



**Legacy**  
Ag Credit, ACA

2017 ANNUAL REPORT



Part of the Farm Credit System

## Letter to Stockholders

To our Stockholders:

On behalf of the Board of Directors and staff of Legacy Ag Credit, ACA, we are pleased to present our 2017 Annual Report and financial results.

We would also like to thank you for your continued patronage. We exist solely for you, our members, and we look forward to continuing to provide financially related services that benefit agriculture and rural home lending and help you achieve your future plans.

We are proud to announce that, based on our 2017 earnings, your Board of Directors has declared a cash patronage of \$2.1 million. The patronage will be paid to eligible stockholders in April 2018. While we can't guarantee future patronage, your Board of Directors has made it a central part of its ongoing strategic plan and intends to share earnings with the membership in a cooperative manner.

The Association had a good year in 2017. Total assets were \$251.1 million at December 31, 2017, compared to \$242.0 million at December 31, 2016. Net income was \$3.4 million for the year ended December 31, 2017. Member's Equity was \$55.5 million at December 31, 2017 or approximately 22.1% of total assets. Credit quality improved substantially in 2017. At December 31, 2017, 98.0% of the Association's assets were considered acceptable, compared to 91.0% at December 31, 2016.

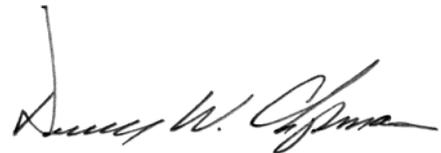
We have exciting plans for Legacy in 2018 and beyond. We have completely redesigned our website and are making plans to increase our visibility on social media pages like Facebook and LinkedIn. We budgeted additional funds for marketing and public relations in 2018. All of these plans are designed to continue to reach additional prospective members throughout our territory, continue to promote Legacy and the Farm Credit System, and grow the Association through quality new loans.

Finally, we would like to encourage each of you to look for information about upcoming 2018 Association customer appreciation events near you. We would like to meet each of you at one of these events and learn more about how we can continue to provide value to your membership in Legacy Ag Credit.

*"Financing Your Legacy"*



Terry Milligan  
Chairman of the Board



Derrell W. Chapman, CPA  
Chief Executive Officer

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## REPORT OF MANAGEMENT

The consolidated financial statements of Legacy Ag Credit, ACA (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. Other financial information included in the annual 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' 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 consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who also conduct a review of internal controls to the extent necessary to comply with auditing standards 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 consolidated 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 board of directors has overall responsibility for the association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

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



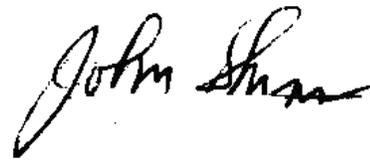
Derrell Chapman, CPA, Chief Executive Officer  
March 14, 2018



Terry Milligan, Chairman, Board of Directors  
March 14, 2018



Daryl D. Belt, Chief Financial Officer  
March 14, 2018



John Shinn, CPA, Chairman, Audit Committee  
March 14, 2018

## REPORT OF AUDIT COMMITTEE

The Audit Committee (committee) is composed of the entire board of directors of Legacy Ag Credit, ACA. In 2017, 18 committee meetings were held. The committee oversees the scope of Legacy Ag Credit, ACA's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on Legacy Ag Credit, ACA's website. The committee approved the appointment of PricewaterhouseCoopers LLP for 2017.

Management is responsible for Legacy Ag Credit, ACA's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements are prepared under the oversight of the committee. PricewaterhouseCoopers LLP is responsible for performing an independent audit of Legacy Ag Credit, ACA's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and for issuing a report thereon. The committee's responsibilities include monitoring and overseeing these processes.

In this context, the committee reviewed and discussed Legacy Ag Credit, ACA's audited consolidated financial statements for the year ended December 31, 2017 (audited consolidated financial statements) with management and PricewaterhouseCoopers LLP. The committee also reviews with PricewaterhouseCoopers LLP the matters required to be discussed by authoritative guidance "The Auditor's Communication With Those Charged With Governance," and both PricewaterhouseCoopers LLP's and Legacy Ag Credit, ACA's internal auditors directly provide reports on significant matters to the committee.

The committee discussed with PricewaterhouseCoopers LLP its independence from Legacy Ag Credit, ACA. The committee also reviewed the nonaudit services provided by PricewaterhouseCoopers LLP and concluded that these services were not incompatible with maintaining the independent accountant's independence. The committee has discussed with management and PricewaterhouseCoopers LLP such other matters and received such assurances from them as the committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the committee recommended that the board of directors include the audited consolidated financial statements in Legacy Ag Credit, ACA's Annual Report to Stockholders for the year ended December 31, 2017.

### Audit Committee Members

John Shinn, CPA, Chairman  
Cody Newman  
Brandon Sides  
Paul Nicklas  
Ron Gabriel  
Terry Milligan  
Bill Melton  
Randy Reeves

*March 14, 2018*

LEGACY AG CREDIT, ACA

FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

(unaudited)

(dollars in thousands)

	2017	2016	2015	2014	2013
<b><u>Balance Sheet Data</u></b>					
<u>Assets</u>					
Cash	\$ 105	\$ 122	\$ 105	\$ 97	\$ 84
Loans	246,433	238,026	231,972	228,889	216,168
Less: allowance for loan losses	1,303	2,081	2,358	3,026	3,299
Net loans	245,130	235,945	229,614	225,863	212,869
Investment in and receivable from the Farm Credit Bank of Texas	3,894	3,819	3,588	3,677	4,236
Other property owned, net	-	222	174	296	787
Other assets	1,931	1,935	1,734	1,990	1,877
Total assets	\$ 251,060	\$ 242,043	\$ 235,215	\$ 231,923	\$ 219,853
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 3,485	\$ 1,439	\$ 1,285	\$ 1,808	\$ 2,125
Obligations with maturities greater than one year	192,116	184,010	178,965	178,025	169,534
Total liabilities	195,601	185,449	180,250	179,833	171,659
<u>Members' Equity</u>					
Capital stock and participation certificates	1,107	1,112	1,101	1,080	1,022
Unallocated retained earnings	54,313	55,405	53,771	50,857	46,935
Accumulated other comprehensive income (loss)	39	77	93	153	237
Total members' equity	55,459	56,594	54,965	52,090	48,194
Total liabilities and members' equity	\$ 251,060	\$ 242,043	\$ 235,215	\$ 231,923	\$ 219,853
<b><u>Statement of Income Data</u></b>					
Net interest income	\$ 7,556	\$ 7,526	\$ 7,718	\$ 7,816	\$ 7,784
(Provision for loan losses) or loan loss reversal	201	272	701	171	(765)
Income from the Farm Credit Bank of Texas	811	850	813	838	826
Other noninterest income	363	280	193	1,407	521
Noninterest expense	(5,523)	(5,044)	(4,911)	(5,060)	(4,451)
Net income (loss)	\$ 3,408	\$ 3,884	\$ 4,514	\$ 5,172	\$ 3,915
<b><u>Key Financial Ratios for the Year</u></b>					
Return on average assets	1.4%	1.6%	1.97%	2.3%	1.8%
Return on average members' equity	6.0%	7.1%	8.5%	10.2%	8.3%
Net interest income as a percentage of average earning assets	3.2%	3.1%	3.4%	3.5%	3.7%
Net charge-offs (recoveries) as a percentage of average loans	0.2%	0.002%	-0.01%	0.05%	0.4%

**LEGACY AG CREDIT, ACA**

**FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA**

(unaudited)

(dollars in thousands)

<u><b>Key Financial Ratios at Year End *</b></u>	<u><b>2017</b></u>	<u><b>2016</b></u>	<u><b>2015</b></u>	<u><b>2014</b></u>	<u><b>2013</b></u>
Members' equity as a percentage of total assets	<b>22.1%</b>	23.4%	23.4%	22.5%	21.9%
Debt as a percentage of members' equity	<b>352.7%</b>	327.7%	327.9%	345.2%	356.2%
Allowance for loan losses as a percentage of loans	<b>0.5%</b>	0.9%	1.0%	1.3%	1.5%
Common equity tier 1 ratio	<b>22.8%</b>	n/a	n/a	n/a	n/a
Tier 1 capital ratio	<b>22.8%</b>	n/a	n/a	n/a	n/a
Total capital ratio	<b>23.6%</b>	n/a	n/a	n/a	n/a
Permanent capital ratio	<b>23.0%</b>	22.8%	23.0%	21.4%	20.9%
Tier 1 leverage ratio	<b>21.7%</b>	n/a	n/a	n/a	n/a
UREE leverage ratio	<b>22.8%</b>	n/a	n/a	n/a	n/a
Core surplus ratio	<b>n/a</b>	22.4%	22.5%	20.9%	20.4%
Total surplus ratio	<b>n/a</b>	22.4%	22.5%	20.9%	20.4%
 <u><b>Net Income Distribution</b></u>					
Cash patronage paid	<b>\$ 2,400</b>	\$ 2,250	\$ 1,600	\$ 1,250	\$ 1,000

\*Effective January 1, 2017 the new regulatory capital ratios were implemented by the association. Regulatory ratios remained well above regulatory minimums, including the conservation and leverage buffers at December 31, 2017. For additional information, refer to Note 9 to the consolidated financial statements, "Members Equity," included in this annual report.

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
(Unaudited)**

The following commentary explains management's assessment of the principal aspects of the consolidated financial condition and results of operations of Legacy Ag Credit, ACA, including its wholly-owned subsidiaries, Legacy, PCA and Legacy Land Bank, FLCA (association) for the years ended December 31, 2017, 2016 and 2015, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the association's audit committee.

**Forward-Looking Information:**

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will" or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international and farm-related business sectors;
- weather-related, disease-related and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

**Significant Events:**

In December 2017, the association received a direct loan patronage of \$722,016 from the bank, representing 39 basis points on the average daily balance of the association's direct loan with the bank. During 2017, the association received \$86,050 in patronage payments from the bank, based on the association's stock investment in the bank. Also, the association received a capital markets patronage of \$2,499 from the bank, representing 75 basis points on the association's average balance of participations in the bank's patronage pool program.

In December 2017, the board of directors approved a patronage accrual related to 2017 earnings of \$2,100,000. In February 2018, the board of directors approved payment of this patronage which will be paid in April 2018.

In January 2017, the board of directors approved a patronage payment of \$2,400,000 related to 2016 earnings which was paid in April 2017.

As previously communicated by a letter to stockholders dated November 22, 2016, the merger with Texas Farm Credit Services was terminated by a vote of the Legacy Ag Credit board at the November 2016 board meeting. See Terminated Merger Discussion section in 2016 Annual Report for additional information.

Effective January 10, 2017, the association was placed under special supervision by the Farm Credit Administration (FCA) related to the manner in which the decision was made to terminate the merger with Texas Farm Credit Services. The FCA, through three Supervisory Letters issued during 2017, established a number of supervisory requirements including the engagement of a board consultant approved by the FCA.

Effective February 20, 2018, FCA recognized the progress made by the board in improving its governance performance and terminated the three previously issued Supervisory Letters. FCA issued a new Supervisory Letter dated February 20, 2018 that included an ongoing requirement for a board consultant, fulfillment of certain planned board training activities, and submission of a

plan for benchmarking assessments of both board and individual director performance compared to previous assessments. The board has plans and resources in place to meet the requirements of the February 20, 2018 FCA letter.

### 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 loan products are available to eligible borrowers along with competitive variable, fixed, adjustable, LIBOR-based and prime-based interest rates. Loan maturities range from one to 40 years, with annual operating loans comprising the majority of the commercial loans and 20- to 30-year maturities comprising the majority of the mortgage loans. Loans serviced by the association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

The composition of the association's loan portfolio, including principal less funds held of \$246,432,546, \$238,025,851 and \$231,971,684 as of December 31, 2017, 2016 and 2015, respectively, is described more fully in detailed tables in Note 4 to the consolidated financial statements, "Loans and Allowance for Loan Losses" included in this annual report.

### Purchase and Sales of Loans:

During 2017, 2016 and 2015, the association was participating in loans with other lenders. As of December 31, 2017, 2016 and 2015, these participations totaled \$37,018,074, \$36,304,350 and \$33,622,714, or 15.0 percent, 15.3 percent and 14.5 percent of loans, respectively. The association had no participations purchased from entities outside the district. The association has also sold participations of \$0, \$1,014,457 and \$1,084,398 as of December 31, 2017, 2016 and 2015, respectively.

### 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, net of allowance.

The following table illustrates the association's components and trends of high-risk assets serviced for the prior three years as of December 31:

	2017		2016		2015	
	Amount	%	Amount	%	Amount	%
Nonaccrual	\$ 1,932,653	39.1%	\$ 3,060,977	46.8%	\$ 4,834,434	57.1%
Formally restructured	3,005,558	60.9%	3,258,080	49.8%	3,450,056	40.8%
Other property owned, net	-	0.0%	221,724	3.4%	173,976	2.1%
Total	\$ 4,938,211	100.0%	\$ 6,540,781	100.0%	\$ 8,458,466	100.0%

At December 31, 2017, 2016 and 2015, loans that were considered impaired were \$4,938,211, \$6,319,057 and \$8,284,490, representing 2.0 percent, 2.7 percent and 3.6 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net.

The association held no properties classified as other property owned at December 31, 2017.

At December 31, 2016, other property owned consisted of one property. This property consisted of a house with poultry houses and land. The net carrying value of the property was equivalent to its fair value of \$221,724. Net operating expenses incurred on other property owned were \$46,255. During 2016, there were two sales of other property owned that resulted in a net gain of \$50,975.

During 2015, the association wrote-off the remaining balance of one acquired property. The property consisted of inventory which was deemed to be uncollectible. This write-off resulted in a loss of \$44,765.

Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the association is not affected by any seasonal characteristics. The factors affecting the operations of the association are the same factors that would affect any agricultural real estate lender.

## Allowance for Loan Losses:

The following table provides relevant information regarding the allowance for loan losses as of, or for the year ended, December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Allowance for loan losses	\$ <b>1,302,631</b>	\$ 2,080,948	\$ 2,357,719
Allowance for loan losses to total loans	<b>0.5%</b>	0.9%	1.0%
Allowance for loan losses to nonaccrual loans	<b>67.4%</b>	68.0%	48.8%
Allowance for loan losses to impaired loans	<b>26.4%</b>	32.9%	28.5%
Net charge-offs to average loans	<b>0.2%</b>	0.002%	-0.01%

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management may consider other qualitative factors in determining and supporting the level of allowance for loan losses including but not limited to: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, borrower repayment capacity, depth of lender staff, and/or past trends, and weather-related influences.

Based upon ongoing risk assessment and the allowance for loan losses procedures outlined above, the allowance for loan losses of \$1,302,631, \$2,080,948 and \$2,357,719 at December 31, 2017, 2016 and 2015, respectively, is considered adequate by management to compensate for inherent losses in the loan portfolio at such dates. Management's process for the evaluation of allowance for loan losses includes a portfolio analysis and historical loss experience.

## Results of Operations:

The association's net income for the year ended December 31, 2017, was \$3,408,207 as compared to \$3,883,973 for the year ended December 31, 2016, reflecting a decrease of \$475,766, or 12.3 percent. The association's net income for the year ended December 31, 2015 was \$4,514,173. Net income decreased \$630,200, or 14.0 percent, in 2016 versus 2015.

