

**CENTRAL TEXAS FARM CREDIT, ACA**

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**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.



Boyd J. Chambers, Chief Executive Officer and President

*August 8, 2017*



Robby A. Halfmann, Chairman, Board of Directors

*August 8, 2017*



Keith Prater, Controller

*August 8, 2017*

## **CENTRAL TEXAS FARM CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Central Texas Farm Credit, ACA (Agricultural 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 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 ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

### **Significant Events:**

#### 2017

In March 2017, a patronage refund of \$6,000,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2016, and the amount was based on the Association's 2016 operating results.

#### 2016

In December 2016, the Association received a direct loan patronage of \$1,592,290 from the Farm Credit Bank of Texas (Bank), representing 41 basis points on the average daily balance of the Association's direct loan with the Bank. During 2016, the Association also received \$128,071 in patronage payments from the Bank, based on the Association's stock investment in the Bank. In addition, the Association received a capital markets patronage of \$54,450 from the Bank, representing 75 basis points on the Association's average balance of participations in the Bank's patronage pool program.

In September 2016, the Association completed construction of a new headquarters building located in the city of Early, which is included in premises and equipment on the consolidated balance sheet.

In March 2016, a patronage refund of \$5,600,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2015, and the amount was based on the Association's 2015 operating results.

#### 2015

In December 2015, the Association received a direct loan patronage of \$1,448,584 from the Bank, representing 42 basis points on the average daily balance of the Association's direct loan with the Bank. During 2015, the Association received \$112,767 in patronage payments from the Bank, based on the Association's stock investment in the Bank.

In March 2015, a patronage refund of \$5,200,000 was distributed to the Association's borrowers. The patronage refund was declared by the board of directors in December 2014, and the amount was based on the Association's 2014 operating results.

#### 2014

In December 2014, the Association received a direct loan patronage of \$1,382,295 from the Bank, representing 43 basis points on the average daily balance of the Association's direct loan with the Bank. In addition, the Association received \$52,750 in patronage payments from the Bank, representing 75 basis points on the average daily balance of Association loan volume in the Bank's participation pool program. The Association also received \$104,954 in patronage payments throughout the course of the year based on the Association's stock investment in the Bank.

Effective October 15, 2014, Michael Antle resigned from his position as controller of Central Texas Farm Credit, ACA. Controller duties were handled by existing Association staff until Keith Prater was hired as the new controller on January 20, 2015.

The chairman of the board and audit committee, Jerry Don Klose, did not run for re-election in April 2014 because he reached the mandatory retirement age of 70. Mr. Klose officially stepped down after the May 2014 board meeting once the election results were known, and his seat had been filled by Steven Lehrmann. At the June 2014 meeting, the board elected Robby A. Halfmann to serve as the board chairman, Kenneth D. Harvick to serve as vice-chairman, and Burl D. Lowery to serve as the audit committee chairman.

## **Loan Portfolio:**

Total loans outstanding at June 30, 2017, including nonaccrual loans, were \$493,684,595 compared to \$489,350,168 at December 31, 2016, reflecting an increase of 0.9 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.7 percent at June 30, 2017, compared to 0.6 percent at December 31, 2016.

The Association recorded \$52,508 in charge-offs and did not record any recoveries for the quarter ended June 30, 2017. There were no recoveries or charge-offs recorded for the same period in 2016. The Association's allowance for loan losses was 0.2 percent of total loans outstanding as of June 30, 2017, and December 31, 2016.

Currently, the Association has \$3,308,170 in nonaccrual loans stemming from eleven loans. These loans are included in the Association's core loan portfolio. There have been no material changes in the Association's borrower profile, geographic distribution, commodity concentration, or asset quality.

### *Problem Loans*

#### 2017

During the second quarter of 2017, the Association recorded a charge-off in the amount of \$52,508.

#### 2016

During the third quarter of 2016, a nonaccrual loan in the amount of \$198,666 was foreclosed on. The property was sold during the quarter and the Association was paid in full.

During the third quarter of 2016, three production and intermediate term loans to a borrower were downgraded to Substandard Non-Accrual and a subsequent charge-off of \$1,029,171 was recognized.

