

**ALABAMA AG CREDIT, ACA**

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**2018  
Quarterly Report  
Second Quarter**



**For the Quarter Ended June 30, 2018**

## REPORT OF MANAGEMENT

The consolidated financial statements of Alabama Ag Credit, ACA (Association) are prepared by management, who are responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' (Bank) and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The annual financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The audit committee of the board of directors has oversight responsibility for the Association's system of internal controls and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditor to review the scope and results of their work. The independent auditors and internal auditor have direct access to the audit committee.

The undersigned certify that, to the best of our knowledge and belief, the consolidated financial statements and other financial information included in this quarterly report reliably present the financial condition of Alabama Ag Credit, ACA and the results of its operations for the periods shown.



Douglas Thiessen, President/Chief Executive Officer  
August 9, 2018



John Carl Sanders, Chairman, Board of Directors  
August 9, 2018



M. Scott Sellers, CPA, Sr. VP/Chief Financial Officer  
August 9, 2018



J.K. Love, CPA, Chairman, Audit Committee  
August 9, 2018

**ALABAMA AG CREDIT, ACA  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Alabama Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter and six months ended June 30, 2018. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2017 Annual Report to Stockholders.

The Association 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 consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

**Results of Operations**

The Association had net income of \$4,220,278 and \$8,950,745 for the three and six months ended June 30, 2018, as compared to net income of \$3,536,240 and \$7,775,324 for the same period in 2017, reflecting an increase of 15.6 and 15.1 percent. Net interest income was \$6,929,191 and \$13,805,259 for the three and six months ended June 30, 2018, compared to \$6,669,708 and \$13,486,083 for the same period in 2017.

	Six months ended			
	June 30, 2018		June 30, 2017	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 967,107,390	\$ 24,177,340	\$ 922,654,073	\$ 21,978,484
Interest-bearing liabilities	807,328,670	10,372,081	770,962,564	8,492,431
Impact of capital	<u>\$ 159,778,720</u>		<u>\$ 151,691,509</u>	
Net interest income	<u>\$ 13,805,259</u>		<u>\$ 13,486,053</u>	
	2018		2017	
	<u>Average Yield</u>		<u>Average Yield</u>	
Yield on loans	5.04%		4.80%	
Cost of interest-bearing liabilities	2.59%		2.22%	
Interest rate spread	2.45%		2.58%	
Impact of capital	0.43%		0.37%	
Net interest income as a percentage of average earning assets	2.88%		2.95%	

	Six months ended:		
	June 30, 2018 vs. June 30, 2017		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 1,058,926	\$ 1,139,930	\$ 2,198,856
Interest expense	400,580	1,479,070	1,879,650
Net interest income	<u>\$ 658,346</u>	<u>\$ (339,140)</u>	<u>\$ 319,206</u>

Interest income for the three and six months ended June 30, 2018, increased by \$1,269,608 and \$2,198,856, or 11.5 and 10.0 percent respectively, from the same period of 2017, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the three and six months ended June 30, 2018, increased by \$1,010,125 and \$1,879,650, or 22.9 and 22.1 percent, from the same period of 2017 due to an increase in average debt volume and an increase in the cost of debt. Average loan volume for the second quarter of 2018 was \$975,646,325, compared to \$931,985,888 in the second quarter of 2017.

Noninterest income for the three months ended June 30, 2018, increased by \$15,402, or 3.6 percent, over the same period of 2017. The increase is primarily due to an increase in patronage income from the Bank due to an increase in the average direct note to the Bank for the three months ended June 30, 2018 compared to the three months ended June 30, 2017. Noninterest income for the six months ended June 30, 2018, increased by \$513,374, or 54.9 percent, over the same period of 2017. The increase is due primarily to an insurance fund refund from the Farm Credit System Insurance Corporation (FCSIC) that was received in the first quarter of 2018. No refund was received in 2017.

Noninterest expenses for the three months ended June 30, 2018 decreased by \$99,075, or 3.1 percent, as compared to the same period in 2017. The decrease is primarily due to a decrease in Insurance Fund Premiums. The decrease is the result of lower Insurance Fund premiums from 2017 to 2018. Noninterest expenses for the six months ended June 30, 2018 increased by \$92,659, or 1.5 percent, as compared to the same period in 2017. The increase is primarily due to an increase in salaries and benefits as a result of a larger workforce and normal increase in compensation rates.

The Association's return on average assets for the six months ended June 30, 2018, was 1.82 percent compared to 1.65 percent for the same period in 2017. The Association's return on average equity for the six months ended June 30, 2018, was 10.28 percent, compared to 9.39 percent for the same period in 2017.

### Loan Portfolio

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loans are available to eligible borrowers with competitive prime- and LIBOR-based, fixed and adjustable interest rates and loan maturities ranging up to 40 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with seasonal cash-flow capabilities of the borrower.