Net interest income for 2017, 2016 and 2015 was \$7,555,955, \$7,525,977 and \$7,717,725, respectively, reflecting an increase of \$29,978, or 0.4 percent, for 2017 versus 2016 and a decrease of \$191,748, or 2.5 percent, for 2016 versus 2015. Net interest income is the principal source of earnings for the association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	<u>2017</u>		<u>2016</u>		<u>2015</u>	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Loans	\$ <b>238,944,318</b>	\$ <b>12,071,271</b>	\$ 239,737,040	\$ 11,797,840	\$ 225,253,663	\$ 11,596,085
Interest-bearing liabilities	<b>185,285,597</b>	<b>4,515,316</b>	187,427,414	4,271,863	174,297,849	3,878,360
Impact of capital	<b>\$ 53,658,721</b>		<b>\$ 52,309,626</b>		<b>\$ 50,955,814</b>	
Net interest income		<b>\$ 7,555,955</b>		<b>\$ 7,525,977</b>		<b>\$ 7,717,725</b>

	<u>2017</u>	<u>2016</u>	<u>2015</u>
	Average Yield	Average Yield	Average Yield
Yield on loans	<b>5.05%</b>	4.92%	5.15%
Cost of interest-bearing liabilities	<b>2.44%</b>	2.28%	2.23%
Interest rate spread	<b>2.61%</b>	2.64%	2.92%

	2017 vs. 2016			2016 vs. 2015		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income - loans	\$ (39,011)	\$ 312,442	\$ 273,431	\$ 745,604	\$ (543,849)	\$ 201,755
Interest expense	(48,816)	292,269	243,453	292,146	101,357	393,503
Net interest income	\$ 9,805	\$ 20,173	\$ 29,978	\$ 453,458	\$ (645,206)	\$ (191,748)

Interest income for 2017 increased by \$273,431, or 2.3 percent, compared to 2016, primarily due to an increase in yield on loans. Interest expense for 2017 increased by \$243,453, or 5.7 percent, compared to 2016 due to an increase in the cost of interest-bearing liabilities. The interest rate spread decreased by -3 basis points to 2.61 percent in 2017 from 2.64 percent in 2016, primarily because of the changes in interest income and expense. The interest rate spread decreased by -28 basis points to 2.64 percent in 2016 from 2.92 percent in 2015, primarily due to the decline in the average yield on loans.

Noninterest income for 2017 increased by \$44,159, or 3.9 percent, compared to 2016, due primarily to an increase in loan fees offset by a reduction in patronage received from FCBT. Noninterest income for 2016 increased by \$123,866, or 12.3 percent, compared to 2015, due primarily to an increase in patronage and loan fee income as well as a net gain on sale of other property owned.

The reversals of provisions for loan losses decreased by \$70,500, or 25.9 percent, compared to 2016, due primarily to a reduction in impaired loan volume.

Operating expenses consist primarily of salaries, employee benefits and purchased services. Expenses for purchased services may include administrative services, marketing, information systems, accounting and loan processing, among others. Operating expenses increased by \$479,403, or 9.5 percent, in 2017 compared to 2016 primarily due to an increase in purchased services. There was an increase in required legal and consulting services due to the terminated merger which resulted in an increase in fees of \$224,384. Appraisal fees and legal fees passed on to borrowers increased by \$89,944. Due to an increase in regulatory compliance requirements, audit services increased by \$93,818. The increase in operating expenses included a decrease of \$39,798 in premiums to the Insurance Fund, resulting from a decrease in the premium rates from 16 basis points for the first half and 18 basis points for the second half of 2016 to 15 basis points in 2017.

For the year ended December 31, 2017, the association's return on average assets was 1.4 percent, as compared to 1.6 percent and 1.97 percent for the years ended December 31, 2016 and 2015, respectively. For the year ended December 31, 2017, the association's return on average members' equity was 6.0 percent, as compared to 7.1 percent and 8.5 percent for the years ended December 31, 2016 and 2015, respectively.

Because the association depends on the bank for funding, any significant positive or negative factors affecting the operations of the bank may have an effect on the operations of the association.

### Liquidity and Funding Sources:

The interest rate risk inherent in the association's loan portfolio is substantially mitigated through the funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process.

The primary source of liquidity and funding for the association is a direct loan from the bank. The outstanding balance of \$191,700,575, \$183,651,931 and \$178,621,128 as of December 31, 2017, 2016 and 2015, respectively, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 2.44 percent, 2.28 percent and 2.23 percent at December 31, 2017, 2016 and 2015, respectively. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the bank and is governed by a general financing agreement. The increase in note payable to the bank and related accrued interest payable since December 31, 2016, is due to an 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 \$54,075,456, \$53,929,815 and \$53,035,534 at December 31, 2017, 2016 and 2015, respectively. The maximum amount the association may borrow from the bank as of December 31, 2017, was \$234,641,210 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, 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.

The liquidity policy of the association is to manage cash balances, to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued during 2018. As borrower payments are received, they are applied to the association's note payable to the bank.

The association will continue to fund its operations through direct borrowings from the bank, capital surplus from prior years and borrower stock. It is management's opinion that funds available to the association are sufficient to fund its operations for the coming year.

### **Capital Resources:**

The association's capital position remains strong, with total members' equity of \$55,458,870, \$56,594,000 and \$54,964,957 at December 31, 2017, 2016 and 2015, respectively.

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. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The association's permanent capital ratio at December 31, 2017, 2016 and 2015 was 23.0 percent, 22.8 percent and 23.0 percent, respectively. Under the new regulations, the association is required to maintain a minimum common equity tier 1 (CET1), tier 1 capital, and total capital ratios of 4.5 percent, 6.0 percent, and 8.0 percent, along with a capital conservation buffer of 2.5 percent applicable to each ratio, respectively. The 2.5 percent capital conservation buffer will be phased in over a three year period ending on December 31, 2019. The association's common equity tier 1 ratio was 22.8 percent, tier 1 capital ratio was 22.8 percent, and total capital ratio was 23.6 percent at December 31, 2017. Under the new regulations, the association is required to maintain a minimum tier 1 leverage ratio of 4.0 percent, along with a leverage buffer of 1.0 percent, and a minimum unallocated retained earnings equivalents (UREE) leverage ratio of 1.5 percent. The association's tier 1 leverage ratio was 21.7 and UREE leverage ratio was 22.8 at December 31, 2017. The CET1 capital ratio is an indicator of the institution's highest quality of capital and consists of unallocated retained earnings, qualifying common cooperative equities (CCEs) that meet the required holding periods, and paid-in capital. The tier 1 capital ratio is a measure of the institution's quality of capital and financial strength. The total capital ratio is supplementary to the tier 1 capital ratio, the components of which include qualifying CCEs subject to certain holding periods, third-party capital subject to certain holding periods and limitations, and allowance and reserve for credit losses subject to certain limitations. The tier 1 leverage ratio is used to measure the amount of leverage an institution has incurred against its capital base, of which at least 1.5 percent must be unallocated retained earnings (URE) and URE equivalents. This is the UREE leverage ratio.

Prior to January 1, 2017 the core surplus ratio measures available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The association's core surplus ratio at December 31, 2016 and 2015 was 22.4 percent and 22.5 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measures available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the reserves existing to protect borrowers' investments in the association. The association's total surplus ratio at December 31, 2016 and 2015 was 22.4 percent and 22.5 percent, respectively, which is in compliance with the FCA's minimum ratio requirement of 7.0 percent.

### **Regulatory Matters:**

Effective January 10, 2017 the association was placed under special supervision by the Farm Credit Administration (FCA) related to the manner in which the decision was made to terminate the merger with Texas Farm Credit Services. The FCA, through three Supervisory Letters issued during 2017, established a number of supervisory requirements including the engagement of a board consultant approved by the FCA.

Effective February 20, 2018, FCA recognized the progress made by the board in improving its governance performance and terminated the three previously-issued Supervisory Letters. FCA issued a new Supervisory Letter dated February 20, 2018 that included an ongoing requirement for a board consultant, fulfillment of certain planned board training activities, and submission of a plan for benchmarking assessments of both board and individual director performance compared to previous assessments. The board has plans and resources in place to meet the requirements of the February 20, 2018 FCA letter.

On July 28, 2016, the Farm Credit Administration published a final regulation to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule were 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 replaces existing core surplus and total surplus requirements with common equity tier 1, tier 1 and total capital risk-based capital ratio requirements. The final rule also replaces the existing net collateral ratio with a tier 1 leverage ratio and is applicable to all banks and associations. The permanent capital ratio will continue to remain in effect with the final rule.

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

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

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

The public comment period ended on October 23, 2014. FCA anticipates release of a final rule in the first quarter of 2018.

In 2017, 2016 and 2015, the association paid patronage of \$2,399,984, \$2,249,884 and \$1,600,000, respectively. See Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report, for further information.

#### **Relationship With the Bank:**

The association's statutory obligation to borrow only from the bank is discussed in Note 8 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The bank's ability to access capital of the association is discussed in Note 2 to the consolidated financial statements, "Summary of Significant Accounting Policies," included in this annual report, within the section "Capital Stock Investment in the Bank."

The bank's role in mitigating the association's exposure to interest rate risk is described in the section "Liquidity and Funding Sources" of Management's Discussion and Analysis and in Note 8 to the consolidated financial statements, "Note Payable to the Bank," included in this annual report.

The bank provides computer systems to support the critical operations of all district associations. In addition, each association has operating systems and facility-based systems that are not supported by the bank. As disclosed in Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report, the bank provides many services that the association can utilize, such as administrative, marketing, information systems and accounting services. Additionally, the bank bills district expenses to the associations, such as the Farm Credit System Insurance Corporation insurance premiums.

**Other:**

New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Acts of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA changed the federal corporate tax rate from 35 percent to 21 percent. The association is exempt from federal and certain other income taxes as provided by the Farm Credit Act; however, the change in the federal corporate tax rate will have a financial statement impact for year-end 2017 for district associations that will require the revaluation of any deferred taxes (assets or liabilities), which will result in either a tax expense or tax benefit to the income statement. While the full impact of the TCJA is difficult to predict and may not be fully known for several years, changes that could affect the associations' business and customers include, but are not limited to, modifications to deductions surrounding interest expense and equipment purchases, tax incentives related to renewable energy initiatives, deductions impacting agricultural producers who sell their products to cooperatives and the overall changes in the competitive environment impacting financial institutions.

**Summary:**

Regardless of the state of the agricultural economy, your association's board of directors and management, as well as the board of directors and management of the bank, have been committed to offering their borrowers a ready source of financing at a competitive price. Your continued support will be critical to the success of this association.



## Report of Independent Auditors

To the Board of Directors of Legacy Ag Credit, ACA

We have audited the accompanying consolidated financial statements of Legacy Ag Credit, ACA and its subsidiaries (the Association), which comprise the consolidated balance sheets as of December 31, 2017, December 31, 2016 and December 31, 2015, and the related consolidated statements of comprehensive income, changes in members' equity and cash flows for the years then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Legacy Ag Credit, ACA and its subsidiaries as of December 31, 2017, December 31, 2016 and December 31, 2015, and the results of their operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

March 14, 2018

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	December 31,		
	2017	2016	2015
<b><u>Assets</u></b>			
Cash	\$ 104,733	\$ 121,720	\$ 104,812
Loans	246,432,546	238,025,851	231,971,684
Less: allowance for loan losses	1,302,631	2,080,948	2,357,719
Net loans	245,129,915	235,944,903	229,613,965
Accrued interest receivable	1,129,861	1,111,228	1,107,074
Investment in and receivable from the Farm Credit Bank of Texas:			
Capital stock	3,695,075	3,738,505	3,486,430
Other	199,386	80,883	101,859
Other property owned, net	-	221,724	173,976
Premises and equipment	636,280	485,401	474,752
Other assets	165,157	338,647	151,782
Total assets	<b>\$ 251,060,407</b>	<b>\$ 242,043,011</b>	<b>\$ 235,214,650</b>
<b><u>Liabilities</u></b>			
Note payable to the Farm Credit Bank of Texas	\$ 191,700,575	\$ 183,651,931	\$ 178,621,128
Advance conditional payments	30,594	1,272	-
Accrued interest payable	416,552	357,914	343,575
Drafts outstanding	5,095	201,009	252,089
Patronage distributions payable	2,100,000	-	-
Other liabilities	1,348,721	1,236,885	1,032,901
Total liabilities	<b>195,601,537</b>	<b>185,449,011</b>	<b>180,249,693</b>
<b><u>Members' Equity</u></b>			
Capital stock and participation certificates	1,106,505	1,112,315	1,100,475
Unallocated retained earnings	54,313,434	55,405,211	53,771,122
Accumulated other comprehensive income (loss)	38,931	76,474	93,360
Total members' equity	<b>55,458,870</b>	<b>56,594,000</b>	<b>54,964,957</b>
Total liabilities and members' equity	<b>\$ 251,060,407</b>	<b>\$ 242,043,011</b>	<b>\$ 235,214,650</b>

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

*LEGACY AG CREDIT, ACA—2017 Annual Report*

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Year Ended December 31,		
	2017	2016	2015
<b><u>Interest Income</u></b>			
Loans	\$ 12,071,271	\$ 11,797,840	\$ 11,596,085
<b><u>Interest Expense</u></b>			
Note payable to the Farm Credit Bank of Texas	4,515,304	4,271,863	3,878,358
Advance conditional payments	12	-	2
Total interest expense	4,515,316	4,271,863	3,878,360
Net interest income	7,555,955	7,525,977	7,717,725
(Reversal of) Loan Losses	(201,336)	(271,836)	(701,120)
Net interest income after provision for losses	7,757,291	7,797,813	8,418,845
<b><u>Noninterest Income</u></b>			
Income from the Farm Credit Bank of Texas:			
Patronage income	810,565	850,293	813,041
Loan fees	274,045	204,183	149,893
Financially related services income	404	639	675
Gain on sale of other property owned	1,715	50,975	-
Gain on sale of premises and equipment, net	27,985	-	19,033
Gain on other assets	31,412	-	-
Other noninterest income	27,852	23,729	23,311
Total noninterest income	1,173,978	1,129,819	1,005,953
<b><u>Noninterest Expenses</u></b>			
Salaries and employee benefits	3,043,409	2,974,053	2,873,152
Directors' expense	291,397	289,062	217,050
Purchased services	853,203	416,521	406,904
Travel	195,078	182,441	214,458
Occupancy and equipment	273,293	257,547	272,851
Communications	139,426	120,780	99,302
Advertising	49,671	88,227	97,764
Public and member relations	125,515	109,056	133,777
Supervisory and exam expense	105,211	92,780	79,289
Insurance Fund premiums	283,569	323,367	254,739
Provision for other property owned	-	15,689	76,890
Loss on other property owned, net	21,092	30,566	59,892
Other noninterest expense	142,198	143,570	124,557
Total noninterest expenses	5,523,062	5,043,659	4,910,625
<b>NET INCOME</b>	<b>3,408,207</b>	<b>3,883,973</b>	<b>4,514,173</b>
Other comprehensive income:			
Change in postretirement benefit plans	(37,543)	(16,886)	(59,640)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 3,370,664</b>	<b>\$ 3,867,087</b>	<b>\$ 4,454,533</b>

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

*LEGACY AG CREDIT, ACA—2017 Annual Report*

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY**

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2014	\$ 1,080,365	\$ 50,856,949	\$ 153,000	\$ 52,090,314
Comprehensive income	-	4,514,173	(59,640)	4,454,533
Capital stock/participation certificates and allocated retained earnings issued	141,125	-	-	141,125
Capital stock/participation certificates and allocated retained earnings retired	(121,015)	-	-	(121,015)
Patronage paid	-	(1,600,000)	-	(1,600,000)
<b>Balance at December 31, 2015</b>	<b>1,100,475</b>	<b>53,771,122</b>	<b>93,360</b>	<b>54,964,957</b>
Comprehensive income	-	3,883,973	(16,886)	3,867,087
Capital stock/participation certificates issued	129,390	-	-	129,390
Capital stock/participation certificates and allocated retained earnings retired	(117,550)	-	-	(117,550)
Patronage paid	-	(2,249,884)	-	(2,249,884)
<b>Balance at December 31, 2016</b>	<b>1,112,315</b>	<b>55,405,211</b>	<b>76,474</b>	<b>56,594,000</b>
Comprehensive income	-	3,408,207	(37,543)	3,370,664
Preferred stock issued				
Capital stock/participation certificates issued	140,330	-	-	140,330
Preferred stock retired				
Capital stock/participation certificates and allocated retained earnings retired	(146,140)	-	-	(146,140)
Patronage paid	-	(2,399,984)	-	(2,399,984)
Patronage accrual	-	(2,100,000)	-	(2,100,000)
<b>Balance at December 31, 2017</b>	<b>\$ 1,106,505</b>	<b>\$ 54,313,434</b>	<b>\$ 38,931</b>	<b>\$ 55,458,870</b>

