# PLAINS LAND BANK, FLCA

## 2017
## Quarterly Report
## Second Quarter

## For the Quarter Ended June 30, 2017

**REPORT OF MANAGEMENT**

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

Greggory S. Lloyd

Greggory S. Lloyd, Chief Executive Officer
*July 20, 2017*

Don James

Don James, Chairman, Board of Directors
*July 20, 2017*

Cathy D. Scribner

Cathy D. Scribner, Chief Financial Officer
*July 20, 2017*

## PLAINS LAND BANK, FLCA
## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Plains Land Bank, FLCA (Federal Land Credit Association), referred to as the Association, for the quarter ended June 30, 2017. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2016 Annual Report to Stockholders.

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

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

**Significant Events:**

In January 2017, a patronage of $6,000,000 was declared. This patronage was subsequently paid in March 2017. In April 2017 the Association determined that a borrower's share of patronage had been improperly calculated in the January 2017 patronage declaration, and an additional patronage of $2,500 was declared and paid out in May 2017 to remedy the error.

**Loan Portfolio:**

Total loans outstanding at June 30, 2017, including nonaccrual loans, were $565,036,049 compared to $529,302,933 at December 31, 2016, reflecting an increase of 6.8 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.5 percent at June 30, 2017, compared to 0.6 percent at December 31, 2016.

The Association did not record any recoveries or charge-offs for the quarter ended June 30, 2017, or for the same period in 2016. The Association's allowance for loan losses was 0.3 percent of total loans outstanding as of June 30, 2017, and December 31, 2016.

**Risk Exposure:**

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

| | **June 30, 2017** | | December 31, 2016 | |
|---|---|---|---|---|
| | **Amount** | **%** | Amount | % |
| Nonaccrual | **$ 2,794,911** | **63.5%** | $ 3,261,163 | 88.3% |
| 90 days past due and still accruing interest | **1,606,921** | **36.5%** | 431,464 | 11.7% |
| Total | **$ 4,401,832** | **100.0%** | $ 3,692,627 | 100.0% |

**Results of Operations:**

The Association had net income of $3,107,641 and $5,818,405 for the three and six months ended June 30, 2017, as compared to net income of $2,904,846 and $5,105,134 for the same periods in 2016, reflecting an increase of 7.0 and 14.0 percent. Net interest income was $3,946,175 and $7,828,908 for the three and six months ended June 30, 2017, compared to $3,682,692 and $7,213,647 for the same periods in 2016.

| | Six months ended: | | | |
|---|---|---|---|---|
| | **June 30, 2017** | | June 30, 2016 | |
| | **Average Balance** | **Interest** | Average Balance | Interest |
| Loans | **$ 542,398,828** | **$ 13,194,662** | $ 514,570,427 | $ 12,095,741 |
| Interest-bearing liabilities | **446,624,756** | **5,365,754** | 422,283,426 | 4,882,094 |
| Impact of capital | **$ 95,774,072** | | $ 92,287,001 | |
| Net interest income | | **$ 7,828,908** | | $ 7,213,647 |

| | **2017 Average Yield** | 2016 Average Yield |
|---|---|---|
| Yield on loans | **4.91%** | 4.75% |
| Cost of interest-bearing liabilities | **2.42%** | 2.34% |
| Interest rate spread | **2.49%** | 2.41% |
| Net interest income as a percentage of average earning assets | **2.91%** | 2.83% |

| | **Six months ended: June 30, 2017 vs. June 30, 2016** | | |
|---|---|---|---|
| | **Increase due to** | | |
| | **Volume** | **Rate** | **Total** |
| Interest income - loans | **$ 652,331** | **$ 446,590** | **$ 1,098,921** |
| Interest expense | **280,630** | **203,030** | **483,660** |
| Net interest income | **$ 371,701** | **$ 243,560** | **$ 615,261** |

Interest income for the three and six months ended June 30, 2017, increased by $560,138 and $1,098,921, or 9.1 percent from the same periods of 2016, primarily due to increases in yields on earning assets and an increase in average loan volume. Interest expense for the three and six months ended June 30, 2017, increased by $296,655 and $483,660, or 11.9 and 9.9 percent, from the same periods of 2016 due to an increase in interest rates offset by an increase in average debt volume. Average loan volume for the second quarter of 2017 was $548,718,060, compared to $526,150,594 in the second quarter of 2016. The average net interest rate spread on the loan portfolio for the second quarter of 2017 was 2.49 percent, compared to 2.41 percent in the second quarter of 2016.

