AG TEXAS
FARM CREDIT SERVICES

Quarterly Report

The Third Quarter Ended
September 30, 2017

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Report of Management

The consolidated financial statements of *AgTexas Farm Credit Services* ("**Association**") are prepared by management, who is 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 and there are no significant changes in the association's internal controls or in other factors that could significantly affects such controls during the quarter.

The undersigned certify that this quarterly report has been reviewed and prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate and complete to the best of his knowledge and belief.

Tim McDonald, Chief Executive Officer
November 2, 2017

Dennis Anthony, Chairman, Board of Directors
November 2, 2017

Jerry Spruill, Chief Financial Officer
November 2, 2017

The third quarter consolidated financial statements of AgTexas Farm Credit Services, including its wholly-owned subsidiaries AgTexas, PCA and AgTexas, FLCA (collectively referred to herein as the "**Association**"), is unaudited, but contains all adjustments necessary for a fair presentation of the interim financial condition and results of operations. The statements are prepared in conformity with generally accepted accounting principles and prevailing practices within the banking industry. In preparing these consolidated statements and meeting its responsibility for reliable financial information, management depends upon the Association's accounting and internal control systems which have been designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorized and recorded.

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 following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of the Association for the three and nine months ended September 30, 2017, and should be read in conjunction with the accompanying *unaudited consolidated financial statements* ("**CFS**") and the *Association's 2016 Annual Report to Stockholders* ("**2016 Annual Report**"). Management prepared the accompanying CFS under the oversight of the Association's Audit Committee.

Significant Events. The Association distributed patronage of approximately $12.2 million in cash and an additional $2.6 million in allocated equities in the first quarter of 2017. This represented the 2016 patronage declared by the Association.

In January 2017, the Association received clearance from FCA and the board approved the issuance of 20 million shares of a series of preferred stock, par value of $1.00 per share. The stock was issued March 24, 2017. The stock is designated as *Fixed-to-Floating Rate Perpetual Cumulative Preferred Stock, Series A* ("**Series A Preferred Stock**"). The Series A Preferred stock has a fixed rate dividend of 5% for ten years, payable semi-annually. After ten years, the dividend rate becomes a floating rate at 5.00% above 6-month LIBOR. On or after 5 years, the Association may, at its option, redeem all or part of the Series A Preferred Stock. The Series A Preferred Stock is non-voting, except: (*i*) to materially change the Association's Charter or Bylaws that would materially adversely affect the holder of Series A Preferred Stock, (*ii*) to create, issue or authorize any class of stock ranking senior to the Series A Preferred Stock as to dividends or liquidation.

Loan Portfolio.

Total loans outstanding at September 30, 2017, including nonaccrual loans, were $1,822,380,781 compared to $1,609,618,017 at December 31, 2016, reflecting an increase of 13.2 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.7 percent at September 30, 2017, compared to 1.0 percent at December 31, 2016.

The Association recorded $27,522 in recoveries and $0 in charge-offs for the nine months ended September 30, 2017, and $158,767 in recoveries and $51 in charge-offs for the same period in 2016. The Association's allowance for credit losses, which consists of the allowance for loan losses and the reserve for unfunded credit commitments, was 0.4 percent and 0.5 percent of total loans outstanding as of September 30, 2017, and December 31, 2016, respectively.

The financial performance of the Association may be significantly impacted by the quality of loans within the loan portfolio. Internal policies and procedures, as well as third party credit reviews and examinations help to ensure asset quality is properly reflected. Additional detail on credit quality is illustrated in the following table.

	September 30, 2017	September 30, 2016	December 31, 2016
Acceptable	94.6%	94.4%	94.8%
OAEM	2.8%	2.6%	2.6%
Substandard/doubtful	2.6%	3.0%	2.6%
	100.0%	**100.0%**	**100.0%**

Changes in the Association's loan portfolio from December 31, 2016 to September 30, 2017 follow:

	September 30, 2017		December 31, 2016	
Loan Type	Amount	%	Amount	%
Real estate mortgage	$ 971,186,931	53.3%	$ 839,581,250	52.2%
Production and intermediate term	642,583,217	35.3%	553,610,612	34.4%
Agribusiness:				
Loans to cooperatives	3,867,899	0.2%	5,159,236	0.3%
Processing and marketing	76,421,394	4.2%	72,453,282	4.5%
Farm-related business	15,200,191	0.8%	18,379,677	1.1%
Communication	14,711,867	0.8%	12,116,836	0.8%
Energy	4,045,794	0.2%	4,384,590	0.3%
Rural residential real estate	4,776,406	0.3%	5,596,877	0.3%
Lease receivables	533,675	0.0%	124,636	0.0%
Mission-related investments	89,053,407	4.9%	98,211,021	6.1%
Total	$ 1,822,380,781	100.0%	$ 1,609,618,017	100.0%

The Association's portfolio includes significant *mission related investments* ("**MRIs**"). The MRIs were authorized under the *Farm Credit Administration* ("**FCA**") approved *Rural America Bond Pilot Program* ("**RAB**). The RAB program was designed to meet the growing and changing needs of agricultural enterprises, agribusinesses, and various infrastructure needs in rural communities through investment in these areas. FCA ended the RAB pilot program as of December 31, 2014.