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

*LEGACY AG CREDIT, ACA—2017 Annual Report*

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2017	2016	2015
<b>Cash flows from operating activities:</b>			
Net income	\$ 3,408,207	\$ 3,883,973	\$ 4,514,173
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses or (loan loss reversal)	(201,336)	(271,836)	(701,120)
Provision for acquired property	-	15,689	76,890
Gain on other property owned, net	(1,715)	(50,975)	59,892
Gain on other assets	(31,412)	-	-
Depreciation	138,943	100,300	118,563
Gain on sale of premises and equipment, net	(27,985)	-	(19,033)
(Increase) decrease in accrued interest receivable	(18,633)	(4,154)	168,479
(Increase) decrease in other receivables from the Farm			
Credit Bank of Texas	(118,503)	20,976	68,996
Decrease (increase) in other assets	204,902	(186,865)	(12,973)
Increase in accrued interest payable	58,638	14,339	6,334
Increase (decrease) in other liabilities	74,293	187,098	(109,247)
Net cash provided by operating activities	<u>3,485,399</u>	<u>3,708,545</u>	<u>4,170,954</u>
<b>Cash flows from investing activities:</b>			
Increase in loans, net	(9,096,226)	(6,479,721)	(3,161,482)
Cash recoveries of loans previously charged off	24,476	12,897	33,843
Proceeds from redemption (purchase) of investment in the Farm Credit Bank of Texas	43,430	(252,075)	19,660
Purchases of premises and equipment	(266,047)	(67,434)	(2,521)
Proceeds from sales of premises and equipment	58,999	-	39,851
Proceeds from sales of other property owned	256,724	351,745	27,286
Net cash used in investing activities	<u>(8,978,644)</u>	<u>(6,434,588)</u>	<u>(3,043,363)</u>

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

*LEGACY AG CREDIT, ACA—2017 Annual Report*

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2017	2016	2015
<b>Cash flows from financing activities:</b>			
Net draws on note payable to the Farm Credit Bank of Texas	8,048,644	5,030,803	933,578
Decrease in drafts outstanding	(195,914)	(51,080)	(473,411)
Increase in advance conditional payments	29,322	1,272	-
Issuance of capital stock and participation certificates	140,330	129,390	141,125
Retirement of capital stock and participation certificates	(146,140)	(117,550)	(121,015)
Cash dividends paid	(2,399,984)	(2,249,884)	(1,600,000)
Patronage distributions paid	-	-	-
Net cash provided by (used in) financing activities	5,476,258	2,742,951	(1,119,723)
Net (decrease) increase in cash	(16,987)	16,908	7,868
Cash at the beginning of the year	121,720	104,812	96,944
Cash at the end of the year	\$ 104,733	\$ 121,720	\$ 104,812

**Supplemental schedule of noncash investing and financing activities:**

Loans transferred to other property owned	\$ 33,285	\$ 364,207	\$ 27,286
Loans charged off	601,457	17,832	1,375

**Supplemental cash information:**

Cash paid during the year for:			
Interest	\$ 4,456,678	\$ 4,257,524	\$ 4,046,839

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

*LEGACY AG CREDIT, ACA—2017 Annual Report*

**LEGACY AG CREDIT, ACA**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — ORGANIZATION AND OPERATIONS:**

- A. Organization: Legacy Ag Credit, ACA, including its wholly-owned subsidiaries, Legacy, PCA and Legacy Land Bank, FLCA (collectively called “the association”), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in the counties of Franklin, Gregg, Harrison, Hopkins, Kaufman, Marion, Rains, Upshur, Van Zandt and Wood in the state of Texas.

The association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). At December 31, 2017, the System consisted of three Farm Credit Banks (FCBs) and their affiliated associations, one Agricultural Credit Bank (ACB) and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (bank) and its related associations are collectively referred to as the “district.” The bank provides funding to all associations within the district and is responsible for supervising certain activities of the district associations. At December 31, 2017, the district consisted of the bank, one FLCA and 13 ACA parent companies, which have two wholly-owned subsidiaries, an FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of System associations to ensure their compliance with the Farm Credit Act, FCA regulations, and safe and sound banking practices.

The Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected borrower capital at par or stated value and (3) for other specified purposes. The Insurance Fund is also available for the discretionary uses by the FCSIC of providing assistance to certain troubled System institutions and to cover the operating expenses of the FCSIC. Each System bank has been required to pay premiums, which may be passed on to the association, into the Insurance Fund, based on its annual average adjusted outstanding insured debt until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or other such percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the FCSIC is required to reduce premiums as necessary to maintain the Insurance Fund at the 2 percent level. As required by the Farm Credit Act, as amended, the FCSIC may return excess funds above the secure base amount to System institutions.

FCA regulations require borrower information to be held in strict confidence by Farm Credit institutions, their directors, officers and employees. Directors and employees of the Farm Credit institutions are prohibited, except under specified circumstances, from disclosing nonpublic personal information about members.

- B. Operations: The Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services that can be offered by the association. The association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents and farm-related businesses. The association makes and services short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the bank.

The association also serves as an intermediary in offering credit life insurance and multi-peril crop insurance.

The association’s financial condition may be affected by factors that affect the bank. The financial condition and results of operations of the bank may materially affect stockholders’ investments in the association. Upon request, stockholders of the association will be provided with the Farm Credit Bank of Texas and District Associations’ Annual Report to Stockholders,

which includes the combined financial statements of the bank and all of the district associations. The district's annual report discusses the material aspects of the financial condition, changes in financial condition, and results of operations for the bank and the district. In addition, the district's annual report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Insurance Fund.

The lending and financial services offered by the bank are described in Note 1A, "Organization and Operations," of the district's annual report to stockholders.

## **NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

The accounting and reporting policies of the association conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates. The consolidated financial statements include the accounts of Legacy, PCA and Legacy Land Bank, FLCA. All significant intercompany transactions have been eliminated in consolidation.

- A. 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 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, 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 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, the FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The 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." The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the 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 determined the effect was not material to its financial condition or results of operations and will not change its current recognition practices.

- B. Cash: Cash, as included in the statement of cash flows, represents cash on hand and on deposit at local banks.
- C. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and net deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. Authoritative accounting guidance requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan and are generally considered substandard or doubtful, which is in accordance with the loan rating model, as described below. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest and penalty interest incurred as a result of past-due status, is collected or otherwise discharged in full.

Impaired loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. Additionally, all loans over 180 days past due are placed in nonaccrual status. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years). Loans are charged off at the time they are determined to be uncollectible.

A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the association grants a concession to the debtor that it would not otherwise consider. A concession is generally granted in order to minimize the association's economic loss and avoid foreclosure. Concessions vary by program and are borrower-specific and may include interest rate reductions, term extensions, payment deferrals or the acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. A loan restructured in a troubled debt restructuring is an impaired loan.

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, the interest portion of payments is recognized as current interest income. Nonaccrual loans may be returned to accrual status when principal and interest are current, the borrower has demonstrated payment performance, there are no unrecovered prior charge-offs and collection of future payments is no longer in doubt. If previously unrecognized interest income exists at the time the loan is transferred to accrual status, cash received at the time of or subsequent to the transfer is first recorded as interest income until such time as the recorded balance equals the contractual indebtedness of the borrower.

The bank and related associations use a two-dimensional loan rating model based on an internally generated combined system risk-rating guidance that incorporates a 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan, assuming default has occurred or is expected to occur within the next 12 months.

Each of the probability of default categories carries a distinct percentage of default probability. The 14-point risk-rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned (OAEM) and grows significantly as a loan

moves to a substandard (viable) level. A substandard (nonviable) rating indicates that the probability of default is almost certain.

The credit risk-rating methodology is a key component of the association's allowance for loan losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for loan losses is maintained at a level considered adequate by management to provide for probable losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition, collateral value, portfolio quality, current production conditions and economic conditions, and prior loan loss experience. Management may consider other qualitative factors in determining and supporting the level of allowance for loan losses including but not limited to: the concentration of lending in agriculture, combined with uncertainties associated with farmland values, commodity prices, exports, government assistance programs, regional economic effects, borrower repayment capacity, depth of lender staff, and/or past trends, and weather-related influences. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by their nature, contain elements of uncertainty and imprecision. Changes in the agricultural economy and their impact on borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary significantly from the institutions' expectations and predictions of those circumstances.

The allowance for loan losses includes components for loans individually evaluated for impairment and loans collectively evaluated for impairment. Generally, for loans individually evaluated the allowance for loan losses represents the difference between the recorded investment in the loan and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for loan losses is determined using the risk-rating model.

- D. **Capital Stock Investment in the Farm Credit Bank of Texas:** The association's investment in the bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted periodically based on the association's proportional utilization of the bank compared to other district associations. The bank requires a minimum stock investment of 2 percent of the association's average borrowing from the bank. This investment is carried at cost plus allocated equities in the accompanying consolidated balance sheet.

If needed to meet regulatory capital adequacy requirements, the board of directors of the bank may increase the percentage of stock held by an association from 2 percent of the average outstanding balance of borrowings from the bank to a maximum of 5 percent of the average outstanding balance of borrowings from the bank.

- E. **Other Property Owned, Net:** Other property owned, net, consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, and is recorded at fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. On at least an annual basis, revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned in the statements of comprehensive income.
- F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method using estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- G. **Advance Conditional Payments:** The association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the association on such accounts at rates established by the board of directors.
- H. **Employee Benefit Plans:** Employees of the association participate in either the district defined benefit retirement plan (DB plan) or the defined contribution plan (DC plan). All eligible employees may participate in the Farm Credit Benefits Alliance 401(k) Plan. The DB plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB plan is noncontributory and provides benefits based on salary and years of service. The "projected unit credit" actuarial method is used for financial reporting and funding purposes for the DB plan.

Participants in the DC plan generally include employees who elected to transfer from the DB plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC plan direct the placement of their employers' contributions, 5.0 percent of eligible pay for the year ended December 31, 2017, made on their behalf into various investment alternatives.

The structure of the district's DB plan is characterized as multi-employer, since neither the assets, liabilities nor costs of the plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. The association recognized pension costs for the DC plan of \$114,750, \$116,444 and \$120,188 for the years ended December 31, 2017, 2016 and 2015 respectively. For the DB plan, the association recognized pension costs of \$0, \$0 and \$0 for the years ended December 31, 2017, 2016 and 2015, respectively.

The association also participates in the Farm Credit Benefits Alliance 401(k) Plans, which requires the associations to match 100 percent of employee contributions up to 3.0 percent of eligible earnings and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of eligible earnings. Association 401(k) plan costs are expensed as incurred. The association's contributions to the 401(k) plan were \$88,524, \$90,163 and \$91,227 for the years ended December 31, 2017, 2016 and 2015, respectively.

In addition to the DB plan, the DC plan and the Farm Credit Benefits Alliance 401(k) plan above, the association sponsors a defined contribution supplemental retirement plan. This plan is a nonqualified 401(k) plan however; to date no contributions have been made. Therefore, there are no associated liabilities included in the association's consolidated balance sheet. Likewise, there have been no employee benefit costs related to the nonqualified plan included in the association's consolidated statement of comprehensive income.

In addition to pension benefits, the association provides certain health care and life insurance 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 other liabilities on the consolidated balance sheet. For further information about the association's employee benefit plans, see Note 11, "Employee Benefit Plans."

- I. **Income Taxes:** The ACA holding company conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are operated through the wholly-owned FLCA subsidiary, which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through the wholly-owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income tax. The association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. Deferred taxes are provided on the association's taxable income on the basis of a proportionate share of the tax effect of temporary differences not allocated in patronage form. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the association's expected patronage program, which reduces taxable earnings.

New U.S. tax laws resulting from legislation commonly known as the Tax Cuts and Jobs Acts of 2017 (TCJA) were enacted in late 2017. Among other things, the TCJA changed the federal corporate tax rate from 35 percent to 21 percent. FLCA subsidiaries are exempt from federal and state income tax; however, the change in the federal corporate tax rate will have a financial statement impact for year-end 2017 on ACAs and PCA subsidiaries that will require the revaluation of any deferred taxes (assets or liabilities) in the year of enactment (2017). This will result in either a tax expense or tax benefit to the income statement.

- J. **Patronage Refunds From the Farm Credit Bank of Texas:** The association records patronage refunds from the bank on an accrual basis.

- K. Fair Value Measurement: The FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets. Also included in Level 1 are assets held in trust funds, which relate to deferred compensation and our supplemental retirement plan. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace. Pension plan assets that are invested in equity securities, including mutual funds and fixed-income securities that are actively traded, are also included in Level 1.

Level 2 — Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly. Level 2 inputs include the following: (a) quoted prices for similar assets or liabilities in active markets; (b) quoted prices for identical or similar assets or liabilities in markets that are not active so that they are traded less frequently than exchange-traded instruments, the prices are not current or principal market information is not released publicly; (c) inputs other than quoted prices that are observable such as interest rates and yield curves, prepayment speeds, credit risks and default rates; and (d) inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate debt securities, and derivative contracts. Pension plan assets that are derived from observable inputs, including corporate bonds and mortgage-backed securities, are reported in Level 2.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities are considered Level 3. These unobservable inputs reflect the reporting entity's own assumptions about assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, asset-backed securities, highly structured or long-term derivative contracts, certain loans and other property owned. Pension plan assets such as certain mortgage-backed securities that are supported by little or no market data in determining the fair value are included in Level 3.

The fair value disclosures are presented in Note 13, "Fair Value Measurements."

- L. Off-balance-sheet credit exposures: Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. Commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party. The credit risk associated with commitments to extend credit and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

**NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans as of December 31 follows:

Loan Type	2017		2016		2015	
	Amount	%	Amount	%	Amount	%
Real estate mortgage	\$ 197,323,124	80.1%	\$ 190,398,110	80.0%	\$ 186,778,168	80.5%
Production and intermediate term	12,447,990	5.0%	11,091,817	4.7%	10,701,356	4.6%
Agribusiness:						
Loans to cooperatives	1,673,345	0.7%	1,577,708	0.7%	384,688	0.2%
Processing and marketing	20,123,055	8.2%	19,429,639	8.2%	16,037,266	6.9%
Farm-related business	761,706	0.3%	757,724	0.3%	1,504,760	0.6%
Communication	3,757,372	1.5%	2,930,922	1.2%	2,071,279	0.9%
Energy	4,369,376	1.8%	6,764,173	2.8%	7,150,076	3.1%
Water and waste water	1,994,398	0.8%	1,993,552	0.8%	1,992,703	0.9%
Rural residential real estate	3,982,180	1.6%	3,082,206	1.3%	5,351,388	2.3%
Total	\$ 246,432,546	100.0%	\$ 238,025,851	100.0%	\$ 231,971,684	100.0%

The association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding participations purchased and sold as of December 31, 2017:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Production and intermediate term	\$ 4,338,822	\$ -	\$ -	\$ -	\$ 4,338,822
Agribusiness	22,558,106	-	-	-	22,558,106	-
Communication	3,757,372	-	-	-	3,757,372	-
Energy	4,369,376	-	-	-	4,369,376	-
Water and waste water	1,994,398	-	-	-	1,994,398	-
Total	\$ 37,018,074	\$ -	\$ -	\$ -	\$ 37,018,074	\$ -

Geographic Distribution:

County	2017	2016	2015
Van Zandt	14.9%	15.7%	15.5%
Hopkins	13.9%	14.4%	14.5%
Kaufman	10.2%	10.0%	11.6%
Wood	7.9%	8.5%	7.4%
Upshur	6.7%	7.4%	6.8%
Harrison	5.7%	6.0%	6.1%
Franklin	3.7%	3.0%	3.8%
Marion	2.2%	1.9%	1.9%
Rains	1.3%	1.1%	0.9%
Gregg	0.7%	0.7%	0.8%
Other	32.8%	31.3%	30.7%
Totals	100.0%	100.0%	100.0%

The association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the association's lending activities is collateralized, and the association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the association's credit risk exposure is considered in the determination of the allowance for loan losses.

