - | - | - | - | - | - |
| Recoveries | 5 | - | - | - | - | - | - | - | - | 5 |
| Provision for credit losses (loan loss reversal) | (4) | (9) | 240 | (38) | (77) | (1) | - | - | (3) | 108 |
| Other * | - | (58) | 247 | 4 | 77 | - | - | - | 4 | 274 |
| Balance at September 30, 2018 | \$ 88 | \$ 900 | \$ 6,069 | \$ 356 | \$ 4,823 | \$ 30 | \$ - | \$ - | \$ 55 | \$ 12,321 |
| Balance at December 31, 2017 | \$ 117 | \$ 954 | \$ 2,679 | \$ 364 | \$ 3,439 | \$ - | \$ - | \$ - | \$ 86 | \$ 7,639 |
| Charge-offs | - | - | - | - | - | - | - | - | - | - |
| Recoveries | 11 | - | - | 120 | - | - | - | - | - | 131 |
| Provision for credit losses (loan loss reversal) | (43) | 93 | 3,672 | (133) | 1,381 | 30 | - | - | (46) | 4,954 |
| Other * | 3 | (147) | (282) | 5 | 3 | - | - | - | 15 | (403) |
| Balance at September 30, 2018 | \$ 88 | \$ 900 | \$ 6,069 | \$ 356 | \$ 4,823 | \$ 30 | \$ - | \$ - | \$ 55 | \$ 12,321 |
| Individually evaluated for impairment | \$ - | \$ - | \$ 3,842 | \$ - | \$ 2,779 | \$ - | \$ - | \$ - | \$ 52 | \$ 6,673 |
| Collectively evaluated for impairment | 88 | 900 | 2,227 | 356 | 2,044 | 30 | - | - | 3 | 5,648 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - | - | - | - | - | - |
| Balance at September 30, 2018 | \$ 88 | \$ 900 | \$ 6,069 | \$ 356 | \$ 4,823 | \$ 30 | \$ - | \$ - | \$ 55 | \$ 12,321 |
| Balance at June 30, 2017 | \$ 119 | \$ 677 | \$ 2,592 | \$ 448 | \$ 4,386 | \$ - | \$ - | \$ - | \$ 83 | \$ 8,305 |
| Charge-offs | - | - | - | - | - | - | - | - | - | - |
| Recoveries | 18 | - | - | - | - | - | - | - | - | 18 |
| Provision for credit losses (loan loss reversal) | (21) | 263 | 18 | (101) | (189) | - | - | - | 1 | (29) |
| Other * | - | (55) | (135) | 4 | (8) | - | - | - | - | (194) |
| Balance at September 30, 2017 | \$ 116 | \$ 885 | \$ 2,475 | \$ 351 | \$ 4,189 | \$ - | \$ - | \$ - | \$ 84 | \$ 8,100 |
| Balance at December 31, 2016 | \$ 74 | \$ 712 | \$ 2,259 | \$ 526 | \$ 3,997 | \$ - | \$ - | \$ - | \$ 82 | \$ 7,650 |
| Charge-offs | - | - | - | - | - | - | - | - | - | - |
| Recoveries | 24 | - | 5 | - | 1,420 | - | - | - | - | 1,449 |
| Provision for credit losses (loan loss reversal) | 23 | 212 | 202 | (197) | (1,330) | - | - | - | 2 | (1,088) |
| Other * | (5) | (39) | 9 | 22 | 102 | - | - | - | - | 89 |
| Balance at September 30, 2017 | \$ 116 | \$ 885 | \$ 2,475 | \$ 351 | \$ 4,189 | \$ - | \$ - | \$ - | \$ 84 | \$ 8,100 |
| Individually evaluated for impairment | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 79 | \$ 79 |
| Collectively evaluated for impairment | 116 | 885 | 2,475 | 351 | 4,189 | - | - | - | 5 | 8,021 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - | - | - | - | - | - |
| Balance at September 30, 2017 | \$ 116 | \$ 885 | \$ 2,475 | \$ 351 | \$ 4,189 | \$ - | \$ - | \$ - | \$ 84 | \$ 8,100 |
| Recorded Investments | | | | | | | | | | |
| in Loans Outstanding: | | | | | | | | | | |
| Ending balance at September 30, 2018 | \$ 626,141 | \$ 709,434 | \$ 3,020,671 | \$ 396,065 | \$ 1,327,858 | \$ 13,781 | \$ 11,937,943 | \$ 36,444 | \$ 16,416 | \$ 18,084,753 |
| Individually evaluated for impairment | \$ 1,204 | \$ - | \$ 8,601 | \$ - | \$ 10,277 | \$ - | \$ 11,937,943 | \$ - | \$ 2,571 | \$ 11,960,596 |
| Collectively evaluated for impairment | \$ 624,937 | \$ 709,434 | \$ 3,012,070 | \$ 396,065 | \$ 1,317,581 | \$ 13,781 | \$ - | \$ 36,444 | \$ 13,845 | \$ 6,124,157 |
| Loans acquired with deteriorated credit quality | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Ending Balance at September 30, 2017 | \$ 430,813 | \$ 574,643 | \$ 2,608,337 | \$ 355,729 | \$ 1,282,420 | \$ 8,105 | \$ 11,393,967 | \$ 35,695 | \$ 18,047 | \$ 16,707,756 |
| Individually evaluated for impairment | \$ 3,759 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 11,393,967 | \$ - | \$ 4,203 | \$ 11,401,929 |
| Collectively evaluated for impairment | \$ 427,054 | \$ 574,643 | \$ 2,608,337 | \$ 355,729 | \$ 1,282,420 | \$ 8,105 | \$ - | \$ 35,695 | \$ 13,844 | \$ 5,305,827 |
| Loans acquired with deteriorated credit quality | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |

* Reserve for losses on letters of credit recorded in other liabilities

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. Troubled debt restructurings 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 September 30, 2018, the total recorded investment in TDR loans was \$12,425, including \$9,853 classified as nonaccrual and \$2,572 classified as accrual, with specific allowance for loan losses of \$52. Additional commitments to lend to borrowers whose loans have been modified in TDRs were \$733 at September 30, 2018, and there were no additional commitments to lend to borrowers whose loans have been modified in TDRs at December 31, 2017.