The Association's return on average assets for the six months ended June 30, 2017, was 2.10 percent compared to 1.94 percent for the same period in 2016. The Association's return on average equity for the six months ended June 30, 2017, was 10.82 percent, compared to 9.97 percent for the same period in 2016.

**Liquidity and Funding Sources:**

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

| | **June 30, 2017** | December 31, 2016 |
|---|---|---|
| Note payable to the Bank | **$ 470,015,855** | $ 436,304,583 |
| Accrued interest on note payable | **948,768** | 858,809 |
| Total | **$ 470,964,623** | $ 437,163,392 |

The Association operates under a general financing agreement (GFA) with the Bank. The current GFA is effective through September 30, 2018. The primary source of liquidity and funding for the Association is a direct loan from the Bank. The outstanding balance of $470,015,855 as of June 30, 2017, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.51 percent at June 30, 2017. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by the general financing agreement. The increase in note payable to the Bank and related accrued interest payable since December 31, 2016, is due to the Association's increase in assets since year end. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were $94,889,162 at June 30, 2017. The maximum amount the Association may borrow from the Bank as of June 30, 2017, was $569,390,628 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, 2018, unless sooner terminated by the Bank upon the occurrence of an event of default, or by the Association, in the event of a breach of this agreement by the Bank, upon giving the Bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the Bank 120 days' prior written notice.

**Capital Resources:**

The Association's capital position decreased by $135,430 at June 30, 2017, compared to December 31, 2016. The Association's debt as a percentage of members' equity was 4.27:1 as of June 30, 2017, compared to 3.97:1 as of December 31, 2016. Farm Credit Administration regulations require the Association to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations.

**Significant Recent Accounting Pronouncements:**

In March 2017, the Financial Accounting Standards Board (FASB) issued guidance entitled "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association's financial condition but could change the classification of certain items in the results of operations.

In August 2016, 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 Associations'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 currently evaluating the impact of adoption on its financial condition and results of operations.

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In August 2014, the FASB issued guidance entitled "Presentation of Financial Statements — Going Concern." The guidance governs management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This guidance requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year after the date the financial statements are issued or within one year after the financial statements are available to be issued, when applicable. Substantial doubt exists if it is probable that the entity will be unable to meet its obligations for the assessed period. This guidance became effective for interim and annual periods ending after December 15, 2016. The Association adopted this guidance in the fourth quarter of 2016 and management made its initial assessment as of December 31, 2016.

In May 2014, the FASB issued guidance entitled, "Revenue from Contracts with Customers." The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

**Regulatory Matters:**

On March 10, 2016, the Farm Credit Administration approved a final rule to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule are as follows:

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

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

**Relationship With the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2016 Annual Report of Plains Land Bank, FLCA more fully describe the Association's relationship with the Bank.

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

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Plains Land Bank, FLCA, 5625 Fulton Drive, Amarillo, Texas 79109-4212 or calling (806) 353-6688. The annual and quarterly stockholder reports for the Association are also available on its website at *www.plainslandbank.com.* Copies of the Association's quarterly stockholder reports can also be requested by e-mailing *cscribner@plainslandbank.com.*

**PLAINS LAND BANK, FLCA**

**BALANCE SHEET**

| | | June 30, 2017 (unaudited) | | December 31, 2016 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash | $ | **439,022** | $ | 3,649,379 |
| Loans | | **565,036,049** | | 529,302,933 |
| Less: allowance for loan losses | | **1,849,075** | | 1,797,569 |
| Net loans | | **563,186,974** | | 527,505,364 |
| Accrued interest receivable | | **8,406,330** | | 9,195,274 |
| Investment in and receivable from the Farm Credit Bank of Texas: | | | | |
| Capital stock | | **8,591,100** | | 8,591,100 |
| Premises and equipment, net | | **1,746,969** | | 1,822,518 |
| Other assets | | **1,720,020** | | 559,598 |
| Total assets | $ | **584,090,415** | $ | 551,323,233 |
| **LIABILITIES** | | | | |
| Note payable to the Farm Credit Bank of Texas | $ | **470,015,855** | $ | 436,304,583 |
| Accrued interest payable | | **948,768** | | 858,809 |
| Drafts outstanding | | **588,730** | | 1,129,034 |
| Other liabilities | | **1,759,309** | | 2,117,624 |
| Total liabilities | | **473,312,662** | | 440,410,050 |
| **MEMBERS' EQUITY** | | | | |
| Capital stock and participation certificates | | **1,894,300** | | 1,837,220 |
| Unallocated retained earnings | | **108,756,975** | | 108,941,070 |
| Accumulated other comprehensive income | | **126,478** | | 134,893 |
| Total members' equity | | **110,777,753** | | 110,913,183 |
| Total liabilities and members' equity | $ | **584,090,415** | $ | 551,323,233 |