Operation/Commodity	2017		2016		2015	
	Amount	%	Amount	%	Amount	%
Livestock, except dairy and poultry	\$ 76,438,682	31.0%	\$ 76,610,010	32.3%	\$ 72,959,559	31.4%
Field crops except cash grains	44,558,583	18.1%	44,502,979	18.7%	45,248,687	19.5%
Poultry and eggs	38,288,867	15.5%	29,576,552	12.4%	23,674,166	10.2%
Timber	19,370,236	7.9%	20,158,221	8.5%	21,517,622	9.3%
Hunting, trapping and game propagation	11,421,198	4.6%	9,234,838	3.9%	12,989,823	5.6%
Food and kindred products	10,287,649	4.2%	10,426,815	4.4%	5,347,692	2.3%
Wholesale trade - nondurable goods	6,954,123	2.8%	4,406,429	1.9%	4,432,025	1.9%
Real estate	6,028,927	2.4%	6,314,983	2.7%	6,384,081	2.8%
Dairy farms	5,154,836	2.1%	6,777,230	2.8%	7,008,468	3.0%
Animal specialties	5,152,607	2.1%	5,347,715	2.2%	5,554,630	2.4%
Rural home loans	4,878,526	2.0%	4,394,522	1.8%	4,619,010	2.0%
Electric services	4,369,376	1.8%	6,764,173	2.8%	7,090,033	3.1%
Communication	3,757,372	1.5%	2,930,922	1.2%	2,137,173	0.9%
Paper and allied products	2,589,216	1.1%	2,647,519	1.1%	2,660,091	1.1%
Chemical and allied products	2,393,247	1.0%	1,201,029	0.5%	3,217,098	1.4%
Water Supply	1,994,398	0.8%	1,993,552	0.8%	1,992,703	0.9%
Metal cans	848,277	0.3%	2,059,825	0.9%	2,052,948	0.9%
Agricultural services	576,379	0.2%	1,011,243	0.4%	1,358,354	0.6%
Trucking and courier services, except air	427,617	0.2%	416,980	0.2%	432,176	0.2%
Fruit and tree nuts	330,805	0.1%	354,708	0.1%	301,021	0.1%
Vegetables and melons	182,412	0.1%	154,028	0.1%	21,791	0.0%
Horticultural specialties	153,260	0.1%	217,303	0.1%	226,070	0.1%
General farms, primarily crops	142,464	0.1%	188,575	0.1%	229,967	0.1%
General medical and surgical hospitals	63,535	0.0%	-	0.0%	-	0.0%
General farms, primarily livestock	41,607	0.0%	44,124	0.0%	46,693	0.0%
Building materials, hardware and garden supplies	18,894	0.0%	-	0.0%	-	0.0%
Farm and garden machinery equipment	9,453	0.0%	16,749	0.0%	28,795	0.0%
Cash grains	-	0.0%	57,845	0.0%	62,675	0.0%
Fish hatcheries and preserves	-	0.0%	216,982	0.1%	378,333	0.2%
Total	<b>\$ 246,432,546</b>	<b>100.0%</b>	<b>\$ 238,025,851</b>	<b>100.0%</b>	<b>\$ 231,971,684</b>	<b>100.0%</b>

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the association in the collateral, may result in the loan-to-value ratios in excess of the regulatory maximum.

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

	<b>December 31, 2017</b>	December 31, 2016	December 31, 2015
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 1,210,053	\$ 1,625,001	\$ 4,751,398
Production and intermediate term	722,600	1,435,976	65,142
Rural residential real estate	-	-	17,894
Total nonaccrual loans	<b>1,932,653</b>	3,060,977	4,834,434
<b>Accruing restructured loans:</b>			
Real estate mortgage	<b>3,005,558</b>	3,258,080	3,450,056
Total accruing restructured loans	<b>3,005,558</b>	3,258,080	3,450,056
Total nonperforming loans	<b>4,938,211</b>	6,319,057	8,284,490
Other property owned	-	221,724	173,976
Total nonperforming assets	<b>\$ 4,938,211</b>	<b>\$ 6,540,781</b>	<b>\$ 8,458,466</b>

One credit quality indicator utilized by the bank and the association is the Farm Credit Administration's Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

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

The following table shows loans and related accrued interest classified under the Farm Credit Administration's Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of December 31:

	<u>2017</u>		<u>2016</u>		<u>2015</u>
Real estate mortgage					
Acceptable	<b>97.8</b>	%	90.3	%	87.8
OAEM	<b>1.2</b>		8.2		8.6
Substandard/doubtful	<b>1.0</b>		1.5		3.6
	<b>100.0</b>		100.0		100.0
Production and intermediate term					
Acceptable	<b>94.2</b>		86.8		85.8
OAEM	-		0.2		0.2
Substandard/doubtful	<b>5.8</b>		13.0		14.0
	<b>100.0</b>		100.0		100.0
Loans to cooperatives					
Acceptable	<b>100.0</b>		100.0		100.0
OAEM	-		-		-
Substandard/doubtful	-		-		-
	<b>100.0</b>		100.0		100.0
Processing and marketing					
Acceptable	<b>100.0</b>		100.0		100.0
OAEM	-		-		-
Substandard/doubtful	-		-		-
	<b>100.0</b>		100.0		100.0
Farm-related business					
Acceptable	<b>100.0</b>		100.0		100.0
OAEM	-		-		-
Substandard/doubtful	-		-		-
	<b>100.0</b>		100.0		100.0
Communication					
Acceptable	<b>100.0</b>		100.0		100.0
OAEM	-		-		-
Substandard/doubtful	-		-		-
	<b>100.0</b>		100.0		100.0
Energy					
Acceptable	<b>100.0</b>		78.9		100.0
OAEM	-		21.1		-
Substandard/doubtful	-		-		-
	<b>100.0</b>		100.0		100.0
Water and waste water					
Acceptable	<b>100.0</b>		100.0		100.0
OAEM	-		-		-
Substandard/doubtful	-		-		-
	<b>100.0</b>		100.0		100.0
Rural residential real estate					
Acceptable	<b>99.5</b>		98.8		99.2
OAEM	<b>0.5</b>		1.2		0.5
Substandard/doubtful	-		-		0.3
	<b>100.0</b>		100.0		100.0
Total Loans					
Acceptable	<b>98.0</b>		91.0		89.5
OAEM	<b>0.9</b>		7.2		7.0
Substandard/doubtful	<b>1.1</b>		1.8		3.5
	<b>100.0</b>	%	100.0	%	100.0

The following tables provide an age analysis of past due loans (including accrued interest) as of December 31, 2017, 2016 and 2015:

December 31, 2017:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 481,064	\$ 514,049	\$ 995,113	\$ 197,253,775	\$ 198,248,888	\$ -
Production and intermediate term	820,465	11,833	832,298	11,743,555	12,575,853	-
Loans to cooperatives	-	-	-	1,673,982	1,673,982	-
Processing and marketing	-	-	-	20,141,873	20,141,873	-
Farm-related business	-	-	-	762,679	762,679	-
Communication	-	-	-	3,765,705	3,765,705	-
Energy	-	-	-	4,380,561	4,380,561	-
Water and waste water	-	-	-	2,024,620	2,024,620	-
Rural residential real estate	-	-	-	3,988,246	3,988,246	-
<b>Total</b>	<b>\$ 1,301,529</b>	<b>\$ 525,882</b>	<b>\$ 1,827,411</b>	<b>\$ 245,734,996</b>	<b>\$ 247,562,407</b>	<b>\$ -</b>

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	\$ 836,988	\$ 226,436	\$ 1,063,424	\$ 190,246,980	\$ 191,310,404	\$ -
Production and intermediate term	151,216	1,383,672	1,534,888	9,647,089	11,181,977	-
Loans to cooperatives	-	-	-	1,578,007	1,578,007	-
Processing and marketing	-	-	-	19,436,267	19,436,267	-
Farm-related business	-	-	-	758,957	758,957	-
Communication	-	-	-	2,931,457	2,931,457	-
Energy	-	-	-	6,827,939	6,827,939	-
Water and waste water	-	-	-	2,023,774	2,023,774	-
Rural residential real estate	2,558	-	2,558	3,085,739	3,088,297	-
<b>Total</b>	<b>\$ 990,762</b>	<b>\$ 1,610,108</b>	<b>\$ 2,600,870</b>	<b>\$ 236,536,209</b>	<b>\$ 239,137,079</b>	<b>\$ -</b>

December 31, 2015:	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	\$ 1,385,684	\$ 2,841,983	\$ 4,227,667	\$ 183,480,032	\$ 187,707,699	\$ -
Production and intermediate term	-	-	-	10,796,190	10,796,190	-
Loans to cooperatives	-	-	-	384,856	384,856	-
Processing and marketing	-	-	-	16,059,345	16,059,345	-
Farm-related business	-	-	-	1,506,047	1,506,047	-
Communication	-	-	-	2,071,430	2,071,430	-
Energy	-	-	-	7,161,633	7,161,633	-
Water and waste water	-	-	-	2,022,925	2,022,925	-
Rural residential real estate	-	-	-	5,368,633	5,368,633	-
<b>Total</b>	<b>\$ 1,385,684</b>	<b>\$ 2,841,983</b>	<b>\$ 4,227,667</b>	<b>\$ 228,851,091</b>	<b>\$ 233,078,758</b>	<b>\$ -</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 if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of December 31, 2017, the total recorded investment of troubled debt restructured loans was \$3,181,883, including \$176,326 classified as nonaccrual and \$3,005,558 classified as accrual, with specific allowance for loan losses of \$0. The specific allowance is determined quarterly through a net realizable value analysis for each individual loan asset. As of December 31, 2017, there were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring.

There were no troubled debt restructurings that occurred during the years ended December 31, 2017 and 2016. The following table presents additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation, that occurred during the year ended December 31, 2015. The pre-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The post-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end in which the restructuring occurred.

December 31, 2015:	<u>Pre-modification Outstanding Recorded Investment</u>	<u>Post-modification Outstanding Recorded Investment</u>
Troubled debt restructurings:		
Real estate mortgage	\$ 374,282	\$ 373,837
Total	<u>\$ 374,282</u>	<u>\$ 373,837</u>

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). There were no charge-offs recorded at the modification date for the year ending December 31, 2017.

The predominant form of concession granted for troubled debt restructuring includes principal and interest reductions. Other types of modifications include extension of the term, principal or accrued interest reductions, interest rate decreases and delayed payments, among others. At times these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case the association 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 of that year and for which there was a 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.

There were no additional commitments to lend to borrowers whose loans have been modified in TDRs at December 31, 2017, 2016 and 2015.

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:

	<u>Loans Modified as TDRs</u>		
	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Troubled debt restructurings:			
Real estate mortgage	\$ 3,157,345	\$ 3,511,594	\$ 3,932,537
Production and intermediate term	24,538	37,135	57,094
Total	<u>\$ 3,181,883</u>	<u>\$ 3,548,729</u>	<u>\$ 3,989,631</u>
		<u>TDRs on Nonaccrual Status*</u>	
	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Troubled debt restructurings:			
Real estate mortgage	\$ 151,788	\$ 253,514	\$ 482,482
Production and intermediate term	24,538	37,135	57,094
Total	<u>\$ 176,326</u>	<u>\$ 290,649</u>	<u>\$ 539,576</u>

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

Additional impaired loan information is as follows:

	Recorded Investment at 12/31/2017	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Production and intermediate term	\$ 11,833	\$ 11,833	\$ 1,085	\$ 13,153	\$ -
Total	\$ 11,833	\$ 11,833	\$ 1,085	\$ 13,153	\$ -
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 4,215,611	\$ 4,221,064	\$ -	\$ 4,344,363	\$ 329,063
Production and intermediate term	710,767	1,686,612	-	1,346,349	5,366
Total	\$ 4,926,378	\$ 5,907,676	\$ -	\$ 5,690,712	\$ 334,429
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 4,215,611	\$ 4,221,064	\$ -	\$ 4,344,363	\$ 329,063
Production and intermediate term	722,600	1,698,445	1,085	1,359,502	5,366
Total	\$ 4,938,211	\$ 5,919,509	\$ 1,085	\$ 5,703,865	\$ 334,429

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

	Recorded Investment at 12/31/2016	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 2,304,266	\$ 2,353,442	\$ 395,561	\$ 2,427,244	\$ 142,308
Production and intermediate term	652,689	652,751	197,882	280,981	-
Total	\$ 2,956,955	\$ 3,006,193	\$ 593,443	\$ 2,708,225	\$ 142,308
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 2,578,815	\$ 2,589,436	\$ -	\$ 2,417,285	\$ 343,502
Production and intermediate term	783,287	3,215,302	-	384,050	2,254
Total	\$ 3,362,102	\$ 5,804,738	\$ -	\$ 2,801,335	\$ 345,756
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 4,883,081	\$ 4,942,878	\$ 395,561	\$ 4,844,529	\$ 485,810
Production and intermediate term	1,435,976	3,868,053	197,882	665,031	2,254
Total	\$ 6,319,057	\$ 8,810,931	\$ 593,443	\$ 5,509,560	\$ 488,064

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

	Recorded Investment at 12/31/2015	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 3,188,130	\$ 3,240,641	\$ 696,122	\$ 2,756,483	\$ 197,033
Production and intermediate term	57,093	64,327	6,273	67,981	-
Total	<u>\$ 3,245,223</u>	<u>\$ 3,304,968</u>	<u>\$ 702,395</u>	<u>\$ 2,824,464</u>	<u>\$ 197,033</u>
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 5,013,324	\$ 5,039,562	\$ -	\$ 3,874,518	\$ 299,837
Production and intermediate term	8,049	2,446,676	-	16,606	1,888
Rural residential real estate	17,894	17,956	-	19,153	-
Total	<u>\$ 5,039,267</u>	<u>\$ 7,504,194</u>	<u>\$ -</u>	<u>\$ 3,910,277</u>	<u>\$ 301,725</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 8,201,454	\$ 8,280,203	\$ 696,122	\$ 6,631,001	\$ 496,870
Production and intermediate term	65,142	2,511,003	6,273	84,587	1,888
Rural residential real estate	17,894	17,956	-	19,153	-
Total	<u>\$ 8,284,490</u>	<u>\$ 10,809,162</u>	<u>\$ 702,395</u>	<u>\$ 6,734,741</u>	<u>\$ 498,758</u>

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

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2017, 2016 and 2015.