Risk Exposure. High risk assets include impaired loans and other property owned. Impaired loans are comprised of nonaccrual, past due ≥ 90 days and still accruing interest, and formally restructured loans. The following table illustrates the Association's components and trends of high risk assets:

	September 30, 2017		December 31, 2016	
	Amount	%	Amount	%
Nonaccrual	$ 12,283,169	91.2%	$ 16,717,072	85.5%
90 days past due and still accruing interest	-	0.0%	1,439,045	7.4%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	1,178,500	8.8%	1,384,355	7.1%
Total	$ 13,461,669	100.0%	$ 19,540,472	100.0%

Results of Operations. Changes in the Association's results of operations for the three and nine months ended September 30, 2017 and 2016 follow:

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Interest income	$ 19,915,577	$ 17,412,639	$ 53,932,501	$ 49,484,967
Interest expense	(8,620,098)	(6,461,467)	(22,853,011)	(18,484,485)
(Provision for) reversal of loan losses	(76,678)	(719,410)	(106,807)	(1,123,636)
Net interest margin	11,218,801	10,231,762	30,972,683	29,876,846
Noninterest income	4,854,206	3,765,216	11,447,833	11,179,172
Noninterest expense	(6,535,293)	(6,398,867)	(20,888,638)	(19,829,932)
Net income	$ 9,537,714	$ 7,598,111	$ 21,531,878	$ 21,226,086

Net interest margin (interest income less interest expense) is the principal source of earnings and results from relative volumes of interest-earning assets and interest-bearing liabilities, yields on interest-earning assets, and rates on interest-bearing liabilities. Increases in interest income and expense are due to growth in volume offset by a decrease in spread. The decrease in "(Provision for) reversal of loan losses" is due to increases in the allowance for credit losses in the prior year. Noninterest income increase is due to increases in patronage and insurance income compared to the same periods in the prior year. Noninterest expense increased over the prior period but is in line with budget projections.

The effects of changes in average volumes, yields, and rates on interest margin follow:

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	For the nine months ended September 30, 2017		For the nine months ended September 30, 2016	
	Average Balance	Interest	Average Balance	Interest
Total loans and investments	1,674,933,789	53,932,501	1,532,607,595	49,484,967
Interest-bearing liabilities	1,484,028,619	22,853,011	1,365,012,540	18,484,485
Impact of capital	$ 190,905,170		$ 167,595,055	
Net interest income		$ 31,079,490		$ 31,000,482

	2017 Average Yield	2016 Average Yield
Yield on loans and investments	4.31%	4.32%
Cost of interest-bearing	2.06%	1.81%
Interest rate spread	2.25%	2.51%
Interest rate margin	2.48%	2.70%

	Nine months ended September 30: 2017 vs. 2016 Increase (decrease) due to		
	Volume	Rate	Total
Interest income	$ 4,598,735	$ (151,201)	$ 4,447,534
Interest expense	1,611,217	2,757,309	4,368,526
Net interest income	$ 2,987,518	$ (2,908,510)	$ 79,008

The Association's return on average assets was 2.04% & 1.80% for the quarters ended September 30, 2017 & 2016, respectively, and 1.65% & 1.78% for the nine months ended September 30, 2017 & 2016, respectively. The decrease in return on average assets for the nine months ended September 30, 2017 is due to increase in earning assets with lower spreads. The Association's return on average equity was 14.96% & 13.83% for the quarters ended September 30, 2017 & 2016, respectively, and 11.99% & 13.47% for the nine months ended September 30, 2017 & 2016, respectively. The decrease in return on average equity for the nine months ended September 30, 2017 is due to increases in equity as a result of the issuance of Series A Preferred Stock.

Liquidity and Funding Sources. *Interest rate risk* ("**IRR**") inherent in the loan portfolio is substantially mitigated through the funding relationship with the FCBT. FCBT manages IRR through direct loan pricing and asset/liability management. The Association's primary source of liquidity and funding is a direct note payable to FCBT. The following schedule summarizes the Association's borrowings:

	September 30, 2017	December 31, 2016
Note payable to the Bank	$ 1,613,968,558	$ 1,429,487,047
Accrued interest on note payable	2,875,785	2,233,303
Total	$ 1,616,844,343	$ 1,431,720,350

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 $1,613,968,558 as of September 30, 2017, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.16 percent at September 30, 2017. 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 since December 31, 2016, is due to the Association's increase in loan volume. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were $193,922,257 at September 30, 2017. The maximum amount the Association may borrow from the bank as of September 30, 2017, was $1,818,715,911 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 members' equity was $258,134,302 & $217,287,353 at September 30, 2017 & December 31, 2016, respectively, a $40,846,949 increase, which approximates current earnings plus the issuance of preferred stock. The Association's debt as a percentage of members' equity was 6.36:1 as of September 30, 2017, compared to 6.80:1 as of December 31, 2016. FCA regulations require associations to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and *unallocated retained earnings and equivalents* ("**UREE**") ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. See note 4 in the *"Notes to Unaudited Consolidated Financial Statements"*.

Significant Recent Accounting Pronouncements. See Note 1 in CFS.

Regulatory Matters. On March 10, 2016, FCA adopted a final rule to modify the regulatory capital requirements for System banks and associations. The stated objectives of the final rule are as follows:

- To modernize capital requirements while ensuring that the institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System,
- To make System regulatory capital requirements more transparent and
- To meet the requirements of section 939A of the Dodd-Frank Act.

The final rule became effective on January 1, 2017. The Association is in compliance with the required minimum capital standards as of September 30, 2017.

Relationship With FCBT. The Association has a statutory obligation to borrow only from FCBT, which is discussed in note 10, *Note Payable to FCBT*, in the Association's consolidated financial statements in the 2016 Annual Report.

FCBT's ability to access Association capital is discussed in note 2, *Summary of Significant Accounting Policies*, in the Association's consolidated financial statements in the 2016 Annual Report, within the *Farm Credit Bank of Texas Capital Stock* section.