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

## PLAINS LAND BANK, FLCA

### STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

| | Three Months Ended June 30, 2017 | Three Months Ended June 30, 2016 | Six Months Ended June 30, 2017 | Six Months Ended June 30, 2016 |
|---|---|---|---|---|
| **INTEREST INCOME** | | | | |
| Loans | $ 6,746,619 | $ 6,186,481 | $ 13,194,662 | $ 12,095,741 |
| **INTEREST EXPENSE** | | | | |
| Note payable to the Farm Credit Bank of Texas | 2,800,444 | 2,503,789 | 5,365,754 | 4,882,094 |
| Net interest income | 3,946,175 | 3,682,692 | 7,828,908 | 7,213,647 |
| **PROVISION FOR LOAN LOSSES** | 84,719 | 162,216 | 41,637 | 217,493 |
| Net interest income after provision for loan losses | 3,861,456 | 3,520,476 | 7,787,271 | 6,996,154 |
| **NONINTEREST INCOME** | | | | |
| Income from the Farm Credit Bank of Texas: | | | | |
| Patronage income | 503,112 | 443,094 | 1,002,891 | 886,641 |
| Loan fees | 42,353 | 40,211 | 76,421 | 85,345 |
| Financially related services income | 2,312 | 2,351 | 5,256 | 5,522 |
| Other noninterest income | 17,128 | 18,282 | 62,498 | 61,683 |
| Total noninterest income | 564,905 | 503,938 | 1,147,066 | 1,039,191 |
| **NONINTEREST EXPENSES** | | | | |
| Salaries and employee benefits | 691,117 | 553,413 | 1,882,133 | 1,770,779 |
| Directors' expense | 95,429 | 81,392 | 161,612 | 144,909 |
| Purchased services | 66,220 | 76,093 | 147,061 | 162,664 |
| Travel | 23,243 | 24,967 | 62,688 | 52,557 |
| Occupancy and equipment | 62,066 | 55,989 | 127,596 | 121,264 |
| Communications | 14,885 | 10,830 | 25,548 | 20,183 |
| Advertising | 49,964 | 44,905 | 95,184 | 90,743 |
| Public and member relations | 75,507 | 37,846 | 103,379 | 62,397 |
| Supervisory and exam expense | 44,465 | 42,923 | 98,673 | 85,847 |
| Insurance Fund premiums | 161,401 | 163,302 | 349,458 | 343,755 |
| Loss on sale of premises and equipment, net | 10,262 | 59 | 10,263 | 59 |
| Other noninterest expense | 24,161 | 27,849 | 52,337 | 75,054 |
| Total noninterest expenses | 1,318,720 | 1,119,568 | 3,115,932 | 2,930,211 |
| **NET INCOME** | 3,107,641 | 2,904,846 | 5,818,405 | 5,105,134 |
| Other comprehensive income: | | | | |
| Change in postretirement benefit plans | (4,208) | (4,208) | (8,415) | (8,415) |
| **COMPREHENSIVE INCOME** | $ 3,103,433 | $ 2,900,638 | $ 5,809,990 | $ 5,096,719 |

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

**PLAINS LAND BANK, FLCA**

**STATEMENT OF CHANGES IN MEMBERS' EQUITY**
(unaudited)

| | Capital Stock/ Participation Certificates | Retained Earnings Unallocated | Accumulated Other Comprehensive Income (Loss) | Total Members' Equity |
|---|---|---|---|---|
| Balance at December 31, 2015 | $ 1,807,680 | $ 104,450,282 | $ 135,745 | $ 106,393,707 |
| Comprehensive income | - | 5,105,134 | (8,415) | 5,096,719 |
| Capital stock/participation certificates and allocated retained earnings issued | 161,770 | - | - | 161,770 |
| Capital stock/participation certificates and allocated retained earnings retired | (146,580) | - | - | (146,580) |
| Patronage refunds: | | | | |
| Cash | - | (6,750,000) | - | (6,750,000) |
| Balance at June 30, 2016 | $ 1,822,870 | $ 102,805,416 | $ 127,330 | $ 104,755,616 |
| | | | | |
| Balance at December 31, 2016 | $ 1,837,220 | $ 108,941,070 | $ 134,893 | $ 110,913,183 |
| Comprehensive income | - | 5,818,405 | (8,415) | 5,809,990 |
| Capital stock/participation certificates and allocated retained earnings issued | 168,980 | - | - | 168,980 |
| Capital stock/participation certificates and allocated retained earnings retired | (111,900) | - | - | (111,900) |
| Patronage refunds: | | | | |
| Cash | - | (6,002,500) | - | (6,002,500) |
| **Balance at June 30, 2017** | **$ 1,894,300** | **$ 108,756,975** | **$ 126,478** | **$ 110,777,753** |

