

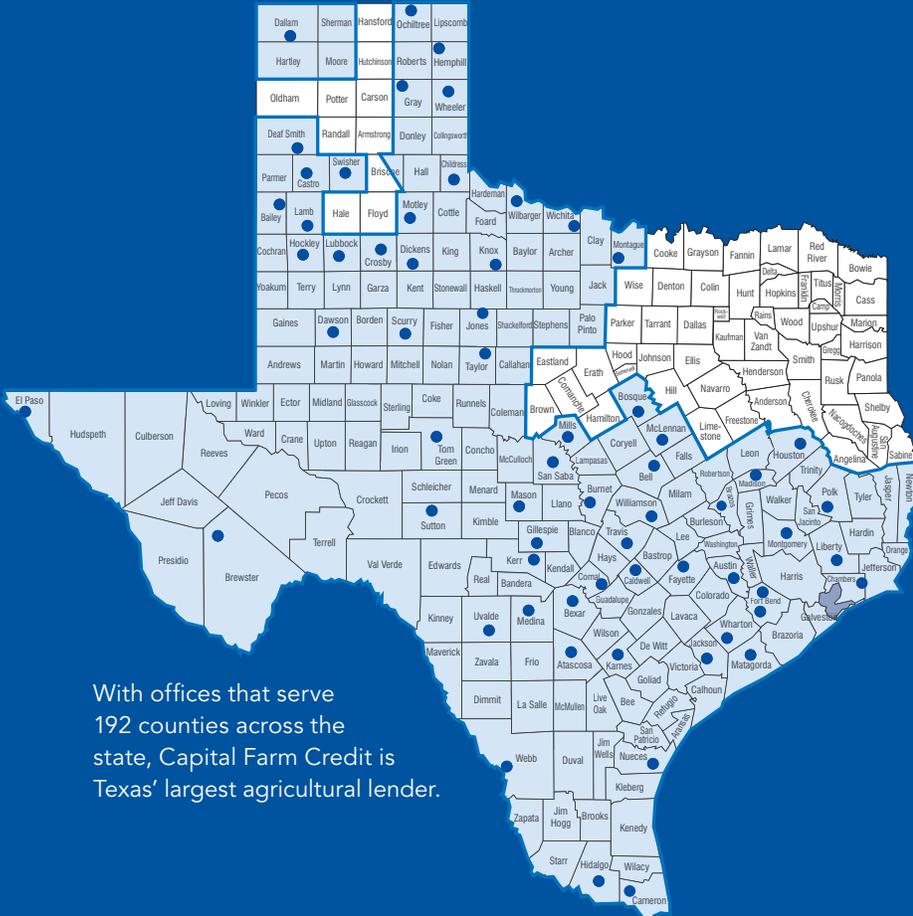
Partnership that really pays

2018 Annual Report



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With offices that serve 192 counties across the state, Capital Farm Credit is Texas’ largest agricultural lender.



Together we're better.



As Our Business Grows, Customers Reap the Dividends

At Capital Farm Credit, our business is creating opportunity.

We provide the loans and financial services farmers and ranchers need to get their start and achieve success. We contribute to vibrant rural communities by financing farm-related businesses and essential infrastructure. And we help bring the rural way of life within reach by financing land and homes.

In 2018, we earned a record \$189.9 million in net income, a 12.5 percent increase year over year. Outstanding loan volume grew to a record \$7.4 billion. We also finished the year with excellent credit quality, reflecting the strength of our portfolio and the economic health of the Lone Star State.

Agriculture and rural communities need steady access to credit no matter what conditions a given year brings. Thanks to our diversification, financial capacity and commitment to our members, we stood ready to meet that need.

Giving Back to Our Members

The better we do financially, the more value we can bring our customers, who own our lending cooperative and share in the earnings through our patron-

age dividend program. This benefit of doing business with Capital Farm Credit effectively lowers our members' borrowing cost.

In the past 10 years, we have distributed more than \$800 million in patronage dividends to our members. The total in 2018 came to \$127.5 million: \$77.5 million of our 2017 earnings, and \$50 million that we had allocated to borrowers in 2011 and retained as capital to fund our cooperative's growth.

Based on our solid financial results in 2018, our board of directors has voted to return 97.1 percent of the year's earnings to our members. We will distribute close to 30,000 patronage checks totaling \$87.5 million this spring — our highest cash distribution yet — and we have set aside an additional \$96.8 million in allocated equities for our members until it is eligible for disbursement.

Enhancing Our Products and Services

One thing that sets Capital Farm Credit apart from most lenders is our mission to help agriculture and rural communities thrive.

Our financing provides a reliable source of capital for borrowers across the Texas countryside, including farmers and ranchers of all ages and experience levels, agribusinesses, landowners and rural homeowners. We offer added security through a variety of insurance products.

In 2018, we continued to invest in our people, products and processes to provide superior service for our members.

We enhanced our expertise through training and hiring, and now have more than 500 employees spanning three-quarters of Texas. We also shifted more administrative work from our credit offices to our back office, giving our lending staff more time to focus on their customers.

Capital Farm Credit customers encounter a consistent lending experience from the Trans-Pecos to the Piney Woods, and from the Lower Rio Grande Valley to the High Plains. They also get fast, efficient financing. In 2018 we increased the loan amounts available through AgFAST, a credit-scoring program with quick loan decisions.



Involved in the Community

Giving Back to Communities

Carrying out our mission goes beyond making loans.

We help the next generation succeed in agriculture by supporting ag education, awarding scholarships, sponsoring leadership programs, and hosting informative seminars for farmers and ranchers. We foster retail outlets for small ag producers by awarding grants to farmers markets. We also support causes that are important to our communities through donations and hands-on volunteering.

Last year for the first time, we awarded close to \$30,000 in grants for FFA and 4-H projects that made local communities better places to live.

At Capital Farm Credit, we are always looking for new ways to make a difference — whether that's expanding our community outreach or providing products and services that make it easier for customers to do business with us.

Our continued growth in 2018 enables us to put our strength and stability to work for agriculture and rural communities in the times ahead. ★



In 2018, we awarded our first Community Outreach Grants to FFA chapters and 4-H clubs that are making a positive difference in their communities. Grants totaling nearly \$30,000 supported 27 worthy projects, including small-town welcome signs, cooking classes for disadvantaged youths, and many community gardens — such as this one in Menard County.



One way we help young, beginning and small farmers and ranchers get off to a strong start is by hosting free educational seminars. Our Next Generation conferences provide valuable information about crop insurance, government programs, raising capital and other topics.

Capital Farm Credit supports all kinds of agriculture, from very small ag operations to large agribusinesses. In 2018, we gave \$1,000 grants and 200 reusable shopping bags to dozens of farmers markets across the state, including the Bellville Farmers Market.



We invested in the future of rural communities and agriculture by awarding more than \$100,000 in scholarships to high school and university students. McKaile Geisler, right, a loan officer in Levelland, presented a \$1,000 scholarship to Ropes High School student Riley Reep.

Each year, we send promising young members to the Farm Credit Young Leaders Program in Washington, D.C., and New York City. At a Wall Street brokerage firm last year, Jennifer and Aaron Martinka, far right, of Milam County learned how the sale of highly rated Farm Credit bonds provides steady funding for agriculture and rural communities.



CEO MESSAGE

Dear Stockholder:

At Capital Farm Credit, carrying out our mission to support agriculture and rural communities has been rewarded by growth for several years running. Earnings and assets doubled in just over a dozen years, reaching a record \$189.9 million in net income and \$7.6 billion in assets at the end of 2018.

Because we are a borrower-owned cooperative, our capital belongs to our customers, who share in our success through our patronage dividend program. We declared \$184.3 million in patronage based on our 2018 earnings, and will distribute the first 47.5 percent to our members in cash this spring, effectively lowering their borrowing costs.

We strive to deliver as much value to our customers as possible, and have embarked on several operational initiatives in the past five years to enhance and streamline how we do things across our large territory.

The work continued behind the scenes in 2018 with hiring, training, redefining some job roles and centralizing more loan processing. We now clearly see the benefits in our efficiency, consistency, strong control environment and customer outreach.

What borrowers will notice is the personal service and custom-tailored financing we provide a diverse customer base. Diversification in our loan portfolio also helps us stay strong so we can be there when members need us most.

While our business benefited from Texas' strong economy, for farmers and ranchers contending with



low commodity prices and adverse weather, 2018 was one of those challenging times. Capital Farm Credit understands the cyclical nature of agriculture, and we stand by our commitment to be a source of competitive, flexible financing.

Last fall, we helped our members advocate for a strong safety net for agriculture by participating in the national Farm Credit Council's Take Action campaign. We're proud to report that our members sent hundreds of letters in support of the farm bill to their congressional representatives via text message. The bill that was signed into law in December gives ag producers much more certainty going forward.

We also are helping elected officials better understand agriculture by inviting them to our customer appreciation events, where they can visit with constituents and learn about the important role Farm Credit plays in their communities.

Our improved efficiency frees us to play an even bigger role in the years ahead — and it was the future that got the most attention in 2018. We have been working hand in hand with Farm Credit Bank of Texas, our funding bank, on technology that will take our service to a new level and give customers convenient new ways to transact business with us. Moving toward that goal will continue to be our main focus in 2019.

It is our pleasure to celebrate another successful year with you, and we look forward to our continued partnership.

Ben R. Novosad

Ben R. Novosad
Chief Executive Officer

REPORT OF MANAGEMENT

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

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

The Audit Committee of the board of directors has oversight responsibility for the association's systems of internal controls and financial reporting. The Audit Committee consults regularly with management, internal auditors and internal credit reviewers and meets periodically with the independent auditors to review the scope and results of their work. The independent auditors, internal auditors and internal credit reviewers have direct access to the Audit Committee.

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



Ben R. Novosad, Chief Executive Officer
March 13, 2019



John Malazzo, Chairman, Board of Directors
March 13, 2019



Don Vandevanter, Chief Financial Officer
March 13, 2019

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The association's chief executive officer and chief financial officer are responsible for establishing and maintaining adequate internal control over financial reporting for the association's consolidated financial statements. For purposes of this report, "internal control over financial reporting" is defined as a process (1) designed by, or under the supervision of the association's principal executives and principal financial officers, or persons performing similar functions (2) effected by its board of directors, management and other personnel and (3) monitored for adherence to by the board's Audit Committee through the association's internal audit staff and internal credit reviewers to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the association and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the association's assets that could have a material effect on its consolidated financial statements.

The association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2018. In making the assessment, management used the framework in Internal Control — Integrated Framework, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the association concluded that as of December 31, 2018, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the association determined that there were no material weaknesses in internal control over financial reporting as of December 31, 2018. A review of the assessment performed was reported to the association's Audit Committee.



Ben R. Novosad, Chief Executive Officer
March 13, 2019



Don Vandevanter, Chief Financial Officer
March 13, 2019

REPORT OF AUDIT COMMITTEE

The Audit Committee (committee) is composed of six directors of Capital Farm Credit, ACA (the association). In 2018, the committee met five times and conducted business by conference call on one occasion. The committee oversees the scope of the association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The committee's approved responsibilities are described more fully in the Audit Committee Charter, which is available on request or on the association's website. The committee approved the appointment of PricewaterhouseCoopers LLP (PwC) for 2018.

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

In this context, the committee reviewed and discussed the association's audited consolidated financial statements for the year ended December 31, 2018 (audited consolidated financial statements), with management and PwC. The committee also reviews with PwC the matters required to be discussed by authoritative guidance, "The Auditor's Communication With Those Charged With Governance," and both PwC and the association's internal auditors directly provide reports on significant matters to the committee.

The committee discussed with PwC its independence from Capital Farm Credit, ACA. The committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining the independent accountant's independence. The committee has discussed with management and PwC other matters and received assurances from them as the committee deemed appropriate.

Based on the foregoing review and discussions and relying thereon, the committee recommended that the board of directors include the audited consolidated financial statements in the association's Annual Report to Stockholders for the year ended December 31, 2018.



Kenton Kimball, Chairman

Additional Members: Richard Counts
 Terry McAlister
 Carl Sample
 Steve Stevens
 Joe David Yates

March 13, 2019

CAPITAL FARM CREDIT, ACA
FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
	2018	2017	2016	2015	2014
<u>Balance Sheet Data</u>					
<u>Assets</u>					
Loans	\$ 7,393,006	\$ 7,245,367	\$ 6,927,965	\$ 6,483,896	\$ 5,886,775
Less: Allowance for losses	(25,495)	(29,450)	(30,287)	(23,328)	(15,773)
Net Loans	<u>7,367,511</u>	<u>7,215,917</u>	<u>6,897,678</u>	<u>6,460,568</u>	<u>5,871,002</u>
Investment -- held-to-maturity	4,388	5,566	6,670	8,098	11,474
Investment in and receivable from the Bank:	147,288	133,710	127,298	114,730	102,671
Other property owned, net	972	3,989	2,634	1,109	3,841
Other assets	119,297	111,475	101,884	92,355	96,739
Total assets	<u>\$ 7,639,456</u>	<u>\$ 7,470,657</u>	<u>\$ 7,136,164</u>	<u>\$ 6,676,860</u>	<u>\$ 6,085,727</u>
<u>Liabilities</u>					
Obligations with maturities of one year or less	\$ 168,172	\$ 154,392	\$ 129,800	\$ 126,868	\$ 135,084
Obligations with maturities greater than one year	6,239,046	6,140,228	5,882,830	5,483,613	4,930,411
Total liabilities	<u>6,407,218</u>	<u>6,294,620</u>	<u>6,012,630</u>	<u>5,610,481</u>	<u>5,065,495</u>
<u>Members' Equity</u>					
Capital stock and participation certificates	25,804	25,519	25,049	24,419	23,417
Non-qualified allocated retained earnings	624,839	578,054	528,533	487,489	446,477
Unallocated retained earnings	581,674	576,158	571,198	555,052	553,366
Accumulated other comprehensive (loss) income	(79)	(3,694)	(1,246)	(581)	(3,028)
Total members' equity	<u>1,232,238</u>	<u>1,176,037</u>	<u>1,123,534</u>	<u>1,066,379</u>	<u>1,020,232</u>
Total liabilities and members' equity	<u>\$ 7,639,456</u>	<u>\$ 7,470,657</u>	<u>\$ 7,136,164</u>	<u>\$ 6,676,860</u>	<u>\$ 6,085,727</u>
Year Ended December 31,					
<u>Statement of Income Data</u>					
Net interest income	\$ 234,723	\$ 227,346	\$ 215,137	\$ 202,715	\$ 186,754
Reversal of (Provision for) credit losses	3,469	(2,315)	(7,361)	(3,465)	3,019
Income from the Bank	35,041	29,029	27,392	23,765	21,960
Other noninterest income	15,293	10,943	9,221	8,478	11,226
Noninterest expense	(98,676)	(96,260)	(93,235)	(92,180)	(78,867)
Benefit from (Provision for) income taxes	1	(7)	(8)	(11)	(9)
Net income	<u>\$ 189,851</u>	<u>\$ 168,736</u>	<u>\$ 151,146</u>	<u>\$ 139,302</u>	<u>\$ 144,083</u>
<u>Key Financial Ratios for the Year</u>					
Return on average assets	2.5%	2.3%	2.2%	2.2%	2.5%
Return on average members' equity	15.8%	14.7%	13.1%	13.5%	14.9%
Net interest margin as a percentage of average earning assets	3.2%	3.2%	3.2%	3.3%	3.3%
Net charge-offs (recoveries) as a percentage of average loans	0.0%	0.0%	0.0%	-0.1%	0.0%

CAPITAL FARM CREDIT, ACA
FIVE-YEAR SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA
(unaudited)
(dollars in thousands)

	December 31,				
	2018	2017	2016	2015	2014
<u>Key Financial Ratios at Year End *</u>					
Members' equity as a percentage of total assets	16.1%	15.7%	15.7%	16.0%	16.8%
Debt as a percentage of members' equity	520.0%	535.2%	535.2%	526.1%	496.5%
Allowance for loan losses as a percentage of loans	0.3%	0.4%	0.4%	0.4%	0.3%
Common Equity tier 1 ratio	14.3%	13.4%	n/a	n/a	n/a
Tier 1 capital ratio	14.3%	13.4%	n/a	n/a	n/a
Total capital ratio	15.1%	15.0%	n/a	n/a	n/a
Permanent capital ratio	14.8%	14.7%	14.6%	14.8%	16.3%
Tier 1 leverage ratio	14.8%	13.9%	n/a	n/a	n/a
UREE leverage ratio	9.5%	9.5%	n/a	n/a	n/a
Total surplus ratio	n/a	n/a	14.4%	14.5%	16.0%
Core surplus ratio	n/a	n/a	14.4%	14.5%	16.0%
<u>Net Income Distribution/Allocation</u>					
Cash patronage paid	\$ 77,506	\$ 57,170	\$ 56,746	\$ 71,980	\$ 65,477
Cash retirement of nonqualified written notice of allocation	50,000	36,785	36,783	39,867	-
Nonqualified notices of allocation	96,787	86,341	77,830	80,885	70,070

*Effective January 1, 2017 the Farm Credit Administration implemented new capital ratios. The association's ratios remained well above the regulatory minimums, including the conservation and leverage buffers at December 31, 2018. For more information, see Note 10 in the accompanying consolidated financial statements, "Members Equity" included in this annual report.