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans at December 31:

	2017	2016	2015
Interest income which would have been recognized under the original terms	\$ 496,471	\$ 690,403	\$ 737,535
Less: interest income recognized	(334,429)	(488,064)	(498,758)
Foregone interest income	<u>\$ 162,042</u>	<u>\$ 202,339</u>	<u>\$ 238,777</u>

A summary of the changes in the allowance for credit losses and the ending balance of loans outstanding is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>								
Balance at								
December 31, 2016	\$ 1,694,453	\$ 257,900	\$ 28,885	\$ 2,923	\$ 79,111	\$ 15,000	\$ 2,676	\$ 2,080,948
Charge-offs	(10,972)	(590,486)	-	-	-	-	-	(601,458)
Recoveries	14,277	10,200	-	-	-	-	-	24,477
Provision for loan losses	(557,641)	392,789	8,987	1,015	(35,033)	(12,747)	1,294	(201,336)
Balance at								
December 31, 2017	<u>\$ 1,140,117</u>	<u>\$ 70,403</u>	<u>\$ 37,872</u>	<u>\$ 3,938</u>	<u>\$ 44,078</u>	<u>\$ 2,253</u>	<u>\$ 3,970</u>	<u>\$ 1,302,631</u>
Ending Balance: individually evaluated for impairment	\$ -	\$ 1,085	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,085
Ending Balance: collectively evaluated for impairment	<u>\$ 1,140,117</u>	<u>\$ 69,318</u>	<u>\$ 37,872</u>	<u>\$ 3,938</u>	<u>\$ 44,078</u>	<u>\$ 2,253</u>	<u>\$ 3,970</u>	<u>\$ 1,301,546</u>
<b>Recorded Investment in Loans Outstanding:</b>								
Ending Balance at								
December 31, 2017	<u>\$ 198,248,888</u>	<u>\$ 12,575,853</u>	<u>\$ 22,578,534</u>	<u>\$ 3,765,705</u>	<u>\$ 4,380,561</u>	<u>\$2,024,620</u>	<u>\$ 3,988,246</u>	<u>\$ 247,562,407</u>
Ending balance for loans individually evaluated for impairment	<u>\$ 4,215,611</u>	<u>\$ 722,600</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,938,211</u>
Ending balance for loans collectively evaluated for impairment	<u>\$ 194,033,277</u>	<u>\$ 11,853,253</u>	<u>\$ 22,578,534</u>	<u>\$ 3,765,705</u>	<u>\$ 4,380,561</u>	<u>\$2,024,620</u>	<u>\$ 3,988,246</u>	<u>\$ 242,624,196</u>
	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>								
Balance at								
December 31, 2015	\$ 2,104,266	\$ 158,146	\$ 20,786	\$ 1,960	\$ 53,291	\$ 15,020	\$ 4,250	\$ 2,357,719
Charge-offs	(17,833)	-	-	-	-	-	-	(17,833)
Recoveries	2,254	10,643	-	-	-	-	-	12,897
Provision for loan losses	(394,234)	89,111	8,099	963	25,820	(20)	(1,574)	(271,835)
Balance at								
December 31, 2016	<u>\$ 1,694,453</u>	<u>\$ 257,900</u>	<u>\$ 28,885</u>	<u>\$ 2,923</u>	<u>\$ 79,111</u>	<u>\$ 15,000</u>	<u>\$ 2,676</u>	<u>\$ 2,080,948</u>
Ending Balance: individually evaluated for impairment	\$ 395,561	\$ 197,882	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 593,443
Ending Balance: collectively evaluated for impairment	<u>\$ 1,298,892</u>	<u>\$ 60,018</u>	<u>\$ 28,885</u>	<u>\$ 2,923</u>	<u>\$ 79,111</u>	<u>\$ 15,000</u>	<u>\$ 2,676</u>	<u>\$ 1,487,505</u>
<b>Recorded Investment in Loans Outstanding:</b>								
Ending Balance at								
December 31, 2016	<u>\$ 191,310,404</u>	<u>\$ 11,181,977</u>	<u>\$ 21,773,231</u>	<u>\$ 2,931,457</u>	<u>\$ 6,827,939</u>	<u>\$2,023,774</u>	<u>\$ 3,088,297</u>	<u>\$ 239,137,079</u>
Ending balance for loans individually evaluated for impairment	<u>\$ 4,883,081</u>	<u>\$ 1,435,976</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,319,057</u>
Ending balance for loans collectively evaluated for impairment	<u>\$ 186,427,323</u>	<u>\$ 9,746,001</u>	<u>\$ 21,773,231</u>	<u>\$ 2,931,457</u>	<u>\$ 6,827,939</u>	<u>\$2,023,774</u>	<u>\$ 3,088,297</u>	<u>\$ 232,818,022</u>

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>								
Balance at								
December 31, 2014	\$ 2,776,745	\$ 201,056	\$ 11,399	\$ 1,330	\$ 20,953	\$ 11,314	\$ 3,574	\$ 3,026,371
Charge-offs	(1,375)	-	-	-	-	-	-	(1,375)
Recoveries	22,458	11,385	-	-	-	-	-	33,843
Provision for loan losses	(694,089)	(54,295)	9,387	630	32,338	3,706	1,203	(701,120)
Balance at								
December 31, 2015	<u>\$ 2,103,739</u>	<u>\$ 158,146</u>	<u>\$ 20,786</u>	<u>\$ 1,960</u>	<u>\$ 53,291</u>	<u>\$ 15,020</u>	<u>\$ 4,777</u>	<u>\$ 2,357,719</u>
Ending Balance:								
individually evaluated for impairment	\$ 696,122	\$ 6,273	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 702,395
Ending Balance:								
collectively evaluated for impairment	<u>\$ 1,407,617</u>	<u>\$ 151,873</u>	<u>\$ 20,786</u>	<u>\$ 1,960</u>	<u>\$ 53,291</u>	<u>\$ 15,020</u>	<u>\$ 4,777</u>	<u>\$ 1,655,324</u>
<b>Recorded Investment in Loans Outstanding:</b>								
Ending Balance at								
December 31, 2015	<u>\$ 187,707,699</u>	<u>\$ 10,796,190</u>	<u>\$ 17,950,248</u>	<u>\$ 2,071,430</u>	<u>\$ 7,161,633</u>	<u>\$ 2,022,925</u>	<u>\$ 5,368,633</u>	<u>\$ 233,078,758</u>
Ending balance for loans individually evaluated for impairment	\$ 8,201,454	\$ 65,142	\$ -	\$ -	\$ -	\$ -	\$ 17,894	\$ 8,284,490
Ending balance for loans collectively evaluated for impairment	<u>\$ 179,506,245</u>	<u>\$ 10,731,048</u>	<u>\$ 17,950,248</u>	<u>\$ 2,071,430</u>	<u>\$ 7,161,633</u>	<u>\$ 2,022,925</u>	<u>\$ 5,350,739</u>	<u>\$ 224,794,268</u>

#### NOTE 4 — INVESTMENT IN THE FARM CREDIT BANK OF TEXAS

The investment in the Farm Credit Bank of Texas is a requirement of borrowing from the bank and is carried at cost plus allocated equities, not fair value, in the accompanying balance sheet. Estimating the fair value of the association's investment in the Farm Credit Bank of Texas is not practicable because the stock is not traded. The association owns 1.23% of the issued stock of the bank as of December 31, 2017. As of that date, the bank's assets totaled \$22.84 billion and members' equity totaled \$1.67 billion. The bank's earnings were \$196.0 million during 2017.

#### NOTE 5 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	2017	2016	2015
Land and improvements	\$ 97,859	\$ 97,859	\$ 97,859
Building and improvements	508,039	508,039	508,040
Furniture and equipment	104,872	72,050	66,400
Computer equipment and software	62,771	60,437	70,822
Automobiles	507,072	391,704	346,064
Fixed asset holding	6,881	-	-
	<u>1,287,494</u>	<u>1,130,089</u>	<u>1,089,185</u>
Accumulated depreciation	(651,214)	(644,688)	(614,433)
Total	<u>\$ 636,280</u>	<u>\$ 485,401</u>	<u>\$ 474,752</u>

The association owns buildings in Sulphur Springs, Canton and Gilmer, and leases office space in Kaufman, Longview and Sulphur Springs (two locations). The Kaufman and Longview building leases are on a month-to-month basis. Both Sulphur Springs building leases are one-year leases which expire in 2018. General office equipment is leased with expiration in 2019. Lease expense was \$49,185, \$52,260 and \$52,212 for 2017, 2016 and 2015, respectively. Minimum annual lease payments for the next five years are as follows:

	<u>Operating</u>
2018	\$ 32,952
2019	3,552
2020	-
2021	-
2022	-
Thereafter	-
Total	<u>\$ 36,504</u>

**NOTE 6 — OTHER PROPERTY OWNED, NET:**

Net gain (loss) on other property owned, net consists of the following for the years ended December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Gain (loss) on sale, net	\$ 1,715	\$ 50,975	\$ (44,765)
Provision expense	-	(15,689)	(76,890)
Operating income (expense), net	<u>(21,092)</u>	<u>(30,566)</u>	<u>(15,126)</u>
Net gain (loss) on other property owned	<u>\$ (19,377)</u>	<u>\$ 4,720</u>	<u>\$ (136,781)</u>

The association held no properties classified as other property owned at December 31, 2017.

At December 31, 2016, other property owned consisted of one property. This property consisted of a house with poultry houses and land. The net carrying value of the property was equivalent to its fair value of \$221,724. Net operating expenses incurred on other property owned were \$46,255. During 2016, there were two sales of other property owned that resulted in a net gain of \$50,975.

During 2015, the association wrote off the remaining balance of one acquired property. The property consisted of inventory which was deemed to be uncollectible. This write-off resulted in a loss of \$44,765.

**NOTE 7 — OTHER ASSETS AND OTHER LIABILITIES:**

Other assets comprised the following at December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Accounts receivable other	\$ 156,164	\$ 326,258	\$ 140,032
Other	8,993	12,389	11,750
Total	<u>\$ 165,157</u>	<u>\$ 338,647</u>	<u>\$ 151,782</u>

Other liabilities comprised the following at December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Accounts payable	\$ 950,582	\$ 851,787	\$ 659,467
Post-retirement benefits liability	263,654	236,076	229,541
Accrued annual leave	122,515	141,047	134,480
Other	11,970	7,975	9,413
Total	<u>\$ 1,348,721</u>	<u>\$ 1,236,885</u>	<u>\$ 1,032,901</u>

## **NOTE 8 — NOTE PAYABLE TO THE BANK:**

The interest rate risk inherent in the association's loan portfolio is substantially mitigated through the funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process. The association's indebtedness to the bank represents borrowings by the association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the bank's cost of funding the loans the association has outstanding to its borrowers. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2020, 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.

The total amount and the weighted average interest rate of the association's direct loan from the bank at December 31, 2017, 2016 and 2015, was \$191,700,575 at 2.44 percent, \$183,651,931 at 2.28 percent and \$178,621,128 at 2.23 percent, respectively.

Under the Act, the association is obligated to borrow only from the bank unless the bank approves borrowing from other funding sources. The bank and FCA regulations have established limitations on the association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2017, 2016 and 2015, the association's note payable was within the specified limitations. The maximum amount the association may borrow from the bank as of December 31, 2017, was \$234,641,210, as defined by the general financing agreement.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the general financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. As of and for the years ended December 31, 2017, 2016 and 2015, the association was not subject to remedies associated with the covenants in the general financing agreement.

## **NOTE 9— MEMBERS' EQUITY:**

A description of the association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

Protection of certain borrower equity is provided under the Act that requires the association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

In accordance with the Act and the association's capitalization bylaws, each borrower is required to invest in the association as a condition of borrowing. The investment in Class A capital stock (for farm loans), or participation certificates (for rural home and farm related business loans) is equal to 2 percent of the loan amount, up to a maximum amount of \$1,000. The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the association may increase the percentage of stock requirement for each borrower up to a maximum of 5 percent of the loan amount.

Each owner of Class A capital stock is entitled to a single vote, while participation certificates provide no voting rights to their owners.

Within two years of repayment of a loan, the association capital bylaws require the conversion of any borrower's outstanding Class A to Class C stock. Class C stock has no voting rights except in a case where a new issuance of preferred stock has been submitted

to stockholders affected by the preference. Redemption of Class C shares is made solely at the discretion of the association's board of directors. At December 31, 2017, 2016 and 2015, the association had no Class C stock.

All borrower stock is at-risk. As such, losses that result in impairment of capital stock or participation certificates shall be borne on a pro rata basis by all holders of Class A, Class C capital stock and participation certificates. In the event of liquidation of the association, capital stock and participation certificates would be utilized as necessary to satisfy any remaining obligations in excess of the amounts realized on the sale or liquidation of assets. Any excess of the amounts realized on the sale or liquidation of assets over the association's obligations to external parties and to the bank would be distributed to the association's stockholders.

Dividends and patronage distributions may be paid on the capital stock and participation certificates of the association, as the board of directors may determine by resolution, subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following patronage distributions were declared and paid in 2017, 2016 and 2015, respectively:

<u>Date Declared</u>	<u>Date Paid/ To Be Paid</u>	<u>Patronage</u>
December 2017	April 2018	2,100,000
January 2017	April 2017	2,399,984
January 2016	March 2016	2,249,884
January 2015	March 2015	1,600,000

The Farm Credit Administration sets minimum regulatory capital requirements for banks and associations. Effective January 1, 2017, new regulatory capital requirements for banks and associations were adopted. These new requirements replaced the core surplus and total surplus requirements with Common Equity Tier 1, Tier 1 Capital and Total Capital risk-based capital ratio requirements. The new requirements also replaced the existing net collateral ratio for System Banks with a Tier 1 Leverage ratio and an Unallocated Retained Earnings (URE) and URE Equivalents Leverage ratio that are applicable to both the banks and associations. The Permanent Capital Ratio continues to remain in effect; however, the risk-adjusted assets are calculated differently than in the past. As of December 31, 2017, the association is not prohibited from retiring stock or distributing earnings.

The following sets forth the regulatory capital ratio requirements and ratios at December 31, 2017:

<u>Risk-adjusted:</u>	<u>Regulatory Minimums</u>	<u>Conservation Buffer*</u>	<u>Total</u>	<u>As of December 31, 2017</u>
Common equity tier 1 ratio	4.50%	2.50%	7.00%	22.81%
Tier 1 capital ratio	6.00%	2.50%	8.50%	22.81%
Total capital ratio	8.00%	2.50%	10.50%	23.63%
Permanent capital ratio	7.00%	0.00%	7.00%	23.00%
<u>Non-risk-adjusted:</u>				
Tier 1 leverage ratio**	4.00%	1.00%	5.00%	21.68%
UREE leverage ratio	1.50%	0.00%	1.50%	22.76%

\*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. There is no phase-in of the leverage buffer.