The following table summarizes TDR loan balances by loan type:

| | Loans Modified as TDRs | | TDRs in Nonaccrual Status | |
|----------------------|------------------------|-------------------|---------------------------|-------------------|
| | September 30, 2018 | December 31, 2017 | September 30, 2018 | December 31, 2017 |
| Agribusiness | \$ 8,601 | \$ - | \$ 8,601 | \$ - |
| Real estate mortgage | 1,252 | 3,393 | 1,252 | 3,393 |
| Mission-related | 2,572 | 2,607 | - | - |
| Total | <u>\$ 12,425</u> | <u>\$ 6,000</u> | <u>\$ 9,853</u> | <u>\$ 3,393</u> |

The following table presents additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the nine months ended September 30, 2018. There were no loans designated as troubled debt restructurings during the three months ended September 30, 2018, and during the three and nine months ended September 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 nine months ended September 30, 2018:

| | Premodification Outstanding Recorded Investment | Postmodification Outstanding Recorded Investment |
|-------------------------------|--|---|
| Troubled debt restructurings: | | |
| Agribusiness | \$ 7,739 | \$ 8,588 |
| Total | <u>\$ 7,739</u> | <u>\$ 8,588</u> |

The predominant form of concession granted for the troubled debt restructuring includes an interest rate reduction.

During the period there were no payment defaults on loans that were restructured during the previous 12 months. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

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 September 30, 2018, were approximately \$268.46 billion.

In the normal course of business, the bank has various outstanding commitments and contingent liabilities, including the possibility of actions against the bank 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 bank.

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 September 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: | | | | |
| Federal funds | \$ 179,986 | \$ - | \$ 179,986 | \$ - |
| Investments available for sale: | | | | |
| Agency-guaranteed debt | 174,069 | - | 174,069 | - |
| Corporate debt | 364,789 | - | 364,789 | - |
| Mortgage-backed securities | 4,710,272 | - | 4,710,272 | - |
| U.S. Treasury securities | 298,055 | - | 298,055 | - |
| Asset-backed securities | 84,146 | - | 84,146 | - |
| Mission-related and other available-for-sale investments | 37,305 | - | - | 37,305 |
| Loans valued under the fair value option | 9,475 | - | 9,475 | - |
| Derivative assets | 21,285 | - | 21,285 | - |
| Assets held in nonqualified benefit trusts | 744 | 744 | - | - |
| Total assets | \$ 5,880,126 | \$ 744 | \$ 5,842,077 | \$ 37,305 |
| Liabilities: | | | | |
| Derivative liabilities | \$ 71 | \$ - | \$ 71 | \$ - |
| Letters of credit | 606 | - | - | 606 |
| Total liabilities | \$ 677 | \$ - | \$ 71 | \$ 606 |

Loans With Fair Value Option

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. 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 fair value of loans held under the fair value option totaled \$9,475 at September 30, 2018.

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 June 30, 2018 to September 30, 2018:

| | Assets | Liabilities | |
|---|---------------------|--------------------|------------|
| | Agricultural | | |
| | Mortgage- | | |
| | Backed | Letters of | |
| | Securities | Credit | Net |
| | | | |
| Balance at June 30, 2018 | \$ 39,427 | \$ 709 | \$ 38,718 |
| Net losses included in other comprehensive income | (40) | - | (40) |
| Purchases, issuances and settlements | (2,082) | (103) | (1,979) |
| Balance at September 30, 2018 | \$ 37,305 | \$ 606 | \$ 36,699 |

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 September 30, 2018.

| | Assets | | Liabilities | |
|---|---------------------|-------------------|--------------------|------------|
| | Agricultural | | | |
| | Mortgage- | Mortgage- | | |
| | Backed | Backed | Letters of | |
| | Securities | Securities | Credit | Net |
| | | | | |
| Balance at January 1, 2018 | \$ - | \$ 43,317 | \$ 846 | \$ 42,471 |
| Net gains (losses) included in other comprehensive income | 95 | (170) | - | (75) |
| Purchases, issuances and settlements | 91,561 | (5,842) | (240) | 85,959 |
| Transfers out of Level 3 | (91,656) | - | - | (91,656) |
| Balance at September 30, 2018 | \$ - | \$ 37,305 | \$ 606 | \$ 36,699 |

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the three months ended September 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 are included in Level 3 as 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 September 30, 2018, for each of the fair value hierarchy levels are summarized below:

| | Fair Value Measurements | | | |
|---------------------|-------------------------|---------------|-------------|------------------|
| | Total | Quoted Prices | Significant | Significant |
| | | in Active | Other | Unobservable |
| | | Markets for | Observable | Inputs |
| | Identical Assets | Inputs | Inputs | |
| | (Level 1) | (Level 2) | (Level 3) | |
| Assets: | | | | |
| Loans | \$ 12,375 | \$ - | \$ - | \$ 12,375 |
| Total assets | \$ 12,375 | \$ - | \$ - | \$ 12,375 |

Assets and liabilities measured 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 | Significant | Significant |
| | | in Active | Other | Unobservable |
| | | Markets for | Observable | Inputs |
| | Identical Assets | Inputs | Inputs | |
| | (Level 1) | (Level 2) | (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 | - |
| Mortgage-backed securities | 4,356,715 | - | 4,356,715 | - |
| U.S. Treasury securities | 249,207 | - | 249,207 | - |
| 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 | 551 | 551 | - | - |
| Total assets | \$ 5,411,264 | \$ 551 | \$ 5,367,396 | \$ 43,317 |
| Liabilities: | | | | |
| Derivative liabilities | \$ 248 | \$ - | \$ 248 | \$ - |
| Letters of credit | 846 | - | - | 846 |
| Total liabilities | \$ 1,094 | \$ - | \$ 248 | \$ 846 |