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

**PLAINS LAND BANK, FLCA**
**NOTES TO THE FINANCIAL STATEMENTS**
(UNAUDITED)

## NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Plains Land Bank, FLCA (Federal Land Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the Armstrong, Briscoe, Carson, Floyd, Gray, Hale, southwest portion of Hall, Hansford, Hemphill, Hutchinson, Lipscomb, Motley, Ochiltree, Oldham, Potter, Randall and Roberts in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2016, as contained in the 2016 Annual Report to Stockholders.

In the opinion of management, the accompanying financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2016, as contained in the 2016 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. Descriptions of the significant accounting policies are included in the 2016 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In March 2017, the Financial Accounting Standards Board (FASB) issued guidance entitled "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association's financial condition but could change the classification of certain items in the results of operations.

In August 2016, 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, FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is currently evaluating the impact of adoption on its financial condition and results of operations.

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." This guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

In August 2014, the FASB issued guidance entitled "Presentation of Financial Statements — Going Concern." The guidance governs management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This guidance requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year after the date the financial statements are issued or within one year after the financial statements are available to be issued, when applicable. Substantial doubt exists if it is probable that the entity will be unable to meet its obligations for the assessed period. This guidance became effective for interim and annual periods ending after December 15, 2016. The Association adopted this guidance in the fourth quarter of 2016 and management made its initial assessment as of December 31, 2016.

In May 2014, the FASB issued guidance entitled, "Revenue from Contracts with Customers." The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The Association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

The financial statements comprise the operations of the FLCA. The preparation of these financial statements requires the use of management's estimates. The results for the quarter ended June 30, 2017, are not necessarily indicative of the results to be expected for the year ended December 31, 2017. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

| Loan Type | **June 30, 2017 Amount** | December 31, 2016 Amount |
|---|---|---|
| Production agriculture: | | |
| Real estate mortgage | **$ 490,649,582** | $ 454,024,356 |
| Production and intermediate term | **7,218,150** | 8,859,832 |
| Agribusiness: | | |
| Processing and marketing | **31,282,116** | 32,082,070 |
| Loans to cooperatives | **5,582,139** | 4,924,672 |
| Farm-related business | **1,380,279** | 1,814,188 |
| Energy | **15,539,614** | 16,673,398 |
| Communication | **7,832,069** | 7,089,784 |
| Rural residential real estate | **5,552,100** | 3,834,633 |
| Total | **$ 565,036,049** | $ 529,302,933 |

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at June 30, 2017:

| | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Agribusiness | $ 35,150,145 | $ - | $ - | $ - | $ 35,150,145 | $ - |
| Energy | 15,539,614 | - | - | - | 15,539,614 | - |
| Real estate mortgage | 8,785,651 | 3,804,153 | - | - | 8,785,651 | 3,804,153 |
| Communication | 7,832,069 | - | - | - | 7,832,069 | - |
| Production and intermediate term | 7,218,150 | - | - | - | 7,218,150 | - |
| Total | $ 74,525,629 | $ 3,804,153 | $ - | $ - | $ 74,525,629 | $ 3,804,153 |

The Association is authorized under the Farm Credit Act to accept "advance conditional payments" (ACPs) from borrowers. To the extent the borrower's access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower's related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest is generally paid by the Association on such balances. There were no ACPs at June 30, 2017, and December 31, 2016, respectively.