After the sale of acquired property in 2013, a balance of \$129,075 was held in acquired property to represent funds still owed to the Association. During the third quarter of 2016 that amount was charged off as the collection of those funds was no longer expected.

#### 2015

During the first quarter of 2015, a nonaccrual loan in the amount of \$85,486 was foreclosed on, and the collateral was then acquired by the Association. The property was sold during the second quarter of 2015 and a gain of \$4,109 was recognized.

#### 2014

During the first quarter of 2014, a recovery of \$8,210 was made on a loan that had been charged off in 2009.

During the second quarter of 2014, a participation loan formally restructured in 2009, and previously reported as a trouble debt restructuring, was paid in full.

During the third quarter of 2014, a recovery of \$25,052 was made on an operating loan that was charged off in 2013.

In 2010, the Association, through a purchased participation as a part of a lending group, acquired a small percentage ownership interest in an ethanol plant. In August 2014, the Association sold its equity interest in the ethanol plant. The total sales price of the Association's equity interest was \$1,400,400 and resulted in a gain on sale of \$877,350

### *Territory Conditions*

The local economy in our chartered territory is relatively strong. Real estate prices are stable and the land sales have continued to increase despite sagging ag-related commodities and petroleum prices and the lost income for people connected to those industries. The majority of the Association's new loans made during the past number of years have been to absentee landowners with diverse income sources looking for a place for a small agricultural operation or recreational use. As a result, the Association has a diversified portfolio that is not heavily dependent on agricultural income. Even those borrowers who are primarily agricultural producers typically have outside income from a spouse's employment, part-time jobs, investments, etc. The above is reflected in the Association's sound credit quality and small number of delinquencies.

During the second quarter of 2017, most of the state including the Association's territory experienced fair temperatures for late spring and early summer. Rainfall has been sporadic yet still average to above average in areas. This has kept pastures in fairly good shape, allowed hay production to continue and hasn't affected small grain harvesting. According to a USDA report at the end of June, all of

the Association's territory was out of any dry or drought category, along with 73% of the state. Many area lakes remain full or near capacity.

The USDA's report "Texas Crop Progress and Condition" for the last week of June 2017 reported 78 percent of cotton in good to fair condition. Corn was 81 percent in good to fair condition with silage harvest in full swing. Sorghum was reported as 82 percent in good to fair condition with 15 percent in excellent condition. Soybeans were in good shape with 72 percent good to fair condition and 24 percent in excellent condition. Wheat prices began increasing in May with news of heat and drought damaged crops in the Midwest. Prices had been in the low \$4 range until the news of expected crop losses pushed prices into the mid to upper \$5 range. This should help our territory wheat farmers that have been hurt by low prices created by high inventories after last year's harvest.

Cattle markets continued the trend upward through early June and then began declining. By the end of the second quarter most of the gains had diminished. Heavy selling in the drought stricken Dakotas have added to the downward pressure. Lower feed and petroleum costs have continued to help ease the stress to some degree.

Most of our borrowers continue to do well right now, but many remain cautious due to weakened commodity markets and the possible effect of lower oil prices on the local economies in our territory. Management realizes the impact the current commodity environment could potentially have on borrowers. We feel our portfolio is managed very well as operating loans are reviewed at least annually and in some cases more often. It is our belief that the PD ratings accurately reflect the risk level of the portfolio and no impairment pool for any specific commodity is necessary at this time.

### 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	\$ 3,308,170	100.0%	\$ 2,736,218	100.0%
Total	\$ 3,308,170	100.0%	\$ 2,736,218	100.0%

### Results of Operations:

The Association had net income of \$2,486,733 and \$4,703,871 for the three and six months ended June 30, 2017, as compared to net income of \$2,412,287 and \$4,722,414 for the same periods in 2016, reflecting an increase of 3.1 percent and decrease of 0.4 percent, respectively. Net interest income was \$3,689,698 and \$7,311,149 for the three and six months ended June 30, 2017, compared to \$3,524,828 and \$7,086,700 for the same periods in 2016.