\*\*Must include the regulatory minimum requirement for the URE and UREE Leverage ratio

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 old
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

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

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

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of seven years, allocated equities held for a minimum of seven years or not subject to revolvement, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus 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 five years, allocated equities held for a minimum of five years, subordinated debt and limited-life preferred stock greater than five years to maturity at issuance subject to certain limitations, and 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 and 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 total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

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

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
<b>Numerator:</b>				
Unallocated retained earnings	<b>\$ 39,713,594.00</b>	<b>\$ 39,713,594.00</b>	<b>\$ 39,713,594.00</b>	<b>\$ 39,713,594.00</b>
Paid-in capital	-	-	-	-
<b>Common Cooperative Equities:</b>				
Statutory minimum purchased borrower stock	<b>1,100,551</b>	<b>1,100,551</b>	<b>1,100,551</b>	<b>1,100,551</b>
Other required member purchased stock held <5 years				
Other required member purchased stock held ≥ 5 years but < 7 years				
Other required member purchased stock held ≥7 years				
<b>Allocated equities:</b>				
Allocated equities held <5 years				
Allocated equities held ≥5 years but < 7 years				
Allocated equities held ≥7 years	-	-	-	-
Nonqualified allocated equities not subject to retirement	<b>15,777,695</b>	<b>15,777,695</b>	<b>15,777,695</b>	<b>15,777,695</b>
Non-cumulative perpetual preferred stock		-	-	-
Other preferred stock subject to certain limitations			-	-
Subordinated debt subject to certain limitation			-	-
Allowance for loan losses and reserve for credit losses subject to certain limitations*			<b>1,904,864</b>	
<b>Regulatory Adjustments and Deductions:</b>				
Amount of allocated investments in other System institutions	<b>(3,738,022)</b>	<b>(3,738,022)</b>	<b>(3,738,022)</b>	<b>(3,738,022)</b>
Other regulatory required deductions	-	-	-	-
	<u>52,853,818</u>	<u>52,853,818</u>	<u>54,758,682</u>	<u>52,853,818</u>
<b>Denominator:</b>				
Risk-adjusted assets excluding allowance	<b>235,474,246</b>	<b>235,474,246</b>	<b>235,474,246</b>	<b>235,474,246</b>
<b>Regulatory Adjustments and Deductions:</b>				
Regulatory deductions included in total capital	<b>(3,738,022)</b>	<b>(3,738,022)</b>	<b>(3,738,022)</b>	<b>(3,738,022)</b>
Allowance for loan losses				<b>(1,904,864)</b>
	<u>\$ 231,736,224.00</u>	<u>\$ 231,736,224.00</u>	<u>\$ 231,736,224.00</u>	<u>\$ 229,831,360.00</u>

\*Capped at 1.25% of risk-adjusted assets

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

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 39,713,594	\$ 39,713,594
Paid-in capital	-	-
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	1,100,551	-
Other required member purchased stock held <5 years		
Other required member purchased stock held ≥ 5 years but < 7 years		
Other required member purchased stock held ≥ 7 years		
Allocated equities:		
Allocated equities held <5 years		
Allocated equities held ≥5 years but < 7 years		
Allocated equities held ≥7 years	-	-
Nonqualified allocated equities not subject to retirement	15,777,695	15,777,695
Non-cumulative perpetual preferred stock	-	-
Other preferred stock subject to certain limitations		
Subordinated debt subject to certain limitation		
Allowance for loan losses and reserve for credit losses subject to certain limitations		
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(3,738,022)	-
Other regulatory required deductions	-	-
	<u>52,853,818</u>	<u>55,491,289</u>
Denominator:		
Total Assets	249,086,955	249,086,955
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(5,253,490)	(5,253,490)
	<u>\$ 243,833,465</u>	<u>\$ 243,833,465</u>

At December 31, the association had the following shares of Class A capital stock, Class B stock and participation certificates outstanding at a par value of \$5 per share:

	2017	2016	2015
Class A stock	214,636	216,141	213,633
Participation certificates	6,665	6,322	6,462
Total	<u>221,301</u>	<u>222,463</u>	<u>220,095</u>

An additional component of equity is accumulated other comprehensive income, which is reported net of taxes as follows:

**Accumulated Other Comprehensive Income (Loss)**

	2017	2016	2015
Nonpension postretirement benefits	\$ 38,931	\$ 76,474	\$ 93,360

The association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. The following table summarizes the changes in accumulated other comprehensive income (loss) and the location on the income statement for the year ended December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Accumulated other comprehensive income (loss) at January 1	\$ 76,474	\$ 93,360	\$ 153,000
Actuarial gains(losses)	(25,751)	(4,065)	(30,129)
Amortization of prior service (credit) costs included in salaries and employee benefits	(8,197)	(8,197)	(8,215)
Amortization of actuarial (gain) loss included in salaries and employee benefits	(3,595)	(4,624)	(21,296)
Other comprehensive income (loss), net of tax	<u>(37,543)</u>	<u>(16,886)</u>	<u>(59,640)</u>
Accumulated other comprehensive income at December 31	<u>\$ 38,931</u>	<u>\$ 76,474</u>	<u>\$ 93,360</u>

#### NOTE 10 — INCOME TAXES:

There was no provision for income taxes for the years ended December 31, 2017, 2016 or 2015.

The provision for (benefit from) income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows for the years ended December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Federal tax at statutory rate	\$ 1,192,873	\$ 1,359,391	\$ 1,579,960
Effect of nontaxable FLCA subsidiary	(2,026,767)	(2,007,105)	(2,131,610)
Change in valuation allowance	(2,232,157)	648,442	552,029
Change in statutory tax rate	3,066,051	(728)	(379)
Provision for (benefit from) income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Deferred tax assets and liabilities in accordance with accounting guidance, "Accounting for Income Taxes," are comprised of the following at December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<u>Deferred Tax Assets</u>			
Allowance for loan losses	\$ 14,098	\$ 89,528	\$ 54,541
Loss carryforwards	4,583,974	6,740,702	6,127,247
Gross deferred tax assets	<u>4,598,072</u>	<u>6,830,230</u>	<u>6,181,788</u>
Deferred tax asset valuation allowance	<u>(4,598,072)</u>	<u>(6,830,230)</u>	<u>(6,181,788)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The association recorded valuation allowances of \$4,598,072, \$6,830,230 and \$6,181,788 during 2017, 2016 and 2015, respectively. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that they will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the association's expected patronage program, which reduces taxable earnings. The association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly.

The enactment of federal tax legislation in late December 2017, among other things, lowered the federal corporate tax rate from 35 percent to 21 percent beginning in 2018. In accordance with GAAP, the change to the lower corporate tax rate led to a revaluation of our deferred tax liabilities and deferred tax assets in the period of enactment (2017). The provision for income taxes in 2017 was mainly due to a decrease in deferred tax assets with a corresponding valuation allowance resulting from the enactment of federal tax legislation in late December 2017 which, among other things, lowered the federal corporate tax rate from 35 percent to 21 percent beginning in 2018.

## NOTE 11 — EMPLOYEE BENEFIT PLANS:

**Employee Retirement Plans:** Employees of the association participate in either the defined benefit retirement plan (DB plan) or the defined contributions plan (DC plan) and are eligible to participate in the Farm Credit Benefits Alliance 401(k) Plan. These plans are described more fully in section I of Note 2, “Summary of Significant Accounting Policies.” The structure of the district’s DB plan is characterized as multi-employer, since neither the assets, liabilities nor cost of any plan is segregated or separately accounted for by participating employers (bank and associations). No portion of any surplus assets is available to any participating employer. As a result, participating employers of the plan only recognize as cost the required contributions for the period and a liability for any unpaid contributions required for the period of their financial statements. Plan obligations, assets and the components of annual benefit expenses are recorded and reported upon district combination only. The association records current contributions to the DB plan as an expense in the current year.

The CEO and certain executive or highly-compensated employees in the association are eligible to participate in a separate nonqualified supplemental 401(k) plan, named the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan (supplemental 401(k) plan). This plan allows district employers to elect to participate in any or all of the following benefits:

- Restored Employer Contributions – to allow “make-up” contributions for eligible employees whose benefits to the qualified 401(k) plan were limited by the Internal Revenue Code during the year
- Elective Deferrals – to allow eligible employees to make pre-tax deferrals of compensation above and beyond any deferrals into the qualified 401(k) plan
- Discretionary Contributions – to allow participating employers to make a discretionary contribution to an eligible employee’s account in the plan and to designate a vesting schedule

The association elected to participate in the defined contribution supplemental retirement plan. There were no contributions made to this plan for the years ended December 31, 2017, 2016 and 2015. There were no payments made from the supplemental 401(k) plan to active employees during 2017, 2016 and 2015.

The DB plan is noncontributory and benefits are based on salary and years of service. The legal name of the plan is Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The DB plan is not subject to any contractual expiration dates. The DB plan’s funding policy is to fund current year benefits expected to be earned by covered employees plus an amount to improve the accumulated benefit obligation funded status by a percentage approved by the plan sponsor. The plan sponsor is the board of the Farm Credit Bank of Texas. The “projected unit credit” actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. Actuarial information regarding the DB pension plan accumulated benefit obligation and plan asset is calculated for the district as a whole and is presented in the district’s Annual Report to Stockholders. The actuarial present value of vested and nonvested accumulated benefit obligation exceeded the net assets of the DB plan as of December 31, 2017.

The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

- a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- c. If the association chooses to stop participating in some of its multi-employer plans, it may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The following table includes additional information regarding the funded status of the plan, the association’s contributions and the percentage of association contribution to total plan contributions for the years ended December 31, 2017, 2016 and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Funded status of plan	<b>69.7 %</b>	66.4 %	66.8 %
Association's contribution	\$ -	\$ -	\$ -
Percentage of association's contribution to total contributions	<b>0.0 %</b>	0.0 %	0.0 %

The funded status presented above is based on the percentage of plan assets to projected benefit obligations. DB plan funding is based on the percentage of plan assets to the accumulated benefit obligation, which was 73.4 percent, 70.6 percent and 72.5 percent at December 31, 2017, 2016 and 2015, 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 other liabilities. Employees hired prior to January 1, 2004, and who are at least 55 years of age (or at least age 50 with 30 years of service) may retire and have their medical premium paid on a percentage of cost sharing basis predicated on length of employment service. Employees hired before this date that have reached the age requirement and have 25 years of service will receive 100 percent of their medical premium paid. Employees hired after January 1, 2004, will be eligible for access only to retiree medical benefits for themselves, but will be responsible for 100 percent of the premium.

The following table reflects the benefit obligation, cost and actuarial assumptions for the association's other postretirement benefits:

<b>Disclosure Information Related to Retirement Benefits</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Change in Accumulated Postretirement Benefit Obligation</b>			
Accumulated postretirement benefit obligation, beginning of year	\$ 236,076	\$ 229,541	\$ 199,676
Service cost	6,786	6,670	4,847
Interest cost	10,541	10,484	8,827
Plan participants' contributions	690	690	690
Actuarial loss (gain)	25,751	4,065	30,129
Benefits paid	(16,190)	(15,374)	(14,628)
Accumulated postretirement benefit obligation, end of year	\$ 263,654	\$ 236,076	\$ 229,541
<b>Change in Plan Assets</b>			
Plan assets at fair value, beginning of year	\$ -	\$ -	\$ -
Company contributions	15,500	14,684	13,938
Plan participants' contributions	690	690	690
Benefits paid	(16,190)	(15,374)	(14,628)
Plan assets at fair value, end of year	\$ -	\$ -	\$ -
Funded status of the plan	\$ (263,654)	\$ (236,076)	\$ (229,541)
<b>Amounts Recognized in Statement of Financial Position</b>			
Other liabilities	\$ (263,654)	\$ (236,076)	\$ (229,541)
<b>Amounts Recognized in Accumulated Other Comprehensive Income</b>			
Net actuarial loss (gain)	\$ (32,786)	\$ (62,132)	\$ (70,821)
Prior service cost (credit)	(6,145)	(14,342)	(22,539)
Total	\$ (38,931)	\$ (76,474)	\$ (93,360)
<b>Weighted-Average Assumptions Used to Determine Obligations at Year End</b>			
Measurement date	12/31/2017	12/31/2016	12/31/2015
Discount rate	4.00%	4.60%	4.70%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	7.70%	6.75%	7.00%
Health care cost trend rate assumed for next year - Rx	6.90%	6.50%	6.50%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2026	2025	2025

<b>Total Cost</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Service cost	\$ 6,786	\$ 6,670	\$ 4,847
Interest cost	10,541	10,484	8,827
Amortization of:			
Unrecognized prior service cost	(8,197)	(8,197)	(8,215)
Unrecognized net loss (gain)	(3,595)	(4,624)	(21,296)
Net postretirement benefit cost	\$ 5,535	\$ 4,333	\$ (15,837)
<b>Other Changes in Plan Assets and Projected Benefit Obligation Recognized in Other Comprehensive Income</b>			
Net actuarial loss (gain)	\$ 25,751	\$ 4,065	\$ 30,129
Amortization of net actuarial loss (gain)	3,595	4,624	21,296
Amortization of prior service cost	8,197	8,197	8,215
Total recognized in other comprehensive income	\$ 37,543	\$ 16,886	\$ 59,640
<b>AOCI Amounts Expected to be Amortized Into Expense in 2018</b>			
Unrecognized prior service cost	\$ (6,145)		
Unrecognized net loss (gain)	(622)		
Total	\$ (6,767)		
<b>Weighted-Average Assumptions Used to Determine Benefit Cost</b>			
Measurement date	<b>12/31/2016</b>	12/31/2015	12/31/2014
Discount rate	4.60%	4.70%	4.55%
Health care cost trend rate assumed for next year (pre-/post-65) - medical	6.75%	7.00%	7.25%
Health care cost trend rate assumed for next year - Rx	6.50%	6.50%	6.75%
Ultimate health care cost trend rate	4.50%	4.50%	5.00%
Year that the rate reaches the ultimate trend rate	2025	2025	2024
<b>Expected Future Cash Flows</b>			
<b>Expected Benefit Payments (net of employee contributions)</b>			
Fiscal 2018	\$ 15,994		
Fiscal 2019	16,879		
Fiscal 2020	18,105		
Fiscal 2021	19,667		
Fiscal 2022	21,218		
Fiscal 2023–2027	62,946		
<b>Expected Contributions</b>			
Fiscal 2018	\$ 15,994		

**NOTE 12 — RELATED PARTY TRANSACTIONS:**

Directors of the association, except for any director-elected directors, are required to be borrowers/stockholders of the association. Also, in the ordinary course of business, the association may enter into loan origination or servicing transactions with its officers, relatives of officers and directors, or with organizations with which such persons are associated. Such loans are subject to special approval requirements contained in FCA regulations and are made on the same terms, including interest rates, amortization schedule and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons for the association amounted to \$1,970,495, \$1,710,221 and \$1,823,725 at December 31, 2017, 2016 and 2015, respectively. During 2017, \$986,125 of new loans were made, and repayments totaled \$352,529. In the opinion of management, no such loans outstanding at December 31, 2017, 2016 and 2015 involved more than a normal risk of collectability.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems and accounting services and allocations of expenses incurred by the bank and passed through to the associations, such as FCSIC expenses. The bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$408,751, \$509,604 and \$451,704 in 2017, 2016 and 2015, respectively.

The association received patronage payments from the bank totaling \$810,565, \$850,293 and \$813,041 during 2017, 2016 and 2015, respectively.

**NOTE 13 — FAIR VALUE MEASUREMENTS:**

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. See Note 2, "Summary of Significant Accounting Policies," for additional information.

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

December 31, 2017	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 10,748	\$ 10,748
Other property owned	-	-	-	-
December 31, 2016				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$3,104,711	\$3,104,711
Other property owned	-	-	276,000	276,000
December 31, 2015				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$2,544,551	\$2,544,551
Other property owned	-	-	190,400	190,400

The association revised fair value measurement inputs for the reporting of certain loans measured at fair value on a nonrecurring basis using Level 3 inputs at December 31, 2016 and 2015. The disclosure was revised to report impaired loans with specific reserves only. The Level 3 fair value was disclosed at \$3,549,508 on the 2016 Annual Report, for the December 31, 2016 disclosure, and has been revised to \$3,104,711. The Level 3 fair value was disclosed at \$2,707,733 on the 2016 Annual Report, for December 31, 2015 disclosure, and has been revised to \$2,544,551.

Management has evaluated the impact of these errors and concluded that the amounts are immaterial to previously issued financial statements; however, it has elected to revise the reporting of certain loans measured at fair value on a nonrecurring basis in order to correctly present such amounts. The correction had no effect on the balance sheet, the statement of comprehensive income, earnings or the financial ratios

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

**December 31, 2017**  
**Fair Value Measurement Using**

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>					
Cash	\$ 104,733	\$ 104,733	\$ -	\$ -	\$ 104,733
Net loans	245,119,167	-	-	239,796,224	239,796,224
Total Assets	<u>\$ 245,223,900</u>	<u>\$ 104,733</u>	<u>\$ -</u>	<u>\$ 239,796,224</u>	<u>\$ 239,900,957</u>
<b>Liabilities:</b>					
Note payable to bank	\$ 191,700,575	\$ -	\$ -	\$ 187,559,843	\$ 187,559,843
Total Liabilities	<u>\$ 191,700,575</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 187,559,843</u>	<u>\$ 187,559,843</u>

December 31, 2016  
Fair Value Measurement Using

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>					
Cash	\$ 121,720	\$ 121,720	\$ -	\$ -	\$ 121,720
Net loans	232,395,395	-	-	229,955,472	229,955,472
Total Assets	<u>\$ 232,517,115</u>	<u>\$ 121,720</u>	<u>\$ -</u>	<u>\$ 229,955,472</u>	<u>\$ 230,077,192</u>
<b>Liabilities:</b>					
Note payable to bank	\$ 183,651,931	\$ -	\$ -	\$ 180,621,674	\$ 180,621,674
Total Liabilities	<u>\$ 183,651,931</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 180,621,674</u>	<u>\$ 180,621,674</u>

December 31, 2015  
Fair Value Measurement Using

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>					
Cash	\$ 104,812	\$ 104,812	\$ -	\$ -	\$ 104,812
Net loans	226,906,232	-	-	224,934,473	224,934,473
Total Assets	<u>\$ 227,011,044</u>	<u>\$ 104,812</u>	<u>\$ -</u>	<u>\$ 224,934,473</u>	<u>\$ 225,039,285</u>
<b>Liabilities:</b>					
Note payable to bank	\$ 178,621,128	\$ -	\$ -	\$ 177,102,848	\$ 177,102,848
Total Liabilities	<u>\$ 178,621,128</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 177,102,848</u>	<u>\$ 177,102,848</u>

### *Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements*

The association had no assets or liabilities measured at fair value on a recurring basis for 2017, 2016 or 2015.