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

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| **Nonaccrual loans:** | | |
| Real estate mortgage | $ **2,794,911** | $ 3,261,163 |
| Total nonaccrual loans | **2,794,911** | 3,261,163 |
| | | |
| **Accruing loans 90 days or more past due:** | | |
| Agribusiness | **1,606,921** | - |
| Real estate mortgage | - | 431,464 |
| Total accruing loans 90 days or more past due | **1,606,921** | 431,464 |
| | | |
| Total nonperforming assets | $ **4,401,832** | $ 3,692,627 |

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

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

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

| | **June 30, 2017** | December 31, 2016 |
|---|---|---|
| Real estate mortgage | | |
| Acceptable | **95.6** % | 95.7 % |
| OAEM | **2.6** | 2.2 |
| Substandard/doubtful | **1.8** | 2.1 |
| | **100.0** | 100.0 |
| Production and intermediate term | | |
| Acceptable | **100.0** | 85.8 |
| OAEM | **-** | - |
| Substandard/doubtful | **-** | 14.2 |
| | **100.0** | 100.0 |
| Agribusiness | | |
| Acceptable | **95.8** | 96.0 |
| OAEM | **-** | - |
| Substandard/doubtful | **4.2** | 4.0 |
| | **100.0** | 100.0 |
| Energy | | |
| Acceptable | **80.5** | 81.1 |
| OAEM | **19.5** | 18.9 |
| Substandard/doubtful | **-** | - |
| | **100.0** | 100.0 |
| Communication | | |
| Acceptable | **100.0** | 100.0 |
| OAEM | **-** | - |
| Substandard/doubtful | **-** | - |
| | **100.0** | 100.0 |
| Rural residential real estate | | |
| Acceptable | **100.0** | 100.0 |
| OAEM | **-** | - |
| Substandard/doubtful | **-** | - |
| | **100.0** | 100.0 |
| Total loans | | |
| Acceptable | **95.4** | 95.1 |
| OAEM | **2.7** | 2.5 |
| Substandard/doubtful | **1.9** | 2.4 |
| | **100.0** % | 100.0 % |

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

| June 30, 2017 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans | Recorded Investment >90 Days and Accruing |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 1,090,696 | $ 143,509 | $ 1,234,205 | $ 497,613,669 | $ 498,847,874 | $ - |
| Processing and marketing | - | - | - | 31,316,621 | 31,316,621 | - |
| Energy | - | - | - | 15,576,582 | 15,576,582 | - |
| Communication | - | - | - | 7,836,333 | 7,836,333 | - |
| Production and intermediate term | - | - | - | 7,237,211 | 7,237,211 | - |
| Loans to cooperatives | - | 1,606,921 | 1,606,921 | 4,057,632 | 5,664,553 | 1,606,921 |
| Rural residential real estate | 17,622 | - | 17,622 | 5,561,560 | 5,579,182 | - |
| Farm-related business | - | - | - | 1,384,023 | 1,384,023 | - |
| Total | $ 1,108,318 | $ 1,750,430 | $ 2,858,748 | $ 570,583,631 | $ 573,442,379 | $ 1,606,921 |

| 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 | $ 482,835 | $ 431,464 | $ 914,299 | $ 462,093,759 | $ 463,008,058 | $ 431,464 |
| Processing and marketing | - | - | - | 32,153,390 | 32,153,390 | - |
| Energy | - | - | - | 16,707,477 | 16,707,477 | - |
| Communication | - | - | - | 7,092,107 | 7,092,107 | - |
| Production and intermediate term | - | - | - | 8,887,329 | 8,887,329 | - |
| Loans to cooperatives | - | - | - | 4,972,109 | 4,972,109 | - |
| Rural residential real estate | - | - | - | 3,855,939 | 3,855,939 | - |
| Farm-related business | - | - | - | 1,821,798 | 1,821,798 | - |
| Total | $ 482,835 | $ 431,464 | $ 914,299 | $ 537,583,908 | $ 538,498,207 | $ 431,464 |

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.

There were no troubled debt restructured loans as of June 30, 2017. As of June 30, 2017 and December 31, 2016 there were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring.

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 quarter ending June 30, 2017.

The predominant form of concession granted for troubled debt restructuring includes principle concessions. 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 we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

Additional impaired loan information is as follows:

| | June 30, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | **Recorded Investment** | **Unpaid Principal Balance**[a] | **Related Allowance** | Recorded Investment | Unpaid Principal Balance[a] | Related Allowance |
| Impaired loans with a related allowance for credit losses: | | | | | | |
| Real estate mortgage | $ - | $ - | $ - | $ - | $ - | $ - |
| Loans to cooperatives | - | - | - | - | - | - |
| Total | $ - | $ - | $ - | $ - | $ - | $ - |
| Impaired loans with no related allowance for credit losses: | | | | | | |
| Real estate mortgage | $ 2,794,911 | $ 2,795,066 | $ - | $ 3,692,627 | $ 3,664,913 | $ - |
| Loans to cooperatives | 1,606,921 | 1,529,415 | - | - | - | - |
| Total | $ 4,401,832 | $ 4,324,481 | $ - | $ 3,692,627 | $ 3,664,913 | $ - |
| Total impaired loans: | | | | | | |
| Real estate mortgage | $ 2,794,911 | $ 2,795,066 | $ - | $ 3,692,627 | $ 3,664,913 | $ - |
| Loans to cooperatives | 1,606,921 | 1,529,415 | - | - | - | - |
| Total | $ 4,401,832 | $ 4,324,481 | $ - | $ 3,692,627 | $ 3,664,913 | $ - |