**MANAGEMENT’S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(ALL DOLLAR AMOUNTS IN THOUSANDS)**

The following commentary explains management’s assessment of the principal aspects of the consolidated financial condition and results of operations of Capital Farm Credit, ACA, including its wholly-owned subsidiaries, Capital Farm Credit, PCA and Capital Farm Credit, FLCA (collectively referred to as the association) for the years ended December 31, 2018, 2017 and 2016, and should be read in conjunction with the accompanying consolidated financial statements. The accompanying financial statements were prepared under the oversight of the association’s Audit Committee.

Forward-Looking Information:

This annual report contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as “anticipates,” “believes,” “could,” “estimates,” “may,” “should,” “will” or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond the association’s control. The association is impacted by factors that would impact any agricultural real estate lender. These risks and uncertainties include but are not limited to:

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

Commodity Review and Outlook:

Capital Farm Credit’s territory covers most of Texas except for the northeast quadrant and seven counties in the Panhandle. The acreage within the association’s territory includes a broad spectrum of agriculture commodities, land types, production seasons and farming and ranching practices. This variety allows the association to have a loan portfolio comprised of a wide range of commodities with different influences, risks, opportunities and customers. While most of the production and farm revenue is generated by farmers and ranchers who are engaged in managing full-time operations, there are also many part-time farming and ranching operations. Part-time operators have revenue from nonagricultural sources, and many of these operators invest heavily in their agriculture operations with their time and money, and as a result, further diversify the association’s credit risks across the portfolio.

The Texas economy continues to grow, but there was some slowdown in the fourth quarter of 2018. Job growth continues to be strong across the state, particularly in the energy, finance and manufacturing sectors. Oil prices showed a significant decrease at the end of 2018, but production continues to accelerate. The agriculture economy continues to be affected by the strong dollar and the tariff wars with China, with most agricultural commodity prices at low levels. Nevertheless, land prices are stable to improving throughout the state. Even with a below optimistic outlook for the agricultural economy, the demand for farm loans continues.

The following is a review and outlook of some of the key commodities served by the association and a summary of industries and economic factors that impact our part-time producers. The percentages shown were determined based on the outstanding loan volume tied to the specific type of operation or commodity as of December 31, 2018.

Livestock (51.7 percent of the loan portfolio) – Cattle producers continue to experience challenges after the very high prices in 2014 and 2015, when producers across the state were expanding their herds, fell dramatically in 2016 and have remained low through 2018. While feed prices for producers have been low for much of the year, significant rainfall throughout the state at the end of the year created less than ideal pasture conditions. Domestic use of beef and per capita consumption are projected to remain relatively stable for 2019, and supply may taper somewhat. The outlook for 2019 is for prices to improve slightly, which may help the producers, but there will be continued challenges.

Crops (20.3 percent of the loan portfolio) – Crop producers experienced many challenges during 2018, with little to no early rainfall in a lot of areas followed by abnormally high rainfall during the harvest. Corn and cotton production were below normal, with many producers filing claims for crop insurance. This, coupled with higher operating expenses, led to some deterioration in working capital for producers. As they prepare for 2019, the winter rains should help with sub-moisture, and there is an optimistic outlook for an improvement in feed grain prices. However, due to the continued overall increase in the supply of cotton, those prices are expected to come down in 2019.

Hunting and recreation (9.6 percent of the loan portfolio) – Texas’ general economic outlook for 2019 suggests continued economic expansion, which should bode well overall for land prices. Large and small scale hunting and recreational operations continue to be profitable. These models include various types of lease arrangements and sometimes may include a variety of services, such as cabins, meals, and guides with the leases. With low unemployment and continued expansion in the overall state economy, these operations should continue to perform well.

Dairy (3.5 percent of the loan portfolio) – Dairy producers continued to struggle with low commodity prices through much of 2018. However, some improvement is expected in 2019. Milk and dairy production are expected to continue to increase, but a projected increase in demand and use of dairy products may lead to improved prices for the producers. Profits have been available for those operations that are efficient and are soundly managed, and expectations are for similar results in 2019.

Timber (2.9 percent of the loan portfolio) – Lumber prices continued their upward trend through June 2018, but saw a sharp decline in the last six months of the year. A slowdown in housing starting at the end of 2018 may lend itself toward continued lower prices in the industry for 2019.

Other (12.0 percent of the loan portfolio) – The outlook for the overall economy for 2019 remains positive, but growth is expected to slow down from the more favorable levels experienced in the prior couple of years. Higher interest rates and operating costs, coupled with low commodity prices, will continue to strain agricultural producers. However, favorable unemployment rates and strong labor demand should continue to influence land prices positively. The state’s economy should continue to be stronger than the national economy as the population of the state continues to grow rapidly. The association expects this to continue to have a positive influence on loan demand and the repayment capacity for part-time farmers and ranchers.

Significant Events:

Patronage Refunds by Association

The board of directors approved a \$184,330 patronage distribution for 2018. Of that amount \$87,543 of this distribution will be paid in cash in March 2019 and \$96,787 will be distributed in the form of nonqualified allocated equity, which means the owners of these distributions will not pay federal income taxes until the equities are retired. It is the board’s intention with these allocations to assign ownership of the earnings of the association, allowing the stockholders to benefit more fully from the earnings of the association and to create a method to make future equity distributions in the form of cash. While there is not a planned retirement of these allocated equities, the board of directors will make an annual evaluation of the association’s capital position and determine if some cash retirements of these equities can be made. In 2017, the board of directors approved a \$163,847 patronage distribution with cash patronage payable of \$77,506 and \$86,341 in nonqualified allocations. In March 2018 the association finalized the computation of these distributions which resulted in a reduction in cash patronage payable of \$102 for an actual cash distribution of \$77,404 and no change to the nonqualified allocated equity distributions. In 2016, the board of directors approved a \$135,000 patronage distribution, with cash patronage payable of \$57,170 and \$77,830 in nonqualified allocations. In March 2017 the association finalized the computation of these distributions which resulted in a decrease in nonqualified allocations of \$35 resulting in an actual allocation of \$77,795, and a reduction in cash patronage payable of \$38 for an actual cash distribution of \$57,132.

In September 2018 the board of directors approved a resolution to retire \$50,000 in nonqualified allocated equities which were paid to the recipients in November 2018. The retirement was a distribution of 56 percent of the remaining earnings allocated in 2011. In September 2017 the board of directors approved a resolution to retire \$36,785 in nonqualified allocated equities which were paid to the recipients in November 2018. The retirement was a distribution of all the earnings allocated in 2010. In September 2016 the board of directors approved a resolution to retire \$36,783 in nonqualified allocated equities. The retirement was a distribution of 50 percent of the earnings allocated in 2010.

Patronage Refund Received from Farm Credit Bank of Texas

The association received income in the form of a direct loan patronage of \$26,508, \$23,236 and \$23,472 from the Farm Credit Bank of Texas (Bank), representing 0.43, 0.39 and 0.41 percent of the average daily balance of the association’s direct loan with the Bank at December 31, 2018, 2017 and 2016, respectively. The association also received \$3,172, \$2,520 and \$2,008 in patronage payments from the Bank, based on the association’s stock investment in the Bank at December 31, 2018, 2017 and 2016, respectively. In addition, as a result of the CPP transaction discussed under the ‘Loan Portfolio’ section below, the association received patronage of \$855 in 2018. Also, the association received a capital markets patronage of \$4,506, \$3,273 and \$1,912 from the Bank in 2018, 2017 and 2016 representing 0.75, 0.75 and 0.75 percent, respectively on the year’s average daily balance for loan participations sold to the Bank.

Point of Purchase Equipment Financing

The association partners with other Farm Credit associations to facilitate a point of purchase equipment financing program under the name of AgDirect LLP (AgDirect). The AgDirect program operates through independent equipment dealers to originate and refinance agricultural equipment loans. The association's investment in AgDirect was \$9,237, \$8,556 and \$7,648 at December 31, 2018, 2017 and 2016, respectively. Income from this program was \$1,164, \$779 and \$702 for the years ended December 31, 2018, 2017 and 2016, respectively and is included in other income in the accompanying Consolidated Statement of Comprehensive Income.

Relationships with Unincorporated Business Entities

The association and the Bank made investments in a limited partnership, the Advantage Capital Ag Partners L.P., that will provide junior capital to rural and agriculture businesses in the United States. This partnership is a Rural Business Investment Company (RBIC), and the investment by the association and the Bank is allowed under the Mission-Related Investment authorities granted in the Farm Credit Act. The association's investment in RBIC was \$11,624, \$11,573 and \$6,775 at December 31, 2018, 2017 and 2016, respectively. This investment is included in "other assets" on the balance sheet. The association recorded gains and (losses) in 2018, 2017 and 2016 of (\$2,551), \$388, and (\$240), respectively.

Loan Portfolio:

The association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The association's loan volume consists primarily of long-term real estate mortgage loans, production and intermediate-term loans and farm-related business loans. These loan products are available to eligible borrowers with competitive variable, fixed, LIBOR-based and prime-based interest rates. For all loan products, the association is able to lock an interest rate spread for the pricing term of the loan. When the pricing term expires on a loan, the association is subject to a new cost of funds from the Bank. However, the association is then also able to establish a new interest spread on the loan to the customer. Pricing terms range from one month on LIBOR and prime based products, and from 90 days to 30 years on fixed rate products. Loan maturities range from one to 40 years, with annual operating loans comprising the majority of the production loans and five- to 20-year maturities comprising the majority of the mortgage loans. Loans serviced by the association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

At December 31, 2018, the association's loan volume was \$7,393,006, an increase of \$147,639 or 2.0 percent from December 31, 2017. In September 2018, the association completed a sale of \$99,586 in loans to the Farm Credit Bank of Texas as part of their capitalized participation pool (CPP). In accordance with this program, the association capitalizes this loan pool with a 6 percent investment in the Bank in exchange for the net earnings this pool generates. The CPP program allows the association to manage its capital by controlling the amount of loan volume on the balance sheet without impacting the profitability of the association. The association recognized earnings of \$855 in 2018. The earnings from the program are under the control and discretion of FCBT. At December 2017, loan volume was \$7,245,367, which was 4.6 percent higher than the December 31, 2016 loan volume of \$6,927,965. Volume increased in 2018 across the portfolio, with the most significant growth in the real estate mortgage loans of \$134,774 and production loans of \$9,468. The credit quality of the association's portfolio has improved from the prior year and continues to remain strong. Loans classified as acceptable were 96.6 percent of the total portfolio at December 31, 2018, in comparison to 96.0 percent of the total portfolio at December 31, 2017, and 95.3 percent at December 31, 2016. Overall, there has been no significant change in the geographical distribution of the portfolio or the types of loans that comprise the portfolio. The composition of the association's loan portfolio is described more fully in detailed tables in Note 4 to the consolidated financial statements, "Loans and Allowance for Credit Losses."

At December 31, 2018, 2017 and 2016, the association held 4, 5 and 5 transactions respectively, which are reported as loans on the consolidated balance sheet totaling \$6,100, \$6,253 and \$6,397 with remaining commitments of \$0, \$44 and \$44 extended under the Rural America Bond Program approved by the Farm Credit Administration (FCA). The program is designed to meet the growing and changing needs of agricultural enterprises, agribusinesses and rural communities by providing investment in rural areas.

Purchase and Sales of Loans:

The association has obtained loan guarantees from the Federal Agricultural Mortgage Corporation (Farmer Mac) through an arrangement with the Bank in the form of standby commitments to purchase qualifying loans. At December 31, 2018, 2017 and 2016, loans totaling \$15,241, \$30,986 and \$35,437, respectively, were guaranteed by these commitments. Fees paid for these guarantees totaled \$110, \$143 and \$165 in 2018, 2017 and 2016, respectively, and are reflected in "other noninterest expense" in the consolidated statement of income.

The association participates in loans with other lenders. As of December 31, 2018, 2017 and 2016, loan participations purchased by the association totaled \$882,179, \$861,901 and \$851,317, or 11.9 percent, 11.9 percent and 12.3 percent of loans, respectively. Included in these amounts are participations purchased from entities other than the Bank and its related associations (collectively referred to as the “District”) of \$354,930, \$351,631 and \$323,770, or 4.8 percent, 4.9 percent and 4.7 percent of loans, respectively. The association has also sold participations to other lenders of \$1,387,089, \$1,148,866 and \$921,856 as of December 31, 2018, 2017 and 2016, respectively.

Investments:

During 2010, the association exchanged loans totaling \$27,975 for Farmer Mac guaranteed mortgage-backed securities (AMBS). The loans were previously covered under the Long Term Standby Commitments to Purchase (LTSCP) Agreement with Farmer Mac. These loans were sold to Farmer Mac and then repurchased in the form of a guaranteed AMBS investment. The primary objective in pursuing the AMBS conversion alternative is to reduce the association’s credit exposure to Farmer Mac by putting the association in a position to benefit from the United States Treasury line of credit (under Section 8.13 of the Farm Credit Act), which is only available for the payment of Farmer Mac’s guarantee obligations on securities, not for its obligations under the LTSCP program. No gain or loss was recognized in the financial statements as a result of the exchange transaction. These AMBS are included in the association’s consolidated balance sheet as held-to-maturity investments at an amortized cost balance of \$4,388, \$5,566 and \$6,670 at December 31, 2018, 2017 and 2016, respectively. The association continues to service the loans included in that transaction.

Risk Exposure:

High-risk assets include nonaccrual loans, loans which are past due 90 days or more and still accruing interest, formally restructured loans and other property owned, net. The following table reflects the association’s components and trends of high-risk assets serviced for the prior three years as of December 31:

	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
Loans:						
Nonaccrual loans	\$ 48,007	79.3%	\$ 68,953	83.6%	\$ 88,740	84.2%
90 days past due and still accruing interest	37	0.1%	23	0.0%	3,677	3.5%
Formally restructured loans	11,487	19.0%	9,594	11.6%	10,283	9.8%
Other property owned, net	972	1.6%	3,989	4.8%	2,634	2.5%
Total	\$ 60,503	100.0%	\$ 82,559	100.0%	\$ 105,334	100.0%

At December 31, 2018, 2017 and 2016, loans that were considered impaired were \$59,531, \$78,570 and \$102,700, representing 0.8 percent, 1.1 percent and 1.5 percent of loan volume, respectively. Nonaccrual loans decreased \$20,946 during 2018. This decrease was recognized primarily in the production and real estate mortgage sectors. This decrease was related to several loans that were returned to accrual status due to improved performance and other nonaccrual loans that were paid down. Formally restructured loans increased \$1,893 during 2018. This increase can be attributed primarily to one loan in the production agriculture-real estate mortgage loan category. In addition, the association saw a decrease in its other property of \$3,017 during 2018. The decrease was related to the sale of six properties.

Management also continues to routinely evaluate and monitor counterparty and collateral risks in an effort to avoid concentrations that could result in excess exposure to a single counterparty or type of collateral. The loan portfolio management practices in place have been designed to ensure loans and industries with actual or potential problems are promptly identified, monitored and addressed in a manner that allows the lending staff to work with problem customers and industries through periods of adversity.