Total loans outstanding at June 30, 2018, stated at recorded investment (principal less funds held), were \$981,717,531 compared to \$955,830,732 at December 31, 2017, reflecting an increase of 2.7 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.5 percent at June 30, 2018 and at December 31, 2017. The major commodities within the Association's portfolio are timber, cattle, poultry and field crops.

The Association recorded \$1,699 in recoveries and \$88,888 in charge-offs for the quarter ended June 30, 2018, and \$1,699 in recoveries and \$59,213 in charge-offs for the same period in 2017. The Association's allowance for loan losses was 0.7 percent of total loans outstanding as of June 30, 2018, and December 31, 2017.

The following table reflects the credit quality of the Association's loan volume as of:

	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Acceptable	97.8 %	98.2 %
OAEM	0.9	0.8
Substandard/doubtful	1.3	1.0
	<u>100.0 %</u>	<u>100.0 %</u>

### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	<u>June 30, 2018</u>		<u>December 31, 2017</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 4,868,289	66.2%	\$ 4,987,706	69.6%
90 days past due and still accruing interest	658,029	8.9%	58,723	0.8%
Formally restructured	1,789,031	24.3%	2,078,563	29.0%
Other property owned, net	41,200	0.6%	41,200	0.6%
Total	<u>\$ 7,356,549</u>	<u>100.0%</u>	<u>\$ 7,166,192</u>	<u>100.0%</u>

## Liquidity and Funding Sources

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the Bank), which obtains its funds through the issuance of System-wide obligations. The following schedule summarizes the Association's borrowings.

	June 30, 2018	December 31, 2017
Note payable to the Bank	\$ 822,377,690	\$ 793,712,363
Accrued interest on note payable	1,823,195	1,629,260
Total	<u>\$ 824,200,885</u>	<u>\$ 795,341,623</u>

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2018. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of \$822,377,690 as of June 30, 2018, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.70 percent at June 30, 2018. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the GFA. The increase in note payable to the Bank and related accrued interest payable since December 31, 2017, is due to increased funding needs generated by growth in the Association's loan portfolio. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$159,662,131 at June 30, 2018. The maximum amount the Association may borrow from the Bank as of June 30, 2018, was \$973,289,172 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

## Capital Resources

The Association's capital position increased by \$9,016,058 at June 30, 2018, compared to December 31, 2017. The Association's debt as a ratio of members' equity was 4.61:1 as of June 30, 2018, compared to 4.75:1 as of December 31, 2017.

Farm Credit Administration regulations require the Association to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of June 30, 2018, the Association exceeded all regulatory capital requirements.

## Significant Recent Accounting Pronouncements

Information regarding significant recent accounting pronouncements, required to be disclosed, is incorporated herein by reference to Note 1 to the consolidated financial statements, "Organization and Significant Accounting Policies," included in this quarterly report.

## Relationship With the Farm Credit Bank of Texas

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2017 Annual Report of Alabama Ag Credit, ACA more fully describe the Association's relationship with the Bank.

The Texas Farm Credit District's (District) annual and quarterly stockholder reports, as well as those of the Bank, are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcf@farmcreditbank.com](mailto:fcf@farmcreditbank.com). The annual and quarterly stockholder reports for the Bank and the District are also available on its website at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's annual and quarterly stockholder reports are also available free of charge, upon request. The quarterly reports will be available on the Association's website at [www.AlabamaAgCredit.com](http://www.AlabamaAgCredit.com) approximately 40 days after quarter end and can also be obtained by writing to Alabama Ag Credit, ACA, 2660 EastChase Lane, Suite 401, Montgomery, Alabama, 36117 or calling (334) 270-8687. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [Kim.Bond@AlabamaAgCredit.com](mailto:Kim.Bond@AlabamaAgCredit.com). The Association's annual stockholder report is available on its website 75 days after the fiscal year end. Copies of the Association's annual stockholder report can also be requested 90 days after the fiscal year end.

**ALABAMA AG CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>June 30, 2018 (unaudited)</b>	<b>December 31, 2017</b>
<b><u>ASSETS</u></b>		
Cash	\$ 14,227	\$ 13,074
Loans	981,717,531	955,830,732
Less: allowance for loan losses	6,454,519	6,632,476
Net loans	<u>975,263,012</u>	<u>949,198,256</u>
Accrued interest receivable	9,860,567	8,514,757
Investment in and receivable from the Bank:		
Capital stock	15,533,315	15,533,315
Accrued patronage receivable	450,000	116,993
Other	799,816	1,225,117
Other property owned, net	41,200	41,200
Premises and equipment, net	6,513,543	6,612,044
Other assets	794,315	504,317
Total assets	<u><u>\$ 1,009,269,995</u></u>	<u><u>\$ 981,759,073</u></u>
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 822,377,690	\$ 793,712,363
Accrued interest payable	1,823,195	1,629,260
Drafts outstanding	212,317	153,633
Patronage distributions payable	7,302	8,494,220
Other liabilities	4,980,870	6,917,034
Total liabilities	<u><u>829,401,374</u></u>	<u><u>810,906,510</u></u>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	4,063,630	4,004,710
Unallocated retained earnings	176,379,437	167,430,087
Accumulated other comprehensive loss	(574,446)	(582,234)
Total members' equity	<u><u>179,868,621</u></u>	<u><u>170,852,563</u></u>
Total liabilities and members' equity	<u><u>\$ 1,009,269,995</u></u>	<u><u>\$ 981,759,073</u></u>