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 June 30, 2017, to September 30, 2017:

| | Assets | | Liabilities | |
|---|----------------------------|---|-------------------|-----------|
| | Mortgage-Backed Securities | Agricultural Mortgage-Backed Securities | Letters of Credit | Total |
| Balance at June 30, 2017 | \$ 40,800 | \$ 47,661 | \$ 763 | \$ 87,698 |
| Net losses (gains) included in other comprehensive income | (196) | (98) | - | (294) |
| Purchases, issuances and settlements | 28,922 | (1,402) | (13) | 27,533 |
| Transfers out of Level 3 | (40,800) | - | - | (40,800) |
| Balance at September 30, 2017 | \$ 28,726 | \$ 46,161 | \$ 750 | \$ 74,137 |

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 September 30, 2017.

| | Assets | | Liabilities | |
|---|----------------------------|---|-------------------|-----------|
| | Mortgage-Backed Securities | Agricultural Mortgage-Backed Securities | Letters of Credit | Net |
| Balance at January 1, 2017 | \$ - | \$ 53,335 | \$ 594 | \$ 52,741 |
| Net (losses) gains included in other comprehensive income | (520) | 212 | - | (308) |
| Purchases, issuances and settlements | 70,046 | (7,386) | 156 | 62,504 |
| Transfers out of Level 3 | (40,800) | - | - | (40,800) |
| Balance at September 30, 2017 | \$ 28,726 | \$ 46,161 | \$ 750 | \$ 74,137 |

There were no transfers of assets or liabilities into or out of Level 1 from other levels during the three months ended September 30, 2017. Agricultural mortgage-backed securities (AMBS) are included in Level 3 due to limited activity or less transparency around inputs to their valuation. Mortgage-backed securities (or MBS) are included in Level 3 due to the fact that their valuation was based on Level 3 criteria (broker quotes). The liability for letters of credit is included in Level 3 due to a determination that their valuation, based on fees currently charged for similar agreements, may not closely correlate to a fair value for instruments that are not regularly traded in the secondary market.

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

| | Fair Value Measurement | | |
|--------------|--|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | |
| Loans | \$ 119 | \$ - | \$ - |
| Total assets | \$ 119 | \$ - | \$ - |

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:

| September 30, 2018: | Fair Value Measurements Using | | | | |
|--------------------------|-------------------------------|--|---|--|------------------------|
| | Total Carrying Amount | 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 | \$ 27,419 | \$ 27,419 | \$ - | \$ - | \$ 27,419 |
| Net loans | 18,012,343 | - | - | 17,717,863 | 17,717,863 |
| Liabilities: | | | | | |
| Bonds and notes | \$ 22,281,676 | \$ - | \$ - | \$ 22,031,191 | \$ 22,031,191 |
| Total liabilities | \$ 22,281,676 | \$ - | \$ - | \$ 22,031,191 | \$ 22,031,191 |

| December 31, 2017: | Fair Value Measurements Using | | | | |
|--------------------------|-------------------------------|--|---|--|------------------------|
| | Total Carrying Amount | 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 | \$ 56,183 | \$ 56,183 | \$ - | \$ - | \$ 56,183 |
| Net loans | 17,077,538 | - | - | 16,994,401 | 16,994,401 |
| Liabilities: | | | | | |
| Bonds and notes | \$ 20,951,223 | \$ - | \$ - | \$ 20,902,279 | \$ 20,902,279 |
| Total liabilities | \$ 20,951,223 | \$ - | \$ - | \$ 20,902,279 | \$ 20,902,279 |

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. Fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability in active markets among willing participants at the reporting date. Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction. The following represent a brief summary of the valuation techniques used by the bank 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 September 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 Farm Credit Administration 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, including certain non-agency securities, the bank obtains prices from third-party pricing services.

Assets Held in Nonqualified Benefits Trusts

Assets held in trust funds related to deferred compensation and supplemental retirement plans 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 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, including the LIBOR and Overnight Index Swap curves 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.

Other Property Owned

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

Sensitivity to Changes in Significant Unobservable Inputs

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

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

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

Information About Recurring and Nonrecurring Level 3 Fair Value Measurements

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

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

Information about Recurring and Nonrecurring Level 2 Fair Value Measurements

| | Valuation Technique(s) | Input |
|--|---------------------------------------|---|
| Federal funds sold | Carrying value | Par/principal |
| Investment securities available for sale | Quoted prices Discounted cash flow | Price for similar security Constant prepayment rate Appropriate interest rate yield curve |
| Loans held under the fair value option | 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.

The primary types of derivative instruments used and the amount of activity (notional amounts derivatives) during the nine months ended September 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 | 500,000 | - | 500,000 |
| Maturities/Amortizations | - | - | - |
| Balance at September 30, 2018 | \$ 750,000 | \$ 195,000 | \$ 945,000 |

To minimize the risk of credit losses, the bank deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitors the credit standing and levels of exposure to individual counterparties. In addition, substantially all derivative contracts are supported by bilateral collateral agreements with counterparties requiring the posting of collateral in the event certain dollar thresholds of exposure of one party to another are reached, which thresholds may vary, depending on the counterparty’s credit rating. The bank does not anticipate nonperformance by any of these counterparties. However, derivative contracts are reflected in the financial statements on a gross basis regardless of the netting agreement. At September 30, 2018, and December 31, 2017, the bank’s credit exposure to counterparties was \$21,214 and \$8,684, respectively. At September 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 the bank has credit exposure with at September 30, 2018:

| | Remaining Years to Maturity | | | Maturity Distribution Netting | Exposure | Collateral Held | Exposure Net of Collateral |
|--------------|-----------------------------------|-------------------------|------------------|-------------------------------------|------------------|--------------------|----------------------------------|
| | Less Than One to Five Years | More Than Five Years | Total | | | | |
| | Moody's Credit Rating | | | | | | |
| A1 | \$ - | \$ 36 | \$ 36 | \$ - | \$ 36 | \$ - | \$ 36 |
| Aa2 | - | 3,458 | 3,458 | - | 3,458 | - | 3,458 |
| Aa3 | 8,935 | 1,317 | 10,252 | - | 10,252 | - | 10,252 |
| Aa3 | 5,098 | 1,990 | 7,088 | - | 7,088 | - | 7,088 |
| Aa3 | - | 380 | 380 | - | 380 | - | 380 |
| Total | \$ 14,033 | \$ 7,181 | \$ 21,214 | \$ - | \$ 21,214 | \$ - | \$ 21,214 |