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

| | For the Three Months Ended | | | | For the Six Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | **June 30, 2017** | | June 30, 2016 | | **June 30, 2017** | | June 30, 2016 | |
| | **Average Impaired Loans** | **Interest Income Recognized** | Average Impaired Loans | Interest Income Recognized | **Average Impaired Loans** | **Interest Income Recognized** | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for credit losses: | | | | | | | | |
| Real estate mortgage | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Loans to cooperatives | - | - | - | - | - | - | - | - |
| Total | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Impaired loans with no related allowance for credit losses: | | | | | | | | |
| Real estate mortgage | $ 2,716,433 | $ 933 | $ 956,587 | $ 12,451 | $ 2,721,117 | $ 1,100 | $ 956,587 | $ 25,675 |
| Loans to cooperatives | 1,529,415 | 18,684 | - | - | 1,529,415 | 38,948 | - | - |
| Total | $ 4,245,848 | $ 19,617 | $ 956,587 | $ 12,451 | $ 4,250,532 | $ 40,048 | $ 956,587 | $ 25,675 |
| Total impaired loans: | | | | | | | | |
| Real estate mortgage | $ 2,716,433 | $ 933 | $ 956,587 | $ 12,451 | $ 2,721,117 | $ 1,100 | $ 956,587 | $ 25,675 |
| Loans to cooperatives | $ 1,529,415 | $ 18,684 | - | - | $ 1,529,415 | $ 38,948 | - | - |
| Total | $ 4,245,848 | $ 19,617 | $ 956,587 | $ 12,451 | $ 4,250,532 | $ 40,048 | $ 956,587 | $ 25,675 |

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

| | Real Estate Mortgage | Production and Intermediate Term | Agribusiness | Communication | Energy | Rural Residential Real Estate | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for Credit Losses:** | | | | | | | |
| Balance at March 31, 2017 | $ 1,268,178 | $ 26,525 | $ 226,601 | $ 44,740 | $ 191,640 | $ 10,241 | $ 1,767,925 |
| Charge-offs | - | - | - | - | - | - | - |
| Recoveries | - | - | - | - | - | - | - |
| Provision for loan losses | 90,648 | (2,634) | (6,741) | 6,327 | (5,095) | 2,214 | 84,719 |
| Other | (2,408) | 1,685 | (8,187) | 1,644 | 3,697 | - | (3,569) |
| Balance at June 30, 2017 | $ 1,356,418 | $ 25,576 | $ 211,673 | $ 52,711 | $ 190,242 | $ 12,455 | $ 1,849,075 |
| Balance at December 31, 2016 | $ 1,218,496 | $ 126,716 | $ 209,105 | $ 33,335 | $ 201,849 | $ 8,068 | $ 1,797,569 |
| Charge-offs | - | - | - | - | - | - | - |
| Recoveries | - | - | - | - | - | - | - |
| Provision for loan losses | 141,649 | (110,009) | 9,098 | 19,202 | (22,690) | 4,387 | 41,637 |
| Other | (3,727) | 8,869 | (6,530) | 174 | 11,083 | - | 9,869 |
| Balance at June 30, 2017 | $ 1,356,418 | $ 25,576 | $ 211,673 | $ 52,711 | $ 190,242 | $ 12,455 | $ 1,849,075 |
| Ending Balance: | | | | | | | |
| Individually evaluated for impairment | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Collectively evaluated for impairment | 1,356,418 | 25,576 | 211,673 | 52,711 | 190,242 | 12,455 | 1,849,075 |
| Balance at June 30, 2017 | $ 1,356,418 | $ 25,576 | $ 211,673 | $ 52,711 | $ 190,242 | $ 12,455 | $ 1,849,075 |
| Balance at March 31, 2016 | $ 1,211,134 | $ 66,968 | $ 207,966 | $ 25,290 | $ 140,556 | $ 12,434 | $ 1,664,348 |
| Charge-offs | - | - | - | - | - | - | - |
| Recoveries | - | - | - | - | - | - | - |
| Provision for loan losses | 33,460 | 71,773 | 16,359 | 8,249 | 32,077 | 298 | 162,216 |
| Other | - | - | - | - | - | - | - |
| Balance at June 30, 2016 | $ 1,244,594 | $ 138,741 | $ 224,325 | $ 33,539 | $ 172,633 | $ 12,732 | $ 1,826,564 |
| Balance at December 31, 2015 | $ 1,202,847 | $ 77,629 | $ 165,168 | $ 25,648 | $ 124,012 | $ 13,767 | $ 1,609,071 |
| Charge-offs | - | - | - | - | - | - | - |
| Recoveries | - | - | - | - | - | - | - |
| Provision for loan losses | 41,747 | 61,112 | 59,157 | 7,891 | 48,621 | (1,035) | 217,493 |
| Other | - | - | - | - | - | - | - |
| Balance at June 30, 2016 | $ 1,244,594 | $ 138,741 | $ 224,325 | $ 33,539 | $ 172,633 | $ 12,732 | $ 1,826,564 |
| Ending Balance: | | | | | | | |
| Individually evaluated for impairment | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Collectively evaluated for impairment | 1,244,594 | 138,741 | 224,325 | 33,539 | 172,633 | 12,732 | 1,826,564 |
| Balance at June 30, 2016 | $ 1,244,594 | $ 138,741 | $ 224,325 | $ 33,539 | $ 172,633 | $ 12,732 | $ 1,826,564 |