	Six months ended:			
	June 30, 2017		June 30, 2016	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 488,502,392	\$ 11,343,739	\$ 483,368,132	\$ 10,732,021
Interest-bearing liabilities	391,564,331	4,032,590	387,210,838	3,645,321
Impact of capital	\$ 96,938,061		\$ 96,157,294	
Net interest income		\$ 7,311,149		\$ 7,086,700

  

	2017	2016
	Average Yield	Average Yield
Yield on loans	4.68%	4.46%
Cost of interest-bearing liabilities	2.07%	1.89%
Interest rate spread	2.61%	2.57%
Net interest income as a percentage of average earning assets	3.02%	2.95%

<b>Six months ended:</b>			
<b>June 30, 2017 vs. June 30, 2016</b>			
<b>Increase due to</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
Interest income - loans	<b>\$ 113,678</b>	<b>\$ 498,040</b>	<b>\$ 611,718</b>
Interest expense	<b>40,871</b>	<b>346,398</b>	<b>387,269</b>
Net interest income	<b>\$ 72,807</b>	<b>\$ 151,642</b>	<b>\$ 224,449</b>

Interest income for the three and six months ended June 30, 2017, increased by \$406,502 and \$611,718, or 7.6 and 5.7 percent respectively, from the same periods of 2016, primarily due to increases in average loan volume and an increase in yields on earning assets. Interest expense for the three and six months ended June 30, 2017, increased by \$241,632 and \$387,269, or 13.0 and 10.6 percent, from the same periods of 2016 due to increase in interest rates and in average debt volume. Average loan volume for the second quarter of 2017 was \$489,049,164, compared to \$486,567,533 in the second quarter of 2016. The average net interest rate spread on the loan portfolio for the second quarter of 2017 was 2.61 percent, compared to 2.57 percent in the second quarter of 2016.

The Association's return on average assets for the six months ended June 30, 2017, was 1.88 percent compared to 1.91 percent for the same period in 2016. The Association's return on average equity for the six months ended June 30, 2017, was 8.93 percent, compared to 9.21 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.

	<b>June 30, 2017</b>	December 31, 2016
Note payable to the Bank	<b>\$ 398,627,794</b>	\$ 391,352,088
Accrued interest on note payable	<b>701,073</b>	641,184
Total	<b>\$ 399,328,867</b>	\$ 391,993,272

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 \$398,627,794 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 2.18 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 GFA. 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 funding needs as evidenced by the increase in total assets from 2016 to 2017. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$93,651,405 at June 30, 2017. The maximum amount the Association may borrow from the Bank as of June 30, 2017, was \$496,388,562 as defined by the GFA. The indebtedness continues in effect until the expiration date of the GFA, 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 \$4,713,401 at June 30, 2017, compared to December 31, 2016. The Association's debt as a percentage of members' equity was 3.71:1 as of June 30, 2017, compared to 3.87:1 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 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 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, and early application was permitted. 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 Central Texas Farm Credit, ACA more fully describe the Association's relationship with the Bank.

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

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Central Texas Farm Credit, ACA, P.O. Box 3200, Early, Texas 76803 or calling (325) 643-5563. The annual and quarterly stockholder reports for the Association are also available on its website at [www.centraltexasfarmcredit.com](http://www.centraltexasfarmcredit.com). Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [Keith.Prater@farmcreditbank.com](mailto:Keith.Prater@farmcreditbank.com).



**CENTRAL TEXAS FARM CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>June 30, 2017 (unaudited)</b>	<b>December 31, 2016</b>
<b><u>ASSETS</u></b>		
Cash	\$ 492,022	\$ 1,387,052
Loans	493,684,595	489,350,168
Less: allowance for loan losses	1,171,103	1,067,401
Net loans	492,513,492	488,282,767
Accrued interest receivable	4,508,744	4,524,649
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	7,755,675	7,755,675
Other	1,801,298	54,449
Premises and equipment, net	3,561,194	3,585,408
Other assets	955,381	193,918
Total assets	<u>\$ 511,587,806</u>	<u>\$ 505,783,918</u>
<b><u>LIABILITIES</u></b>		
Note payable to the Farm Credit Bank of Texas	\$ 398,627,794	\$ 391,352,088
Accrued interest payable	701,073	641,184
Drafts outstanding	501,466	551,735
Dividends payable	-	6,000,000
Other liabilities	3,208,448	3,403,287
Total liabilities	<u>403,038,781</u>	<u>401,948,294</u>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	2,300,265	2,283,345
Unallocated retained earnings	106,444,721	101,740,850
Accumulated other comprehensive loss	(195,961)	(188,571)
Total members' equity	<u>108,549,025</u>	<u>103,835,624</u>
Total liabilities and members' equity	<u>\$ 511,587,806</u>	<u>\$ 505,783,918</u>