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

ALABAMA AG CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 12,357,817	\$ 11,088,209	\$ 24,177,340	\$ 21,978,484
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	5,428,626	4,418,501	10,372,081	8,492,431
Net interest income	6,929,191	6,669,708	13,805,259	13,486,053
<b><u>PROVISION FOR LOAN LOSSES</u></b>				
Provision for (reversal of) loan losses	9,421	319,499	(112,191)	323,309
Net interest income after provision for loan losses	6,919,770	6,350,209	13,917,450	13,162,744
<b><u>NONINTEREST INCOME</u></b>				
Patronage income from the Bank	328,317	270,925	647,238	537,998
Loan fees	88,524	79,975	161,595	201,684
Gain (loss) on sale of premises and equipment, net	25,416	75,979	70,685	126,119
Other noninterest income	354	330	569,241	69,584
Total noninterest income	442,611	427,209	1,448,759	935,385
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,998,966	1,916,721	4,010,370	3,794,012
Directors' expense	74,627	119,413	177,739	200,420
Purchased services	98,960	153,103	180,879	197,108
Travel	182,730	212,956	358,166	346,704
Occupancy and equipment	174,290	197,599	361,748	402,371
Communications	69,110	70,630	140,498	148,778
Advertising	85,387	64,655	143,309	128,754
Public and member relations	99,259	91,696	216,505	189,191
Supervisory and exam expense	71,879	68,253	159,136	151,462
Insurance Fund premiums	181,521	281,791	474,492	648,283
Other components of net periodic postretirement benefit cost	33,357	-	66,714	-
Loss (gain) on other property owned, net	180	228	1,632	(950)
Other noninterest expense	71,837	64,133	124,276	116,672
Total noninterest expenses	3,142,103	3,241,178	6,415,464	6,322,805
<b>NET INCOME</b>	<b>4,220,278</b>	<b>3,536,240</b>	<b>8,950,745</b>	<b>7,775,324</b>
Other comprehensive income:				
Change in postretirement benefit plans	3,894	(1,455)	7,788	(2,910)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 4,224,172</b>	<b>\$ 3,534,785</b>	<b>\$ 8,958,533</b>	<b>\$ 7,772,414</b>

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

ALABAMA AG CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY  
(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Unallocated Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2016	\$ 3,913,875	\$ 159,081,109	\$ (380,576)	\$ 162,614,408
Net income	-	7,775,324	-	7,775,324
Other comprehensive income	-	-	(2,910)	(2,910)
Capital stock/participation certificates issued	286,205	-	-	286,205
Capital stock/participation certificates retired	(223,780)	-	-	(223,780)
Patronage refunds:				
Change in patronage declared and paid	-	606	-	606
Balance at June 30, 2017	<u>\$ 3,976,300</u>	<u>\$ 166,857,039</u>	<u>\$ (383,486)</u>	<u>\$ 170,449,853</u>
Balance at December 31, 2017	\$ 4,004,710	\$ 167,430,087	\$ (582,234)	\$ 170,852,563
Net income	-	8,950,745	-	8,950,745
Other comprehensive income	-	-	7,788	7,788
Capital stock/participation certificates issued	277,780	-	-	277,780
Capital stock/participation certificates retired	(218,860)	-	-	(218,860)
Patronage refunds:				
Change in patronage declared and paid	-	(1,395)	-	(1,395)
<b>Balance at June 30, 2018</b>	<b><u>\$ 4,063,630</u></b>	<b><u>\$ 176,379,437</u></b>	<b><u>\$ (574,446)</u></b>	<b><u>\$ 179,868,621</u></b>

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

**ALABAMA AG CREDIT, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

Alabama Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Autauga, Baldwin, Barbour, Bibb, Bullock, Butler, Chambers, Chilton, Choctaw, Clarke, Coffee, Conecuh, Coosa, Covington, Crenshaw, Dale, Dallas, Elmore, Escambia, Geneva, Greene, Hale, Henry, Houston, Lee, Lowndes, Macon, Marengo, Mobile, Monroe, Montgomery, Perry, Pickens, Pike, Russell, Sumter, Tallapoosa, Tuscaloosa, Washington and Wilcox in the state of Alabama. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2017, as contained in the 2017 Annual Report to Stockholders.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with GAAP, except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by the Farm Credit Administration (FCA), associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2017, as contained in the 2017 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Descriptions of the significant accounting policies are included in the 2017 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35% to 21%. 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. Early adoption is permitted. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

In August 2017, the Financial Accounting Standards Board (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 Association is evaluating the impact of adoption on the Association’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 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association’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 becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association's financial condition or its results of operations but may change the classification of certain items in the statement of cash flows.