| | Real Estate Mortgage | Production and Intermediate Term | Agribusiness | Communication | Energy | Rural Residential Real Estate | Total |
|---|---|---|---|---|---|---|---|
| **Recorded Investments in Loans Outstanding:** | | | | | | | |
| Ending Balance at June 30, 2017 | $ 498,847,874 | $ 7,237,211 | $ 38,365,197 | $ 7,836,333 | $ 15,576,582 | $ 5,579,182 | $ 573,442,379 |
| Individually evaluated for impairment | $ 2,794,911 | $ - | $ 1,606,921 | $ - | $ - | $ - | $ 4,401,832 |
| Collectively evaluated for impairment | $ 496,052,963 | $ 7,237,211 | $ 36,758,276 | $ 7,836,333 | $ 15,576,582 | $ 5,579,182 | $ 569,040,547 |
| Ending Balance at June 30, 2016 | $ 458,625,892 | $ 9,318,282 | $ 43,373,731 | $ 6,784,335 | $ 18,437,714 | $ 3,912,004 | $ 540,451,958 |
| Individually evaluated for impairment | $ 1,021,809 | $ - | $ - | $ - | $ - | $ - | $ 1,021,809 |
| Collectively evaluated for impairment | $ 457,604,083 | $ 9,318,282 | $ 43,373,731 | $ 6,784,335 | $ 18,437,714 | $ 3,912,004 | $ 539,430,149 |

## NOTE 3 — CAPITAL:

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

### Regulatory Capitalization Requirements

Effective January 1, 2017, the regulatory capital requirements for System banks and associations were modified. The new regulations replaced existing core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect.

The Association's ratios were as follows:

| Risk-adjusted: | Regulatory Minimums | Conservation Buffer | Total | As of June 30, 2017 |
|---|---|---|---|---|
| Common equity tier 1 ratio | 4.50% | 2.50% | 7.00% | 17.23% |
| Tier 1 capital ratio | 6.00% | 2.50% | 8.50% | 17.23% |
| Total capital ratio | 8.00% | 2.50% | 10.50% | 17.55% |
| Permanent capital ratio | 7.00% | 0.00% | 7.00% | 17.28% |
| **Non-risk-adjusted:** | | | | |
| Tier 1 leverage ratio | 4.00% | 1.00% | 5.00% | 17.92% |
| UREE leverage ratio | 1.50% | 0.00% | 1.50% | 19.13% |

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

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

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

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

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

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

- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.

- Total capital is tier 1 capital plus other required borrower stock held for a minimum of 5 years, allocated equities held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.

- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.