FCBT's role to help mitigate Association exposure to IRR is described in the *Liquidity and Funding Sources* section of *Management's Discussion & Analysis of Financial Condition and Results of Operations* and note 10, *Note Payable to FCBT*, in the Association's consolidated financial statements in the 2016 Annual Report.

FCBT provides computer systems to support the critical operations of all *10th Farm Credit District* ("**District**") associations. In addition, each association has operating systems and facility-based systems that are not supported by FCBT. As disclosed in note 14, *Related Party Transactions*, in the Association's consolidated financial statements in the 2016 Annual Report, FCBT provides many services to the Association, which include administrative, marketing, and accounting services and information systems.

The Association's financial condition may be impacted by factors that affect FCBT. The financial condition and results of operations of FCBT may materially affect Association stockholders' investment in the Association.

Annual & Quarterly Stockholder Report Availability. The District's 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 *fcb@farmcreditbank.com*. The annual and quarterly stockholder reports for the bank and the District are also available on its website at *www.farmcreditbank.com.*

Annual and quarterly stockholder reports for the Association are available free of charge on the Association's website www.agtexas.com or by *i*) writing to AgTexas Farm Credit Services, P.O. Box 53240, Lubbock, Texas 79453, *ii*) calling (806) 687-4068, or *iii*) e-mailing jerry.spruill@agtexas.com.

Unaudited Consolidated Balance Sheets

	September 30, 2017 Unaudited	December 31, 2016 Audited
Assets		
Cash	$ 79,324	$ 44,194
Investments	2,805,185	3,810,694
Loans	1,822,380,781	1,609,618,017
Less: allowance for loan losses	6,626,958	6,252,551
Net loans	1,815,753,823	1,603,365,466
Accrued interest receivable	20,999,587	18,901,845
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	28,847,850	28,847,850
Other	8,751,494	18,753,596
Other property owned, net	1,178,500	1,384,355
Premises and equipment	19,185,491	19,233,069
Other assets	1,544,443	1,156,372
Total assets	$ 1,899,145,697	$ 1,695,497,441
Liabilities		
Note payable to the Farm Credit Bank of Texas	$ 1,613,968,558	$ 1,429,487,047
Advance conditional payments	9,287,718	11,873,910
Accrued interest payable	2,875,785	2,233,303
Drafts outstanding	1,012,991	6,964,428
Accrued postretirement benefit liability	6,770,488	6,583,002
Patronage distributions payable	1,173	12,222,647
Other liabilities	7,094,682	8,845,751
Total liabilities	1,641,011,395	1,478,210,088
Members' Equity		
Capital stock and participation certificates	4,109,440	4,050,575
Preferred stock	20,000,000	-
Allocated retained earnings	25,144,487	25,144,487
Unallocated retained earnings	133,893,060	112,924,216
Additional paid-in capital	75,310,003	75,446,357
Accumulated other comprehensive income	(322,688)	(278,282)
Total members' equity	258,134,302	217,287,353
Total liabilities and members' equity	$ 1,899,145,697	$ 1,695,497,441

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

Unaudited Consolidated Statements of Comprehensive Income

	For the three months ended		For the nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
	Unaudited	Unaudited	Unaudited	Unaudited
Interest income				
Loans	$ 19,876,002	$ 17,359,846	$ 53,802,864	$ 49,320,893
Investments	39,575	52,793	129,637	164,074
Total interest income	19,915,577	17,412,639	53,932,501	49,484,967
Interest expense				
Note payable to the Farm Credit Bank of Texas	8,613,355	6,455,087	22,824,496	18,461,998
Advance conditional payments	6,743	6,380	28,515	22,487
Total interest expense	8,620,098	6,461,467	22,853,011	18,484,485
Net interest income	11,295,479	10,951,172	31,079,490	31,000,482
Provision for loan losses	76,678	719,410	106,807	1,123,636
Net interest income after provision for losses	11,218,801	10,231,762	30,972,683	29,876,846
Noninterest income				
Farm Credit Bank of Texas patronage income	2,748,724	2,411,305	7,814,361	7,261,492
Loan fees	41,811	9,205	387,565	223,522
Fees for financially related services	1,775,415	1,294,687	2,283,097	1,915,691
Other	288,256	50,019	962,810	1,778,467
Total noninterest income	4,854,206	3,765,216	11,447,833	11,179,172
Noninterest expenses				
Salaries and employee benefits	4,262,452	4,283,026	13,660,876	12,990,100
Directors' expense	84,434	83,192	325,734	402,384
Purchased services	153,414	243,673	982,198	944,149
Travel	314,652	274,799	921,592	823,003
Occupancy and equipment	345,559	295,051	1,014,252	889,569
Communication	95,712	76,841	290,162	244,886
Advertising	127,656	137,912	435,387	504,346
Public and member relations	163,114	164,613	634,493	544,446
Federally regulated examination fees	126,281	116,425	338,206	296,978
FCSIC insurance premiums	454,232	507,545	1,293,202	1,350,206
Other noninterest expense	407,787	215,790	992,536	839,865
Total noninterest expenses	6,535,293	6,398,867	20,888,638	19,829,932
Net income	9,537,714	7,598,111	21,531,878	21,226,086
Other comprehensive income:				
Change in postretirement benefit plans	(14,802)	(14,802)	(44,406)	(44,406)
Comprehensive income	$ 9,522,912	$ 7,583,309	$ 21,487,472	$ 21,181,680