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 5,785,327	\$ 5,378,825	\$ 11,343,739	\$ 10,732,021
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Farm Credit Bank of Texas	2,095,629	1,853,997	4,032,590	3,645,321
Net interest income	3,689,698	3,524,828	7,311,149	7,086,700
<b><u>PROVISION FOR LOAN LOSSES (LOAN LOSS REVERSAL)</u></b>				
Net interest income after provision for loan losses (loan loss reversal)	(1,569)	87,515	156,381	127,282
<b><u>NONINTEREST INCOME</u></b>				
Income from the Farm Credit Bank of Texas:				
Patronage income	336,501	326,250	666,721	644,318
Loan fees	35,646	49,269	66,766	85,640
Financially related services income	1,533	1,440	4,307	4,568
Other noninterest income	15,961	15,260	18,228	15,260
Total noninterest income	389,641	392,219	756,022	749,786
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	944,528	865,098	1,913,913	1,756,075
Directors' expense	40,201	34,591	79,584	67,833
Purchased services	102,983	41,966	149,323	88,854
Travel	60,245	57,494	97,804	102,507
Occupancy and equipment	91,973	76,115	181,720	139,514
Communications	30,769	28,800	58,384	56,011
Advertising	27,738	76,106	71,236	139,570
Public and member relations	82,881	36,507	171,587	101,589
Supervisory and exam expense	42,706	-	94,768	40,871
Insurance Fund premiums	136,666	144,528	312,358	327,294
Loss on sale of premises and equipment, net	135	-	135	-
Other noninterest expense	33,350	56,040	76,107	166,672
Total noninterest expenses	1,594,175	1,417,245	3,206,919	2,986,790
<b>NET INCOME</b>	<b>2,486,733</b>	<b>2,412,287</b>	<b>4,703,871</b>	<b>4,722,414</b>
Other comprehensive loss:				
Change in postretirement benefit plans	(3,695)	(2,493)	(7,390)	(4,986)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 2,483,038</b>	<b>\$ 2,409,794</b>	<b>\$ 4,696,481</b>	<b>\$ 4,717,428</b>

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

CENTRAL TEXAS FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock / Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total Members' Equity</u>
Balance at December 31, 2015	\$ 2,232,325	\$ 98,715,418	\$ (197,886)	\$ 100,749,857
Comprehensive income	-	4,722,414	(4,986)	4,717,428
Capital stock/participation certificates and allocated retained earnings issued	156,500	-	-	156,500
Capital stock/participation certificates and allocated retained earnings retired	(143,085)	-	-	(143,085)
Balance at June 30, 2016	<u>\$ 2,245,740</u>	<u>\$ 103,437,832</u>	<u>\$ (202,872)</u>	<u>\$ 105,480,700</u>
Balance at December 31, 2016	\$ 2,283,345	\$ 101,740,850	\$ (188,571)	\$ 103,835,624
Comprehensive income	-	4,703,871	(7,390)	4,696,481
Capital stock/participation certificates and allocated retained earnings issued	192,655	-	-	192,655
Capital stock/participation certificates and allocated retained earnings retired	(175,735)	-	-	(175,735)
<b>Balance at June 30, 2017</b>	<b><u>\$ 2,300,265</u></b>	<b><u>\$ 106,444,721</u></b>	<b><u>\$ (195,961)</u></b>	<b><u>\$ 108,549,025</u></b>

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

**CENTRAL TEXAS FARM CREDIT, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

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

The Central Texas Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Baylor, Brown, Callahan, Coke, Coleman, Comanche, Concho, Haskell, Irion, Jones, Knox, McCulloch, Menard, Mills, Reagan, Runnels, San Saba, Sterling, and Tom Green. The Association is a lending institution of the Farm Credit System (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 consolidated 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 Farm Credit Association (FCA), associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2016, as contained in the 2016 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. Descriptions of the significant accounting policies are included in the 2016 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