With regard to 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. Information about Other Financial Instrument Fair Value Measurements:

	<b><u>Valuation Technique(s)</u></b>	<b><u>Input</u></b>
Cash	Carrying value	Par/principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Note payable to bank	Discounted cash flow	Benchmark yield curve Derived yield spread Own credit risk

### **Valuation Techniques**

As more fully discussed in Note 2, “Summary of Significant Accounting Policies,” accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability in active markets among willing participants at the reporting date. Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain of the estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction. The following represent a brief summary of the valuation techniques used by the association for assets and liabilities:

#### *Loans*

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

#### *Other Property Owned*

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

#### *Note payable to the Farm Credit Bank of Texas*

The note payable to the bank is not regularly traded; thus, quoted market prices are not available. Fair value of this instrument is discounted based on the association’s and bank’s loan rates as well as on management estimates. For the purposes of this estimate it is assumed that the cash flow on the note is equal to the principal payments on the association’s loan receivables plus accrued interest on the note payable. This assumption implies that earnings on the association’s interest margin are used to fund operating expenses and capital expenditures. Management has no basis to determine whether the fair values would be indicative of the value negotiated in an actual sale.

## **NOTE 14 — COMMITMENTS AND CONTINGENCIES**

In addition to those commitments and contingencies discussed in Note 2, “Summary of Significant Accounting Policies,” the association is involved in various legal proceedings in the ordinary 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.

The association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2017, \$16,563,982 of commitments and \$184,825 of commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the balance sheet until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers, and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower.

## **NOTE 15 — REGULATORY ENFORCEMENT MATTERS**

As previously communicated by a letter to stockholders dated November 22, 2016, the merger with Texas Farm Credit Services was terminated by a vote of the Legacy Ag Credit board at the November 2016 board meeting. See Terminated Merger Discussion section in 2016 Annual Report for additional information.

Effective January 10, 2017, the association was placed under special supervision by the Farm Credit Administration (FCA) related to the manner in which the decision was made to terminate the merger with Texas Farm Credit Services. The FCA, through three Supervisory Letters issued during 2017, established a number of supervisory requirements including the engagement of a board consultant approved by the FCA.

Effective February 20, 2018, FCA recognized the progress made by the board in improving its governance performance and terminated the three previously issued Supervisory Letters. FCA issued a new Supervisory Letter dated February 20, 2018 that included an ongoing requirement for a board consultant, fulfillment of certain planned board training activities, and submission of a plan for benchmarking assessments of both board and individual director performance compared to previous assessments. The board has plans and resources in place to meet the requirements of the February 20, 2018 FCA letter.

**NOTE 16 — QUARTERLY FINANCIAL INFORMATION (UNAUDITED):**

Quarterly results of operations for the years ended December 31 (in thousands) follow:

	2017				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,732	\$ 2,070	\$ 1,930	\$ 1,824	\$ 7,556
(Provision for) reversal of loan losses	(10)	118	51	42	201
Noninterest income (expense), net	(990)	(1,115)	(1,126)	(1,118)	(4,349)
Net income	<u>\$ 732</u>	<u>\$ 1,073</u>	<u>\$ 855</u>	<u>\$ 748</u>	<u>\$ 3,408</u>

	2016				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,809	\$ 1,796	\$ 1,844	\$ 2,077	\$ 7,526
(Provision for) reversal of loan losses	42	13	178	39	272
Noninterest income (expense), net	(1,011)	(1,019)	(970)	(914)	(3,914)
Net income	<u>\$ 840</u>	<u>\$ 790</u>	<u>\$ 1,052</u>	<u>\$ 1,202</u>	<u>\$ 3,884</u>

	2015				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,112	\$ 1,849	\$ 1,887	\$ 1,870	\$ 7,718
(Provision for) reversal of loan losses	291	380	19	11	701
Noninterest income (expense), net	(1,011)	(1,049)	(991)	(854)	(3,905)
Net income	<u>\$ 1,392</u>	<u>\$ 1,180</u>	<u>\$ 915</u>	<u>\$ 1,027</u>	<u>\$ 4,514</u>

**NOTE 17 — SUBSEQUENT EVENTS:**

The association has evaluated subsequent events through March 14, 2018, which is the date the financial statements were issued or available to be issued.

In February 2018, the board of directors approved a patronage payment related to 2017 earnings of \$2,100,000. The patronage will be paid in April 2018.

There are no subsequent events requiring disclosure as of March 14, 2018.

## **DISCLOSURE INFORMATION AND INDEX**

(Unaudited)

*Disclosures Required by Farm Credit Administration Regulations*

### **DESCRIPTION OF BUSINESS**

The description of the territory served, the persons eligible to borrow, the types of lending activities engaged in and the financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report.

The descriptions of significant developments that had or could have a material impact on earnings, interest rates to borrowers, patronage, or dividends and acquisitions or dispositions of material assets, changes in the reporting entity, changes in patronage policies or practices and financial assistance provided by or to the association through loss sharing or capital preservation agreements or from any other source, if any, required to be disclosed in this section are incorporated herein by reference from "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

### **DESCRIPTION OF PROPERTY**

Legacy Ag Credit, ACA (association) serves its 10-county territory through its main administrative and lending office at 303 Connally St., Sulphur Springs, Texas 75482. Additionally, there are four branch lending offices located throughout the territory. The association owns the office buildings in Sulphur Springs, Gilmer and Canton, free of debt. The association leases two office buildings in Sulphur Springs and one office building each in Kaufman and Longview.

### **LEGAL PROCEEDINGS**

In the ordinary course of business, the association is involved in various legal proceedings. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the consolidated financial statements of the association.

### **DESCRIPTION OF CAPITAL STRUCTURE**

The information required to be disclosed in this section is incorporated herein by reference from Note 9 to the consolidated financial statements, "Members' Equity," included in this annual report.

### **DESCRIPTION OF LIABILITIES**

The description of liabilities required to be disclosed in this section is incorporated herein by reference from Note 8, "Note Payable to the Bank," Note 12, "Employee Benefit Plans" and in "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 3 and 14 to the consolidated financial statements, "Summary of Significant Accounting Policies" and "Commitments and Contingencies," respectively, included in this annual report.

### **RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS**

The association's financial condition may be impacted by factors that affect the Farm Credit Bank of Texas (bank), as discussed in Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report. The financial condition and results of operations of the bank may materially affect the stockholders' investment in the association.

The annual and quarterly stockholder reports of the Farm Credit Bank of Texas (bank) and of the Texas Farm Credit District (district) 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 78720-2590 or calling (512) 483-9204. Copies of the bank and district annual and quarterly stockholder reports can also be requested by e-mailing [fcb@farmcreditbank.com](mailto:fcb@farmcreditbank.com). The annual and quarterly stockholder reports are also available on its website at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The association's quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Legacy Ag Credit, ACA, 303 Connally St., Sulphur

Springs, TX 75482 or calling (903)885-9566. Copies of the association’s quarterly stockholder reports can also be requested by e-mailing sherry.jennings@legacyaca.com. The association’s annual stockholder report is available on its website at www.legacyaca.com 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.

### SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2017, required to be disclosed, is incorporated herein by reference to the “Five-Year Summary of Selected Consolidated Financial Data” included in this annual report to stockholders.

### MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

“Management’s Discussion and Analysis,” which precedes the consolidated financial statements in this annual report, is incorporated herein by reference.

### DIRECTORS AND SENIOR OFFICERS

The association’s member-elected and director-elected board of directors and senior officers are as follows:

NAME	POSITION	DATE ELECTED/ EMPLOYED	TERM EXPIRES
Terry D. Milligan	Chairman of the Board	2010	2019
John Shinn	Board-Appointed Director	2016	2019
Ron Gabriel	Vice Chairman	2011	2018
Cody Newman	Director	2000	2019
Paul Nicklas	Director	2013	2018
Brandon Sides	Director	2017	2020
David R. Reeves	Director	2017	2020
William Melton	Board-Appointed Director	2017	2020
Derrell Chapman	CEO	2017	-
Al Conner	SVP/CCO	2012	-
Sherry Jennings	SVP/CAO	2007	-
Daryl D. Belt	SVP/CFO	2007	-

A brief statement of the business and employment background of each director and senior officer is provided for informational purposes.

**Terry D. Milligan**, director and chairman of the board. Mr. Milligan owns and operates a beef cattle operation and hay production operation in Van Zandt County and Bryan and Atoka counties in Oklahoma, and he operates Milligan & Company Fire Ant Control. In 2015, he retired from USDA after 34 years of service. Mr. Milligan holds an associate’s degree in farm and ranch management from Murray State College in Tishomingo, Oklahoma. Mr. Milligan has served as chairman of the board since 2016. He had previously served as vice chairman of the board and executive session secretary, and he is the association’s representative on the Farm Credit Bank of Texas Stockholder Advisory Council. He has served as stockholder-elected director since his election in 2010.

**John Shinn**, outside director and chairman of the audit committee. Mr. Shinn resides in Ben Wheeler, Texas. He holds a BBA in accounting, has been a Certified Public Accountant since 1984 and owns and operates a private CPA practice in Van Zandt County, Texas. He previously served as Van Zandt County Auditor, and he serves as a member of the Van Zandt County Child Welfare Board and the Van Zandt County Wildlife and Nature Resources Committee. Mr. Shinn has served as an outside or board-appointed director since 2016.

**Ron Gabriel**, director and vice chairman of the board. Mr. Gabriel resides in Grand Saline, Texas, where he owns and operates oil field service companies and a beef cattle, horse and hay operation. He is the owner, director and president/CEO of Lubri-Pump, Inc., owner and President/CEO of Turbo Drilling Fluids, Inc., and Four Star Rentals, L.L.C., owner and president/secretary/treasurer of Gabriel Land Holdings, LLC, and owner/director of Energy Devices of Texas, Inc. and CLUHEIR, LLC. He is past chairman of the

Legacy Ag Credit, ACA compensation committee and the nominating committee, and he served on the Spring Hill School Board for six (6) years. He was appointed as director in January, 2011 and was first elected by the stockholders in June 2011.

**Cody Newman**, director. Mr. Newman is president and co-owner in a family business, the Newman Corporation, which manages investments and operational activities in oil and gas production and real estate development, located in Harrison County. He serves as a board member of NH, Inc./Newman Ranches, a family business which operates ranches, purchases and sells livestock, and manages timber production in Harrison and Marion counties. Additionally, Mr. Newman serves on the board of the Upshur Rural Electric Cooperative Corporation and previously served as a school board member for Harleton ISD. Mr. Newman holds a B.S. in agriculture and business from Texas A&M Commerce. He served as director at large for the association from 2000 until he was elected director by the stockholders in 2008. He was elected board vice chairman in 2010 and served in that position until 2015. Additionally, he has served as audit committee vice chairman and chairman of the compensation committee.

**Paul Nicklas**, director. Mr. Nicklas resides in Canton, Texas, where he owns and operates a commercial cow-calf operation, concentrating on alternative marketing strategies, breed composition and sire selection. Additionally, he owns and operates a small business in Van Zandt, Kaufman and Henderson counties. Mr. Nicklas is a former licensed Texas real estate agent, a professional bondsman of Texas, and a retired Texas peace officer. He has served as a stockholder-elected director since his election in 2013.

**Brandon Sides**, director and chairman of the compensation committee. Mr. Sides resides in Canton, Texas, where he is co-owner and operator of Sides Pea Farm & Processing Facility. He serves on the Dallas School District Farm to School Steering Committee. Mr. Sides holds a political science degree with a minor in business and Spanish from the University of Texas, and he completed one year of the law degree/MBA at Golden State College in San Francisco. He was appointed as director in February 2017 and was elected by the stockholders in September 2017 to a three-year term.

**David R. (Randy) Reeves**, director. Mr. Reeves resides in Marshall, Texas. He has served as a County Extension Agent – Agriculture for over 30 years, serving in Harrison, Hardin, Upshur and Gregg counties. He has a BS in agricultural economics and an MS in General Agriculture, both from Tarleton State University in Stephenville, Texas. Mr. Reeves coordinates the Annual East Texas Turfgrass Conference held each February at the Overton Research and Extension Center, and he writes a weekly news article and horticulture blog for the Longview News Journal as well as a monthly producer newsletter for the Oil Belt Farm & Ranch Club. Mr. Reeves currently serves as a school board member for the Texas Early College High School in Marshall, Texas, and Panola Charter School in Carthage, Texas. Mr. Reeves was elected as director in September 2017.

**William (Bill) Melton**, outside director and chairman of the compliance committee. Mr. Melton resides in Columbia, South Carolina. He has worked for Farm Credit in various capacities for 41 years, most recently serving as CEO of Cape Fear Farm Credit in Fayetteville, NC. Until his retirement in June 2013, Mr. Melton served as Senior Vice President and Chief Lending Officer at AgFirst Farm Credit Bank. Prior to joining AgFirst in 1987, Bill was employed for 12 years with three Farm Credit associations located in North Carolina and Georgia and served in roles of increasing responsibility, including four years as CEO. He completed a three-year certificate program at the Graduate School of Banking of the South at LSU and received a B.S. degree in agricultural economics from North Carolina State University. He served two years on active duty with the U.S. Army, one year in the Army Reserve, and six years with the NC Air National Guard. He served as a board member on the National Chicken Council and the NC Southeast Partnership. Mr. Melton was a member of Fannie Mae's Affordable Housing Advisory Council and a member of USDA's Strikeforce Initiative for Economic Growth and Opportunity Advisory Committee for North Carolina. Mr. Melton was appointed as an outside or board-appointed director in February, 2017.

**Derrell Chapman, CPA**, serves as chief executive officer. He was selected as CEO and began his service with the association in September of 2017. He previously served as President and CEO and as a director of First Federal Bank Texas and its holding company, East Texas Financial Services, Inc., both located in Tyler, Texas. He previously served as chief financial officer of those same entities. Mr. Chapman was also a regional president for a \$22 billion commercial bank in the Tyler market. Mr. Chapman has a BBA in finance from Texas A&M University in College Station, Texas. Mr. Chapman is a Certified Public Accountant licensed in the state of Texas, and has over 37 years of experience in the financial services industry.

**Al Conner** serves as chief credit officer, and he served as interim chief executive officer prior to Mr. Chapman's selection. Mr. Conner joined Legacy Ag Credit, ACA in December 2012. Mr. Conner began his Farm Credit career in 1976 as a loan officer for the Federal Land Bank of Vidalia, Georgia, and Ohoopie PCA. Mr. Conner served as branch manager for the Federal Land Bank of Gainesville, Florida and North Florida, PCA in Lake City, Florida, from 1979 to 1982. Mr. Conner moved to Columbia, South Carolina, in April 1982 where he continued his Farm Credit career until his retirement from the AgFirst Farm Credit Bank in March 2011. Mr. Conner gained extensive lending experience during this 29-year tenure with the AgFirst Farm Credit Bank where he served as a senior loan officer, senior credit reviewer, vice president in credit review and vice president/relationship manager. Mr. Conner holds a B.S. in dairy science from the University of Georgia.

**Sherry Sturgis** joined Legacy Ag Credit, ACA in 2007 and serves as SVP and chief administrative officer. Mrs. Sturgis has over 20 years' banking experience in the Sulphur Springs area, most recently serving as senior administrative officer with Guaranty Bond Bank. Mrs. Sturgis began her banking career in 1988 with Texas Commercial Savings, continuing while under the management of the Resolution Trust Corporation, and served as administrative officer of First American Bank & Mortgage until the merger with Guaranty Bond Bank. She has extensive operational experience, including credit operations and human resource management. She attended Texas A&M University in Commerce, Texas (formerly East Texas State University).