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

Unaudited Consolidated Statements of Changes in Members' Equity

	Capital Stock/ Participation Certificates	Preferred Stock	Retained Earnings Allocated	Retained Earnings Unallocated	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2015	$ 3,989,035	$ -	$ 22,511,743	$ 99,152,953	$ 75,446,357	$ (111,604)	$ 200,988,484
Comprehensive income	-	-	-	21,226,086	-	(44,406)	21,181,680
Capital stock/participation certificates issued	638,325	-	-	-	-	-	638,325
Capital stock/participation certificates retired	(584,420)	-	-	-	-	-	(584,420)
Patronage dividends:							
Paid or accrued	-	-	1,630	(21,507)	-	-	(19,877)
Balance at September 30, 2016	$ 4,042,940	$ -	$ 22,513,373	$ 120,357,532	$ 75,446,357	$ (156,010)	$ 222,204,192
Balance at December 31, 2016	$ 4,050,575	$ -	$ 25,144,487	$ 112,924,216	$ 75,446,357	$ (278,282)	$ 217,287,353
Comprehensive income	-	-	-	21,531,878	-	(44,406)	21,487,472
Preferred stock issued	-	20,000,000	-	-	-	-	20,000,000
Issuance costs of preferred stock	-	-	-	-	(136,354)	-	(136,354)
Capital stock/participation certificates issued	618,925	-	-	-	-	-	618,925
Capital stock/participation certificates retired	(560,060)	-	-	-	-	-	(560,060)
Preferred stock dividends:							
Paid	-	-	-	(500,000)	-	-	(500,000)
Patronage dividends:							
Paid or accrued	-	-	-	(63,034)	-	-	(63,034)
Balance at September 30, 2017	$ 4,109,440	$ 20,000,000	$ 25,144,487	$ 133,893,060	$ 75,310,003	$ (322,688)	$ 258,134,302

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

Note 1: Organization, Operations & Significant Accounting Policies

AgTexas Farm Credit Services ("**AgTX ACA**") and its wholly-owned subsidiaries, *AgTexas, PCA* ("**PCA**") and *AgTexas, FLCA* ("**FLCA**"), are collectively referred to herein as the "**Association**." AgTX ACA provides financing and related services through FLCA and PCA. FLCA makes secured long-term agricultural real estate and rural home mortgage loans. PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

These notes and the encompassing unaudited consolidated financial statements for AgTX ACA (collectively referred to herein as "**CFS**"), include the accounts of PCA and FLCA. All significant intercompany balances and transactions are eliminated in consolidation. In management's opinion, these CFS reflect all adjustments necessary to fairly state results for the interim periods presented, which are of a normal recurring nature.

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, 2016, as contained in the 2016 Annual Report to Stockholders.

In the opinion of management, the CFS 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 *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, 2016 as contained in the 2016 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 ending December 31, 2017. Descriptions of the significant accounting policies are included in the 2016 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.

Significant Recent Accounting Pronouncements. 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 currently evaluating the impact of adoption on its financial condition and results of operations.In March 2017, the Financial Accounting Standards Board (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 is not expected to impact the Association's financial condition but could change the classification of certain items in the results of operations.

In August 2016, 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 is not expected to impact the Association's financial condition or its results of operations but could 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 currently 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 currently 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 is not expected to impact the Association'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. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

Reclassifications. Certain prior year amounts have been aggregated and/or reclassified to conform with the current interim presentation.

Note 2: *Held to Maturity* ("HTM") Investment Securities

Federal Agricultural Mortgage Corporation ("**Farmer Mac**") guaranteed *agricultural mortgage-backed securities* ("**AMBS**") comprise the Association's investment portfolio, and the Association services the underlying loans. Additional information follows:

	September 30, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
AMBS	$ 2,805,185	$ 33,307	$ -	$ 2,838,492	5.58%

	December 31, 2016				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
AMBS	$ 3,810,694	$ 30,916	$ -	$ 3,841,610	5.39%

The Association has not experienced impairments of these securities. Farmer Mac guarantees the underlying mortgages, and the Association has the ability and intent to hold these securities to maturity or pay-off and it is unlikely the Association would be required to sell these securities. These AMBS have contractual weighted average maturities of 3.7 years as of September 30, 2017, however, expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Note 3: Loans & *Allowance for Loan Losses* ("ALL")

Loans. Loan *carrying amounts* (outstanding principal adjusted as applicable for capitalized accrued interest, direct partial charge-offs, deferred fees or costs on originated loans, and unamortized purchase premiums and discounts; excludes uncapitalized accrued interest) by portfolio *segment* follows:

Loan Type	September 30, 2017 Amount	%	December 31, 2016 Amount	%
Real estate mortgage	$ 971,186,931	53.3%	$ 839,581,250	52.2%
Production and intermediate term	642,583,217	35.3%	553,610,612	34.4%
Agribusiness:				
Loans to cooperatives	3,867,899	0.2%	5,159,236	0.3%
Processing and marketing	76,421,394	4.2%	72,453,282	4.5%
Farm-related business	15,200,191	0.8%	18,379,677	1.1%
Communication	14,711,867	0.8%	12,116,836	0.8%
Energy	4,045,794	0.2%	4,384,590	0.3%
Rural residential real estate	4,776,406	0.3%	5,596,877	0.3%
Lease receivables	533,675	0.0%	124,636	0.0%
Mission-related investments	89,053,407	4.9%	98,211,021	6.1%
Total	$ 1,822,380,781	100.0%	$ 1,609,618,017	100.0%

Mission-related investment and real estate mortgage loans purchased with 100% U.S. government agency or government sponsored enterprise guarantees present essentially no credit risk other than purchase premiums, which are forfeited when borrowers prepay or refinance their loans before the premiums are fully amortized. Management anticipates and considers potential prepayments to estimate an appropriate amortization period. Net purchased premiums included in the mission-related investment and real estate mortgage loan balances above as of September 30, 2017 and December 31, 2016, follow:

	September 30, 2017	December 31, 2016
Real estate mortgage	$ 6,624,230	$ 5,032,470
Mission-related investments	1,119,918	1,774,852
Total premium	$ 7,744,148	$ 6,807,322

The Association may purchase or sell participations in loans to diversify risk, manage loan volume, and comply with FCA regulations. Participation carrying amount details as of September 30, 2017 follow:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ 49,609,126	$ 160,195,513	$ 251,271,178	$ 3,007,883	$ 300,880,304	$ 163,203,396
Production and intermediate term	42,173,837	433,987,061	-	-	42,173,837	433,987,061
Agribusiness	82,677,832	-	-	-	82,677,832	-
Communication	14,711,867	-	-	-	14,711,867	-
Energy	4,045,794	-	-	-	4,045,794	-
Lease receivables	391,870	-	-	-	391,870	-
Mission-related investm	-	1,589,357	-	-	-	1,589,357
Total	$ 193,610,326	$ 595,771,931	$ 251,271,178	$ 3,007,883	$ 444,881,504	$ 598,779,814

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 advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. Balances of ACPs were $25,118,356 and $25,390,651 at September 30, 2017 and December 31, 2016, respectively.

Credit Quality. Loans are the Association’s primary asset. Collectability of these assets is critical to the Association’s financial position and results of operations. Collectability is primarily a function of credit quality.

Loans that have not performed in accordance with terms demonstrate heightened credit risk, and the level and trends in non-performing loans is a strong indicator of credit quality. Non-performing loans and *other property owned* (“**OPO**”) comprise non-performing assets.

The recorded investment in a loan, as defined by GAAP, includes the outstanding principal adjusted, as applicable, for accrued interest, direct partial charge-offs, deferred fees or costs on originated loans, and unamortized purchase premiums and discounts; the recorded investment in a loan does not include an allocation of the ALL or any specific valuation adjustments. The recorded investment in non-performing asset balances by loan portfolio segment and OPO follow:

	September 30, 2017	December 31, 2016
Nonaccrual loans:		
Real estate mortgage	$ 6,628,658	$ 8,925,985
Production and intermediate term	2,616,583	4,137,206
Rural residential real estate	176,377	194,119
Mission-related investments	2,861,551	3,459,762
Total nonaccrual loans	12,283,169	16,717,072
Accruing restructured loans:		
Real estate mortgage	-	-
Production and intermediate term	-	-
Rural residential real estate	-	-
Mission-related investments	-	-
Total accruing restructured loans	-	-
Accruing loans 90 days or more past due:		
Real estate mortgage	-	240,395
Production and intermediate term	-	1,198,650
Rural residential real estate	-	-
Mission-related investments	-	-
Total accruing loans 90 days or more past due	-	1,439,045
Total non-performing loans	12,283,169	18,156,117
Other property owned	1,178,500	1,384,355
Total non-performing assets	$ 13,461,669	$ 19,540,472

Age analysis of the recorded investment in past due loans by loan segment follows:

September 30, 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	$ 3,873,513	$ 5,104,579	$ 8,978,092	$ 973,894,720	$ 982,872,812	$ -
Production and intermediate-term	2,355,073	1,865,147	4,220,220	646,608,622	650,828,842	-
Loans to cooperatives	-	-	-	3,880,257	3,880,257	-
Processing and marketing	-	-	-	76,568,530	76,568,530	-
Farm-related business	703,496	-	703,496	14,674,407	15,377,903	-
Communication	-	-	-	14,740,744	14,740,744	-
Energy	-	-	-	4,054,846	4,054,846	-
Rural residential real estate	-	-	-	4,798,849	4,798,849	-
Lease receivables	-	-	-	538,456	538,456	-
Mission-related investments	-	2,861,551	2,861,551	86,777,646	89,639,197	-
Total	$ 6,932,082	$ 9,831,277	$ 16,763,359	$ 1,826,537,077	$ 1,843,300,436	$ -

December 31, 2016	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	$ 479,703	$ 6,056,466	$ 6,536,169	$ 843,555,649	$ 850,091,818	$ 240,395
Production and intermediate-term	7,009,478	2,000,628	9,010,106	551,960,577	560,970,683	1,198,650
Loans to cooperatives	-	-	-	5,197,287	5,197,287	-
Processing and marketing	-	-	-	72,663,687	72,663,687	-
Farm-related business	-	-	-	18,459,906	18,459,906	-
Communication	-	-	-	12,120,908	12,120,908	-
Energy	-	-	-	4,394,885	4,394,885	-
Rural residential real estate	238,953	-	238,953	5,381,094	5,620,047	-
Lease receivables	-	-	-	126,604	126,604	-
Mission-related investments	491,060	-	491,060	98,245,959	98,737,019	-
Total	$ 8,219,194	$ 8,057,094	$ 16,276,288	$ 1,612,106,556	$ 1,628,382,844	$ 1,439,045

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 investment.