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, and early application was permitted. 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 consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended June 30, 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	<b>June 30, 2017</b>	December 31, 2016
	<b>Amount</b>	Amount
Production agriculture:		
Real estate mortgage	<b>\$ 346,440,223</b>	\$ 339,804,096
Production and intermediate term	<b>61,187,785</b>	64,552,843
Agribusiness:		
Processing and marketing	<b>42,053,315</b>	44,048,379
Farm-related business	<b>14,032,470</b>	11,086,417
Loans to cooperatives	<b>2,934,645</b>	3,155,415
Communication	<b>13,934,618</b>	13,257,859
Energy	<b>11,979,179</b>	12,502,093
Rural residential real estate	<b>1,084,463</b>	943,066
Water and waste water	<b>37,897</b>	-
Total	<b><u>\$ 493,684,595</u></b>	<b><u>\$ 489,350,168</u></b>

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	\$ 44,534,291	\$ -	\$ -	\$ -	\$ 44,534,291
Communication	13,934,618	-	-	-	13,934,618	-
Energy	11,979,179	-	-	-	11,979,179	-
Real estate mortgage	10,348,266	13,865,926	-	-	10,348,266	13,865,926
Production and intermediate term	9,244,109	1,734,726	-	-	9,244,109	1,734,726
<b>Total</b>	<b>\$ 90,040,463</b>	<b>\$ 15,600,652</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 90,040,463</b>	<b>\$ 15,600,652</b>

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:

	<b>June 30, 2017</b>	December 31, 2016
<b>Nonaccrual loans:</b>		
Real estate mortgage	<b>\$ 1,896,111</b>	\$ 1,389,744
Production and intermediate term	<b>1,412,059</b>	1,346,475
Total nonaccrual loans	<b>3,308,170</b>	2,736,219
 Total nonperforming loans	 <b>3,308,170</b>	 2,736,219
Total nonperforming assets	<b>\$ 3,308,170</b>	\$ 2,736,219

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:

	<b>June 30, 2017</b>	December 31, 2016
Real estate mortgage		
Acceptable	<b>98.2</b> %	98.3 %
OAEM	<b>0.8</b>	1.2
Substandard/doubtful	<b>1.0</b>	0.5
	<b>100.0</b>	100.0
Production and intermediate term		
Acceptable	<b>89.4</b>	91.3
OAEM	<b>7.4</b>	5.5
Substandard/doubtful	<b>3.2</b>	3.2
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Communication		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Energy		
Acceptable	<b>78.3</b>	78.8
OAEM	<b>9.1</b>	21.2
Substandard/doubtful	<b>12.6</b>	-
	<b>100.0</b>	100.0
Rural residential real estate		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Water and waste water		
Acceptable	<b>100.0</b>	-
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	-
Total loans		
Acceptable	<b>96.9</b>	97.1
OAEM	<b>1.7</b>	2.1
Substandard/doubtful	<b>1.4</b>	0.8
	<b>100.0</b> %	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	\$ 402,957	\$ 931,699	\$ 1,334,656	\$ 348,691,444	\$ 350,026,100	\$ -
Production and intermediate term	360,711	1,412,059	1,772,770	60,260,961	62,033,731	-
Processing and marketing	-	-	-	42,096,299	42,096,299	-
Farm-related business	-	-	-	14,039,469	14,039,469	-
Communication	-	-	-	13,943,598	13,943,598	-
Energy	-	-	-	11,993,350	11,993,350	-
Loans to cooperatives	-	-	-	2,935,483	2,935,483	-
Rural residential real estate	-	-	-	1,086,982	1,086,982	-
Water and waste water	-	-	-	38,327	38,327	-
<b>Total</b>	<b>\$ 763,668</b>	<b>\$ 2,343,758</b>	<b>\$ 3,107,426</b>	<b>\$ 495,085,913</b>	<b>\$ 498,193,339</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	\$ 2,913,223	\$ 728,329	\$ 3,641,552	\$ 339,737,848	\$ 343,379,400	\$ -
Production and intermediate term	303,987	1,346,475	1,650,462	63,733,303	65,383,765	-
Processing and marketing	-	-	-	44,135,294	44,135,294	-
Communication	-	-	-	13,263,801	13,263,801	-
Energy	-	-	-	12,520,147	12,520,147	-
Farm-related business	-	-	-	11,091,179	11,091,179	-
Loans to cooperatives	-	-	-	3,156,013	3,156,013	-
Rural residential real estate	-	-	-	945,218	945,218	-
<b>Total</b>	<b>\$ 3,217,210</b>	<b>\$ 2,074,804</b>	<b>\$ 5,292,014</b>	<b>\$ 488,582,803</b>	<b>\$ 493,874,817</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 June 30, 2017, the Association had no troubled debt restructured loans. In restructuring where principal is forgiven, the amount of forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest).