Cash Flow Hedges

The bank's derivative instruments at September 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 | Fair Value | Fair Value | Balance Sheet | Fair Value | Fair Value |
|--------------------|---------------|--------------------|-------------------|-------------------|--------------------|-------------------|
| | Location | September 30, 2018 | December 31, 2017 | Location | September 30, 2018 | December 31, 2017 |
| Interest rate caps | Other assets | \$ 497 | \$ 396 | Other liabilities | \$ - | \$ - |
| Pay fixed swaps | Other assets | 20,788 | 8,536 | Other liabilities | 71 | 248 |

| | Gain Recognized in OCI on Derivatives (Effective Portion) at September 30, | | | Amount of Gain (Loss) Reclassified From AOCI Into Income (Expense) (Effective Portion) at September 30, | |
|--------------------|---|--------|---------------------------|--|----------|
| | 2018 | 2017 | | 2018 | 2017 |
| Interest rate caps | \$ 101 | \$ 368 | Interest expense | \$ (114) | \$ (168) |
| Pay fixed swaps | 12,932 | 2,018 | Interest income (expense) | 321 | (668) |

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, with issuance costs on preferred stock of \$1.3 million. Dividends accrued on the Class B-3 preferred stock were \$1.6 million as of September 30, 2018, and were 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 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:

| Risk-adjusted | Regulatory Minimums | Conservation Buffers* | Total Regulatory Requirement | As of September 30, 2018 | As of December 31, 2017 |
|----------------------------|------------------------|--------------------------|------------------------------------|--------------------------------|----------------------------|
| Common equity tier 1 ratio | 4.5% | 2.5% * | 7.0% | 10.08% | 10.52% |
| Tier 1 capital ratio | 6.0 | 2.5 * | 8.5 | 16.67 | 16.59 |
| Total capital ratio | 8.0 | 2.5 * | 10.5 | 16.67 | 16.68 |
| Permanent capital ratio | 7.0 | 0.0 | 7.0 | 16.55 | 16.60 |
| Non-risk-adjusted | | | | | |
| Tier 1 leverage ratio | 4.0 | 1.0 | 5.0 | 7.44 | 7.33 |
| UREE leverage ratio | 1.5 | 0.0 | 1.5 | 2.91 | 3.08 |

*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
- Inclusion of unfunded commitments for direct notes from district associations

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 7 years, allocated equities held for a minimum of 7 years or not subject to revolvment, 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 5 years, allocated equities held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance 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 revolvment 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.

The components of the bank's risk-adjusted capital, based on 90-day average balances, were as follows at September 30, 2018:

| (dollars in thousands) | Common equity tier 1 ratio | Tier 1 capital ratio | Total capital ratio | Permanent capital ratio |
|--|----------------------------------|-------------------------|------------------------|----------------------------|
| Numerator: | | | | |
| Unallocated retained earnings | \$ 871,123 | \$ 871,123 | \$ 871,123 | \$ 871,123 |
| Common Cooperative Equities: | | | | |
| Purchased other required stock ≥7 years | 263,734 | 263,734 | 263,734 | 263,734 |
| Allocated stock ≥7 years | 36,042 | 36,042 | 36,042 | 36,042 |
| Allocated equities: | | | | |
| Allocated equities held ≥7 years | 39,144 | 39,144 | 39,144 | 39,144 |
| Noncumulative perpetual preferred stock | - | 700,000 | 700,000 | 700,000 |
| Allowance for loan losses and reserve for credit losses subject to certain limitations | - | - | 14,049 | - |
| Regulatory Adjustments and Deductions: | | | | |
| Amount of allocated investments in other System institutions | (142,322) | (142,322) | (142,322) | (142,322) |
| Excess above third-party capital limits | - | (2,488) | (16,537) | (16,537) |
| Other regulatory required deductions | (256) | (256) | (256) | (256) |
| Total | \$ 1,067,465 | \$ 1,764,977 | \$ 1,764,977 | \$ 1,750,928 |
| Denominator: | | | | |
| Risk-adjusted assets excluding allowance | \$ 10,589,391 | \$ 10,589,391 | \$ 10,589,391 | \$ 10,589,391 |
| Regulatory Adjustments and Deductions: | | | | |
| Allowance for loan losses | - | - | - | (11,947) |
| Total | \$ 10,589,391 | \$ 10,589,391 | \$ 10,589,391 | \$ 10,577,444 |

The components of the bank's risk-adjusted capital, based on 90-day average balances, were as follows at December 31, 2017:

| (dollars in thousands) | Common equity tier 1 ratio | Tier 1 capital ratio | Total capital ratio | Permanent capital ratio |
|--|-------------------------------|-------------------------|------------------------|----------------------------|
| Numerator: | | | | |
| Unallocated retained earnings | \$ 851,333 | \$ 851,333 | \$ 851,333 | \$ 851,333 |
| Common Cooperative Equities: | | | | |
| Purchased other required stock ≥7 years | 248,931 | 248,931 | 248,931 | 248,931 |
| Allocated stock ≥7 years | 36,042 | 36,042 | 36,042 | 36,042 |
| Allocated equities: | | | | |
| Allocated equities held ≥7 years | 33,365 | 33,365 | 33,365 | 33,365 |
| Noncumulative perpetual preferred stock | - | - | - | - |
| Allowance for loan losses and reserve for credit losses subject to certain limitations | - | - | 9,638 | - |
| Regulatory Adjustments and Deductions: | | | | |
| Amount of allocated investments in other System institutions | (127,533) | (127,533) | (127,533) | (127,533) |
| Other regulatory required deductions | (265) | (265) | (265) | (265) |
| Total | \$ 1,041,873 | \$ 1,041,873 | \$ 1,051,511 | \$ 1,041,873 |
| Denominator: | | | | |
| Risk-adjusted assets excluding allowance | \$ 9,899,452 | \$ 9,899,452 | \$ 9,899,452 | \$ 9,899,452 |
| Regulatory Adjustments and Deductions: | | | | |
| Allowance for loan losses | - | - | - | (8,085) |
| Total | \$ 9,899,452 | \$ 9,899,452 | \$ 9,899,452 | \$ 9,891,367 |