**Daryl D. Belt** serves as SVP and chief financial officer. Mr. Belt joined the Association in 2007 and has been with the Farm Credit System since 1993 in various capacities with associations and the district bank (FCBT). Mr. Belt was with JPMorgan Chase & Co. for 10 years prior to joining Farm Credit. Mr. Belt holds a B.B.A. in finance from the University of Texas.

### COMPENSATION OF DIRECTORS

Directors were compensated for their service to the association in the form of an honorarium at the rate of \$700 per day for official activities and \$150 for teleconference meetings, and they were reimbursed for certain expenses incurred while representing the association in an official capacity. Mileage for attending official meetings during 2017 was paid at the IRS-approved rate of 56.0 cents per mile. A copy of the travel policy is available to stockholders of the association upon request.

Director	Number of Days Served Associated With		Total Compensation in 2017
	Board Meetings	Other Official Activities	
Terry D. Milligan	15	57	\$ 35,950
John Shinn	15	41	28,850
Ron Gabriel	13	29	22,850
Cody Newman	16	27	23,300
Paul Nicklas	13	31	24,250
Brandon Sides	14	28	25,050
David R. Reeves	5	6	6,750
William Melton	12	34	23,200
A.G. Sandifeer	8	30	19,350
			<u>\$ 209,550</u>

The aggregate compensation paid to directors in 2017, 2016 and 2015 was \$209,550, \$225,600 and \$162,200, respectively. Additional detail regarding director compensation paid for committee service (which is included in the table above) is as follows for 2017:

Director	Committee	
	Audit	Other Official Activities
Terry D. Milligan	\$ 1,200	\$ 34,750
John Shinn	1,200	27,650
Ron Gabriel	1,200	21,650
Cody Newman	1,200	22,100
Paul Nicklas	1,200	23,050
Brandon Sides	300	24,750
David R. Reeves	150	6,600
William Melton	1,200	22,000
A.G. Sandifeer	1,050	18,300
	<u>\$ 8,700</u>	<u>\$ 200,850</u>

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$81,847, \$63,514 and \$54,850 in 2017, 2016 and 2015, respectively.

## COMPENSATION OF SENIOR OFFICERS

### Compensation Discussion and Analysis – Senior Officers

The compensation plan for all employees provides for base salaries to be administered consistent with competitive financial industry survey data of like-sized financial institutions. In 2017, 2016 and 2015 bonuses were paid in accordance with the bonus plan as discussed below in the Chief Executive Officer (CEO) Compensation Policy.

#### Chief Executive Officer (CEO) Compensation Policy

The CEO's base salary is benchmarked against that paid to CEOs of other financial institutions.

A critical factor to the association's success is its ability to attract, develop and retain staff that is knowledgeable and efficient in their ability to support the association in the execution of its strategic objectives and delivery of association results that maximize the value to the stockholders. This objective holds particularly true for the association's chief executive officer (CEO) and senior officer group. The association operates utilizing a compensation program which focuses on the performance and contributions of its employees in achieving the association's financial and operational objectives, all for the ultimate benefit of its stockholder/members. The association's board of directors, through its compensation committee, establishes salary and incentive programs utilizing data derived from independent third-party compensation specialists in the financial services sector to ensure that salary and incentive structures are in line with market-comparable positions. Studies provided by third-party compensation specialists form the foundation for the association's evaluation and establishment of salary and incentive plans used by the association.

All association employees, including senior officers, can earn compensation above base salary through an annual success-sharing incentive plan. The term of the plan is each calendar year beginning January 1 through December 31. The plan is based upon the achievement of predetermined association performance goals for loan growth, credit quality, average delinquencies for the year and adjusted net income. The following criteria is also used for determining eligibility for the incentive pay: (1) the association must receive an overall rating of "satisfactory" on credit administration on its Internal Credit Review and (2) eligible employees must receive an annual performance rating of "meets standards" on his/her individual performance review.

#### Summary Compensation Table

The following table summarizes the compensation paid to the CEO and all senior officers of the association during 2017, 2016 and 2015. This may include other non-senior officers if their total compensation is within the top five highest paid employees. Amounts reflected in the table are presented in the year the compensation was earned.

<u>Name of Individual or number in group</u>	<u>Year</u>	<u>Salary (b)</u>	<u>Bonus (c)</u>	<u>Deferred/ Perquisite (d)</u>	<u>Other (e)</u>	<u>Total</u>
<b>Derrell Chapman - CEO</b>	<b>2017</b>	\$ 57,578	\$ 11,217	\$ 7,132	\$ 30,000	\$ 105,928
<b>Al Conner (Interim CEO / CCO)</b>	<b>2017</b>	\$ 214,308	\$ 41,303	\$ 2,304	\$ -	\$ 257,915
Al Conner (CCO / Interim CEO)	2016	\$ 166,648	\$ 17,497	\$ 2,488	\$ -	\$ 186,632
Joseph Crouch - CEO	2016	\$ 224,837	\$ 23,636	\$ 45,238	\$ -	\$ 293,711
Joseph Crouch - CEO	2015	\$ 218,553	\$ 27,318	\$ 44,343	\$ -	\$ 290,214

#### Senior Officers / OHCI (a)

5	2017	\$ 608,186	\$ 130,380	\$ 175,854	\$ 28,629	\$ 943,049
4	2016	\$ 460,230	\$ 69,913	\$ 116,863	\$ -	\$ 647,006
6	2015	\$ 692,103	\$ 105,067	\$ 150,230	\$ -	\$ 947,399

(a) Aggregate number of senior officers/highly compensated individuals, excluding CEO.

(b) Gross salary

(c) Bonuses paid in early 2018 related to 2017 performance.

(d) Deferred/Perquisites include all non-salary related benefits provided to the employee such as 401(K) matching and contributions to the Defined Contribution retirement plan (as discussed in Note 2 H), medical and dental insurance premiums paid by the employer, imputed income on employer paid life insurance and imputed income for personal use of Association vehicles (as described below).

(e) Amounts in the “Other” column include a signing bonus for the CEO and for Senior Officers/OHCI it represents a retention bonus paid in connection with the terminated merger.

Disclosure of information on the total compensation paid and the arrangements of the compensation plans during the last fiscal year to any senior officer or to any other officer included in the aggregate are available and will be disclosed to shareholders of the institution upon request.

Certain employees are assigned association-owned vehicles for use in normal business operations. For all personal mileage traveled in association vehicles, the association includes in the earnings of the respective employees an amount derived by an IRS established method. Amounts relating to personal use of association vehicles are included in the “Deferred/Perquisite” column in the table above along with other association-provided benefits. Employees who use their personal automobile for business purposes were reimbursed during 2017 at the IRS-approved rate of 53.5 cents per mile.

Neither the CEO nor any other senior officer received noncash compensation exceeding \$5,000 in 2017, 2016 and 2015.

Senior officers, including the CEO, are reimbursed for reasonable travel, subsistence and other related expenses while conducting association business. A copy of the association’s travel policy is available to shareholders upon request.

#### **TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS**

The association’s policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 12 to the consolidated financial statements, “Related Party Transactions,” included in this annual report.

#### **DIRECTORS’ AND SENIOR OFFICERS’ INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS**

There have been no events that have occurred in the last five years (bankruptcy, conviction or naming in a criminal proceeding, or judgment or finding limiting a right to engage in a business) that are material to the evaluation of the ability or integrity of any person who served as director or senior officer of the association.

#### **RELATIONSHIP WITH INDEPENDENT AUDITOR**

The association selected PricewaterhouseCoopers LLP to audit its financial statements and provide an opinion thereon for its 2017 annual report. The total fees paid for professional services rendered by PricewaterhouseCoopers LLP for the association during 2017 were \$57,711 for audit services and \$10,100 for tax services.

#### **RELATIONSHIP WITH UNINCORPORATED BUSINESS ENTITIES**

The association has a business relationship with LAC Asset Holding, LLC, which is a limited liability company, formed for the purpose of acquiring and managing unusual and complex collateral (acquired property).

#### **FINANCIAL STATEMENTS**

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 14, 2018, and the report of management in this annual report to stockholders, are incorporated herein by reference.

#### **MEMBER/SHAREHOLDER PRIVACY**

Members’ nonpublic personal financial information is protected by Farm Credit Administration regulation. Our directors and employees are restricted from disclosing information not normally contained in published reports or press releases about the association or its members.

**CREDIT AND SERVICES TO YOUNG, BEGINNING AND SMALL FARMERS AND RANCHERS,  
AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS**

**2018 Credit and Services Plan to Young, Beginning and Small Farmers and Ranchers**

**Mission**

The Association will make a concerted and cooperative effort to offer credit and related services to young, beginning or small (YBS) farmers, ranchers, producers or harvesters of aquatic products as supported by their creditworthiness. Sound and constructive credit to YBS farmers may include credit for nonagricultural purposes (Other Credit Needs) as well as agricultural purposes.

**Definitions**

- Young Farmer – age 35 or younger
- Beginning Farmer – 10 years or less experience
- Small Farmer - \$250,000 or less gross agricultural income

**Demographic Data**

Per 2012 USDA Census			Legacy Ag Credit, ACA			
			2017 Loans	% of Portfolio	2015 Loans	% of Portfolio
Young Farmers	1,091	7.5%	297	15.7%	255	15.7%
Beginning Farmers	4,239	29.1%	958	50.6%	842	51.8%
Small Farmers	14,169	97.3%	1,542	81.4%	1,345	82.7%
Total Farms	14,562		1,895		1,627	

\*For 10 chartered association counties

**Association Goals**

Each year, the Board and Management establish quantitative targets in the business plan to measure and evaluate progress toward serving Young, Beginning and Small farmers and ranchers in our territory. The association’s YBS loans, as a percentage of total loans outstanding at year end, are reflected in the above table for 2017 and 2016.

Compared to the United States Department of Agriculture’s 2012 Census of Agriculture data for the 10 chartered association counties, Legacy is outpacing demographics in its penetration of the Young and Beginning farmer segments. The largest potential for future penetration continues to be in the Small farmer category and, while Small farmers currently represent roughly 82 percent of the association’s loan portfolio, we recognize that, based on the demographics, there remains additional opportunity to serve this segment within the association’s territory.

As the chart on the following pages outlines, the association fell below the projected gross YBS originations in the 2017 plan. However, by number and volume YBS loans continue to make up a majority of the association’s loan portfolio and originations. The total number of YBS loans in the portfolio exceeds the plan by number but is below on volume due to the smaller average loan size.

As the association continues to build momentum in the marketplace, the association has established goals for 2018 of 3 percent above those established in 2017. Continued enhancement of the association’s visibility in the communities in which we serve, as well as direct marketing and communications, particularly to YBS farmers in our territory, will improve the association’s ability to reach its goals.

The following chart identifies the association’s goals for years 2018, 2019 and 2020. Based on these goals, the association expects that the volume and number of YBS farmers served throughout this timeline in our territory will continue to grow.

**2017 Actual Numbers**

*(000's omitted)*

	Loans Outstanding		Gross New Business Plus Commitments FYE	
Category	Number of Loans	Volume	Number of Loans	Volume
Young	297	\$22,072	50	\$6,353
Beginning	958	\$105,901	136	\$21,759
Small	1,542	\$157,852	237	\$32,162

**2017 Goals**

	Loans Outstanding		Gross New Business Plus Commitments FYE	
Category	Number of Loans	Volume	Number of Loans	Volume
Young	263	\$22,641	61	\$4,622
Beginning	867	\$119,363	159	\$28,081
Small	1,385	\$162,845	276	\$35,967

**2018 Goals**

	Loans Outstanding		Gross New Business Plus Commitments FYE	
Category	Number of Loans	Volume	Number of Loans	Volume
Young	271	\$23,416	65	\$4,903
Beginning	893	\$112,350	169	\$29,792
Small	1,427	\$167,465	293	\$38,158

**2019 Goals**

	Loans Outstanding		Gross New Business Plus Commitments FYE	
Category	Number of Loans	Volume	Number of Loans	Volume
Young	279	\$24,119	67	\$5,050
Beginning	920	\$115,721	174	\$30,685
Small	1,470	\$172,489	302	\$39,302

**2020 Goals**

	Loans Outstanding		Gross New Business Plus Commitments FYE	
Category	Number of Loans	Volume	Number of Loans	Volume
Young	287	\$24,842	69	\$5,202
Beginning	948	\$119,193	179	\$31,606
Small	1,514	\$177,664	311	\$40,481

## **Related Services**

The Association works to identify and meet the unique needs of young, beginning and small operations by offering related services such as:

- Participate in outreach opportunities that provide borrowers and local producers with valuable information regarding farm planning and management, product marketing, and risk management
- Credit life insurance and fee appraisal services
- Allocation of additional time, from inquiry through closing, to assist qualified borrowers with real estate purchases
- Recognition and allowance for circumstances unique to YBS applicants
- Support of federal and state sponsored guarantee programs for YBS borrowers
- Facilitation of loan processing with Farm Service Agency and Small Business Administration

## **Outreach to the YBS Segment**

The Association realizes the future of agriculture rests with young producers, and outreach was evidenced through continued participation in numerous local activities, such as:

- Co-sponsorship of outreach opportunities targeting young farmers and ranchers within the territory
- Support and participation of career day events at local universities
- Sponsorship of an association borrower for the annual Farm Credit Young Leaders Program, which gives current and future leaders insight into the ways Farm Credit supports agriculture
- Participation in the Texas District membership and sponsorship program through FCBT, which supports various YBS statewide organizations and events
- Supporting local 4-H and FFA chapter events
- Sponsoring Texas AgriLife Extension Service events which train and address beginning farmers needs
- Purchasing of livestock show animals
- Maintaining a visible presence at hay shows and rodeos within the territory
- Exhibiting and distributing marketing material at trade shows and equipment auctions
- Sponsoring local charitable and civic events

## Strategies

- Through staff meetings and periodic memorandums, review the association's YBS Farmer and New Generation loan programs and policies with association personnel to ensure an understanding of and compliance with policies and procedures.
- Ensure YBS loans are properly identified and classified in accordance with systemwide classification standards.
- Internal controls, and more specifically, the lines of responsibility in administering the YBS program, are contained within existing association loan policies and procedures regarding standard and New Generation loan programs. Each loan officer is charged with maintaining soundness and monitoring performance results within the YBS loan portfolio.
- Increase utilization of the Association's New Generation loan program. The Association's goal is to close five loans for a total of \$200,000 in 2018.
- Ensure the association's Marketing Program adequately targets YBS farmers and ranchers by requiring that branch offices participate in at least one YBS marketing activity on a quarterly basis. Activities will include but not be limited to 4-H and FFA events, youth livestock shows, hay shows, chamber events, support to local charitable and service organizations and other related service events. Documentation of all such activities is required and reported quarterly to Legacy's Board of Directors.
- Review and update, when needed, the association lending standards to ensure maximum penetration in the YBS farmer market based on their creditworthiness and the financial ability of the association.
- Promoting the YBS Program with a positive attitude is required for the entire staff.
- Opportunities to cooperate will include utilization of the association's New Generation Program, with coordinated efforts with USDA on its Young and Beginning Farmer participation programs.
- An annual report of the association's YBS loan related data is submitted to the Farm Credit Bank of Texas after each calendar year end. The Farm Credit Bank of Texas compiles YBS data on a districtwide basis and submits to FCA and to the association board of directors. A capsule report of YBS loan-related statistics is provided to the association board of directors on a quarterly basis. Reporting to stockholders is contained in the Annual Report, which is completed during the first quarter of each calendar year for the preceding full calendar year.
- Monitor closely the clear lines of responsibility for YBS program implementation by loan officers. Additionally, track performance and results of the association's YBS Program and report quarterly to the association's Board of Directors.
- Loans to FFA and 4H students for the purchase of show animals.