The predominant form of concession granted for troubled debt restructuring is extension of the term. Other types of modifications include 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 <sup>a</sup>	Related Allowance	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Production and intermediate term	-	-	-	-	-	-
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 1,896,111	\$ 1,969,670	\$ -	\$ 1,389,744	\$ 1,389,744	\$ -
Production and intermediate term	1,412,059	2,441,231	-	1,346,475	1,346,475	-
Total	\$ 3,308,170	\$ 4,410,901	\$ -	\$ 2,736,219	\$ 2,736,219	\$ -
Total impaired loans:						
Real estate mortgage	\$ 1,896,111	\$ 1,969,670	\$ -	\$ 1,389,744	\$ 1,389,744	\$ -
Production and intermediate term	1,412,059	2,441,231	-	1,346,475	1,346,475	-
Total	\$ 3,308,170	\$ 4,410,901	\$ -	\$ 2,736,219	\$ 2,736,219	\$ -

<sup>a</sup> 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	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Production and intermediate term	-	-	-	-	-	-	-	-
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans with no related allowance for credit losses:								
Production and intermediate term	\$ 1,374,284	\$ -	\$ -	\$ -	\$ 1,368,669	\$ -	\$ -	\$ -
Real estate mortgage	1,256,478	8,159	1,152,926	-	1,056,636	-	840,122	-
Total	\$ 2,630,762	\$ 8,159	\$ 1,152,926	\$ -	\$ 2,425,305	\$ -	\$ 840,122	\$ -
Total impaired loans:								
Production and intermediate term	\$ 1,374,284	\$ -	\$ -	\$ -	\$ 1,368,669	\$ -	\$ -	\$ -
Real estate mortgage	1,256,478	8,159	1,152,926	-	1,056,636	-	840,122	-
Total	\$ 2,630,762	\$ 8,159	\$ 1,152,926	\$ -	\$ 2,425,305	\$ -	\$ 840,122	\$ -