The components of the bank's non-risk-adjusted capital, based on 90-day average balances, were as follows at September 30, 2018:

| <u>(dollars in thousands)</u> | Tier 1 | UREE |
|--|-----------------------------|-----------------------------|
| | leverage ratio | leverage ratio |
| Numerator: | | |
| Unallocated retained earnings | \$ 871,123 | \$ 871,123 |
| Common Cooperative Equities: | | |
| Purchased other required stock ≥ 7 years | 263,734 | - |
| Allocated stock ≥ 7 years | 36,042 | - |
| Allocated equities: | | |
| Allocated equities held ≥ 7 years | 39,144 | - |
| Noncumulative perpetual preferred stock | 700,000 | - |
| Regulatory Adjustments and Deductions: | | |
| Amount of allocated investments in other System institutions | (142,322) | (142,322) |
| Amount of allocated equities in other System institutions | - | (39,144) |
| Excess above third-party capital limits | (2,488) | - |
| Other regulatory required deductions | (256) | - |
| Total | <u>\$ 1,764,977</u> | <u>\$ 689,657</u> |
| Denominator: | | |
| Total Assets | \$ 23,883,519 | \$ 23,883,519 |
| Regulatory Adjustments and Deductions: | | |
| Regulatory deductions included in tier 1 capital | (154,030) | (154,030) |
| Total | <u>\$ 23,729,489</u> | <u>\$ 23,729,489</u> |

The components of the bank's non-risk-adjusted capital, based on 90-day average balances, were as follows at December 31, 2017:

| <u>(dollars in thousands)</u> | Tier 1 leverage | UREE leverage |
|--|-----------------------------|-----------------------------|
| | ratio | ratio |
| Numerator: | | |
| Unallocated retained earnings | \$ 851,333 | \$ 851,333 |
| Common Cooperative Equities: | | |
| Purchased other required stock ≥ 7 years | 248,931 | - |
| Allocated stock ≥ 7 years | 36,042 | - |
| Allocated equities: | | |
| Allocated equities held ≥ 7 years | 33,365 | - |
| Noncumulative perpetual preferred stock | - | - |
| Regulatory Adjustments and Deductions: | | |
| Amount of allocated investments in other System institutions | (127,533) | (127,533) |
| Amount of allocated equities in other System institutions | - | (33,365) |
| Other regulatory required deductions | (265) | - |
| Total | <u>\$ 1,041,873</u> | <u>\$ 690,435</u> |
| Denominator: | | |
| Total Assets | \$ 22,554,092 | \$ 22,554,092 |
| Regulatory Adjustments and Deductions: | | |
| Regulatory deductions included in tier 1 capital | (142,802) | (142,802) |
| Total | <u>\$ 22,411,290</u> | <u>\$ 22,411,290</u> |

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

In addition to pension benefits, the bank provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multiemployer and, consequently, the liability for these benefits is included in other liabilities. Bank employees hired after January 1, 2004, will be eligible for retiree medical benefits for themselves and their spouses at their expense but will be responsible for 100 percent of the related premiums. The following table summarizes the components of net periodic benefit costs for the bank’s other postretirement benefit costs for the nine months ended September 30:

| | Other Postretirement Benefits | |
|------------------------------------|----------------------------------|--------|
| | 2018 | 2017 |
| Service Cost | \$ 205 | \$ 182 |
| Interest Cost | 370 | 372 |
| Amortization of prior service cost | (104) | (139) |
| Amortization of net actuarial loss | 69 | - |
| | \$ 540 | \$ 415 |

The components of net periodic benefit cost other than the service cost component are included in the line item “other components of net periodic postretirement benefit cost” in the income statement.

The structure of the district’s defined benefit pension plan is characterized as multiemployer, since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations).

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 bank, these elements include unrealized gains or losses on the bank's available-for-sale investment portfolio, amortization of retirement benefit elements and changes in the value of cash flow derivative instruments.

The following table summarizes the changes in the balance of the components of AOCL for the nine months ended September 30, 2018:

| | Total | Unrealized Loss on Securities | Retirement Benefit Plans | Cash Flow Derivative Instruments |
|--|---------------------------|--|---|---|
| Balance, January 1, 2018 | \$ (51,902) | \$ (56,813) | \$ (1,815) | \$ 6,726 |
| Change in unrealized losses on available-for-sale securities | | | | |
| Net change in unrealized losses on investment securities | <u>(56,357)</u> | <u>(56,357)</u> | | |
| Net change in unrealized losses on securities | <u>(56,357)</u> | <u>(56,357)</u> | | |
| Change in postretirement benefit plans | | | | |
| Amounts amortized into net periodic expense: | | | | |
| Amortization of prior service credits | <u>(35)</u> | | <u>(35)</u> | |
| Net change in postretirement benefit plans | <u>(35)</u> | | <u>(35)</u> | |
| Change in cash flow derivative instruments | | | | |
| Unrealized gain on cash flow derivative instruments | 13,033 | | | 13,033 |
| Reclassification of amount recognized in interest expense | <u>(207)</u> | | | <u>(207)</u> |
| Net change in cash flow derivative instruments | <u>12,826</u> | | | <u>12,826</u> |
| Total other comprehensive (loss) income | <u>(43,566)</u> | <u>(56,357)</u> | <u>(35)</u> | <u>12,826</u> |
| Balance, September 30, 2018 | <u>\$ (95,468)</u> | <u>\$ (113,170)</u> | <u>\$ (1,850)</u> | <u>\$ 19,552</u> |