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

Allowance for Credit Losses:

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Allowance for loan losses	\$ 25,495	\$ 29,450	\$ 30,287
Allowance for loan losses to total loans	0.3%	0.4%	0.4%
Allowance for loan losses to nonaccrual loans	53.1%	43.9%	35.2%
Allowance for loan losses to impaired loans	42.8%	38.5%	30.5%
Net charge-offs (recoveries) to average loans	0.0%	0.0%	0.0%

The year-end allowance for credit losses is based upon estimates that consider the general financial strength of the overall economy and the agricultural economy, as well as the association's loan portfolio composition, credit administration and prior loan loss experience. The association calculates its allowance in two parts, specific allowances and a general allowance. The association evaluates all loans classified as impaired for a specific allowance. This specific allowance is generally based upon the value of the collateral securing the loan relative to the loan amount outstanding. Allowance for credit losses of \$2,627, \$1,249 and \$3,241 were specifically related to impaired loans totaling \$59,531, \$78,570 and \$102,700 at December 31, 2018, 2017 and 2016, respectively. These specific allowances represent 4.4 percent, 1.6 percent and 3.2 percent of the impaired loans at December 31, 2018, 2017 and 2016, respectively. The association experienced loan charge-offs of \$2,295, \$4,496 and \$857 in 2018, 2017 and 2016, respectively, representing 2.9 percent, 4.4 percent and 1.2 percent of the previous year-end balance of impaired loans. Charge-offs in 2018 were primarily in the production and intermediate portfolio in the crop and livestock commodities. Most of the loan charge-offs in 2017 were the result of one customer's misappropriation of proceeds on the sale of collateral. This violation was reported to federal authorities. In addition the association recovered loans previously charged off in the amounts of \$1,434, \$1,163 and \$1,442 in 2018, 2017 and 2016, respectively.

The association also provides line of credit financing to customers to cover short-term and variable needs. As a result, the association has unfunded commitments for which a separate reserve is maintained. This reserve is reported as a liability on the association's consolidated balance sheet.

The association monitors its general allowance to recognize the trend in the quality of the portfolio. The association uses industry-based loan pools to calculate its general allowance on the loans that are not analyzed specifically. Risk factors are applied to the loan volume in each industry pool based upon current economic conditions and the credit quality of the loans in that pool. As credit quality and general economic factors have improved, the association decreased the general allowance. Total allowances on loans not considered impaired were \$22,868, \$28,201 and \$27,046 at December 31, 2018, 2017 and 2016, respectively. The allowance for credit losses at December 31, 2018, is considered adequate by management to recognize any inherent losses in the loan portfolio.

Results of Operations:

The association's net income for the year ended December 31, 2018, was \$189,851 as compared to \$168,736 for the year ended December 31, 2017, reflecting an increase of \$21,115 or 12.5 percent. The association's net income for the year ended December 31, 2016, was \$151,146. Net income increased \$17,590, or 11.6 percent, in 2017 as compared to 2016.

Net interest income for 2018, 2017 and 2016 was \$234,723, \$227,346 and \$215,137, respectively. This reflects increases of \$7,377, or 3.2 percent, for 2018 versus 2017 and \$12,209, or 5.7 percent, for 2017 versus 2016. Net interest income is the principal source of earnings for the association and is impacted by loan volume, yields on loans and cost of debt. Over the last three years, the association has benefited from

higher loan volumes, higher levels of capital and higher interest rates. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following tables:

	2018		2017		2016	
	Average Balance	Interest	Average Balance	Interest	Average Balance	Interest
Accrual loans and investments	\$ 7,289,406	\$ 402,332	\$ 6,956,902	\$ 361,817	\$ 6,660,251	\$ 331,278
Interest-bearing liabilities	6,223,384	167,609	5,959,780	134,471	5,725,666	116,141
Impact of capital	1,066,022		997,122		934,585	
Net interest income		\$ 234,723		\$ 227,346		\$ 215,137

	Average Yield		Average Yield		Average Yield	
Yield on loans and investments	5.52%		5.20%		4.97%	
Cost of interest-bearing liabilities	2.69%		2.26%		2.03%	
Net interest spread	2.83%		2.94%		2.94%	

	2018 vs. 2017			2017 vs. 2016		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income	\$ 17,293	\$ 23,222	\$ 40,515	\$ 14,755	\$ 15,784	\$ 30,539
Interest expense	\$ 5,948	\$ 27,190	\$ 33,138	\$ 4,749	\$ 13,581	\$ 18,330
Net interest income	\$ 11,345	\$ (3,968)	\$ 7,377	\$ 10,006	\$ 2,203	\$ 12,209

While most of the improvement in net interest income for the last three years is due to the increase in loan volume, the association has also benefited from higher levels of capital. This reduced the amount of debt borrowed in relation to loan volume.

Interest income for 2018 increased by \$40,515, or 11.2 percent, compared to 2017, primarily due to an increase in interest rates and loan volume. Interest expense for 2018 increased by \$33,138, or 24.6 percent, compared to 2017 due to an increase in the association's cost of funds and an increase in the direct note balance. The interest rate spread decreased by 11 basis points to 2.83 percent in 2018 from 2.94 percent in 2017, primarily because of the increase in the association's cost of funds. For several years prior to 2018, the Bank charged an interest spread of 0.52 above their cost of funds on all loans. Effective January 1, 2018, the Bank increased their spread above cost of funds to 0.75 percent on any new loan, or any existing loan that was repriced. The interest rate spread remained consistent at 2.94 percent in 2017 and 2016.

Noninterest income for 2018 increased by \$10,361, or 25.9 percent, compared to 2017, due primarily to an increase in patronage refund received from the Bank. The Bank paid a 43-basis-point cash patronage on the association's average direct note borrowings in 2018 compared to 39-basis point patronage in 2017. With the aforementioned increase in cost of funds from the Bank on all new loans and existing loans that repriced in 2018, the FCBT paid an additional patronage refund to the association to effectively make up for the increased cost of funds. Financially related services income also increased by \$1,767 during 2018 primarily due to the association's implementation of the accounting standard "Revenue from Contracts with Customers." Other noninterest income also increased by \$2,178 primarily due to \$4,512 received from the Farm Credit System Insurance Corporation (FCSIC) for excess insurance fund balances in the allocated insurance reserve accounts partially offset by a loss recognized on the association's investment in RBIC. Noninterest income for 2017 increased by \$3,359, or 9.2 percent, compared to 2016, due primarily to an increase in patronage refund received by the Bank. In addition, gain on other property owned increased \$543 as a result of gains recognized upon sale of acquired property. Other noninterest income also increased by \$962 primarily due to gains recognized on the association's investment in RBIC.

A reversal of provision for credit losses of \$3,469 was recognized for 2018, as compared to a provision for credit loss expense of \$2,315 and \$7,361 in 2017 and 2016, respectively. The decline in provision expense was due to the improvement in credit quality and continued improvement in the general economy. The reversal of the provision was primarily recognized in the association's real estate mortgage portfolio.

Non-interest expenses increased \$2,415 for 2018, or 2.5 percent, compared to 2017. Salaries and employee benefits increased \$5,731 due to new hires, salary adjustments made to existing employees and higher benefit costs. This increase was offset by a decrease in insurance fund premiums of \$3,127 which was a result of decreased premium rates on accrual loans from 15 basis points in 2017 to 9 basis points in 2018. Operating expenses increased by \$3,025 for 2017, or 3.2 percent, compared to 2016. Salaries and employee benefits increased \$2,950 due to new hires, salary adjustments made to existing employees and higher benefit costs. This increase was

offset by a decrease of \$781 in Farm Credit System Insurance Corporation (FCSIC) fund premiums due to decreased premium rates on accrual loans from 18 basis points in 2016 to 15 basis points in 2017.

Authoritative accounting guidance requiring the capitalization and amortization of loan origination fees and costs resulted in the capitalization of \$8,314, \$8,543 and \$8,451 for 2018, 2017 and 2016, respectively, in origination costs. The capitalized costs consisted of salaries and benefits totaling \$8,301, \$8,298 and \$7,668 for 2018, 2017 and 2016, respectively, related to the origination of loans. The capitalized fees, net of the capitalized costs, are amortized over the life of the loans as an adjustment to yield in net interest income. The adjustment to net interest income as a result of this amortization was \$859, \$854, and \$854, respectively.

For the year ended December 31, 2018, the association's return on average assets was 2.5 percent, as compared to 2.3 percent and 2.2 percent for the years ended December 31, 2017 and 2016 respectively. For the year ended December 31, 2018, the association's return on average members' equity was 15.8 percent, as compared to 14.7 percent and 13.1 percent for the years ended December 31, 2017 and 2016, respectively.

Because the association depends on the Bank for funding, any significant positive or negative factors affecting the operations of the Bank could have a similar effect on the operations of the association.

Liquidity and Funding Sources:

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

The primary source of liquidity and funding for the association is a direct loan from the Bank. The outstanding balance of \$6,223,546, \$6,127,915 and \$5,872,624 as of December 31, 2018, 2017 and 2016, respectively, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 2.69 percent, 2.26 percent and 2.03 percent at December 31, 2018, 2017 and 2016, respectively. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the Bank and is governed by a financing agreement. This increase in note payable to the Bank and related accrued interest payable since December 31, 2017, is due to an increase in the association's loan portfolio. The association's own funds, which represent the amount of the association's loan portfolio funded by the association's equity were \$1,008,396, \$920,419 and \$930,659 for the years 2018, 2017 and 2016, respectively. The maximum amount the association may borrow from the Bank as of December 31, 2018, was \$7,250,033 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, 2019, unless sooner terminated by the bank upon the occurrence of an event of default, or by the association, in the event of a breach of this agreement by the bank, upon giving the bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the bank 120 days' prior written notice. The association anticipates the general financing agreement to be renewed by the bank, without any significant adjustments, prior to its expiration.

The liquidity policy of the association is to manage cash balances to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued during 2019. As borrower payments are received, they are applied to the association's note payable to the Bank.

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

Capital Resources:

The association's capital position remains strong with total members' equity of \$1,232,238, \$1,176,037 and \$1,123,534 at December 31, 2018, 2017 and 2016, respectively.

On July 28, 2016, the Farm Credit Administration published a final regulation to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule were as follows:

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

The new capital requirements became effective January 1, 2017, with a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. The association is in compliance with the required minimum capital standards and met the conservation buffers as of December 31, 2018.

The regulations replaced the previously required core surplus and total surplus ratios with Common Equity Tier 1, Tier 1 Capital, and Total Capital risk-based capital ratio requirements. These regulations also added a Tier 1 Leverage ratio and an Unallocated Retained Earnings (URE) and URE Equivalents Leverage (UREE) ratios. The pre-existing Permanent Capital Ratio continued to remain in effect, with some modifications to align with the new regulations. Under regulations governing minimum permanent capital adequacy and other capitalization issues, the association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The permanent capital ratio measures available at-risk capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio is an indicator of the institution's financial capacity to absorb potential losses beyond that provided in the allowance for loss accounts. The association's permanent capital ratio at December 31, 2018, 2017 and 2016 was 14.8 percent, 14.7 percent and 14.6 percent, respectively.

Under the regulations, the association is required to maintain a minimum Common Equity Tier 1 (CET1), Tier 1 Capital, and Total Capital ratios of 4.5 percent, 6.0 percent, and 8.0 percent, along with a capital conservation buffer of 2.5 percent applicable to each ratio, respectively. The 2.5 percent capital conservation buffer will be phased in over a three-year period ending on December 31, 2019. The association's Common Equity Tier 1 ratio in 2018 and 2017 was 14.3 percent and 13.4 percent, respectively, and Tier 1 Capital ratio was 14.3 percent and 13.4 percent, respectively. The total Capital ratio was 15.1 percent and 15.0 percent at December 31, 2018 and 2017. Under the regulations, the association is required to maintain a minimum Tier 1 Leverage ratio of 4.0 percent, along with a leverage buffer of 1.0 percent, and a minimum UREE leverage ratio of 1.5 percent. The association's Tier 1 Leverage ratio at December 31, 2018 and 2017 was 14.8 percent and 13.9 percent, respectively, and UREE Leverage ratio was 9.5 percent and 9.5 percent respectively. The CET1 capital ratio is an indicator of the institution's highest quality of capital and consists of unallocated retained earnings, qualifying common cooperative equities (CCEs) that meet the required holding periods, and paid-in capital. The Tier 1 Capital ratio is a measure of the institution's quality of capital and financial strength. The Total Capital Ratio is supplementary to the Tier 1 Capital ratio, the components of which include qualifying CCEs subject to certain holding periods, and allowance for credit losses subject to certain limitations. The Tier 1 leverage ratio is used to measure the amount of leverage an institution has incurred against its capital base, of which at least 1.5 percent must be URE and URE equivalents. This is the UREE Leverage ratio.

Prior to January 1, 2017, the core surplus ratio measured available core surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio was an indicator of the quality of capital that exists to maintain stable earnings and financial strength. The association's core surplus ratio at December 31, 2016 was 14.4 percent, which was in compliance with the FCA's minimum ratio requirement of 3.5 percent. The total surplus ratio measured available surplus capital relative to risk-adjusted assets and off-balance-sheet contingencies. The ratio was an indicator of the reserves existing to protect borrowers' investments in the association. The association's total surplus ratio at December 31, 2016 was 14.4 percent, which was in compliance with the FCA's minimum ratio requirement of 7.0 percent.

	Capital			Association's ratios as of December 31, 2018
	Regulatory Minimums	Conservation Buffers*	Total	
Risk-adjusted:				
Common equity tier 1 ratio	4.50%	2.50% *	7.00%	14.3%
Tier 1 capital ratio	6.00%	2.50% *	8.50%	14.3%
Total capital ratio	8.00%	2.50% *	10.50%	15.1%
Permanent capital ratio	7.00%	0.00%	7.00%	14.8%
Non-risk-adjusted:				
Tier 1 leverage ratio**	4.00%	1.00% *	5.00%	14.8%
UREE leverage ratio	1.50%	0.00%	1.50%	9.5%

*The 2.5% capital conservation buffer for the risk-adjusted ratios will be phased in over a three-year period ending on December 31, 2019. There is no phase-in of the leverage buffer.

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

The association has been able to maintain solid levels of capital and strong capital ratios, while declaring patronage refunds in cash to its stockholders in the amounts of \$87,543, \$77,506 and \$57,170 in 2018, 2017 and 2016, respectively. The board of directors also

issued \$96,787, \$86,341 and \$77,830 in nonqualified written notices of allocation in 2018, 2017 and 2016, respectively. In addition, the association retired \$50,000, \$36,785 and \$36,783 of previously allocated nonqualified written notices of allocation in November 2018, 2017 and 2016, respectively. See Note 10 to the consolidated financial statements, “Members’ Equity,” included in this annual report, for further information.

The association utilizes income pools to determine and allocate the patronage refunds for its customers. Each patronage-eligible customer’s loan(s) is assigned to a respective pool based upon common characteristics to service and account for such loans. For 2018, 2017 and 2016, the association utilized a participations purchased pool, a participations sold pool and a general loan pool. The participations purchased pool includes all patronage-eligible loans that are purchased from other farm credit entities. The sold loan pool includes any portion of a loan that the association originates, but sells to another entity. The general pool includes all other patronage eligible loans not included in the other pools. Net income is calculated for each pool by including all of the net interest income and other income from the loans in the pool and a reasonable allocation of association expenses for each pool. The allocation of expenses is based upon the costs to service and account for the loans in the pool. Net income for each pool is determined by subtracting the allocation of expenses from the income of the loans in the pool. Any net income from the pool is eligible for distribution only to the customers with loans in that pool. If a pool does not generate net income, there are no earnings available for distribution to those customers with loans in that pool. All pools generated earnings available for distribution in 2018, 2017, and 2016, respectively.

Regulatory Matters:

At December 31, 2018, the association was not under any written agreement with the Farm Credit Administration.

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

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

The regulation became effective January 1, 2019. None of the association’s current investments are significantly affected by the new regulation.

Significant Recent Accounting Pronouncements and Critical Accounting Policies:

Refer to the Note 2-“Summary of Significant Accounting Policies” in this annual report for disclosures of recent accounting pronouncements which may impact the association’s consolidated financial position and results of operations and for critical accounting policies.

Relationship With the Bank:

The association’s statutory obligation to borrow only from the Bank is discussed in Note 9 to the consolidated financial statements, “Note Payable to the Bank,” included in this annual report.

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

The Bank’s role in mitigating the association’s exposure to interest rate risk is described in the section “Liquidity and Funding Sources” of this Management’s Discussion and Analysis and in Note 9 to the consolidated financial statements, “Note Payable to the Bank,” included in this annual report.

The Bank provides computer systems to support the critical operations of all District associations. In addition, each association has operating systems and facility-based systems that are not supported by the Bank. As disclosed in Note 13 to the consolidated financial statements, “Related Party Transactions,” included in this annual report, the Bank provides many services that the association can utilize. Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems, accounting services and allocations of expenses incurred by the Bank passed through to the associations.