Management has rated each loan in the portfolio using the System's 14-point rating system. These aggregated classifications are a significant indicator of credit quality. The classification 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 presents the Association's loan portfolio segment balances, including accrued interest thereon, as a percentage of the total category, as classified by management and aggregated under the FCA's Uniform Loan Classification System:

	September 30, 2017	December 31, 2016
Real estate mortgage		
Acceptable	96.3%	96.7%
OAEM	2.2%	1.7%
Substandard/doubtful	1.5%	1.6%
	100.0%	100.0%
Production and intermediate term		
Acceptable	91.7%	91.4%
OAEM	3.9%	4.1%
Substandard/doubtful	4.4%	4.5%
	100.0%	100.0%
Loans to cooperatives		
Acceptable	97.9%	96.8%
OAEM	0.0%	0.0%
Substandard/doubtful	2.1%	3.2%
	100.0%	100.0%
Processing and marketing		
Acceptable	95.9%	96.1%
OAEM	4.1%	3.9%
Substandard/doubtful	0.0%	0.0%
	100.0%	100.0%
Farm-related business		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	100.0%	100.0%
Communication		
Acceptable	100.0%	100.0%
OAEM	0.0%	0.0%
Substandard/doubtful	0.0%	0.0%
	100.0%	100.0%
Energy		
Acceptable	48.9%	51.2%
OAEM	51.1%	48.8%
Substandard/doubtful	0.0%	0.0%
	100.0%	100.0%
Rural residential real estate		
Acceptable	91.2%	95.4%
OAEM	4.0%	0.0%
Substandard/doubtful	4.8%	4.6%
	100.0%	100.0%
Lease receivables		
Acceptable	92.9%	36.1%
OAEM	7.1%	63.9%
Substandard/doubtful	0.0%	0.0%
	100.0%	100.0%
Mission-related investments		
Acceptable	96.8%	96.4%
OAEM	0.0%	0.0%
Substandard/doubtful	3.2%	3.6%
	100.0%	100.0%
Total Loans		
Acceptable	94.6%	94.8%
OAEM	2.8%	2.6%
Substandard/doubtful	2.6%	2.6%
	100.0%	100.0%

Based on current information and events, management has determined it is probable that scheduled payments of principal or interest on the following loans will not be collected when due according to the contractual terms of the loan agreements and has classified these loans as impaired. Once classified as impaired, management then determines the amount of impairment, if any, on each individual impaired loan; aggregated impairment on individual impaired loans is included in management's estimate of an appropriate ALL at each reporting date.

Impaired loan information, by loan portfolio segment, follows:

	September 30, 2017			December 31, 2016		
	Recorded Investment	Unpaid Principal Balance[a]	Related Allowance	Recorded Investment	Unpaid Principal Balance[a]	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	$ -	$ -	$ -	$ -	$ -	$ -
Production and intermediate term	583,004	595,750	338,500	353,183	365,930	233,000
Rural residential real estate	-	-	-	-	-	-
Mission-related investments	-	-	-	-	-	-
Total	$ 583,004	$ 595,750	$ 338,500	$ 353,183	$ 365,930	$ 233,000
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	$ 6,628,658	$ 7,064,538	$ -	$ 9,166,380	$ 9,620,195	$ -
Production and intermediate term	2,033,579	3,399,420	-	4,982,673	6,361,584	-
Rural residential real estate	176,377	176,377	-	194,119	194,119	-
Mission-related investments	2,861,551	2,861,551	-	3,459,762	3,459,762	-
Total	$11,700,165	$13,501,886	$ -	$17,802,934	$19,635,660	$ -
Total impaired loans:						
Real estate mortgage	$ 6,628,658	$ 7,064,538	$ -	$ 9,166,380	$ 9,620,195	$ -
Production and intermediate term	2,616,583	3,995,170	338,500	5,335,856	6,727,514	233,000
Rural residential real estate	176,377	176,377	-	194,119	194,119	-
Mission-related investments	2,861,551	2,861,551	-	3,459,762	3,459,762	-
Total	$12,283,169	$14,097,636	$ 338,500	$18,156,117	$20,001,590	$ 233,000

	For the nine months ended September 30, 2017		For the nine months ended September 30, 2016		For the Year Ended December 31, 2016	
	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:						
Real estate mortgage	$ -	$ -	$ -	$ -	$ -	$ -
Production and intermediate term	508,639	19,196	438,397	-	400,022	8,645
Rural residential real estate	-	-	-	-	-	-
Mission-related investments	-	-	-	-	-	-
Total	$ 508,639	$ 19,196	$ 438,397	$ -	$ 400,022	$ 8,645
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	$ 6,741,403	$ 21,715	$15,675,717	$ 555,218	$ 2,384,031	$ 191,175
Production and intermediate term	2,331,173	10,431	2,870,143	88,530	1,563,561	208,742
Rural residential real estate	185,794	-	72,456	4,940	103,576	4,939
Mission-related investments	3,380,652	-	3,591,930	-	3,561,823	-
Total	$12,639,022	$ 32,146	$22,210,246	$ 648,688	$ 7,612,991	$ 404,856
Total impaired loans:						
Real estate mortgage	$ 6,741,403	$ 21,715	$15,675,717	$ 555,218	$ 2,384,031	$ 191,175
Production and intermediate term	2,839,812	29,627	3,308,540	88,530	1,963,583	217,387
Rural residential real estate	185,794	-	72,456	4,940	103,576	4,939
Mission-related investments	3,380,652	-	3,591,930	-	3,561,823	-
Total	$13,147,661	$ 51,342	$22,648,643	$ 648,688	$ 8,013,013	$ 413,501

[a] Unpaid principal balance represents the recorded principal balance of the loan.

A restructuring of a debt constitutes a troubled debt restructuring 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.