The following table summarizes the changes in the balance of the components of AOCL for the nine months ended September 30, 2017:

| | Total | Unrealized Gain (Loss) on Securities | Retirement Benefit Plans | Cash Flow Derivative Instruments |
|---|---------------------------|---|---|---|
| Balance, January 1, 2017 | \$ (32,579) | \$ (38,529) | \$ (471) | \$ 6,421 |
| Change in unrealized gains on available-for-sale securities | | | | |
| Net change in unrealized gains on investment securities | <u>4,315</u> | <u>4,315</u> | | |
| Net change in unrealized gains on securities | <u>4,315</u> | <u>4,315</u> | | |
| Change in postretirement benefit plans | | | | |
| Amounts amortized into net periodic expense: | | | | |
| Amortization of prior service credits | <u>(139)</u> | | <u>(139)</u> | |
| Net change in postretirement benefit plans | <u>(139)</u> | | <u>(139)</u> | |
| Change in cash flow derivative instruments | | | | |
| Unrealized loss on cash flow derivative instruments | (2,386) | | | (2,386) |
| Reclassification of amount recognized in interest expense | <u>836</u> | | | <u>836</u> |
| Net change in cash flow derivative instruments | <u>(1,550)</u> | | | <u>(1,550)</u> |
| Total other comprehensive (loss) income | <u>2,626</u> | <u>4,315</u> | <u>(139)</u> | <u>(1,550)</u> |
| Balance, September 30, 2017 | <u>\$ (29,953)</u> | <u>\$ (34,214)</u> | <u>\$ (610)</u> | <u>\$ 4,871</u> |

The following table summarizes reclassifications from AOCI to the statements of comprehensive income for the nine months ended September 30:

| <u>Component of AOCI</u> | <u>Amount Reclassified from AOCI</u> | | <u>Affected Line in the Statement of Comprehensive Income</u> |
|---|--|---------------|---|
| | <u>2018</u> | <u>2017</u> | |
| Amortization of net credits on post-retirement benefit plan | \$ (35) | \$ (139) | Salaries and employee benefits |
| Amortization on cash flow hedges | (207) | 836 | Interest expense |
| Total reclassifications | <u>\$ (242)</u> | <u>\$ 697</u> | |

NOTE 10 — SUBSEQUENT EVENTS

The bank has evaluated subsequent events through November 9, 2018, which is the date the financial statements were issued. There are no other significant subsequent events requiring disclosure as of November 9, 2018.

NOTE 11 — COMBINED ASSOCIATION FINANCIAL DATA

Condensed financial information for the associations follows. All significant transactions and balances between the associations are eliminated in combination. The multiemployer structure of certain of the district's retirement and benefit plans results in the recording of these plans only in the district's combined financial statements.

| Balance sheet data | <u>September 30, 2018</u> | <u>December 31, 2017</u> |
|--------------------------------|---------------------------|--------------------------|
| Cash | \$ 6,749 | \$ 10,829 |
| Investment securities | 16,364 | 18,827 |
| Loans | 18,607,478 | 18,203,989 |
| Less allowance for loan losses | 69,241 | 75,252 |
| Net loans | <u>18,538,237</u> | <u>18,128,737</u> |
| Accrued interest receivable | 209,085 | 169,193 |
| Other property owned | 14,924 | 15,569 |
| Other assets | 516,329 | 467,226 |
| Total assets | <u>\$ 19,301,688</u> | <u>\$ 18,810,381</u> |

| | | |
|--|----------------------|----------------------|
| Notes payable | \$ 15,758,788 | \$ 15,389,216 |
| Other liabilities | 272,132 | 384,826 |
| Total liabilities | <u>16,030,920</u> | <u>15,774,042</u> |
| Preferred stock | 20,000 | 20,000 |
| Capital stock and participation certificates | 65,255 | 65,004 |
| Additional paid-in-capital | 224,625 | 224,625 |
| Retained earnings | 2,971,362 | 2,737,249 |
| Accumulated other comprehensive loss | (10,474) | (10,539) |
| Total shareholders' equity | <u>3,270,768</u> | <u>3,036,339</u> |
| Total liabilities and shareholders' equity | <u>\$ 19,301,688</u> | <u>\$ 18,810,381</u> |

| Statement of income data | <u>Nine Months Ended September 30,</u> | |
|--|--|-------------------|
| | <u>2018</u> | <u>2017</u> |
| Interest income | \$ 707,917 | \$ 633,456 |
| Interest expense | 305,525 | 245,403 |
| Net interest income | 402,392 | 388,053 |
| (Negative provision) provision for loan losses | (1,660) | 9,980 |
| Net interest income after provision | | |
| for loan losses | 404,052 | 378,073 |
| Noninterest income | 91,254 | 70,157 |
| Noninterest expense | 192,503 | 207,666 |
| Benefit from (provision for) income taxes | 254 | (183) |
| Net income | <u>302,549</u> | <u>240,747</u> |
| Other comprehensive loss: | | |
| Change in postretirement benefit plans | 65 | (406) |
| Total other comprehensive loss | <u>65</u> | <u>(406)</u> |
| Comprehensive income | <u>\$ 302,614</u> | <u>\$ 240,341</u> |

ADDITIONAL REGULATORY INFORMATION – FARM CREDIT BANK OF TEXAS
(unaudited)

The following disclosures contain regulatory disclosures as required under Farm Credit Administration (FCA) Regulation 628.63 for risk-adjusted ratios: common equity tier 1, tier 1 capital and total capital. Refer to Note 7 of the accompanying financial statements for information regarding the statutorily required permanent capital ratio. As required, these disclosures are made available for at least three years or such shorter period beginning on January 1, 2017, and can be accessed at Farm Credit Bank of Texas' website at www.farmcreditbank.com.