Report of Independent Auditors

To the Board of Directors of Capital Farm Credit, ACA

We have audited the accompanying consolidated financial statements of Capital Farm Credit, ACA and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018, December 31, 2017 and December 31, 2016, and the related consolidated statements of comprehensive income, changes in members' equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Capital Farm Credit, ACA and its subsidiaries as of December 31, 2018, December 31, 2017 and December 31, 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 13, 2019

CAPITAL FARM CREDIT, ACA
CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	December 31,		
	2018	2017	2016
<u>ASSETS</u>			
Cash	\$ 10	\$ 15	\$ 19
Loans	7,393,006	7,245,367	6,927,965
Less: Allowance for losses	(25,495)	(29,450)	(30,287)
Net Loans	7,367,511	7,215,917	6,897,678
Accrued interest receivable - loans	68,824	64,383	58,506
Accrued interest receivable - investments	63	67	89
Investment -- held-to-maturity	4,388	5,566	6,670
Investment in and receivable from the Bank:			
Capital stock	125,803	118,752	113,809
Receivable	21,485	14,958	13,489
Investments in other Farm Credit Institutions	9,398	8,713	7,801
Other property owned, net	972	3,989	2,634
Premises and equipment, net	15,365	14,205	16,662
Other assets	25,637	24,092	18,807
Total assets	<u>\$ 7,639,456</u>	<u>\$ 7,470,657</u>	<u>\$ 7,136,164</u>
<u>LIABILITIES</u>			
Note payable to the Bank	\$ 6,223,546	\$ 6,127,915	\$ 5,872,624
Advanced conditional payments	10,067	6,638	4,192
Accrued interest payable	15,500	12,313	10,206
Drafts outstanding	1,256	528	4,138
Patronage distributions payable	87,548	77,511	57,174
Unfunded post retirement medical obligation	22,991	25,897	22,938
Reserve for unfunded commitments	431	806	987
Other liabilities	45,879	43,012	40,371
Total liabilities	<u>6,407,218</u>	<u>6,294,620</u>	<u>6,012,630</u>
<u>MEMBERS' EQUITY</u>			
Capital stock and participation certificates	25,804	25,519	25,049
Non-qualified allocated retained earnings	624,839	578,054	528,533
Unallocated retained earnings	581,674	576,158	571,198
Accumulated other comprehensive loss	(79)	(3,694)	(1,246)
Total members' equity	<u>1,232,238</u>	<u>1,176,037</u>	<u>1,123,534</u>
Total liabilities and members' equity	<u>\$ 7,639,456</u>	<u>\$ 7,470,657</u>	<u>\$ 7,136,164</u>

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

CAPITAL FARM CREDIT, ACA
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands)

	Year Ended December 31,		
	2018	2017	2016
<u>Interest Income</u>			
Loans	\$ 402,046	\$ 361,495	\$ 330,902
Investments	286	322	376
Total interest income	<u>402,332</u>	<u>361,817</u>	<u>331,278</u>
<u>Interest Expense</u>			
Note Payable to the Bank	167,528	134,439	116,136
Advance conditional payments	81	32	5
Total interest expense	<u>167,609</u>	<u>134,471</u>	<u>116,141</u>
Net interest income	<u>234,723</u>	<u>227,346</u>	<u>215,137</u>
<u>Provision for Loan Losses</u>			
(Reversal) provision for credit losses	(3,469)	2,315	7,361
Net interest income after provision for losses	<u>238,192</u>	<u>225,031</u>	<u>207,776</u>
<u>Noninterest Income</u>			
Patronage income from the Bank	35,041	29,029	27,392
Loan fees	3,411	3,603	3,929
Financially related services income	5,045	3,278	2,905
Gain on sale of premises and equipment, net	537	270	228
Gain (Loss) on other property owned, net	834	505	(38)
Other noninterest income	5,465	3,287	2,197
Total noninterest income	<u>50,333</u>	<u>39,972</u>	<u>36,613</u>
<u>Noninterest Expense</u>			
Salaries and employee benefits	67,198	61,467	58,517
Insurance Fund premium	5,253	8,380	9,161
Occupancy and equipment	4,803	4,615	4,179
Advertising	3,940	4,021	4,061
Travel	3,775	3,721	3,286
Public and member relations	3,187	2,905	2,736
Purchased services	2,673	2,717	2,911
Supervisory and exam expense	1,873	1,786	1,565
Training	1,058	1,099	1,195
Communications	1,004	1,181	1,154
Director's expense	901	926	843
Other noninterest expenses	3,010	3,442	3,627
Total noninterest expenses	<u>98,675</u>	<u>96,260</u>	<u>93,235</u>
Income before income tax	<u>189,850</u>	<u>168,743</u>	<u>151,154</u>
(Benefit) provision for income tax	(1)	7	8
Net income	<u>\$ 189,851</u>	<u>\$ 168,736</u>	<u>\$ 151,146</u>
Other comprehensive gain (loss):			
Change in postretirement benefit plans	3,615	(2,448)	(665)
Income tax expense related items of other comprehensive income	-	-	-
Other comprehensive gain (loss), net of tax	<u>3,615</u>	<u>(2,448)</u>	<u>(665)</u>
COMPREHENSIVE INCOME	<u>\$ 193,466</u>	<u>\$ 166,288</u>	<u>\$ 150,481</u>

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

CAPITAL FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY
(dollars in thousands)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Loss	Total Members' Equity
		Non qualified Allocated	Unallocated		
Balance at December 31, 2015	\$ 24,419	\$ 487,489	\$ 555,052	\$ (581)	\$ 1,066,379
Comprehensive income:					
Net income	-	-	151,146	-	151,146
Other comprehensive (loss)	-	-	-	(665)	(665)
Capital stock/participation certificates issued	3,945	-	-	-	3,945
Capital stock/participation certificates/ allocated equities retired	(3,315)	(36,783)	-	-	(40,098)
Patronage distributions declared:					
Cash	-	-	(57,170)	-	(57,170)
Other adjustments	-	(3)	-	-	(3)
Nonqualified allocations	-	77,830	(77,830)	-	-
Balance at December 31, 2016	25,049	528,533	571,198	(1,246)	1,123,534
Net income	-	-	168,736	-	168,736
Other comprehensive loss	-	-	-	(2,448)	(2,448)
Capital stock/participation certificates issued	3,863	-	-	-	3,863
Capital stock/participation certificates/ allocated equities retired	(3,393)	(36,785)	-	-	(40,178)
Patronage distributions declared:					
Cash	-	-	(77,506)	-	(77,506)
Other adjustments	-	(35)	71	-	36
Nonqualified allocations	-	86,341	(86,341)	-	-
Balance at December 31, 2017	25,519	578,054	576,158	(3,694)	1,176,037
Net income	-	-	189,851	-	189,851
Other comprehensive gain	-	-	-	3,615	3,615
Capital stock/participation certificates issued	3,685	-	-	-	3,685
Capital stock/participation certificates/ retired	(3,400)	(50,000)	-	-	(53,400)
Patronage distributions declared:					
Cash	-	-	(87,543)	-	(87,543)
Other adjustments	-	(2)	(5)	-	(7)
Nonqualified allocations	-	96,787	(96,787)	-	-
Balance at December 31, 2018	\$ 25,804	\$ 624,839	\$ 581,674	\$ (79)	\$ 1,232,238

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

CAPITAL FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

	Year Ended December 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net income	\$ 189,851	\$ 168,736	\$ 151,146
Adjustments to reconcile net income to net cash provided by operating activities:			
(Reversal of) Provision for loan losses	(3,469)	2,315	7,361
(Gain) loss on other property owned	(1,027)	(505)	38
Revenue recognized on prior year other property owned sales	77	-	-
Depreciation and amortization	3,054	3,593	3,177
(Gain) on sale of premises and equipment, net	(537)	(270)	(228)
Loss (gain) on investment in RBIC	2,551	(388)	240
(Increase) decrease in accrued interest receivable	(4,437)	(5,855)	(5,834)
(Increase) decrease in other assets	(8,021)	(1,956)	184
Increase in accrued interest payable	3,187	2,107	1,188
Increase in other liabilities	3,576	3,152	3,133
Net cash provided by operating activities	\$ 184,805	\$ 170,929	\$ 160,405
 Cash flows from investing activities:			
(Increase) in loans, net	\$ (150,255)	\$ (324,851)	\$ (446,577)
Cash recoveries of loans previously charged off	1,434	1,163	1,442
Purchases of investment in AgDirect, LLP	(685)	(911)	(1,387)
Purchases of investment in RBIC	(2,602)	(4,410)	(3,479)
Purchase of investment in the Bank	(7,051)	(4,943)	(11,795)
Decrease in investments held to maturity	1,178	1,104	1,428
Purchases of premises and equipment	(5,467)	(2,700)	(4,814)
Proceeds from sales of premises and equipment	994	1,225	952
Proceeds from sales of other property owned	5,084	2,713	943
Net cash used in investing activities	\$ (157,370)	\$ (331,610)	\$ (463,287)

The accompanying notes are an integral part of these consolidated financial statement

CAPITAL FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

	Year Ended December 31,		
	2018	2017	2016
Cash flows from financing activities:			
Net increase in note payable to the Bank	\$ 95,631	\$ 255,291	\$ 398,029
Increase (decrease) in drafts outstanding	728	(3,610)	(259)
Increase (decrease) in advance conditional payments	3,429	2,446	(2,022)
Issuance of capital stock and participation certificates	3,685	3,863	3,945
Retirement of capital stock, participation certificates and allocated equities	(53,407)	(40,178)	(40,098)
Patronage distributions paid	(77,506)	(57,135)	(56,746)
Net cash (used in) provided by financing activities	\$ (27,440)	\$ 160,677	\$ 302,849
Net increase (decrease) in cash	(5)	(4)	(33)
Cash at the beginning of the year	15	19	52
Cash at the end of the year	\$ 10	\$ 15	\$ 19
 Supplemental schedule of noncash investing and financing activities:			
Loans transferred to other property owned upon loan foreclosure	\$ 1,117	\$ 3,671	\$ 2,522
Net loans charged off	2,295	4,496	857
Patronage distributions declared	87,543	77,506	57,170
 Supplemental cash information:			
Cash paid during the year for:			
Interest	\$ 164,422	\$ 132,364	\$ 114,953
Income taxes	-	-	-

The accompanying notes are an integral part of these consolidated financial statement

CAPITAL FARM CREDIT, ACA
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(ALL DOLLAR AMOUNTS IN THOUSANDS)

NOTE 1 — ORGANIZATION AND OPERATIONS:

- A. Organization: Capital Farm Credit, ACA, including its wholly-owned subsidiaries, Capital Farm Credit, PCA and Capital Farm Credit, FLCA (collectively called the association), is a member-owned cooperative which provides credit and credit-related services to, or for the benefit of, eligible borrowers/stockholders for qualified agricultural purposes in 192 counties in the state of Texas.

The association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, that was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Act). At December 31, 2018, the System was composed of three Farm Credit Banks (FCBs) and their affiliated associations, one Agricultural Credit Bank (ACB) and its affiliated associations, the Federal Farm Credit Banks Funding Corporation (Funding Corporation) and various service and other organizations.

The Farm Credit Bank of Texas (Bank) and its related associations are collectively referred to as the “District.” The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District associations. At December 31, 2018, the District consisted of the Bank, one FLCA and 13 ACA parent companies (including Capital Farm Credit, ACA), which have two wholly-owned subsidiaries, an FLCA and a PCA, operating in or servicing the states of Alabama, Louisiana, Mississippi, New Mexico and Texas. ACA parent companies provide financing and related services through their FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

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

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

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

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

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

The lending and financial services offered by the Bank are described in Note 1, “Organization and Operations,” of the District’s annual report to stockholders.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation and Consolidation

The consolidated financial statements (the “financial statements”), and the accounting and reporting policies of the association have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and prevailing practices within the banking industry. In consolidation, all significant intercompany accounts and transactions are eliminated, and all material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise. The consolidated financial statements include the accounts of Capital Farm Credit, PCA and Capital Farm Credit, FLCA. All significant intercompany transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses; the valuation of deferred tax assets; the determination of fair value of financial instruments and subsequent impairment analysis. Significant estimates are discussed in these footnotes, as applicable. Actual results could differ from those estimates.

Reclassifications

Certain amounts in prior years’ consolidated financial statements have been reclassified to conform to current financial statement presentation.

A. Recently Issued or Adopted Accounting Pronouncements:

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans.” The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the association’s financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled “Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement.” The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted, and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures until their effective date. The adoption of this guidance will not impact the association’s financial condition or its results of operations, but will impact the fair value measurements disclosures. The association early adopted the removal and modified disclosures during the fourth quarter of 2018.

In February 2018, the FASB issued guidance entitled “Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35 percent to 21 percent. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The association early adopted the guidance during the first quarter of 2018, and the adoption did not materially impact the association.

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

In August 2016, the FASB issued guidance entitled “Classification of Certain Cash Receipts and Cash Payments.” The guidance addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the association’s financial condition or its results of operations but did change the classification of certain items in the statement of cash flows.

In June 2016, the FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The association is evaluating the impact of adoption on the association’s financial condition and its 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. In July 2018, the FASB issued an update entitled “Leases – Targeted Improvements,” which provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. An entity that elects this additional transition method must provide the required disclosures of the now current standard for all prior periods presented. The guidance and related amendments in this updated disclosure become effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The impact of the new standard will be an increase to total assets of \$11.8 million and an increase to total liabilities of \$11.9 million beginning in 2019 and will not have a significant impact to the association’s financial condition or results of operations.

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

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. The guidance sets forth the requirement for new and enhanced disclosures. The association adopted the new standard effective January 1, 2018, using the modified retrospective approach. As the majority of the association’s revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial position, results of operations, equity or cash flows. The total impact to the association in 2018 was \$1.7 million of revenue recognized related to crop insurance.

- B. Cash: Cash, as included in the statement of cash flows, represents cash on hand and on deposit at banks.
- C. Investments: The association’s investments include mortgage-backed securities issued by the Federal Agricultural Mortgage Corporation (Farmer Mac) for which the association has the intent and ability to hold to maturity and which are consequently classified as held-to-maturity. Held-to-maturity investments are carried at cost, adjusted for the amortization of premiums and accretion of discounts. Changes in the fair value of these investments are not recorded unless the investment is deemed to be other-than-temporarily impaired. Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a “credit loss”). If an entity intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into (i) the estimated amount relating to credit loss and (ii) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income.

The association holds additional investments in accordance with mission-related investment and other investment programs approved by the FCA. These programs allow the association to make investments that further the System's mission to serve rural America. Mission-related investments for which the association has the intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for the amortization of premiums and accretion of discounts.

- D. Loans and Allowance for Credit Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

Authoritative accounting guidance requires loan origination fees and direct loan origination costs to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield.

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

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

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

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

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

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

The credit risk-rating methodology is a key component of the association's allowance for credit losses evaluation, and is generally incorporated into its loan underwriting standards and internal lending limit. The allowance for credit losses is maintained at a level

considered adequate by management to provide for probable losses inherent in the loan portfolio. The year-end allowance for credit losses is based upon estimates that consider the general financial strength of the overall economy and the agricultural economy specifically, loan portfolio composition, credit administration and the portfolio's prior loan loss experience. The association calculates its allowance in two parts, specific allowances and general allowance. The association evaluates all loans classified as impaired for a specific allowance. Generally, for loans individually evaluated the allowance for credit losses represents the difference between the loan balance and the present value of the cash flows expected to be collected discounted at the loan's effective interest rate, or at the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. For those loans collectively evaluated for impairment, the allowance for credit losses is determined using factors related to its risk rating, and its commodity type.

The association also provides line of credit financing to customers to cover short-term and variable needs. As a result, the association has unfunded commitments for which a separate reserve is maintained. This reserve is reported as a liability on the association's consolidated balance sheet. The combined amounts of the allowance for loan losses and the reserve for unfunded commitments are referred to as the "allowance for credit losses."

The association purchases loan and lease participations from other System and non-System entities to generate additional earnings and diversify risk related to existing commodities financed and the geographic area served. Additionally, the association sells a portion of certain large loans to other System and non-System entities to reduce risk and comply with established lending limits. Loans are sold and the sale terms comply with requirements under ASC 860 "Transfers and Servicing".

- E. **Capital Stock Investment in the Bank:** The association's investment in the Bank is in the form of Class A voting capital stock and allocated retained earnings. This investment is adjusted annually. The Bank requires a minimum stock investment of 2 percent of the association's average borrowing from the Bank. This investment is carried at cost plus allocated equities from the Bank in the accompanying consolidated balance sheet.