In June 2016, 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 Association is evaluating the impact of adoption on its financial condition and results of operations.

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." This 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 Association's financial condition or its results of operations but did impact the Association's fair value disclosures.

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 Association has determined that the effect of the adoption is not material to its financial condition or results of operations and will not change its current recognition practices.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter ended June 30, 2018, are not necessarily indicative of the results to be expected for the year ended December 31, 2018. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans follows:

Loan Type	June 30, 2018	December 31, 2017
Production agriculture:		
Real estate mortgage	<b>\$ 818,019,576</b>	\$ 797,514,109
Production and intermediate term	<b>98,841,170</b>	97,061,367
Agribusiness:		
Loans to cooperatives	<b>5,767,626</b>	2,373,350
Processing and marketing	<b>33,788,711</b>	36,866,722
Farm-related business	<b>354,805</b>	655,293
Communication	<b>2,846,417</b>	2,893,234
Rural residential real estate	<b>22,099,226</b>	18,466,657
Total	<b><u>\$ 981,717,531</u></b>	<b><u>\$ 955,830,732</u></b>

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with FCA regulations. The following table presents information regarding the balances of participations purchased and sold at June 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	\$ 9,685,536	\$ 32,322,665	\$ -	\$ -	\$ 9,685,536	\$ 32,322,665
Production and intermediate term	14,089,907	987,003	-	-	14,089,907	987,003
Agribusiness	38,290,899	-	-	-	38,290,899	-
Communication	2,846,417	-	-	-	2,846,417	-
Total	<u>\$ 64,912,759</u>	<u>\$ 33,309,668</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 64,912,759</u>	<u>\$ 33,309,668</u>

The Association 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 ACPs are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were \$16,692,891 and \$16,576,311 at June 30, 2018, and December 31, 2017, respectively.

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

	<b>June 30, 2018</b>	December 31, 2017
<b>Nonaccrual loans:</b>		
Real estate mortgage	<b>\$ 4,616,668</b>	\$ 4,562,792
Production and intermediate term	<b>152,630</b>	336,638
Agribusiness	<b>24,110</b>	33,055
Rural residential real estate	<b>74,881</b>	55,221
Total nonaccrual loans	<b>4,868,289</b>	4,987,706
<b>Accruing restructured loans:</b>		
Real estate mortgage	<b>1,384,595</b>	1,659,037
Production and intermediate term	<b>404,436</b>	419,526
Total accruing restructured loans	<b>1,789,031</b>	2,078,563
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	<b>658,029</b>	58,723
Total accruing loans 90 days or more past due	<b>658,029</b>	58,723
Total nonperforming loans	<b>7,315,349</b>	7,124,992
Other property owned	<b>41,200</b>	41,200
Total nonperforming assets	<b>\$ 7,356,549</b>	\$ 7,166,192

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

- Acceptable – assets are expected to be fully collectible and represent the highest quality;
- 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:

	<b>June 30, 2018</b>	December 31, 2017
Real estate mortgage		
Acceptable	97.8 %	98.1 %
OAEM	0.8	0.8
Substandard/doubtful	1.4	1.1
	<b>100.0</b>	100.0
Production and intermediate term		
Acceptable	96.7	97.8
OAEM	2.6	1.7
Substandard/doubtful	0.7	0.5
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	99.9	99.9
OAEM	-	-
Substandard/doubtful	0.1	0.1
	<b>100.0</b>	100.0
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Rural residential real estate		
Acceptable	99.7	99.5
OAEM	-	0.2
Substandard/doubtful	0.3	0.3
	<b>100.0</b>	100.0
Total loans		
Acceptable	97.8	98.2
OAEM	0.9	0.8
Substandard/doubtful	1.3	1.0
	<b>100.0 %</b>	100.0 %

The following tables provide an age analysis of past due loans (including accrued interest) as of:

<u>June 30, 2018</u>	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	\$ 2,443,576	\$ 4,014,063	\$ 6,457,639	\$ 820,027,263	\$ 826,484,902	\$ 658,029
Production and intermediate term	200,820	94,136	294,956	99,794,042	100,088,998	-
Loans to cooperatives	-	-	-	5,813,904	5,813,904	-
Processing and marketing	-	-	-	33,816,397	33,816,397	-
Farm-related business	-	-	-	354,871	354,871	-
Communication	-	-	-	2,847,139	2,847,139	-
Rural residential real estate	210,733	31,807	242,540	21,929,347	22,171,887	-
Total	<b>\$ 2,855,129</b>	<b>\$ 4,140,006</b>	<b>\$ 6,995,135</b>	<b>\$ 984,582,963</b>	<b>\$ 991,578,098</b>	<b>\$ 658,029</b>
<u>December 31, 2017</u>	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	\$ 4,842,756	\$ 461,111	\$ 5,303,867	\$ 799,192,198	\$ 804,496,065	\$ 58,723
Production and intermediate term	171,709	180,533	352,242	98,098,961	98,451,203	-
Loans to cooperatives	-	-	-	2,382,368	2,382,368	-
Processing and marketing	-	-	-	36,935,022	36,935,022	-
Farm-related business	-	-	-	655,574	655,574	-
Communication	-	-	-	2,894,322	2,894,322	-
Rural residential real estate	256,290	9,372	265,662	18,265,273	18,530,935	-
Total	<b>\$ 5,270,755</b>	<b>\$ 651,016</b>	<b>\$ 5,921,771</b>	<b>\$ 958,423,718</b>	<b>\$ 964,345,489</b>	<b>\$ 58,723</b>

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges or acquisition costs, and may also reflect a previous direct write-down of the investment.

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

As of June 30, 2018, the total recorded investment of TDR loans was \$4,694,618, including \$2,905,587 classified as nonaccrual and \$1,789,031 classified as accrual, with specific allowance for loan losses of \$627,357. All loans classified as TDRs were individually evaluated to determine the need for allowance for loan losses. As of June 30, 2018, the Association had no commitments to lend funds to borrowers whose loan terms have been modified in a TDR.

There were no loans with TDR designation, that occurred during the three or six months ended June 30, 2018. Loans formally restructured prior to January 1, 2018, were \$4,694,618.

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest).

The predominant form of concession granted for TDR includes extension of the term and/or delayed payments. Other types of modifications include principal or accrued interest reductions and interest rate decreases, among others. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a TDR. No loans modified in the last 12 months have subsequently defaulted as of June 30, 2018.

The following table provides information on outstanding loans restructured in TDRs at period end. These loans are included as impaired loans in the impaired loan table at:

	<u>Loans Modified as TDRs</u>		<u>TDRs in Nonaccrual Status</u>	
	<u>June 30, 2018</u>	<u>December 31, 2017</u>	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Real estate mortgage	\$ 4,138,552	\$ 4,507,937	\$ 2,753,957	\$ 2,848,900
Production and intermediate term	556,066	575,631	151,630	156,105
Total	<u>\$ 4,694,618</u>	<u>\$ 5,083,568</u>	<u>\$ 2,905,587</u>	<u>\$ 3,005,005</u>

Additional impaired loan information is as follows:

	June 30, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$4,073,411	\$4,057,167	\$657,282	\$4,228,280	\$4,235,041	\$932,168
Production and intermediate term	412,777	401,424	59,742	178,402	178,402	88,417
Farm-related business	-	-	-	33,055	33,055	5,895
Rural residential real estate	31,807	31,807	22,807	-	-	-
Total	<u>\$4,517,995</u>	<u>\$4,490,398</u>	<u>\$739,831</u>	<u>\$4,439,737</u>	<u>\$4,446,498</u>	<u>\$1,026,480</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$2,585,883	\$2,832,939	\$-	\$2,052,272	\$2,298,239	\$-
Production and intermediate term	144,290	247,199	-	577,762	588,204	-
Farm-related business	24,110	24,110	-	-	-	-
Rural residential real estate	43,074	43,074	-	55,221	55,221	-
Total	<u>\$2,797,357</u>	<u>\$3,147,322</u>	<u>\$-</u>	<u>\$2,685,255</u>	<u>\$2,941,664</u>	<u>\$-</u>
Total impaired loans:						
Real estate mortgage	\$6,659,294	\$6,890,106	\$657,282	\$6,280,552	\$6,533,280	\$932,168
Production and intermediate term	557,067	648,623	59,742	756,164	766,606	88,417
Farm-related business	24,110	24,110	-	33,055	33,055	5,895
Rural residential real estate	74,881	74,881	22,807	55,221	55,221	-
Total	<u>\$7,315,352</u>	<u>\$7,637,720</u>	<u>\$739,831</u>	<u>\$7,124,992</u>	<u>\$7,388,162</u>	<u>\$1,026,480</u>