FCA Regulation Section 628.62(a) requires each System bank to provide timely public disclosures at the end of each calendar quarter. Qualitative disclosures that typically do not change each quarter may be disclosed annually after the end of the fourth calendar quarter, provided that any significant changes are disclosed in the interim. FCA provided additional guidance that System banks must provide their first qualitative disclosures as of March 31, 2017, and again at the end of December 31, 2017, provided that any significant changes be disclosed in the interim. After that time, System banks may provide qualitative disclosures annually, as long as any significant changes are disclosed in the interim.

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, with issuance costs on preferred stock of \$1.3 million. Dividends accrued on the Class B-3 preferred stock were \$1.6 million as of September 30, 2018, and were 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 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.

No other significant qualitative changes occurred for the third quarter of 2018 to be included within this disclosure as compared to the disclosures as of December 31, 2017.

Capital Structure

The following table provides a summary of the bank's capital structure at September 30, 2018:

| (dollars in thousands) | Month-End Balance | Three Month Average Daily Balance |
|---|----------------------|---|
| Common equity tier 1 capital (CET1) | | |
| Common cooperative equities: | | |
| Purchased other required stock ≥ 7 years | \$ 268,800 | \$ 263,734 |
| Allocated stock ≥ 7 years | 36,042 | 36,042 |
| Other required member purchased stock | - | - |
| Allocated equities: | | |
| Qualified allocated equities subject to retirement | 39,144 | 39,144 |
| Nonqualified allocated equities subject to retirement | - | - |
| Nonqualified allocated equities not subject to retirement | - | - |
| Unallocated retained earnings | 884,713 | 871,123 |
| Paid-in capital | - | - |
| Regulatory adjustments and deductions made to CET1 | (142,578) | (142,578) |
| Total CET1 | <u>\$ 1,086,121</u> | <u>\$ 1,067,465</u> |
| Tier 1 capital | | |
| Noncumulative perpetual preferred stock | \$ 700,000 | \$ 700,000 |
| Regulatory adjustments and deductions made to tier 1 capital | (2,430) | (2,488) |
| Total additional tier 1 capital | <u>697,570</u> | <u>697,512</u> |
| Total tier 1 capital | <u>\$ 1,783,691</u> | <u>\$ 1,764,977</u> |
| Total capital | | |
| Common cooperative equities not included in CET1 | \$ - | \$ - |
| Tier 2 capital elements (subordinated debt, allowance for loan losses) | 14,158 | 14,049 |
| Regulatory adjustments and deductions made to total capital | (14,158) | (14,049) |
| Total tier 2 capital | - | - |
| Total capital | <u>\$ 1,783,691</u> | <u>\$ 1,764,977</u> |

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.

Capital Adequacy and Capital Buffers

The bank’s risk-adjusted regulatory capital ratios are calculated by dividing the relevant total capital elements by risk-weighted assets. The following table provides the bank’s risk-weighted assets at September 30, 2018:

| (dollars in thousands) | Month-End Balance | Three-Month Average Daily Balance | Risk-Weighted Exposures |
|---|----------------------|---|----------------------------|
| Exposures to: | | | |
| Government-sponsored entities | \$ 15,284,201 | \$ 15,194,896 | \$ 2,513,269 |
| Depository institutions, foreign banks and credit unions* | 27,419 | 19,583 | 2,236 |
| Corporate exposures, including borrower loans and leases | 6,158,509 | 5,916,152 | 5,629,171 |
| Past due and nonaccrual loans | 20,130 | 20,655 | 30,982 |
| Securitized assets | 186,465 | 86,007 | 114,093 |
| Equity investments | 142,578 | 142,578 | 142,578 |
| Other assets | 8,819,264 | 8,734,762 | 2,316,177 |
| Deductions: | | | |
| Regulatory adjustments and deductions made to CET1 | - | - | (142,578) |
| Regulatory adjustments and deductions made to AT1 | - | - | (2,488) |
| Regulatory adjustments and deductions made to tier 2 | - | - | (14,049) |
| Total standardized risk-weighted assets | <u>\$ 30,638,566</u> | <u>\$ 30,114,633</u> | <u>\$ 10,589,391</u> |

*Also includes OFI exposures that are risk weighted as exposures to U.S. depository institutions and credit unions

Capital Conservation and Leverage Buffers

As of September 30, 2018, the bank was well-capitalized and exceeded all capital requirements to which it was subject, including applicable capital buffers. The bank’s capital conservation buffer is the lowest of the calculated buffer listed in the table below at 5.56 percent. The bank’s leverage buffer of 3.44 percent is equal to the tier 1 leverage ratio minus the minimum tier 1 leverage ratio requirement. Because the bank’s conservation and leverage buffers exceed the minimum buffer requirements of 2.5 percent and 1 percent, respectively, the bank currently has no limitations on its distributions and discretionary bonus payments. The aggregate amount of eligible retained income was \$31,736 as of September 30, 2018.

| | Regulatory Minimums | Required Buffer | September 30, 2018 | Calculated Buffer |
|-------------------------------------|------------------------|--------------------|-----------------------|----------------------|
| Common equity tier 1 capital ratio* | 4.5% | 2.5% | 10.08% | 5.58% |
| Tier 1 capital ratio* | 6.0% | 2.5% | 16.67% | 10.67% |
| Total capital ratio* | 8.0% | 2.5% | 16.67% | 8.67% |
| Capital conservation buffer | | | | 5.58% |
| Tier 1 leverage ratio | 4.0% | 1.0% | 7.44% | 3.44% |
| Leverage buffer | | | | 3.44% |

*The capital conservation buffer over risk-adjusted ratio minimums will be phased in over 3 years under the FCA revised capital requirements, up to 2.5 percent beginning in 2020.