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

- F. **Other Property Owned, Net:** Other property owned, net, consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure, and is recorded at fair value less estimated selling costs upon acquisition. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for credit losses. On at least an annual basis, revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in net gains (losses) on other property owned in the statements of comprehensive income.
- G. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost and not depreciated. Depreciation is provided on the straight-line method using estimated useful lives of each asset. Estimate useful lives are as follows: Buildings are 40 years, leasehold improvements are 15 years, furniture and equipment are 10 years, computer equipment and software are 3 years and automobiles are 3 years. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense, and improvements are capitalized.
- H. **Advance Conditional Payments:** The association is authorized under the Act to accept advance payments from borrowers. To the extent that the borrower's access to such funds is restricted, the advance conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as liabilities in the accompanying consolidated balance sheet. Advance conditional payments are not insured. Interest is generally paid by the association on such accounts at rates established by the board of directors, which was 2.15 percent at December 31, 2018.
- I. **Employee Benefit Plans:** Employees of the association participate in either the District defined benefit retirement plan (DB plan) or the defined contribution plan (DC plan). All eligible employees may participate in the Farm Credit Benefits Alliance 401(k) plan. Also, the association sponsors a nonqualified defined contribution 401(k) plan. The DB plan is closed to new participants. Participants generally include employees hired prior to January 1, 1996. The DB plan is noncontributory and provides benefits based on salary and years of service. The "Projected Unit Credit" actuarial method is used for financial reporting and funding purposes for the DB plan.

Participants in the DC plan generally include employees who elected to transfer from the DB plan prior to January 1, 1996, and employees hired on or after January 1, 1996. Participants in the DC plan direct the placement of their employers' contributions, 5.0 percent of eligible pay for the year ended December 31, 2018, made on their behalf into various investment alternatives. The association recognized costs for the DC plan of \$2,267, \$2,057 and \$1,903 for the years ended December 31, 2018, 2017 and 2016, respectively.

The structure of the District's DB plan is characterized as multi-employer, since neither the assets, liabilities nor costs of the plan are segregated or separately accounted for by the associations. No portion of any surplus assets is available to the associations, nor are the associations required to pay for plan liabilities upon withdrawal from the plans. As a result, the associations recognize as pension cost the required contribution to the plans for the year. Contributions due and unpaid are recognized as a liability. For the DB plan, the association recognized costs of \$2,920, \$4,419 and \$4,637 for the years ended December 31, 2018, 2017 and 2016, respectively.

The association also participates in the Farm Credit Benefits Alliance 401(k) plan which requires the associations to match 100 percent of employee contributions up to 3.0 percent of eligible earnings and to match 50 percent of employee contributions for the next 2.0 percent of employee contributions, up to a maximum employer contribution of 4.0 percent of eligible earnings. Association 401(k) plan costs are expensed as incurred. The association's contributions to the 401(k) plan were \$1,904, \$1,771 and \$1,674 for the years ended December 31, 2018, 2017 and 2016, respectively.

In addition to the DB plan, the DC plan and the Farm Credit Benefits Alliance 401(k) plan discussed above, the association also participates in a defined contribution nonqualified supplemental 401(k) plan. The purpose of the plan is (a) to provide eligible employees (those with compensation in excess of \$100 in the immediately preceding tax year) of the association who participate in the 401(k) plan with benefits in excess of the limitations on benefits imposed, (b) to allow a means for those employees to make pre-tax deferrals of additional amounts payable to them to a future payment date and (c) to allow a means for participating employers to provide discretionary deferred income to those employees. The associated liabilities are included in the association's consolidated balance sheet in other liabilities. The total expenses of the nonqualified plan included in the association's employee benefit costs were \$625, \$91 and \$52 for the years ended December 31, 2018, 2017 and 2016, respectively. The increase in the expense is due to an increase in employees electing to participate in the plan and for a retention agreement in place for senior management.

In addition to pension benefits, the association provides certain health care and life insurance benefits to qualifying retired employees (other postretirement benefits). These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in other liabilities. Association employees hired after January 1, 2004, will be eligible for retiree medical benefits for themselves and their spouses but will be responsible for 100 percent of the related premiums.

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

Deferred income taxes have not been provided by the association on patronage stock distributions from the Bank prior to January 1, 1993, the adoption date of FASB guidance on "Accounting for Income Taxes." Management's intent is (1) to permanently invest these and other undistributed earnings in the Bank, thereby indefinitely postponing their conversion to cash, or (2) to pass through any distribution related to pre-1993 earnings to association borrowers through qualified patronage allocations.

The association has not provided deferred income taxes on amounts allocated to the association which relate to the Bank's post-1992 earnings to the extent that such earnings will be passed through to association borrowers through qualified patronage allocations. Additionally, deferred income taxes have not been provided on the Bank's post-1992 unallocated earnings. The Bank currently has no plans to distribute unallocated Bank earnings and does not contemplate circumstances that, if distributions were made, would result in taxes being paid at the association level.

- K. Patronage Refunds From the Farm Credit Bank of Texas: The association records patronage refunds from the Bank on an accrual basis.
- L. Fair Value Measurement: The FASB guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It describes three levels of inputs that may be used to measure fair value:

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

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

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

The fair value disclosures are disclosed in Note 14, “Fair Value Measurements.”

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

NOTE 3 — INVESTMENTS:

Investments Held-to-Maturity

The association's held-to-maturity investments consists of Farmer Mac guaranteed agricultural mortgage-backed securities (AMBS). A summary of the amortized cost and fair value of investment securities held-to-maturity is as follows:

	Amortized	Gross Unrealized	Gross Unrealized	Fair Value	Weighted	Weighted
	Cost	Gains	Losses		Average Yield	Average Life
						(Years)
December 31, 2018						
Agricultural mortgage-backed securities	\$ 4,388	\$ 6	\$ -	\$ 4,394	5.74%	\$ 2.82
	Amortized	Gross Unrealized	Gross Unrealized	Fair Value	Weighted	Weighted
	Cost	Gains	Losses		Average Yield	Average Life
						(Years)
December 31, 2017						
Agricultural mortgage-backed securities	\$ 5,566	\$ 10	\$ -	\$ 5,576	5.31%	\$ 3.47
	Amortized	Gross Unrealized	Gross Unrealized	Fair Value	Weighted	Weighted
	Cost	Gains	Losses		Average Yield	Average Life
						(Years)
December 31, 2016						
Agricultural mortgage-backed securities	\$ 6,670	\$ 62	\$ -	\$ 6,732	4.98%	\$ 3.40

The Farmer Mac AMBS were received in exchange for mortgage loans which were previously covered under the long-term standby commitments to purchase agreement with Farmer Mac. No gain or loss was recognized in the financial statements upon completion of the exchange transactions. Terms of the agreement call for a guarantee fee of 20-50 basis points to be paid to Farmer Mac, and for the association to receive a 30-basis-point fee for servicing the underlying loans.

NOTE 4 — LOANS AND ALLOWANCE FOR CREDIT LOSSES:

A summary of loans as of December 31 follows:

Loan Type	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
Production agriculture:						
Real estate mortgage	\$ 5,642,145	76.4%	\$ 5,507,371	76.0%	\$ 5,226,806	75.5%
Production intermediate term	919,784	12.4%	910,316	12.6%	869,290	12.6%
Farm-related business	594,483	8.0%	595,329	8.2%	581,179	8.4%
Rural residential real estate	102,225	1.4%	105,579	1.5%	106,909	1.5%
Energy	60,626	0.8%	61,398	0.8%	71,192	1.0%
Communication	41,122	0.6%	45,695	0.6%	56,944	0.8%
Lease receivables	17,951	0.2%	7,782	0.1%	5,969	0.1%
Water and waste disposal	8,140	0.1%	4,872	0.1%	1,897	0.0%
Mission-related investments	6,530	0.1%	7,025	0.1%	7,779	0.1%
Total	\$ 7,393,006	100.0%	\$ 7,245,367	100.0%	\$ 6,927,965	100.0%

At December 31, 2018, the association held four transactions, which are reported as loans on the consolidated balance sheet totaling \$6,100 and with \$0 in remaining commitments extended under the Rural America Bond Program approved by the FCA. The program is designed to meet the growing and changing needs of agricultural enterprises, agribusinesses and rural communities by providing qualified loans in rural areas.

The association has purchased and sold participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. In September 2018, the association completed a sale of \$99,586 in loans to the Farm Credit Bank of Texas as part of their capitalized participation pool (CPP). In accordance with this program, the association capitalizes this loan pool with a 6 percent investment in the Bank in exchange for the net earnings this pool generates. The CPP program allows the association to manage its capital by controlling the amount of loan volume on the balance sheet without impacting the profitability of the association. The following table presents information regarding participations purchased and sold as of December 31, 2018:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations	Participations	Participations	Participations	Participations	Participations
	Purchased	Sold	Purchased	Sold	Purchased	Sold
Real estate mortgage	\$ 129,025	\$ 574,651	\$ 8,894	\$ -	\$ 137,919	\$ 574,651
Production and intermediate term	209,339	701,415	-	-	209,339	701,415
Farm-related business	396,139	111,023	4,937	-	401,076	111,023
Communication	41,122	-	-	-	41,122	-
Energy	60,626	-	-	-	60,626	-
Mission-related investments	2,084	-	4,016	-	6,100	-
Lease receivables	17,951	-	-	-	17,951	-
Water and waste disposal	8,046	-	-	-	8,046	-
Total	\$ 864,332	\$ 1,387,089	\$ 17,847	\$ -	\$ 882,179	\$ 1,387,089

Loan Volume by Office

Offices	2018	2017	2016
Agribusiness	14.3%	14.4%	14.7%
Bryan	4.1%	4.0%	3.8%
Kerrville	3.4%	3.5%	3.4%
Muleshoe	3.2%	3.2%	3.3%
San Antonio	3.0%	3.2%	3.1%
Austin	2.9%	2.8%	2.6%
Lubbock	2.8%	2.7%	2.6%
Conroe	2.7%	2.7%	2.8%
Fredericksburg	2.5%	2.7%	2.6%
La Grange	2.4%	2.4%	2.5%
Mason	2.3%	2.3%	2.4%
Hondo	2.3%	2.5%	2.5%
Uvalde	2.3%	2.2%	2.4%
Edna	2.1%	2.3%	2.3%
Burnet	2.0%	1.7%	1.8%
Dayton	2.0%	1.9%	1.9%
Dalhart	1.9%	1.9%	2.3%
Bellville	1.8%	1.9%	2.0%
El Campo	1.8%	1.7%	1.7%
Robstown	1.8%	1.9%	2.0%
Hereford	1.8%	1.6%	1.6%
Temple	1.7%	1.8%	1.8%
Katy	1.7%	1.6%	1.4%
Waco	1.6%	1.6%	1.6%
Rosenberg	1.6%	1.5%	1.3%
Jourdanton	1.6%	1.7%	1.7%
Stamford	1.5%	1.7%	1.5%
San Angelo	1.5%	1.8%	1.5%
New Braunfels	1.5%	1.4%	1.4%
Kenedy	1.4%	1.5%	1.7%
Taylor	1.4%	1.2%	1.0%
San Saba	1.4%	1.3%	1.5%
Lockhart	1.4%	1.3%	1.3%
Wichita Falls	1.3%	1.4%	1.5%
Bowie	1.2%	1.1%	1.1%
Madisonville	1.2%	1.2%	1.3%
Edinburg	1.2%	1.3%	1.4%
Laredo	1.2%	1.3%	1.4%
Munday	1.1%	1.1%	1.3%
Pampa	1.1%	0.9%	0.6%
Bay City	1.0%	0.9%	0.9%
Perryton	1.0%	0.5%	0.5%
Lamesa	0.9%	0.9%	0.8%
Abilene	0.9%	0.8%	0.9%
Spur	0.8%	0.8%	0.8%
El Paso	0.7%	0.8%	0.8%
Alpine	0.7%	0.8%	0.6%
Snyder	0.6%	0.7%	0.6%
Crockett	0.6%	0.6%	0.6%
All Other Offices	2.8%	3.0%	2.9%
Totals	100.0%	100.0%	100.0%

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

Operation/Commodity	2018		2017		2016	
	Amount	%	Amount	%	Amount	%
Livestock	\$ 3,822,558	51.7%	\$ 3,765,050	52.0%	\$ 3,652,986	52.8%
Crops	1,498,424	20.3%	1,472,859	20.3%	1,412,705	20.4%
Hunting	712,703	9.6%	659,895	9.1%	546,055	7.9%
Dairy	261,514	3.5%	228,102	3.1%	202,865	2.9%
Timber	212,063	2.9%	189,179	2.6%	193,950	2.8%
Rural home loans	159,207	2.2%	139,436	1.9%	134,606	1.9%
Utilities	103,348	1.4%	117,349	1.6%	139,391	2.0%
Poultry	75,540	1.0%	91,338	1.3%	82,656	1.2%
Industrial/organic chemical	3,456	0.0%	11,697	0.2%	15,660	0.2%
Other	544,193	7.4%	570,462	7.9%	547,091	7.9%
Total	\$ 7,393,006	100.0%	\$ 7,245,367	100.0%	\$ 6,927,965	100.0%

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

To mitigate the risk of loan losses, the association has obtained loan guarantees in the form of standby commitments to purchase qualifying loans from Farmer Mac through an arrangement with the Bank. The agreements, which will remain in place until the loans are paid in full, give the association the right to sell the loans identified in the agreements to Farmer Mac in the event of defaults (typically four months past due), subject to certain conditions. At December 31, 2018, 2017 and 2016, loans totaling \$15,241, \$30,986 and \$35,437, respectively, were guaranteed by these commitments. Fees paid for these guarantees totaled \$110, \$143 and \$165 in 2018, 2017 and 2016, respectively, and are reflected in "other noninterest expense" in the consolidated statements of comprehensive income.

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

	December 31, 2018	December 31, 2017	December 31, 2016
Nonaccrual loans:			
Real estate mortgage	\$ 30,222	\$ 44,967	\$ 53,841
Production and intermediate-term	11,173	20,557	30,762
Farm-related business	2,793	2,867	3,471
Residential real estate	391	503	574
Energy	3,428	-	-
Lease receivable	-	59	92
Total nonaccrual loans	<u>\$ 48,007</u>	<u>\$ 68,953</u>	<u>\$ 88,740</u>
Accruing restructured loans:			
Real estate mortgage	\$ 5,532	\$ 3,906	\$ 7,715
Production and intermediate-term	4,158	3,723	381
Mission related investments	2,105	2,170	2,229
Total accruing restructured loans	<u>\$ 11,795</u>	<u>\$ 9,799</u>	<u>\$ 10,325</u>
Accruing loans 90 days or more past due:			
Real estate mortgage	\$ 37	\$ 24	\$ 2,313
Production and intermediate-term	-	-	1,538
Total accruing loans 90 days or more past due	<u>\$ 37</u>	<u>\$ 24</u>	<u>\$ 3,851</u>
Total nonperforming loans	<u>\$ 59,839</u>	<u>\$ 78,776</u>	<u>\$ 102,916</u>
Other property owned, net	972	3,989	2,634
Total nonperforming assets	<u>\$ 60,811</u>	<u>\$ 82,765</u>	<u>\$ 105,550</u>

One credit quality indicator utilized by the Bank and 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 considered to be currently collectible but exhibit some potential weakness,
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

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

	2018	2017	2016
Real estate mortgage			
Acceptable	97.4%	96.7%	96.5%
OAEM	1.3%	1.5%	2.0%
Substandard/doubtful	1.3%	1.8%	1.5%
	100.0%	100.0%	100.0%
Production and intermediate-term			
Acceptable	91.0%	90.5%	88.2%
OAEM	4.6%	4.5%	5.1%
Substandard/doubtful	4.4%	5.0%	6.7%
	100.0%	100.0%	100.0%
Farm-related business			
Acceptable	96.8%	97.6%	95.5%
OAEM	0.4%	-	0.8%
Substandard/doubtful	2.8%	2.4%	3.7%
	100.0%	100.0%	100.0%
Rural residential real estate			
Acceptable	98.4%	98.1%	98.6%
OAEM	0.9%	1.0%	0.7%
Substandard/doubtful	0.7%	0.9%	0.7%
	100.0%	100.0%	100.0%
Communication			
Acceptable	100.0%	100.0%	100.0%
OAEM	-	-	-
Substandard/doubtful	-	-	-
	100.0%	100.0%	100.0%
Energy			
Acceptable	92.2%	91.4%	82.3%
OAEM	2.2%	2.5%	17.7%
Substandard/doubtful	5.6%	6.1%	-
	100.0%	100.0%	100.0%
Mission-related investments			
Acceptable	100.0%	100.0%	100.0%
OAEM	-	-	-
Substandard/doubtful	-	-	-
	100.0%	100.0%	100.0%
Lease receivables			
Acceptable	100.0%	99.2%	98.5%
OAEM	-	-	-
Substandard/doubtful	-	0.8%	1.5%
	100.0%	100.0%	100.0%
Water and waste disposal			
Acceptable	100.0%	100.0%	100.0%
OAEM	-	-	-
Substandard/doubtful	-	-	-
	100.0%	100.0%	100.0%
Total loans			
Acceptable	96.6%	96.0%	95.3%
OAEM	1.6%	1.7%	2.4%
Substandard/doubtful	1.8%	2.3%	2.3%
	100.0%	100.0%	100.0%

There were no loans and related interest in the loss category.