There were no troubled debt restructurings that occurred in the first nine months of 2017. The following table presents additional information regarding troubled debt restructurings that occurred during the first nine months of 2016:

For the nine months ended September 30, 2016	Premodification Outstanding Recorded Investment	Postmodification Outstanding Recorded Investment
Troubled debt restructurings:		
Mission-related investments	$ 3,515,235	$ 3,418,303
Total	$ 3,515,235	$ 3,418,303

As of September 30, 2017, the total recorded investment of troubled debt restructured loans was $2,961,914, all of which was classified as nonaccrual, with specific allowance for loan losses of $0. Commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were $0 at September 30, 2017 and $0 at December 31, 2016.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
Real estate mortgage	$ -	$ 1,464,416	$ -	$ 1,464,416
Production and intermediate term	100,363	437,089	100,363	437,089
Mission-related investments	2,861,551	3,459,762	2,861,551	3,459,762
Total	$ 2,961,914	$ 5,361,267	$ 2,961,914	$ 5,361,267

*represents the portion of loans modified as TDRs that are in nonaccrual status

The predominant form of concession granted for troubled debt restructuring includes modifications to extend the term and delay payments. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case management assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

There were no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months for which there was a subsequent payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

Allowance for Loan Losses (“**ALL**”). A summary of changes in ALL and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agri-business	Commun-ication	Energy	Rural Residential Real Estate	Lease Receivable	Mission-Related Investments	Total
Allowance for Credit Losses:									
Balance at December 31, 2016	$ 1,645,914	$ 4,111,717	$ 367,991	$ 42,319	$ 70,108	$ 8,203	$ 786	$ 5,513	$ 6,252,551
Charge-offs	-	-	-	-	-	-	-	-	-
Recoveries	27,364	158	-	-	-	-	-	-	27,522
Provision for loan losses	418,761	(274,125)	(40,136)	18,390	(14,748)	(2,062)	1,859	(1,132)	106,807
Other	(11,132)	221,759	27,781	913	703	54	-	-	240,078
Balance at September 30, 2017	$ 2,080,907	$ 4,059,509	$ 355,636	$ 61,622	$ 56,063	$ 6,195	$ 2,645	$ 4,381	$ 6,626,958
Ending Balance:									
Individually evaluated for impairment	$ -	$ 338,500	$ -	$ -	$ -	$ -	$ -	$ -	$ 338,500
Collectively evaluated for impairment	$ 2,080,907	$ 3,721,009	$ 355,636	$ 61,622	$ 56,063	$ 6,195	$ 2,645	$ 4,381	$ 6,288,458
Acquired with deter-iorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Recorded Investment in Loans Outstanding:									
Ending Balance at September 30, 2017	$ 982,872,812	$ 650,828,842	$95,826,690	$ 14,740,744	$4,054,846	$ 4,798,849	$ 538,456	$ 89,639,197	$ 1,843,300,436
Individually evaluated for impairment	$ 6,628,658	$ 2,616,583	$ -	$ -	$ -	$ 176,377	$ -	$ 2,861,551	$ 12,283,169
Collectively evaluated for impairment	$ 976,244,154	$ 648,212,259	$95,826,690	$ 14,740,744	$4,054,846	$ 4,622,472	$ 538,456	$ 86,777,646	$ 1,831,017,267
Acquired with deter-iorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -

	Real Estate Mortgage	Production and Intermediate Term	Agri-business	Commun-ication	Energy	Rural Residential Real Estate	Lease Receivable	Mission-Related Investments	Total
Allowance for Credit Losses:									
Balance at December 31, 2015	$ 1,493,932	$ 3,414,982	$ 315,459	$ 28,599	$ 34,136	$ 21,433	$ 194	$ 14,422	$ 5,323,157
Charge-offs	(1)	-	-	-	-	(50)	-	-	(51)
Recoveries	157,868	865	-	-	-	34	-	-	158,767
Provision for loan losses	(23,575)	1,042,629	34,703	22,446	39,991	8,128	272	(958)	1,123,636
Other	(15,972)	(442,814)	(52,998)	(2,976)	1,016	3,781	-	-	(509,963)
Balance at September 30, 2016	$ 1,612,252	$ 4,015,662	$ 297,164	$ 48,069	$ 75,143	$ 33,326	$ 466	$ 13,464	$ 6,095,546
Ending Balance:									
Individually evaluated for impairment	$ -	$ 201,000	$ -	$ -	$ -	$ -	$ -	$ -	$ 201,000
Collectively evaluated for impairment	$ 1,612,252	$ 3,814,662	$ 297,164	$ 48,069	$ 75,143	$ 33,326	$ 466	$ 13,464	$ 5,894,546
Acquired with deter-iorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Recorded Investment in Loans Outstanding:									
Ending Balance at September 30, 2016	$ 797,025,596	$ 612,153,110	$95,475,891	$ 11,926,615	$4,837,349	$14,831,988	$ 91,991	$ 102,028,151	$ 1,638,370,691
Individually evaluated for impairment	$ 16,267,729	$ 3,126,612	$ -	$ -	$ -	$ 200,007	$ -	$ 3,481,303	$ 23,075,651
Collectively evaluated for impairment	$ 780,757,867	$ 609,026,496	$95,475,891	$ 11,926,615	$4,837,349	$14,631,981	$ 91,991	$ 98,546,848	$ 1,615,295,038
Acquired with deter-iorated credit quality	$ -	$ 2	$ -	$ -	$ -	$ -	$ -	$ -	$ 2

Note 4: 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 and lease portfolios; 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**.** 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.

		Regulatory Minimums	Capital Conservation Buffer *	Total	As of September 30, 2017
Risk-adjusted:					
01[a]	Common equity tier 1 ratio	4.50%	2.50%	7.00%	12.46%
01[b]	Tier 1 capital ratio	6.00%	2.50%	8.50%	12.46%
01[c]	Total capital ratio	8.00%	2.50%	10.50%	14.19%
01[d]	Permanent capital ratio	7.00%	0.00%	7.00%	13.75%
Non-risk-adjusted:					
02[a]	Tier 1 leverage ratio	4.00%	1.00%	5.00%	10.99%
02[b]	UREE leverage ratio	1.50%	0.00%	1.50%	10.37%

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

Risk-adjusted assets have been defined by FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes which generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

Risk-adjusted assets is calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the deduction of the allowance for loan losses from risk-adjusted assets for the permanent capital ratio.