<sup>a</sup> Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended			
	June 30, 2018		June 30, 2017	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$4,262,762	\$21,396	\$4,217,843	\$15,215
Production and intermediate term	402,230	4,873	247,791	818
Farm-related business	-	-	33,055	-
Rural residential real estate	31,807	-	30,168	-
Total	<u>\$4,696,799</u>	<u>\$26,269</u>	<u>\$4,528,857</u>	<u>\$16,033</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$2,166,329	\$14,438	\$2,470,980	\$5,753
Production and intermediate term	252,872	698	112,562	3,498
Farm-related business	24,110	-	-	-
Rural residential real estate	43,625	-	57,587	-
Total	<u>\$2,486,936</u>	<u>\$15,136</u>	<u>\$2,641,129</u>	<u>\$9,251</u>
Total impaired loans:				
Real estate mortgage	\$6,429,091	\$35,834	\$6,688,823	\$20,968
Production and intermediate term	655,102	5,571	360,353	4,316
Farm-related business	24,110	-	33,055	-
Rural residential real estate	75,432	-	87,755	-
Total	<u>\$7,183,735</u>	<u>\$41,405</u>	<u>\$7,169,986</u>	<u>\$25,284</u>

	For the Six Months Ended			
	June 30, 2018		June 30, 2017	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$4,166,283	\$ 38,176	\$ 3,846,519	\$ 15,215
Production and intermediate term	289,464	4,873	221,811	818
Farm-related business	-	-	37,499	-
Rural residential real estate	21,558	272	30,147	-
Total	<u>\$4,477,305</u>	<u>\$ 43,321</u>	<u>\$ 4,135,976</u>	<u>\$ 16,033</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$2,192,968	\$ 25,751	\$ 2,531,047	\$ 13,864
Production and intermediate term	413,294	6,421	128,389	4,391
Farm-related business	26,247	-	-	-
Rural residential real estate	44,367	-	58,584	-
Total	<u>\$2,676,876</u>	<u>\$ 32,172</u>	<u>\$ 2,718,020</u>	<u>\$ 18,255</u>
Total impaired loans:				
Real estate mortgage	\$6,359,251	\$ 63,927	\$ 6,377,566	\$ 29,079
Production and intermediate term	702,758	11,294	350,200	5,209
Farm-related business	26,247	-	37,499	-
Rural residential real estate	65,925	272	88,731	-
Total	<u>\$7,154,181</u>	<u>\$ 75,493</u>	<u>\$ 6,853,996</u>	<u>\$ 34,288</u>

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 Water	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>							
Balance at March 31, 2018	\$ 6,162,667	\$ 243,178	\$ 75,071	\$ 3,872	\$ -	\$ 49,763	\$ 6,534,551
Charge-offs	-	(88,888)	-	-	-	-	(88,888)
Recoveries	1,699	-	-	-	-	-	1,699
Provision for loan losses	(71,266)	83,757	(10,065)	(17)	3,640	3,372	9,421
Other	3,597	(2,022)	(129)	-	(3,640)	(70)	(2,264)
Balance at June 30, 2018	<u>\$ 6,096,697</u>	<u>\$ 236,025</u>	<u>\$ 64,877</u>	<u>\$ 3,855</u>	<u>\$ -</u>	<u>\$ 53,065</u>	<u>\$ 6,454,519</u>
Balance at December 31, 2017	\$ 6,293,569	\$ 248,540	\$ 58,177	\$ 3,601	\$ -	\$ 28,589	\$ 6,632,476
Charge-offs	-	(88,888)	-	-	-	-	(88,888)
Recoveries	3,398	-	-	-	-	-	3,398
Provision for loan losses	(204,560)	66,376	(2,099)	254	3,640	24,198	(112,191)
Other	4,290	9,997	8,799	-	(3,640)	278	19,724
Balance at June 30, 2018	<u>\$ 6,096,697</u>	<u>\$ 236,025</u>	<u>\$ 64,877</u>	<u>\$ 3,855</u>	<u>\$ -</u>	<u>\$ 53,065</u>	<u>\$ 6,454,519</u>
Ending Balance:							
Individually evaluated for impairment	\$ 990,320	\$ 62,793	\$ -	\$ -	\$ -	\$ 22,807	\$ 1,075,920
Collectively evaluated for impairment	5,106,377	173,232	64,877	3,855	-	30,258	5,378,599
Balance at June 30, 2018	<u>\$ 6,096,697</u>	<u>\$ 236,025</u>	<u>\$ 64,877</u>	<u>\$ 3,855</u>	<u>\$ -</u>	<u>\$ 53,065</u>	<u>\$ 6,454,519</u>
Balance at March 31, 2017	\$ 5,677,554	\$ 248,699	\$ 72,585	\$ 3,657	\$ -	\$ 42,223	\$ 6,044,718
Charge-offs	(59,213)	-	-	-	-	-	(59,213)
Recoveries	1,699	-	-	-	-	-	1,699
Provision for loan losses	279,326	40,625	(2,594)	(14)	-	2,156	319,499
Other	5,042	(1,137)	(11,221)	-	-	161	(7,155)
Balance at June 30, 2017	<u>\$ 5,904,408</u>	<u>\$ 288,187</u>	<u>\$ 58,770</u>	<u>\$ 3,643</u>	<u>\$ -</u>	<u>\$ 44,540</u>	<u>\$ 6,299,548</u>
Balance at December 31, 2016	\$ 5,396,080	\$ 520,729	\$ 67,499	\$ 3,514	\$ -	\$ 42,771	\$ 6,030,593
Charge-offs	(59,213)	-	-	-	-	-	(59,213)
Recoveries	3,398	-	-	-	-	-	3,398
Provision for loan losses	558,416	(237,619)	1,090	(28)	-	1,450	323,309
Other	5,727	5,077	(9,819)	157	-	319	1,461
Balance at June 30, 2017	<u>\$ 5,904,408</u>	<u>\$ 288,187</u>	<u>\$ 58,770</u>	<u>\$ 3,643</u>	<u>\$ -</u>	<u>\$ 44,540</u>	<u>\$ 6,299,548</u>
Ending Balance:							
Individually evaluated for impairment	\$ 1,209,471	\$ 113,429	\$ 5,895	\$ -	\$ -	\$ 21,126	\$ 1,349,921
Collectively evaluated for impairment	4,694,937	174,758	52,875	3,643	-	23,414	4,949,627
Balance at June 30, 2017	<u>\$ 5,904,408</u>	<u>\$ 288,187</u>	<u>\$ 58,770</u>	<u>\$ 3,643</u>	<u>\$ -</u>	<u>\$ 44,540</u>	<u>\$ 6,299,548</u>