The following table provides an age analysis of past due loans (including accrued interest) as of December 31:

December 31, 2018	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	Loans >90 Days and Accruing
Real estate mortgage	\$ 29,535	\$ 10,016	\$ 39,551	\$ 5,652,902	\$ 5,692,453	37
Production and intermediate term	16,571	2,373	18,944	916,582	935,526	-
Farm-related business	5,996	131	6,127	590,510	596,637	-
Rural residential real estate	743	41	784	101,801	102,585	-
Communication	-	-	-	41,125	41,125	-
Energy	199	-	199	60,554	60,753	-
Mission-related investments	-	-	-	6,586	6,586	-
Lease receivables	-	-	-	18,017	18,017	-
Water and waste disposal	-	-	-	8,148	8,148	-
Total	<u>\$ 53,044</u>	<u>\$ 12,561</u>	<u>\$ 65,605</u>	<u>\$ 7,396,225</u>	<u>\$ 7,461,830</u>	<u>\$ 37</u>
December 31, 2017	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or less than 30 Days Past Due	Total Loans	Loans >90 Days and Accruing
Real estate mortgage	\$ 23,845	\$ 11,932	\$ 35,777	\$ 5,519,169	\$ 5,554,946	\$ 24
Production and intermediate term	5,929	6,971	12,900	911,463	924,363	-
Farm-related business	5,850	-	5,850	591,529	597,379	-
Rural residential real estate	478	152	630	105,327	105,957	-
Communication	-	-	-	45,756	45,756	-
Energy	-	-	-	61,529	61,529	-
Mission-related investments	-	-	-	7,083	7,083	-
Lease receivables	-	59	59	7,801	7,860	-
Water and waste disposal	-	-	-	4,877	4,877	-
Total	<u>\$ 36,102</u>	<u>\$ 19,114</u>	<u>\$ 55,216</u>	<u>\$ 7,254,534</u>	<u>\$ 7,309,750</u>	<u>\$ 24</u>
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	Loans >90 Days and Accruing
Real estate mortgage	\$ 25,344	\$ 19,308	\$ 44,652	\$ 5,226,017	\$ 5,270,669	\$ 2,313
Production and intermediate term	24,253	7,399	31,652	849,769	881,421	1,538
Farm-related business	5,045	-	5,045	577,966	583,011	-
Rural residential real estate	602	211	813	106,461	107,274	-
Communication	-	-	-	56,979	56,979	-
Energy	-	-	-	71,333	71,333	-
Mission-related investments	-	-	-	7,840	7,840	-
Lease receivables	-	-	-	6,046	6,046	-
Water and waste disposal	-	-	-	1,898	1,898	-
Total	<u>\$ 55,244</u>	<u>\$ 26,918</u>	<u>\$ 82,162</u>	<u>\$ 6,904,309</u>	<u>\$ 6,986,471</u>	<u>\$ 3,851</u>

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

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

As of December 31, 2018 total troubled debt restructured loans was \$17,545, including \$5,750 classified as nonaccrual and \$11,795 classified as accrual, with specific allowance for credit losses of \$533. As of December 31, 2018, 2017 and 2016, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were \$1, \$68 and \$44, respectively.

The following table presents additional information regarding troubled debt restructurings, which includes both accrual and nonaccrual loans with troubled debt restructuring designation that occurred during the year ended December 31, 2018, 2017 and 2016. The pre-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end prior to the restructuring. The post-modification outstanding recorded investment represents the recorded investment of the loans as of the quarter end the restructuring occurred.

2018	Balance Pre-TDR designation	Balance Post-TDR designation
Troubled debt restructurings:		
Production and intermediate term	\$ 7,786	\$ 5,102
Real estate mortgage	2,399	2,674
Total	<u>\$ 10,185</u>	<u>\$ 7,776</u>
2017	Balance Pre-TDR designation	Balance Post-TDR designation
Troubled debt restructurings:		
Production and intermediate term	\$ 5,296	\$ 5,069
Total	<u>\$ 5,296</u>	<u>\$ 5,069</u>
2016	Balance Pre-TDR designation	Balance Post-TDR designation
Troubled debt restructurings:		
Production and intermediate term	9	8
Total	<u>\$ 9</u>	<u>\$ 8</u>

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no charge-offs recorded at the modification date for the year ending December 31, 2018.

The predominant form of concession granted for troubled debt restructuring is an extension of 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 the association assesses all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

The following table presents information regarding loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months of that year and for which there was a payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

Troubled debt restructurings that subsequently defaulted:	Recorded Investment at December 31, 2018	Recorded Investment at December 31, 2017	Recorded Investment at December 31, 2016
Real estate mortgage	\$ 153	\$ -	\$ -
Production and intermediate term	783	523	-
Total	<u>\$ 936</u>	<u>\$ 523</u>	<u>\$ -</u>

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

	Loans Modified as TDRs		
	December 31, 2018	December 31, 2017	December 31, 2016
Troubled debt restructurings:			
Real estate mortgage	\$ 6,671	\$ 3,981	\$ 7,920
Production and intermediate term	8,638	4,707	832
Farm-related business	131	131	603
Rural residential real estate	-	132	147
Mission-related investments	2,105	2,170	2,229
Total	<u>\$ 17,545</u>	<u>\$ 11,121</u>	<u>\$ 11,731</u>
		TDRs in Nonaccrual Status*	
	December 31, 2018	December 31, 2017	December 31, 2016
Troubled debt restructurings:			
Real estate mortgage	\$ 1,139	\$ 75	\$ 205
Production and intermediate term	4,480	984	451
Farm-related business	131	131	603
Rural residential real estate	-	132	147
Mission-related investments	-	-	-
Total	<u>\$ 5,750</u>	<u>\$ 1,322</u>	<u>\$ 1,406</u>

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

Additional impaired loan information is as follows:

	Loan Balance at 12/31/2018	Unpaid Principal Balance	Related Specific Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	\$ 1,768	\$ 1,972	\$ 235	\$ 1,263	\$ 19
Production and intermediate term	5,786	7,873	927	6,239	50
Farm-related business	2,653	2,653	368	2,691	201
Rural residential real estate	29	48	4	5	3
Energy	3,428	3,428	1,053	2,982	-
Mission-related investments	137	137	40	156	11
Total	<u>\$ 13,801</u>	<u>\$ 16,111</u>	<u>\$ 2,627</u>	<u>\$ 13,336</u>	<u>\$ 284</u>
Impaired loans with no related specific allowance for loan losses:					
Real estate mortgage	\$ 33,937	\$ 36,000	\$ -	\$ 42,520	\$ 711
Production and intermediate term	9,344	13,175	-	14,983	417
Farm-related business	140	3,097	-	134	45
Rural residential real estate	362	567	-	408	5
Energy	-	-	-	3	-
Mission-related investments	1,947	1,947	-	1,950	119
Lease receivables	-	-	-	40	-
Total	<u>\$ 45,730</u>	<u>\$ 54,786</u>	<u>\$ -</u>	<u>\$ 60,038</u>	<u>\$ 1,297</u>
Total impaired loans:					
Real estate mortgage	\$ 35,705	\$ 37,972	\$ 235	\$ 43,783	\$ 730
Production and intermediate term	15,130	21,048	927	21,222	467
Farm-related business	2,793	5,750	368	2,825	246
Rural residential real estate	391	615	4	413	8
Energy	3,428	3,428	1,053	2,985	-
Mission-related investments	2,084	2,084	40	2,106	130
Lease receivables	-	-	-	40	-
Total	<u>\$ 59,531</u>	<u>\$ 70,897</u>	<u>\$ 2,627</u>	<u>\$ 73,374</u>	<u>\$ 1,581</u>

Unpaid principal balance represents the recorded principal balance of the loan.

	Loan Balance at 12/31/2017	Unpaid Principal Balance	Related Specific Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	\$ 240	\$ 248	\$ 30	\$ 1,535	\$ 3
Production and intermediate term	3,499	4,035	771	7,448	33
Farm-related business	2,736	2,736	368	2,819	174
Rural residential real estate	-	-	-	8	-
Mission-related investments	163	163	80	1,507	12
Total	<u>\$ 6,638</u>	<u>\$ 7,182</u>	<u>\$ 1,249</u>	<u>\$ 13,317</u>	<u>\$ 222</u>
Impaired loans with no related specific allowance for loan losses:					
Real estate mortgage	\$ 48,635	\$ 51,160	\$ -	\$ 54,031	\$ 2,836
Production and intermediate term	20,619	24,572	-	19,685	952
Farm-related business	131	3,107	-	461	9
Rural residential real estate	503	737	-	538	-
Mission-related investments	1,985	1,985	-	662	122
Lease receivables	59	81	-	82	-
Total	<u>\$ 71,932</u>	<u>\$ 81,642</u>	<u>\$ -</u>	<u>\$ 75,459</u>	<u>\$ 3,919</u>
Total impaired loans:					
Real estate mortgage	\$ 48,875	\$ 51,408	\$ 30	\$ 55,566	\$ 2,839
Production and intermediate term	24,118	28,607	771	27,133	985
Farm-related business	2,867	5,843	368	3,280	183
Rural residential real estate	503	737	-	546	-
Mission-related investments	2,148	2,148	80	2,169	134
Lease receivables	59	81	-	82	-
Total	<u>\$ 78,570</u>	<u>\$ 88,824</u>	<u>\$ 1,249</u>	<u>\$ 88,776</u>	<u>\$ 4,141</u>

Unpaid principal balance represents the recorded principal balance of the loan.

	Loan Balance at 12/31/2016	Unpaid Principal Balance	Related Specific Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for loan losses:					
Real estate mortgage	\$ 2,833	\$ 2,836	\$ 207	\$ 4,329	\$ -
Production and intermediate term	12,030	12,563	2,580	12,838	99
Farm-related business	2,868	2,868	368	609	-
Rural residential real estate	-	-	-	-	-
Mission-related investments	2,206	2,206	86	2,224	138
Total	<u>\$ 19,937</u>	<u>\$ 20,473</u>	<u>\$ 3,241</u>	<u>\$ 20,000</u>	<u>\$ 237</u>
Impaired loans with no related specific allowance for loan losses:					
Real estate mortgage	\$ 60,887	\$ 63,680	\$ -	\$ 59,934	\$ 3,366
Production and intermediate term	20,608	23,053	-	16,357	493
Farm-related business	603	14,904	-	839	18
Rural residential real estate	574	682	-	452	14
Mission-related investments	-	-	-	-	-
Lease receivables	91	91	-	23	4
Total	<u>\$ 82,763</u>	<u>\$ 102,410</u>	<u>\$ -</u>	<u>\$ 77,605</u>	<u>\$ 3,895</u>
Total impaired loans:					
Real estate mortgage	\$ 63,720	\$ 66,516	\$ 207	\$ 64,263	\$ 3,366
Production and intermediate term	32,638	35,616	2,580	29,195	592
Farm-related business	3,471	17,772	368	1,448	18
Rural residential real estate	574	682	-	452	14
Mission-related investments	2,206	2,206	86	2,224	138
Lease receivables	91	91	-	23	4
Total	<u>\$ 102,700</u>	<u>\$ 122,883</u>	<u>\$ 3,241</u>	<u>\$ 97,605</u>	<u>\$ 4,132</u>

Unpaid principal balance represents the recorded principal balance of the loan.

The association has remaining commitments to lend additional funds to 14, 15 and 18 borrowers whose loans were classified as impaired at December 31, 2018, 2017 and 2016, respectively. These commitments totaled \$2,682, \$3,535 and \$1,456 at December 31, 2018, 2017 and 2016, respectively. The remaining commitments have been considered when establishing the allowance for loan losses, which is recorded in other liabilities.

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

	2018	2017	2016
Total interest income which would have been recognized under the original terms	<u>\$ 3,910</u>	<u>\$ 4,531</u>	<u>\$ 6,964</u>
Less: interest income recognized	<u>1,581</u>	<u>4,141</u>	<u>4,132</u>
Interest income not recognized	<u>\$ 2,329</u>	<u>\$ 390</u>	<u>\$ 2,832</u>

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

	Real Estate Mortgage	Production and Intermediate Term	Farm-related business	Rural Residential Real Estate	Communication	Energy	Mission- Related Investments	Lease Receivable	Total
Allowance for credit losses:									
Balance at									
December 31, 2017	\$ 10,470	\$ 12,955	\$ 4,002	\$ 150	\$ 145	\$ 1,615	\$ 82	\$ 31	\$ 29,450
Charge-offs	(83)	(2,168)	-	(28)	-	-	-	(16)	(2,295)
Recoveries	530	762	76	36	30	-	-	-	1,434
Provision for credit losses	(2,415)	114	(708)	(60)	(89)	(313)	(51)	53	(3,469)
Transfer from reserve on unfunded commitments	15	252	69	-	-	29	10	-	375
Balance at									
December 31, 2018	\$ 8,517	\$ 11,915	\$ 3,439	\$ 98	\$ 86	\$ 1,331	\$ 41	\$ 68	\$ 25,495
Allowance for credit losses:									
individually evaluated for impairment									
	\$ 235	\$ 927	\$ 368	\$ 4	\$ -	\$ 1,053	\$ 40	\$ -	\$ 2,627
Allowance for credit losses:									
collectively evaluated for impairment									
	\$ 8,282	\$ 10,988	\$ 3,071	\$ 94	\$ 86	\$ 278	\$ 1	\$ 68	\$ 22,868
Loans, including accrued interest:									
Ending Balance at									
December 31, 2018	\$ 5,692,453	\$ 935,526	\$ 596,637	\$ 102,585	\$ 41,125	\$ 68,901	\$ 6,586	\$ 18,017	\$ 7,461,830
Ending balance for loans individually evaluated for impairment									
	\$ 35,705	\$ 15,130	\$ 2,793	\$ 391	\$ -	\$ 3,428	\$ 2,084	\$ -	\$ 59,531
Ending balance for loans collectively evaluated for impairment									
	\$ 5,656,748	\$ 920,396	\$ 593,844	\$ 102,194	\$ 41,125	\$ 65,473	\$ 4,502	\$ 18,017	\$ 7,402,299

	Real Estate Mortgage	Production and Intermediate Term	Farm-related business	Rural Residential Real Estate	Communication	Energy	Mission- Related Investments	Lease Receivable	Total
Allowance for credit losses:									
Balance at									
December 31, 2016	\$ 8,194	\$ 15,840	\$ 4,954	\$ 135	\$ 183	\$ 873	\$ 88	\$ 20	\$ 30,287
Charge-offs	(8)	(4,448)	-	(17)	-	-	-	(23)	(4,496)
Recoveries	423	583	116	28	-	-	13	-	1,163
Provision for credit losses	1,858	791	(1,054)	4	(39)	731	(10)	34	2,315
Transfer to reserve on unfunded commitments	3	189	(14)	-	1	11	(9)	-	181
Balance at									
December 31, 2017	\$ 10,470	\$ 12,955	\$ 4,002	\$ 150	\$ 145	\$ 1,615	\$ 82	\$ 31	\$ 29,450

Allowance for credit losses:									
individually evaluated for impairment	\$ 30	\$ 771	\$ 368	\$ -	\$ -	\$ -	\$ 80	\$ -	\$ 1,249
Allowance for credit losses:									
collectively evaluated for impairment	\$ 10,440	\$ 12,184	\$ 3,634	\$ 150	\$ 145	\$ 1,615	\$ 2	\$ 31	\$ 28,201

Loans, including accrued interest:									
Ending Balance at									
December 31, 2017	\$ 5,554,946	\$ 924,363	\$ 597,379	\$ 105,957	\$ 45,756	\$ 66,406	\$ 7,083	\$ 7,860	\$ 7,309,750
Ending balance for loans individually evaluated for impairment	\$ 48,875	\$ 24,118	\$ 2,867	\$ 503	\$ -	\$ -	\$ 2,148	\$ 59	\$ 78,570
Ending balance for loans collectively evaluated for impairment	\$ 5,506,071	\$ 900,245	\$ 594,512	\$ 105,454	\$ 45,756	\$ 66,406	\$ 4,935	\$ 7,801	\$ 7,231,180