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

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvement, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.

- Tier 1 capital ratio is common equity tier 1 plus non-cumulative 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 subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.

- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.

- UREE leverage ratio is unallocated retained earnings, paid-in capital, allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

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

Following are the amounts included in the calculation of the capital ratios as of September 30, 2017:

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	$ 86,702,920	$ 86,702,920
Paid-in capital	75,310,003	75,310,003
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	4,075,460	-
Allocated equities:		
Allocated equities held greater than 7 years	25,144,487	-
Nonqualified allocated equities not subject to retirement	37,780,318	37,780,318
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(29,077,636)	(11,029,848)
Other regulatory required deductions	-	-
	$ 199,935,552	$ 188,763,393
Denominator:		
Total Assets	$ 1,848,607,952	$ 1,848,607,952
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(29,077,636)	(29,077,636)
	$ 1,819,530,316	$ 1,819,530,316

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	$ 86,702,920	$ 86,702,920	$ 86,702,920	$ 86,702,920
Paid-in capital	75,310,003	75,310,003	75,310,003	75,310,003
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	4,075,460	4,075,460	4,075,460	4,075,460
Allocated equities held greater than 7 years	25,144,487	25,144,487	25,144,487	25,144,487
Nonqualified allocated equities not subject to retirement	37,780,318	37,780,318	37,780,318	37,780,318
Other preferred stock subject to certain limitations	-	-	20,000,000	20,000,000
Subordinated debt subject to certain limitation	-	-	-	-
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	7,846,075	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(29,077,636)	(29,077,636)	(29,077,636)	(29,077,636)
Other regulatory required deductions	-	-	-	-
	$ 199,935,552	$ 199,935,552	$ 227,781,627	$ 219,935,552
Denominator:				
Risk-adjusted assets excluding allowance	$ 1,609,322,017	$ 1,609,322,017	$ 1,609,322,017	$ 1,609,322,017
Deductions:				
FCBT patronage accrual	(4,427,976)	(4,427,976)	(4,427,976)	(4,427,976)
Allowance for loan losses	-	-	-	(5,893,371)
	$ 1,604,894,041	$ 1,604,894,041	$ 1,604,894,041	$ 1,599,000,670

Preferred stock issuance**.** In January 2017, the Association received clearance from FCA and the board approved the issuance of 20 million shares of a series of preferred stock, par value of $1.00 per share. The stock was issued March 24, 2017. The stock is designated as *Fixed-to-Floating Rate Perpetual Cumulative Preferred Stock, Series A* ("**Series A Preferred Stock**"). The Series A Preferred stock has a fixed rate dividend of 5% for ten years, payable semi-annually. After ten years, the dividend rate becomes a floating rate at 5.00% above 6-month LIBOR. On or after 5 years, the Association may, at its option, redeem all or part of the Series A Preferred Stock. The Series A Preferred Stock is non-voting, except: (*i*) to materially change the Association's Charter or Bylaws that would materially adversely affect the holder of Series A Preferred Stock, (*ii*) to create, issue or authorize any class of stock ranking senior to the Series A Preferred Stock as to dividends or liquidation.

Note 5: Income taxes

The Association is subject to federal and certain other income taxes. The Association is eligible to operate as cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the Association 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 earnings that will not be distributed as qualified patronage refunds. During 2017, the Association is participating in a patronage program. 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 subsidiary, AgTexas, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

Note 6: 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 15 to the 2016 Annual Report to Stockholders for a more complete description.

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

September 30, 2017	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Assets held in nonqualified benefit trusts	$ 106,108	$ -	$ -	$ 106,108

December 31, 2016	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Assets held in nonqualified benefit trusts	$ 88,216	$ -	$ -	$ 88,216

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

September 30, 2017	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Loans*	$ -	$ -	$ 244,504	$ 244,504
Other property owned	-	-	1,178,500	1,178,500

December 31, 2016	Fair Value Measurement Using			Total Fair
	Level 1	Level 2	Level 3	Value
Assets:				
Loans*	$ -	$ -	$ 120,183	$ 120,183
Other property owned	-	-	1,384,355	1,384,355

*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 Recurring and 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 2 to the 2016 Annual Report, 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. For a more complete description, see notes to the 2016 Annual Report.

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. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

Note 7: Employee Benefit Plans

Employee Retirement Benefits. The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the nine months ended September 30:

	2017	2016
Service cost	$ 104,200	$ 70,932
Interest cost	224,388	144,179
Amortization of prior service credits and losses	(44,406)	(29,604)
Net periodic benefit cost	$ 284,182	$ 185,507

The Association's liability for the unfunded accumulated obligation for these benefits at September 30, 2017, was $6,770,488 and is included in "Accrued postretirement benefit liability" in the balance sheet.

The structure of the Association'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). The Association recognizes its amortized annual contributions to the plan as an expense. The Association contributed $1,653,142 to the District's defined benefit pension plan in 2017. Pension plan funding expense was $1,239,856 and $1,472,895 for the nine months ended September 30, 2017 & 2016.

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 CFS. The following table summarizes the changes in accumulated other comprehensive income (loss) for the nine months ended September 30:

	2017	2016
Accumulated other comprehensive income (loss) at January 1	$ (278,282)	$ (111,604)
Amortization of prior service (credit) costs included in salaries and employee benefits	(44,406)	(44,406)
Accumulated other comprehensive income at September 30	$ (322,688)	$ (156,010)

Note 8: 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 9: Subsequent Events

Association management has evaluated subsequent events through November 2, 2017, which is the date the CFS were issued or available to be issued, with no significant events to report.