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Total
<b>Recorded Investments</b>							
<b>in Loans Outstanding:</b>							
Ending Balance at							
June 30, 2018	\$ 826,484,902	\$ 100,088,998	\$ 39,985,172	\$ 2,847,139	\$ -	\$ 22,171,887	\$ 991,578,098
Individually evaluated for impairment	\$ 11,771,810	\$ 669,825	\$ 24,110	\$ -	\$ -	\$ 74,881	\$ 12,540,626
Collectively evaluated for impairment	\$ 814,713,092	\$ 99,419,173	\$ 39,961,062	\$ 2,847,139	\$ -	\$ 22,097,006	\$ 979,037,472
Ending Balance at							
June 30, 2017	\$ 801,713,346	\$ 94,216,275	\$ 38,643,531	\$ 2,940,247	\$ -	\$ 15,342,160	\$ 952,855,559
Individually evaluated for impairment	\$ 9,256,692	\$ 467,409	\$ 33,055	\$ -	\$ -	\$ 87,144	\$ 9,844,300
Collectively evaluated for impairment	\$ 792,456,654	\$ 93,748,866	\$ 38,610,476	\$ 2,940,247	\$ -	\$ 15,255,016	\$ 943,011,259

### NOTE 3 — CAPITAL

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan portfolio; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

#### Regulatory Capitalization Requirements

<b>Risk-adjusted:</b>	<b>Regulatory Minimums</b>	<b>Conservation Buffer</b>	<b>Total</b>	<b>As of June 30, 2018</b>
Common equity tier 1 ratio	4.50%	2.50%	7.00%	16.43%
Tier 1 capital ratio	6.00%	2.50%	8.50%	16.43%
Total capital ratio	8.00%	2.50%	10.50%	17.09%
Permanent capital ratio	7.00%	0.00%	7.00%	16.53%
<b>Non-risk-adjusted:</b>				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	16.50%
UREE leverage ratio	1.50%	0.00%	1.50%	17.66%

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	174,189,637	174,189,637	174,189,637	174,189,637
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	4,045,417	4,045,417	4,045,417	4,045,417
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	6,597,573	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(15,533,315)	(15,533,315)	(15,533,315)	(15,533,315)
	<u>162,701,739</u>	<u>162,701,739</u>	<u>169,299,312</u>	<u>162,701,739</u>
Denominator:				
Risk-adjusted assets excluding allowance	1,006,100,545	1,006,100,545	1,006,100,545	1,006,100,545
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(15,533,315)	(15,533,315)	(15,533,315)	(15,533,315)
Allowance for loan losses	-	-	-	(6,532,650)
	<u>990,567,230</u>	<u>990,567,230</u>	<u>990,567,230</u>	<u>984,034,580</u>
			Tier 1 leverage ratio	UREE leverage ratio
(dollars in thousands)				
Numerator:				
Unallocated retained earnings			174,189,637	174,189,637
Common Cooperative Equities:				
Statutory minimum purchased borrower stock			4,045,417	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions			(15,533,315)	-
			<u>162,701,739</u>	<u>174,189,637</u>
Denominator:				
Total Assets			1,007,512,381	1,007,512,381
Regulatory Adjustments and Deductions:				
Regulatory deductions included in tier 1 capital			(21,404,168)	(21,404,168)
			<u>986,108,213</u>	<u>986,108,213</u>

An additional component of equity is accumulated other comprehensive income.