	Real Estate Mortgage	Production and Intermediate Term	Farm-related business	Rural Residential Real Estate	Communication	Energy	Mission- Related Investments	Lease Receivable	Total
Allowance for credit losses:									
Balance at									
December 31, 2015	\$ 10,168	\$ 10,465	\$ 2,023	\$ 174	\$ 141	\$ 247	\$ 89	\$ 21	\$ 23,328
Charge-offs	(50)	(807)	-	-	-	-	-	-	(857)
Recoveries	699	168	212	14	349	-	-	-	1,442
Provision for credit losses	(2,598)	6,806	2,844	(53)	(306)	670	(1)	(1)	7,361
Transfer to reserve on unfunded commitments	(25)	(792)	(125)	-	(1)	(44)	-	-	(987)
Balance at									
December 31, 2016	\$ 8,194	\$ 15,840	\$ 4,954	\$ 135	\$ 183	\$ 873	\$ 88	\$ 20	\$ 30,287

Allowance for credit losses:									
individually evaluated for impairment	\$ 207	\$ 2,580	\$ 368	\$ -	\$ -	\$ -	\$ 86	\$ -	\$ 3,241
Allowance for credit losses:									
collectively evaluated for impairment	\$ 7,987	\$ 13,260	\$ 4,586	\$ 135	\$ 183	\$ 873	\$ 2	\$ 20	\$ 27,046

Loans, including accrued interest:									
Ending Balance at									
December 31, 2016	\$ 5,257,669	\$ 894,421	\$ 583,011	\$ 107,274	\$ 56,979	\$ 73,231	\$ 7,840	\$ 6,046	\$ 6,986,471
Ending balance for loans individually evaluated for impairment	\$ 63,720	\$ 32,638	\$ 3,471	\$ 574	\$ -	\$ -	\$ 2,206	\$ 91	\$ 102,700
Ending balance for loans collectively evaluated for impairment	\$ 5,193,949	\$ 861,783	\$ 579,540	\$ 106,700	\$ 56,979	\$ 73,231	\$ 5,634	\$ 5,955	\$ 6,883,771

NOTE 5 – INVESTMENT IN THE FARM CREDIT BANK OF TEXAS:

The investment in the Farm Credit Bank of Texas is a requirement of borrowing from the Bank and is carried at cost plus allocated equities, not fair value, in the accompanying consolidated balance sheet. Estimating the fair value of the association's investment in the Farm Credit Bank of Texas is not practicable because the stock is not traded. The association owns 39.8 percent, 39.4 percent and 40.1 percent of the issued stock of the Bank as of December 31, 2018, 2017, and 2016. As of those dates, the Bank's assets totaled \$24,529,150, \$22,836,605 and \$21,222,398 and members' equity totaled \$1,776,933, \$1,667,884 and \$1,622,252. The Bank's earnings were \$190,530, \$195,986 and \$192,406 during 2018, 2017, and 2016.

NOTE 6 — PREMISES AND EQUIPMENT:

Premises and equipment consisted of the following at December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Land and Improvements	\$ 3,325	\$ 3,337	\$ 3,310
Building and improvements	15,071	14,896	14,428
Furniture and equipment	2,386	2,592	3,112
Computer equipment and software	5,494	7,311	6,896
Automobiles	8,097	6,044	6,913
Construction in progress	459	81	20
	<u>34,832</u>	<u>34,261</u>	<u>34,679</u>
Accumulated depreciation	(19,467)	(20,056)	(18,017)
Total	<u>\$ 15,365</u>	<u>\$ 14,205</u>	<u>\$ 16,662</u>

The association leases office space in Abilene, Austin, Bay City, Boerne, Bryan, Burnet, Conroe, Crockett, Devine, Edinburg, El Paso, Fredericksburg, Georgetown, Harlingen, Hondo, Katy, Kenedy, Laredo, Livingston, New Braunfels, Robstown, Round Rock, San Antonio Seminole and Winnie, Texas. Lease expense was \$2,075, \$2,036 and \$1,796 for 2018, 2017 and 2016, respectively. Minimum annual lease payments for the next five years are as follows:

2019	\$ 2,323
2020	1,935
2021	1,743
2022	1,692
2023	1,651
Thereafter	4,069
Total	<u>\$ 13,413</u>

NOTE 7 – OTHER PROPERTY OWNED, NET:

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Gain on sale of other property owned	\$ 1,027	\$ 573	\$ 2
Carrying value adjustments	2	(172)	-
Holding costs of other property owned	(195)	104	(40)
Net gain (loss) on other property owned	<u>\$ 834</u>	<u>\$ 505</u>	<u>\$ (38)</u>

The association's other property owned (OPO) at December 31, 2018, includes six properties totaling 556.4 acres. All these properties have been individually appraised and the carrying amounts are not in excess of appraised values at December 31, 2018.

NOTE 8 – OTHER ASSETS AND OTHER LIABILITIES:

Other assets comprised the following at December 31:

	2018	2017	2016
Prepaid captive insurance premium	\$ 2,214	\$ 2,267	\$ 2,178
Nonqualified deferred compensation trust	7,103	6,478	5,834
RBIC investment	11,624	11,573	6,775
Acquisition intangibles	2,517	2,863	3,343
Other assets	2,179	911	677
Total assets	<u>\$ 25,637</u>	<u>\$ 24,092</u>	<u>\$ 18,807</u>

Other liabilities comprised the following at December 31:

	2018	2017	2016
Accounts payable	\$ 23,600	\$ 19,895	\$ 18,007
Annual leave payable	3,066	2,859	2,703
FCS insurance payable	5,253	8,380	9,161
Nonqualified deferred compensation payable	7,103	6,478	5,834
Other liabilities	6,857	5,400	4,666
Total liabilities	<u>\$ 45,879</u>	<u>\$ 43,012</u>	<u>\$ 40,371</u>

NOTE 9 — NOTE PAYABLE TO THE BANK:

The interest rate risk inherent in the association's loan portfolio is substantially mitigated through the funding relationship with the bank. The bank manages interest rate risk through its direct loan pricing and asset/liability management process. The association's indebtedness to the bank represents borrowings by the association to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the association's assets, and is governed by a general financing agreement. The interest rate on the direct loan is based upon the bank's cost of funding the loans the association has outstanding to its borrowers. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2019, unless sooner terminated by the bank upon the occurrence of an event of default, or by the association, in the event of a breach of this agreement by the bank, upon giving the bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the bank 120 days' prior written notice.

The total amount and the weighted average interest rate of the association's direct loan from the Bank at December 31, 2018, 2017 and 2016, were \$6,223,546 at 2.69 percent, \$6,127,915 at 2.26 percent and \$5,872,624 at 2.03 percent, respectively.

Under the Act, the association is obligated to borrow only from the Bank unless the Bank approves borrowing from other funding sources. The Bank and FCA regulations have established limitations on the association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2018, 2017 and 2016, the association's note payable was within the specified limitations. The maximum amount the association may borrow from the Bank as of December 31, 2018, was \$7,250,033 as defined by the general financing agreement. This borrowing limit changes as the borrowing base increases or decreases.

In addition to borrowing limits, the financing agreement establishes certain covenants including limits on leases, investments, other debt and dividend and patronage distributions; minimum standards for return on assets and for liquidity; and maintaining records, reporting financial information and establishing policies and procedures. Remedies specified in the general financing agreement associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, and reduction of lending limits or repayment of indebtedness. As of and for the years ended December 31, 2018, 2017 and 2016, the association was not subject to remedies associated with the covenants in the general financing agreement.

NOTE 10 — MEMBERS' EQUITY:

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

In accordance with the Act and the association's capitalization bylaws, each borrower is required to invest in the association as a condition of borrowing. The investment in Class B capital stock or participation certificates is equal to 2 percent of the loan amount,

up to a maximum amount of one thousand dollars. The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, usually by adding the aggregate par value of the capital stock or participation certificates to the principal amount of the related loan obligation. The capital stock or participation certificates are subject to a first lien by the association. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding capital stock or participation certificates.

If needed to meet regulatory capital adequacy requirements, the board of directors of the association may increase the percentage of stock requirement for each borrower up to a maximum of 10 percent of the loan amount.

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

Within two years of repayment of a loan, the association capital bylaws require the conversion of any borrower’s outstanding Class B and participation certificates to Class A stock. Class A stock has no voting rights except in a case where a new issuance of preferred stock has been submitted to stockholders affected by the preference. Redemption of capital stock and participation certificates is made solely at the discretion of the association’s board of directors. At December 31, 2018, 2017 and 2016, the association had \$0, \$1 and \$1, respectively, of Class A stock.

All borrower stock and allocated equities are at-risk. Net losses recorded by the association shall first be applied against unallocated retained earnings. To the extent such losses exceed unallocated retained earnings, such losses would be applied in accordance with association bylaws and be borne first on a pro rata basis by holders of all allocated equities and then on a pro rata basis by all holders of Class A stock, Class B capital stock and participation certificates. In the event of liquidation or dissolution of the association, any assets of the association remaining after payment or retirement of all liabilities shall first be distributed to the holders of stock and participation certificates pro rata in proportion to the number of shares or units of stock or participation certificates then outstanding until an amount equal to the aggregate par value or unit value of all shares of such stock and participation certificates issued and outstanding has been distributed to such holders; second, to the holders of qualified allocated earnings on the basis of the oldest allocations first, until an amount equal to the balance outstanding in this account has been distributed to the holders; third, to the holders of nonqualified allocated earnings on a pro rata basis until an amount equal to the total of all notices outstanding has been distributed to the holders; and fourth, any remaining assets of the association in excess of the association’s obligations to external parties and to the bank shall be distributed to the members, in proportion to which the aggregate patronage of each such member bears to the total patronage of all such parties insofar as practicable, unless provided by law.

Patronage distributions may be paid as the board of directors may determine by resolution subject to capitalization requirements as defined by the FCA. Amounts not distributed are retained as unallocated retained earnings. The following patronage distributions were declared and paid in 2018, 2017 and 2016, respectively:

<u>Date Declared</u>	<u>Nonqualified Allocated Retained Earnings Issued</u>	<u>Cash Patronage</u>	
		<u>Amount</u>	<u>Date Paid (Payable)</u>
December 2018	\$ 96,787	\$ 87,543	March 2019
December 2017	\$ 86,341	\$ 77,506	March 2018
December 2016	\$ 77,830	\$ 57,170	April 2017

The association may create and maintain an allocated surplus account consisting of earnings held therein and allocated to borrowers on a patronage basis pursuant to its bylaws. Allocated surplus may be evidenced by either “qualified written notices of allocation” or “nonqualified written notices of allocation,” or both.

All allocations in the form of qualified written notices of allocation shall be issued in annual series and shall be identified by the year of issuance. Each such series shall be retired fully or on a pro rata basis, only at the discretion of the board, in order of issuance by years as funds are available. Currently, the association has no qualified allocated equity outstanding.

All allocations in the form of nonqualified notices of allocation shall be issued in annual series and identified by the year of issuance. Each annual series may be subdivided between two or more classes. Each such series, or class thereof, shall be retired at the discretion

of the board. The association currently has the following series of nonqualified allocated retained earnings outstanding which includes adjustment made to finalize the computation of these contributions

Declaration for year	Nonqualified Allocated Retained Earnings
2011	\$ 38,206
2012	96,113
2013	78,649
2014	70,067
2015	80,881
2016	77,795
2017	86,341
2018	96,787
Total	\$ 624,839

In September 2018, the board of directors approved a resolution to retire \$50,000 in nonqualified allocated equities which were paid to the stockholders in November 2018. These equities represented 56 percent of the remaining earnings allocated in 2011.

In September 2017, the board of directors approved a resolution to retire \$36,785 in nonqualified allocated equities which were paid to stockholders in November 2017. The equities retired represented all of the earnings allocated in 2010.

In September 2016, the board of directors approved a resolution to retire \$36,783 in nonqualified allocated equities which were paid to stockholders in November 2016. The equities retired represented 50 percent of the earnings allocated in 2010.

The Farm Credit Administration sets minimum regulatory capital requirements for banks and associations. Effective January 1, 2017, new regulatory capital requirements for banks and associations were adopted. These new requirements replaced the core surplus and total surplus requirements with common equity tier 1, tier 1, and total capital (tier 1 plus tier 2) risk-based capital ratio requirements. The new requirements also replaced the existing net collateral ratio for System Banks with a tier 1 leverage ratio and Unallocated Retained Earnings (URE) and URE Equivalents Leverage ratio that are applicable to both the banks and associations. The permanent capital ratio continues to remain in effect; however, the risk-adjusted assets are calculated differently than in the past. As of December 31, 2018, the association is not prohibited from retiring stock or distributing earnings. Furthermore, the association is unaware of any such prohibitions that may apply during the subsequent fiscal year.

The following sets forth the regulatory capital ratio requirements and ratios at December 31, 2018:

	Capital			Association's ratios as of December 31, 2018
	Regulatory Minimums	Conservation Buffers*	Total	
Risk-adjusted:				
Common equity tier 1 ratio	4.50%	2.50% *	7.00%	14.3%
Tier 1 capital ratio	6.00%	2.50% *	8.50%	14.3%
Total capital ratio	8.00%	2.50% *	10.50%	15.1%
Permanent capital ratio	7.00%	0.00%	7.00%	14.8%
Non-risk-adjusted:				
Tier 1 leverage ratio**	4.00%	1.00% *	5.00%	14.8%
UREE leverage ratio	1.50%	0.00%	1.50%	9.5%

*the 2.5% capital conservation buffer for the risk-adjusted ratios will be phased in over a three year period ending on December 31, 2019. There is no phase-in of the leverage buffer.

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

Risk-adjusted assets have been defined by FCA Regulation 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 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 ratios 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, as 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 is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by 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 total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

The components of the association's risk-adjusted capital, based on 90 average balances, were as follows at December 31, 2018:

Risk-adjusted Capital Ratios

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	720,932	720,932	720,932	720,932
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	25,802	25,802	25,802	25,802
Allocated equities held ≥ 7 years	490,898	490,898	490,898	490,898
Nonqualified allocated equities not subject to retirement	-	-	37,651	37,651
Allowance for loan losses and reserve for credit losses subject to certain limitations*			25,440	
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(124,934)	(124,934)	(124,934)	(124,934)
Other regulatory required deductions	(2,511)	(2,511)	(2,511)	(2,511)
	1,110,187	1,110,187	1,173,278	1,147,838
Denominator:				
Risk-adjusted assets excluding allowance	7,890,436	7,890,436	7,890,436	7,890,436
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(127,445)	(127,445)	(127,445)	(127,445)
Allowance for loan losses				(25,440)
	7,762,991	7,762,991	7,762,991	7,737,551

Non-risk-adjusted Capital Ratios

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 720,932	\$ 720,932
Statutory minimum purchased borrower stock	25,802	-
Allocated equities held \geq 7 years	490,898	-
Nonqualified allocated equities not subject to retirement		
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(124,934)	(9,853)
Other regulatory required deductions	(2,511)	(2,511)
	<u>1,110,187</u>	<u>708,568</u>
Denominator:		
Total Assets	7,658,619	7,658,619
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(174,971)	(174,971)
	<u>7,483,648</u>	<u>7,483,648</u>

An FCA regulation empowers the FCA to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

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

ACA Table

	2018	2017	2016
Class A stock	-	-	1
Class B stock	4,909	4,845	4,749
Participation certificates	252	259	260
Total	<u>5,161</u>	<u>5,104</u>	<u>5,010</u>

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

	2018	2017	2016
Accumulated other comprehensive income (loss) at January 1	\$ (3,694)	\$ (1,246)	\$ (581)
Actuarial gains (losses)	2,601	(2,119)	(288)
Prior service (cost) credit	1,054	-	-
Amortization of prior service (credit) costs included in salaries and employee benefits	(224)	(329)	(377)
Amortization of actuarial (gain) loss included in salaries and employee benefits	184	-	-
Income tax expense related to items of other comprehensive income	-	-	-
Other comprehensive income (loss), net of tax	<u>3,615</u>	<u>(2,448)</u>	<u>(665)</u>
Accumulated other comprehensive income (loss) at December 31	<u>\$ (79)</u>	<u>\$ (3,694)</u>	<u>\$ (1,246)</u>

NOTE 11 — INCOME TAXES:

The (benefit from) provision for income taxes follows for the years ended December 31:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current federal tax	\$ (1)	\$ 7	\$ 8
Deferred federal tax	-	-	-
(Benefit from) Provision for income taxes	<u>\$ (1)</u>	<u>\$ 7</u>	<u>\$ 8</u>

The enactment of federal tax legislation in late December 2017 lowered the federal corporate tax from 35 percent to 21 percent beginning January 1, 2018. In accordance with GAAP, the change to lower corporate tax rate led to a remeasurement of the deferred tax liabilities and deferred tax assets in 2017, the period of enactment.