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	Water and Waste Water	Rural Residential Real Estate	Total
<b>Allowance for Credit Losses:</b>								
Balance at								
March 31, 2017	\$ 209,244	\$ 325,753	\$ 255,447	\$ 87,996	\$ 337,031	\$ -	\$ 385	\$ 1,215,856
Charge-offs	(52,508)	-	-	-	-	-	-	(52,508)
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	85,528	(34,143)	(10,137)	(29,728)	(8,073)	(6,038)	1,022	(1,569)
Other	111	8,134	(9,712)	5,494	1	6,046	(750)	9,324
Balance at								
June 30, 2017	\$ 242,375	\$ 299,744	\$ 235,598	\$ 63,762	\$ 328,959	\$ 8	\$ 657	\$ 1,171,103
Balance at								
December 31, 2016	\$ 197,602	\$ 337,170	\$ 246,053	\$ 110,077	\$ 176,128	\$ -	\$ 371	\$ 1,067,401
Charge-offs	(52,508)	-	-	-	-	-	-	(52,508)
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	97,243	(38,004)	(20,225)	(55,253)	171,606	8	1,006	156,381
Other	38	578	9,770	8,938	(18,775)	-	(720)	(171)
Balance at								
June 30, 2017	\$ 242,375	\$ 299,744	\$ 235,598	\$ 63,762	\$ 328,959	\$ 8	\$ 657	\$ 1,171,103
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	242,375	299,744	235,598	63,762	328,959	8	657	1,171,103
Balance at								
June 30, 2017	\$ 242,375	\$ 299,744	\$ 235,598	\$ 63,762	\$ 328,959	\$ 8	\$ 657	\$ 1,171,103
Balance at								
March 31, 2016	\$ 196,084	\$ 235,267	\$ 267,766	\$ 108,673	\$ 158,314	\$ 10,564	\$ 1,376	\$ 978,044
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	(5,978)	18,595	49,361	3,963	21,534	(296)	336	87,515
Other	816	(2,396)	(10,629)	(1,011)	(132)	(764)	(102)	(14,218)
Balance at								
June 30, 2016	\$ 190,922	\$ 251,466	\$ 306,498	\$ 111,625	\$ 179,716	\$ 9,504	\$ 1,610	\$ 1,051,341
Balance at								
December 31, 2015	\$ 215,062	\$ 218,497	\$ 252,003	\$ 104,613	\$ 161,844	\$ 10,607	\$ 1,601	\$ 964,227
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	(24,956)	65,382	62,571	8,106	16,421	(353)	111	127,282
Other	816	(32,413)	(8,076)	(1,094)	1,451	(750)	(102)	(40,168)
Balance at								
June 30, 2016	\$ 190,922	\$ 251,466	\$ 306,498	\$ 111,625	\$ 179,716	\$ 9,504	\$ 1,610	\$ 1,051,341
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	190,922	251,466	306,498	111,625	179,716	9,504	1,610	1,051,341
Balance at								
June 30, 2016	\$ 190,922	\$ 251,466	\$ 306,498	\$ 111,625	\$ 179,716	\$ 9,504	\$ 1,610	\$ 1,051,341
	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communication	Energy	Water and Waste Water	Rural Residential Real Estate	Total
<b>Recorded Investments in Loans Outstanding:</b>								
Ending Balance at								
June 30, 2017	\$ 350,026,100	\$ 62,033,731	\$ 59,071,251	\$ 13,943,598	\$ 11,993,350	\$ 38,327	\$ 1,086,982	\$ 498,193,339
Individually evaluated for impairment	\$ 1,896,111	\$ 1,412,059	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,308,170
Collectively evaluated for impairment	\$ 348,129,989	\$ 60,621,672	\$ 59,071,251	\$ 13,943,598	\$ 11,993,350	\$ 38,327	\$ 1,086,982	\$ 494,885,169
Ending Balance at								
June 30, 2016	\$ 342,940,360	\$ 53,343,894	\$ 67,350,588	\$ 14,127,153	\$ 13,925,477	\$ 1,267,184	\$ 2,179,079	\$ 495,133,735
Individually evaluated for impairment	\$ 1,153,955	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,153,955
Collectively evaluated for impairment	\$ 341,786,405	\$ 53,343,893	\$ 67,350,589	\$ 14,127,153	\$ 13,925,477	\$ 1,267,184	\$ 2,179,079	\$ 493,979,780

### 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:

	<b>Regulatory Minimums</b>	<b>Conservation Buffer</b>	<b>Total</b>	<b>As of June 30, 2017</b>
<b>Risk-adjusted:</b>				
Common equity tier 1 ratio	4.50%	2.50%	7.00%	18.64%
Tier 1 capital ratio	6.00%	2.50%	8.50%	18.64%
Total capital ratio	8.00%	2.50%	10.50%	18.90%
Permanent capital ratio	7.00%	0.00%	7.00%	18.68%
<b>Non-risk-adjusted:</b>				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	19.91%
UREE leverage ratio	1.50%	0.00%	1.50%	21.00%

\*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:

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Regulatory capital ratio	Permanent capital ratio
<b>Numerator:</b>				
Unallocated retained earnings	104,872,295	104,872,295	104,872,295	104,872,295
Paid-in capital	-	-	-	-
<b>Common Cooperative Equities:</b>				
Statutory minimum purchased borrower stock	2,297,423	2,297,423	2,297,423	2,297,423
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	-	-	-	-
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			1,431,061	
<b>Regulatory Adjustments and Deductions:</b>				
Amount of allocated investments in other System institutions	(7,755,675)	(7,755,675)	(7,755,675)	(7,755,675)
Other regulatory required deductions	-	-	-	-
<b>Total Numerator</b>	<b>99,414,043</b>	<b>99,414,043</b>	<b>100,845,104</b>	<b>99,414,043</b>
<b>Denominator:</b>				
Risk-adjusted assets excluding allowance	541,191,193	541,191,193	541,191,193	541,191,193
<b>Regulatory Adjustments and Deductions:</b>				
Regulatory deductions included in total capital	(7,755,675)	(7,755,675)	(7,755,675)	(7,755,675)
Allowance for loan losses				(1,209,143)
<b>Total Denominator</b>	<b>533,435,518</b>	<b>533,435,518</b>	<b>533,435,518</b>	<b>532,226,375</b>

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

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
<b>Numerator:</b>		
Unallocated retained earnings	104,872,295	104,872,295
Paid-in capital	-	-
<b>Common Cooperative Equities:</b>		
Statutory minimum purchased borrower stock	2,297,423	-
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	-	-
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		
<b>Regulatory Adjustments and Deductions:</b>		
Amount of allocated investments in other System institutions	(7,755,675)	-
Other regulatory required deductions	-	-
<b>Total Numerator</b>	<b>99,414,043</b>	<b>104,872,295</b>
<b>Denominator:</b>		
Total Assets	507,175,164	507,175,164
<b>Regulatory Adjustments and Deductions:</b>		
Regulatory deductions included in tier 1 capital	(7,755,675)	(7,755,675)
<b>Total Denominator</b>	<b>499,419,489</b>	<b>499,419,489</b>

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

<b>June 30, 2017</b>	<b>Net of Tax</b>
<b>Nonpension postretirement benefits</b>	<b>\$ (195,961)</b>
<b>Total</b>	<b>\$ (195,961)</b>
June 30, 2016	Net of Tax
Nonpension postretirement benefits	\$ (202,872)
Total	\$ (202,872)

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

	<u>2017</u>	<u>2016</u>
Accumulated other comprehensive loss at January 1	\$ (188,571)	\$ (197,886)
Amortization of prior service credit included in salaries and employee benefits	(8,994)	(4,986)
Amortization of actuarial loss included in salaries and employee benefits	1,604	-
Other comprehensive loss, net of tax	(7,390)	(4,986)
Accumulated other comprehensive loss at June 30	<u>\$ (195,961)</u>	<u>\$ (202,872)</u>

#### **NOTE 4 — INCOME TAXES:**

Central Texas Farm Credit, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Central Texas Farm Credit, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Central Texas Farm Credit, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. The Association's valuation allowance was \$1,165,727 as of the quarter ended June 30, 2017, for no available tax benefit as of that point in time.

#### **NOTE 5 — FAIR VALUE MEASUREMENTS:**

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 13 to the 2016 Annual Report to Stockholders for a more complete description.

There were no assets and liabilities measured at fair value on a nonrecurring basis as of June 30, 2017, or at December 31, 2016.

#### **Valuation Techniques**

As more fully discussed in Note 2 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.

### *Loans Evaluated for Impairment*

For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying real estate collateral since the loans were collateral-dependent. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, a majority of these loans have fair value measurements that fall within Level 3 of the fair value hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

### *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.

### *Cash*

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

## **NOTE 6 — 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	\$ 25,781	\$ 26,897
Interest cost	45,242	43,889
Amortization of prior service credits	(8,994)	(8,993)
Amortization of net actuarial loss	1,604	4,007
Net periodic benefit cost	<u>\$ 63,633</u>	<u>\$ 65,800</u>

The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2017, was \$2,036,919 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, \$175,727 of contributions have been made. The Association presently anticipates contributing an additional \$175,726, to fund the defined benefit pension plan in 2017 for a total of \$351,453.

## **NOTE 7 — COMMITMENTS AND CONTINGENT LIABILITIES:**

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

## **NOTE 8 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through August 8, 2017, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of August 8, 2017.