Credit Risk

System entities have specific lending authorities within their chartered territories. The bank is chartered to serve its associations in Texas, Alabama, Mississippi, Louisiana and most of New Mexico. Our chartered territory is referred to as the district. FCBT serves its chartered territory by lending to the district's Federal Land Credit Association (FLCA) and Agricultural Credit Associations (ACAs). The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which identifies loans that may be impaired based on characteristics such as probability of default (PD) and loss given default (LGD) as is further discussed in the section "Allowance for Loan Losses and Reserve for Unfunded Commitments." Allowance needs by geographic region are only considered in circumstances that may not otherwise be reflected in the PD and LGD such as flooding or drought. There was no allowance attributed to a geographic area as of September 30, 2018.

Refer to the Risk-Adjusted Asset table on page 54 for the bank's total and average loans, investment securities, off -balance-sheet commitments and OTC derivatives. The bank's total loans by type can be found in Note 3.

The following table provides an overview of the remaining contractual maturity of the bank's credit risk portfolio categorized by exposure at September 30, 2018:

| (dollars in thousands) | Due in one year or less | Due after one year through five years | Due after five years | Total |
|-------------------------------|-------------------------------|---|-------------------------|----------------------|
| Loans | \$ 4,435,114 | \$ 8,382,889 | \$ 5,206,661 | \$ 18,024,664 |
| Off-Balance-Sheet Commitments | | | | |
| Financial letters of credit | 62,052 | 9,882 | - | 71,934 |
| Performance letters of credit | 5,285 | 566 | - | 5,851 |
| Commercial letters of credit | 1,642 | 2 | - | 1,644 |
| Unfunded commitments | 3,908,662 | 2,163,964 | 83,708 | 6,156,334 |
| Investments | 287,831 | 586,549 | 4,794,256 | 5,668,636 |
| OTC Derivatives | | | | |
| Interest rate caps | - | 7 | 490 | 497 |
| Pay fixed swaps | - | 14,026 | 6,691 | 20,717 |
| Total | \$ 8,700,586 | \$ 11,157,885 | \$ 10,091,806 | \$ 29,950,277 |

The diversity of states underlying the bank's capital markets and other bank-owned loan portfolio is reflected in the following table:

| | September 30, 2018 | December 31, 2017 2016 | |
|------------------|-----------------------|--------------------------------|-------|
| Texas | 18 % | 15 % | 15 % |
| California | 6 | 5 | 4 |
| Illinois | 5 | 6 | 7 |
| Georgia | 5 | 6 | 7 |
| Minnesota | 5 | 4 | 5 |
| All other states | 61 | 64 | 62 |
| | 100 % | 100 % | 100 % |

Refer to Note 3 for amounts of impaired loans with or with no related allowance, loans in nonaccrual status and greater than 90 days past due, loans past due greater than 90 days and still accruing, the allowance at the end of each reporting period, charge-offs during the period, and changes in components of our allowance for credit losses.

Counterparty Credit Risk and Credit Risk Mitigation

The following table provides the total exposure covered by guarantees/credit derivatives for each separately disclosed credit risk portfolio and the risk-weighted asset amount associated with that exposure. The bank did not hold eligible financial collateral for its loan, investment and derivative portfolios at September 30, 2018.

| Government Guaranteed Asset Type (dollars in thousands) | 90-Day Average Balance | Risk Weighting | Risk-Weighted Amount |
|--|---------------------------|-------------------|-------------------------|
| Investments | \$ 2,932,900 | 0% | \$ - |
| Loans | 2,357 | 0% | - |
| Total | \$ 2,935,257 | | \$ - |

Securitization

The bank currently only participates in credit-related securitizations as investors through the purchase of highly rated asset-backed securities (ABS) as included in its investment portfolio. The bank also holds securitization exposures through the purchase of U.S. government and agency guaranteed securities. The bank has not transferred any exposures that it has originated or purchased from a third party in connection with a securitization of assets as of September 30, 2018, nor does it have any outstanding exposures that it intends to be securitized as of September 30, 2018. The bank did not recognize any gain or loss on securitized assets for the three months ended September 30, 2018. As of September 30, 2018, the bank did not retain any credit-related re-securitization exposures.

Below is an overview of our purchased securitization exposures held as of September 30, 2018, by exposure type and categorized by risk-weighting band and risk-based capital approach.

As of September 30, 2018, the bank did not hold any off-balance sheet securitization exposures nor were any securitization exposures deducted from capital.

| Description of Securitization | Risk-Based Capital Approach | Exposure Amount (dollars in thousands) | Risk Weighted |
|-------------------------------|--------------------------------|--|---------------|
| Agency MBS: | | | |
| GNMA | Standardized Risk Weight | \$ 2,547,783 | 0% |
| FNMA and FHLMC | Standardized Risk Weight | 2,267,435 | 20% |
| Asset-backed securities | Gross-up | 84,282 | 121% |

Equities

We are a limited partner in certain Rural Business Investment Companies (RBICs) for various relationship and strategic reasons. These RBICs facilitate equity and debt investments in agriculture-related businesses that create growth and job opportunities in rural America. These investments are accounted for under the equity method, as the bank is considered to have significant influence. These investments are not publicly traded, and the book value approximates fair value. There have been no sales or liquidations of these investments during the period.

| As of September 30, 2018 (dollars in thousands) | Disclosed in Other Assets | Life-to-Date Losses Recognized in Retained Earnings* |
|--|--|---|
| RBICs | \$ 13,356 | \$ (1,235) |

*Retained earnings is included in common equity tier 1 and total capital ratios

Interest Rate Risk

The following tables set forth the bank's projected annual net interest income and market value of equity for interest rate movements as prescribed by policy as of September 30, 2018, based on the bank's interest-earning assets and interest-bearing liabilities at September 30, 2018:

| Basis points: | Down 110* | Up 100 | Up 200 |
|----------------------------------|------------------|---------------|---------------|
| Change in net interest income | 2.53% | (0.96%) | (2.18%) |
| Change in market value of equity | 7.92% | (7.67%) | (16.17%) |

For interest rate risk management, the \$700.0 million noncumulative perpetual preferred stock is included in liabilities.

*When the 3-month Treasury bill is below 4.00 percent, the shock-down 200 scenario is replaced with a shock-down equal to half of the 3-month Treasury bill.