The Association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Consolidated Statement of Comprehensive Income. The following table summarizes the changes in accumulated other comprehensive income (loss) for the six months ended June 30:

	<u>2018</u>	<u>2017</u>
Accumulated other comprehensive income (loss) at January 1	<b>\$ (582,234)</b>	\$ (380,576)
Amortization of prior service credit included		
in salaries and employee benefits	<b>(8,650)</b>	(11,532)
Amortization of actuarial loss included		
in salaries and employee benefits	<b>16,438</b>	8,622
Other comprehensive income (loss), net of tax	<b>7,788</b>	(2,910)
Accumulated other comprehensive income (loss) at June 30	<b><u>\$ (574,446)</u></b>	<b><u>\$ (383,486)</u></b>

#### NOTE 4 — INCOME TAXES

Alabama Ag Credit, ACA and its PCA subsidiary, Alabama Ag Credit, PCA (Associations) are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. The Association has recorded a full valuation allowance against its deferred tax asset as of June 30, 2018 based on management's estimate that it is more likely than not that the deferred tax asset will not be realized. For the three and six months ended June 30, 2018 and 2017, the Associations had no taxable income. The subsidiary, Alabama Ag Credit, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

## NOTE 5 — FAIR VALUE MEASUREMENTS

FASB 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 13 to the 2017 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

<u>June 30, 2018</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	\$ 74,479	\$ -	\$ -	\$ 74,479
<u>December 31, 2017</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	\$ 62,573	\$ -	\$ -	\$ 62,573

Assets and liabilities measured at fair value on a nonrecurring basis for each of the fair value hierarchy values are summarized below:

<u>June 30, 2018</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$5,143,792	\$5,143,792
Other property owned	-	-	46,350	46,350
<u>December 31, 2017</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans*	\$ -	\$ -	\$ 4,179,616	\$ 4,179,616
Other property owned	-	-	46,350	46,350

\*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance “Accounting by Creditors for Impairment of a Loan.” The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

### Information About Nonrecurring Level 3 Fair Value Measurements

With regard to nonrecurring measurements for impaired loans and other property owned, 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 other property owned and take into account unobservable inputs, such as income and expense, comparable sales, replacement cost and comparability adjustments.

### Valuation Techniques

As more fully discussed in Note 13 to the 2017 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association’s assets and liabilities.

#### *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.

### Loans Evaluated for Impairment

For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying real estate collateral since the loans were collateral-dependent. 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, a majority of these loans have fair value measurements that fall within Level 3 of the fair value 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.

### 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 the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy. As of June 30, 2018, other property owned, net is reported at \$41,200 in the consolidated balance sheet.

## NOTE 6 — EMPLOYEE BENEFIT PLANS

**Employee Retirement Plans:** As discussed in Note 2 and Note 11 to the 2017 Annual Report to Stockholders, employees of the Association participate in either the District's defined benefit pension plan (DB Plan) or the District's defined contribution plan (DC Plan).

The structure of the DB Plan is characterized as multi-employer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (Bank and associations). The Association recognizes its amortized annual contributions to the plan as an expense. The annual contribution is paid in January of each year, and amortized into expense on a monthly basis; unamortized contributions are included in "Other Assets" in the consolidated balance sheet. The following table represents DB contributions made, amounts amortized into expense, and the remaining unamortized contributions amounts as of June 30:

	<u>2018</u>	<u>2017</u>
DB contribution	572,482	433,840
YTD amortization	<u>286,241</u>	<u>216,920</u>
Net periodic benefit cost	<u><u>286,241</u></u>	<u><u>216,920</u></u>

Association contributions to the DC Plan are expensed as incurred. For the six months ended June 30, 2018 and 2017, the Association recognized pension costs for the DC Plan of \$157,802 and \$147,459, respectively.

Employees are also eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. Contributions to the 401(k) plan are expensed as incurred. The Association's contributions to the 401(k) plan were \$122,564 and \$110,595 for the six months ended June 30, 2018 and 2017, respectively.

**Other Postretirement Benefits:** In addition to pension benefits, the Association provides certain health care benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer, and consequently, the liability for these benefits is included in the consolidated balance sheet. The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the three months ended June 30:

	<u>Other Benefits</u>	
	<u>2018</u>	<u>2017</u>
Service cost	\$ 35,406	\$ 29,938
Interest cost	58,926	60,446
Expected return on plan assets	-	-
Amortization of prior service (credits) costs	(8,650)	(11,532)
Amortization of net actuarial (gain) loss	<u>16,438</u>	<u>8,622</u>
Total non-service cost	66,714	57,536
Net periodic benefit cost	<u><u>\$ 102,120</u></u>	<u><u>\$ 87,474</u></u>

The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2018, was \$3,039,451 and is included in "Other Liabilities" in the balance sheet.

**NOTE 7 — COMMITMENTS AND CONTINGENT LIABILITIES**

The Association is involved in various legal proceedings in the normal course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association.

**NOTE 8 — SUBSEQUENT EVENTS**

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