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

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

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

The components of the Association's risk-adjusted capital, based on 90 day average balances, were as follows at June 30, 2017:

Risk-adjusted Capital Ratios

| (dollars in thousands) | Common equity tier 1 ratio | Tier 1 capital ratio | Regulatory capital ratio | Permanent capital ratio |
|---|---|---|---|---|
| Numerator: | | | | |
| Unallocated retained earnings | 106,649,534 | 106,649,534 | 106,649,534 | 106,649,534 |
| Paid-in capital | - | - | - | - |
| Common Cooperative Equities: | | | | |
| Statutory minimum purchased borrower stock | 1,870,891 | 1,870,891 | 1,870,891 | 1,870,891 |
| 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 | - | - | - | - |
| Nonqualified allocated equities not subject to retirement | - | - | - | - |
| 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 | (8,591,100) | (8,591,100) | (8,591,100) | (8,591,100) |
| Other regulatory required deductions | - | - | - | - |
| | 99,929,325 | 99,929,325 | 99,929,325 | 99,929,325 |
| Denominator: | | | | |
| Risk-adjusted assets excluding allowance | 588,541,681 | 588,541,681 | 588,541,681 | 588,541,681 |
| Regulatory Adjustments and Deductions: | | | | |
| Regulatory deductions included in total capital | (8,591,100) | (8,591,100) | (8,591,100) | (8,591,100) |
| Allowance for loan losses | | | | (1,772,433) |
| | 579,950,581 | 579,950,581 | 579,950,581 | 578,178,148 |

The components of the Association's non-risk-adjusted capital, based on 90 day average balances, were as follows at June 30, 2017:

Non-risk-adjusted Capital Ratios

| (dollars in thousands) | Tier 1 leverage ratio | UREE leverage ratio |
|---|---|---|
| Numerator: | | |
| Unallocated retained earnings | 106,649,534 | 106,649,534 |
| Paid-in capital | - | - |
| Common Cooperative Equities: | | |
| Statutory minimum purchased borrower stock | 1,870,891 | - |
| 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 | - | - |
| Nonqualified allocated equities not subject to retirement | - | - |
| 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 | (8,591,100) | - |
| Other regulatory required deductions | - | - |
| | 99,929,325 | 106,649,534 |
| Denominator: | | |
| Total Assets | 566,160,759 | 566,160,759 |
| Regulatory Adjustments and Deductions: | | |
| Regulatory deductions included in tier 1 capital | (8,591,100) | (8,591,100) |
| | 557,569,659 | 557,569,659 |

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

| | | |
|---|---|---|
| **June 30, 2017** | | |
| **Nonpension postretirement benefits** | **$** | **126,478** |
| **Total** | **$** | **126,478** |
| June 30, 2016 | | |
| Nonpension postretirement benefits | $ | 127,330 |
| Total | $ | 127,330 |

The Association's accumulated other comprehensive income relates entirely to its nonpension other postretirement benefits. Amortization of prior service credits and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Statement of Comprehensive Income.

The following table summarizes the changes in accumulated other comprehensive income for the six months ended June 30:

| | 2017 | 2016 |
|---|---|---|
| Accumulated other comprehensive income at January 1 | **$ 134,893** | $ 135,745 |
| Amortization of prior service credits included in salaries and employee benefits | **(8,415)** | (8,415) |
| Amortization of actuarial (gain) loss included in salaries and employee benefits | **-** | - |
| Other comprehensive loss, net of tax | **(8,415)** | (8,415) |
| Accumulated other comprehensive income at June 30 | **$ 126,478** | $ 127,330 |

## NOTE 4 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 12 to the 2016 Annual Report to Stockholders for a more complete description.

There were no assets and liabilities measured at fair value on a recurring basis for the three months ended June 30, 2017 or December 31, 2016.

**Valuation Techniques**

As more fully discussed in Note 12 to the 2016 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Notes to the 2016 Annual Report to Stockholders.

*Cash*

For cash, the carrying amount is a reasonable estimate of fair value.

*Loans*

Fair value is estimated by discounting the expected future cash flows using the Associations' current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the Associations' current loan origination rates as well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

For purposes of estimating fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

The fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral-dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral.

*Commitments to Extend Credit*

The fair value of commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates.

*Other Property Owned*

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

## NOTE 5 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the six months ended June 30:

| | Other Benefits | |
|---|---|---|
| | **2017** | 2016 |
| Service cost | **$ 10,913** | $ 11,974 |
| Interest cost | **25,276** | 24,990 |
| Amortization of prior service credits | **(8,415)** | (8,415) |
| Net periodic benefit cost | **$ 27,774** | $ 28,549 |

The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2017, was $1,137,059 and is included in "Other Liabilities" in the balance sheet.

The structure of the District's defined benefit pension plan is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (Bank and associations). The Association recognizes its amortized annual contributions to the plan as an expense. As of June 30, 2017, $272,693 of contributions have been made. The Association presently anticipates contributing an additional $272,693 to fund the defined benefit pension plan in 2017 for a total of $545,386.

## NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:

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

## NOTE 9 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through July 26, 2017, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of July 26, 2017.