The association has a net operating loss carryforward of \$21,696 available to offset against future taxable income of which \$1,039 will expire in 2024, \$1,811 will expire in 2025, \$8,512 will expire in 2029 and \$10,334 will expire in 2030.

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Federal tax at statutory rate	\$ 39,869	\$ 57,373	\$ 51,392
Federal income tax attributable to:			
Income not subject to federal tax	(36,568)	(52,909)	(49,048)
Nondeductible provision for loan losses	(111)	178	1,959
Patronage distributions	(2,136)	(3,344)	(4,426)
Recoveries (charge-offs) on loans	(299)	(1,280)	(143)
Other	(756)	(11)	274
(Benefit from) Provision for income taxes	<u>\$ (1)</u>	<u>\$ 7</u>	<u>\$ 8</u>

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Allowance for losses on loans	\$ 2,636	\$ 3,047	\$ 5,754
Net operating loss carryforward	4,556	4,556	7,377
Deferred tax assets	7,192	7,603	13,131
Valuation allowance	(7,192)	(7,603)	(13,131)
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The calculation of tax assets and liabilities involves various management estimates and assumptions as to the future taxable earnings. At December 31, 2018, non-patronage income is expected to be less than 5 percent of total taxable income (before patronage) and all patronage income is expected to be disbursed over time. The expected future tax rates are based upon enacted tax laws.

The association recorded valuation allowances of \$7,192, \$7,603 and \$13,131 during 2018, 2017 and 2016, respectively. The association will continue to evaluate the realizability of the deferred tax assets and adjust the valuation allowance accordingly. The association follows FASB guidance on accounting for uncertainty in income taxes. At December 31, 2018, 2017 and 2016, the association did not recognize a tax liability for any uncertain tax positions.

NOTE 12 — EMPLOYEE BENEFIT PLANS:

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

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

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

The association elected to participate in the Supplemental 401(k) Plan and provided for elective deferrals and discretionary contributions to be made through the plan. The total expenses of the nonqualified plan included in the association’s employee benefit costs were \$625, \$91 and \$52 for the years ended December 31, 2018, 2017 and 2016, respectively.

Supplemental 401 (k) Plan

	Farm Credit Benefits Alliance Nonqualified Supplemental 401 (k) Plan
Plan Name	
Present value of accumulated benefits	\$7,103
Contributions made during the year	\$625
Distributions made during the year	--
Funded obligations	\$7,103
Off-balance sheet amounts including benefits earned but not vested	None

The DB plan is noncontributory and benefits are based on salary and years of service. The legal name of the plan is the Farm Credit Bank of Texas Pension Plan; its employer identification number is 74-1110170. The DB plan is not subject to any contractual expiration dates. The DB plan’s funding policy is to fund current year benefits expected to be earned by covered employees plus an amount to improve the accumulated benefit obligation funded status by the percentage approved by the plan sponsor. The plan sponsor is the board of directors of the Farm Credit Bank of Texas. The “projected unit credit” actuarial method is used for both financial reporting and funding purposes. District employers have the option of providing enhanced retirement benefits, under certain conditions, within the DB plan, to facilitate reorganization and/or restructuring. The actuarial present value of vested and nonvested accumulated benefit obligations exceeded the net assets of the DB plan as of December 31, 2018.

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

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

The following table includes additional information regarding the funded status of the plan, the association's contributions, and the percentage of association contribution to total plan contributions for the years ended December 31, 2018, 2017 and 2016:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Funded status of plan	68.0%	69.7%	66.4%
Association's contribution	\$ 2,920	\$ 4,419	\$ 4,637
Percentage of association's contribution to total contributions	29.9%	38.2%	39.3%

The funded status presented above is based on the percentage of plan assets to projected benefit obligations. DB plan funding is based on the percentage of plan assets to the accumulated benefit obligation, which was 70.1 percent, 73.4 percent and 70.6 percent at December 31, 2018, 2017 and 2016, respectively.

Other Postretirement Benefits: In addition to pension benefits, the association provides certain health care benefits to qualifying retired employees (other postretirement benefits) for those employees hired on or before December 31, 2003. These benefits are not characterized as multi-employer and, consequently, the liability for these benefits is included in the liability section of the association's consolidated balance sheet. Association employees hired after January 1, 2004, will be eligible for retiree medical benefits for themselves and their spouses but will be responsible for 100 percent of the related premiums.

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Change in Accumulated Postretirement Benefit Obligation			
Accumulated postretirement benefit obligation, beginning of year	\$ 25,897	\$ 22,938	\$ 21,870
Service cost	456	429	395
Interest cost	1,022	1,039	1,012
Plan participants' contributions	156	151	173
Plan amendments	(1,054)	-	-
Actuarial (Gain) loss	(2,601)	2,119	288
Benefits paid	(885)	(779)	(800)
Accumulated postretirement benefit obligation, end of year	<u>\$ 22,991</u>	<u>\$ 25,897</u>	<u>\$ 22,938</u>
Change in Plan Assets			
Association contributions	\$ 729	\$ 628	\$ 627
Plan participants' contributions	156	151	173
Benefits paid	(885)	(779)	(800)
Plan assets at fair value, end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Amounts Recognized in Consolidated Balance Sheet			
Current liabilities	\$ (870)	\$ (797)	\$ (724)
Noncurrent liabilities	(22,121)	(25,100)	(22,214)
Total	<u>\$ (22,991)</u>	<u>\$ (25,897)</u>	<u>\$ (22,938)</u>
Amounts Recognized in Accumulated Other Comprehensive Income (AOCI)			
Net actuarial (gain) loss	\$ 1,133	\$ 3,919	\$ 1,800
Prior service credit	(1,054)	(225)	(554)
Total	<u>\$ 79</u>	<u>\$ 3,694</u>	<u>\$ 1,246</u>
Measurement date	12/31/2018	12/31/2017	12/31/2016
Discount rate	4.75%	4.00%	4.60%
Health care cost trend rate assumed for next year (pre-/post-65)	7.30%/6.90%	7.70%/6.90%	6.75%/6.50%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2026/2027	2026/2026	2025/2024

Disclosure Information Related to Retirement Benefits	2018	2017	2016
Components of Net Postretirement Benefit Cost			
Service Cost	\$ 456	\$ 429	\$ 395
Interest cost	1,022	1,039	1,012
Amortization of:			
Unrecognized prior service credit	(224)	(329)	(330)
Unrecognized net loss	184	-	-
Actuarial loss	-	-	-
Net postretirement benefit cost	<u>\$ 1,438</u>	<u>\$ 1,139</u>	<u>\$ 1,077</u>
Other Changes in Plan Assets and Benefit Obligation Recognized in Other Comprehensive Income			
Net actuarial (gain) loss	\$ (2,601)	\$ 2,119	\$ 288
Prior service cost	224	329	377
Net actuarial (gain) loss	(1,238)	-	-
Total recognized in other comprehensive income	<u>\$ (3,615)</u>	<u>\$ 2,448</u>	<u>\$ 665</u>
AOCI Amounts Expected to be Amortized into Expense			
Unrecognized prior service cost	\$ (224)	\$ (329)	\$ (330)
Unrecognized net loss	184	-	-
Total	<u>\$ (40)</u>	<u>\$ (329)</u>	<u>\$ (330)</u>
Weighted-Average Assumptions Used to Determine Net Postretirement Benefit Cost			
Measurement date	12/31/2017	12/31/2016	12/31/2015
Discount rate	4.00%	4.60%	4.70%
Health care cost trend rate assumed for next year (pre-/post-65)	7.70%/6.90%	6.75%/6.50%	7.00%/6.50%
Ultimate health care cost trend rate	4.50%	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2026	2025	2025

Expected Future Cash Flows

Expected Benefit Payments (net of employee contributions)

Fiscal 2019	\$ 869
Fiscal 2020	941
Fiscal 2021	1,038
Fiscal 2022	1,113
Fiscal 2023	1,135
Fiscal 2024 to 2028	6,304

Expected Contributions

Fiscal 2019	\$ 869
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NOTE 13 — RELATED PARTY TRANSACTIONS:

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

Total loans to such persons for the association amounted to \$22,046, \$22,184 and \$22,599 at December 31, 2018, 2017 and 2016, respectively. During 2018, 2017 and 2016, \$17,177, \$16,090, and \$18,651 of new loans were made and repayments totaled \$17,642, \$16,505, and \$17,905, respectively. In the opinion of management, no such loans outstanding at December 31, 2018, 2017 and 2016 involved more than a normal risk of collection.

Expenses included in purchased services may include purchased services such as administrative services, marketing, information systems and accounting services and allocations of expenses incurred by the bank and passed through to the associations, such as

FCSIC expenses. The bank charges the individual associations directly for these services based on each association's proportionate usage. These expenses totaled \$744, \$778, and \$968 in 2018, 2017 and 2016, respectively

The association received patronage income from the Bank totaling \$35,041, \$29,029 and \$27,392 during 2018, 2017 and 2016, respectively.

NOTE 14 — FAIR VALUE MEASUREMENTS:

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

Assets measured at fair value on a recurring basis, which are measured at fair value at the end of each reporting period on the association's consolidated balance sheet, at December 31, 2018, 2017 and 2016 for each of the fair value hierarchy values are summarized below. The association did not have any liabilities measured at fair value on a recurring basis.

December 31, 2018	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 7,103	\$ -	\$ -	\$ 7,103
Total assets	\$ 7,103	\$ -	\$ -	\$ 7,103
December 31, 2017				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 6,478	\$ -	\$ -	\$ 6,478
Total assets	\$ 6,478	\$ -	\$ -	\$ 6,478
December 31, 2016				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Assets held in nonqualified benefit trusts	\$ 5,834	\$ -	\$ -	\$ 5,834
Total assets	\$ 5,834	\$ -	\$ -	\$ 5,834

Assets measured at fair value on a nonrecurring basis, which are fair value measurements that are triggered by particular circumstances such as impaired assets, for each of the fair value hierarchy values are summarized below. The association did not have any liabilities measured at fair value on a nonrecurring basis.

December 31, 2018	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 11,174	\$ 11,174
Other property owned	-	-	972	972
December 31, 2017				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 5,389	\$ 5,389
Other property owned	-	-	3,989	3,989
December 31, 2016				
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Loans	\$ -	\$ -	\$ 16,696	\$ 16,696
Other property owned	-	-	2,634	2,634

With regard to impaired loans and other property owned, it is not practicable to provide specific information on inputs as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

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

December 31, 2018					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Assets:					
Cash	\$ 10	\$ 10	\$ -	\$ -	\$ 10
Mission-related and other investments held-to-maturity	4,388	-	-	4,394	4,394
Net loans	7,356,337	-	-	\$ 7,255,620	7,255,620
Total Assets	<u>\$ 7,360,735</u>	<u>\$ 10</u>	<u>\$ -</u>	<u>\$ 7,260,014</u>	<u>\$ 7,260,024</u>
Liabilities:					
Note payable to the Bank	\$ 6,223,546	\$ -	-	\$ 6,138,603	\$ 6,138,603
Total Liabilities	<u>\$ 6,223,546</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,138,603</u>	<u>\$ 6,138,603</u>
December 31, 2017					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Assets:					
Cash	\$ 15	\$ 15	\$ -	\$ -	\$ 15
Mission-related and other investments held-to-maturity	5,566	-	-	5,576	5,576
Net loans	7,209,279	-	-	\$ 7,126,904	7,126,904
Total Assets	<u>\$ 7,214,860</u>	<u>\$ 15</u>	<u>\$ -</u>	<u>\$ 7,132,480</u>	<u>\$ 7,132,495</u>
Liabilities:					
Note payable to the Bank	\$ 6,127,915	\$ -	-	\$ 6,057,896	\$ 6,057,896
Total Liabilities	<u>\$ 6,127,915</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,057,896</u>	<u>\$ 6,057,896</u>
December 31, 2016					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Assets:					
Cash	\$ 19	\$ 19	\$ -	\$ -	\$ 19
Mission-related and other investments held-to-maturity	6,670	-	-	6,732	6,732
Net loans	6,877,741	-	-	\$ 6,838,552	6,838,552
Total Assets	<u>\$ 6,884,430</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 6,845,284</u>	<u>\$ 6,845,303</u>
Liabilities:					
Note payable to the Bank	\$ 5,872,624	\$ -	-	\$ 5,839,162	\$ 5,839,162
Total Liabilities	<u>\$ 5,872,624</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,839,162</u>	<u>\$ 5,839,162</u>

Valuation Techniques

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

	<u>Valuation Technique(s)</u>	<u>Input</u>
Cash	Carrying value	Par/principal and appropriate interest yield
Investments held-to-maturity	Discounted cash flow	Prepayment rates Probability of default Loss severity
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Other interest bearing liabilities	Carrying value	Par/principal and appropriate interest yield
Other property owned	Carrying value	Each collateral property is unique

Information About Level 3 Fair Value Measurements

	<u>Valuation Technique(s)</u>	<u>Unobservable Input</u>	<u>Range of Inputs</u>
Investments held-to-maturity	Discounted cash flow	Prepayment rates	2.3% - 38.0%

A. Cash:

For cash, the carrying amount is a reasonable estimate of fair value. The fair value of term federal funds sold and securities purchased under resale agreements is based on currently quoted market prices, which are reflective of current interest rates.

B. Investment Securities:

Include mortgage-backed securities issued by the Federal Agricultural Mortgage Corporation (Farmer Mac). Fair values are estimated using discounted cash flows considering market interest rates, estimated prepayment rates, probabilities of default and loss severities. Inputs depend significantly on management judgments and experience with the securities. These fair value measurements are classified as level 3 investments.

C. Loans:

Fair value is estimated by discounting the expected future cash flows using the association’s current interest rates at which similar loans would be made to borrowers with similar credit risk. Management has no basis to determine whether the estimated fair values presented would be indicative of the assumptions and adjustments that a purchaser of the association’s loans would seek in an actual sale, which could be less.

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

Fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher discount rates to reflect the uncertainty of continued cash flows. For noncurrent nonaccrual loans, it is assumed that collection will result only from the disposition of the underlying collateral. Fair value of these loans is estimated to equal the aggregate net realizable value of the underlying collateral, discounted at an interest rate that appropriately reflects the uncertainty of the expected future cash flows over the average disposal period. Where the net realizable value of the collateral exceeds the legal obligation for a particular loan, the legal obligation is generally used in place of net realizable value.

The carrying value of accrued interest approximates its fair value.

D. Assets Held in Nonqualified Benefits Trusts:

Assets held in nonqualified benefits trusts related to deferred compensation and supplemental retirement plans are classified as Level 1. Level 1 valuation utilizes quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. The trust funds include investments that are actually traded and have quoted net asset values that are quoted in the marketplace.

E. 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 other property owned involves the use of appraisals or other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

F. Note Payable to the Bank:

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

NOTE 15 — COMMITMENTS AND CONTINGENCIES:

In addition to those commitments and contingencies discussed in Note 2, "Summary of Significant Accounting Policies," the association is involved in various legal proceedings in the ordinary course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the association.

The association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers in the form of commitments to extend credit and commercial letters of credit. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. At December 31, 2018, \$975,054 of commitments and \$25,535 of commercial letters of credit were outstanding.

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

The association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financing obligations. Standby letters of credit are recorded, at fair value, on the balance sheet by the association. At December 31, 2018, there were no standby letters of credit included in other liabilities. Outstanding standby letters of credit have expiration dates ranging from January 1, 2019, to May 1, 2022. The maximum potential amount of future payments the association is required to make under the guarantees is \$25,535.

NOTE 16 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED):

Quarterly results of operations for the years ended December 31 are as follows:

	2018				
	First	Second	Third	Fourth	Total
Net interest income	\$ 58,191	\$ 57,003	\$ 58,528	\$ 61,001	\$ 234,723
(Provision for) reversal of loan losses	2,647	\$ (540)	\$ 2,660	\$ (1,298)	3,469
Noninterest expense, net	(8,497)	\$ (13,664)	\$ (9,063)	\$ (17,117)	(48,341)
Net income	<u>\$ 52,341</u>	<u>\$ 42,799</u>	<u>\$ 52,125</u>	<u>\$ 42,586</u>	<u>\$ 189,851</u>
	2017				
	First	Second	Third	Fourth	Total
Net interest income	\$ 54,591	\$ 56,748	\$ 57,976	\$ 58,031	\$ 227,346
(Provision for) reversal of loan losses	(718)	\$ 156	\$ (1,868)	\$ 115	(2,315)
Noninterest expense, net	(13,329)	\$ (13,643)	\$ (13,438)	\$ (15,885)	(56,295)
Net income	<u>\$ 40,544</u>	<u>\$ 43,261</u>	<u>\$ 42,670</u>	<u>\$ 42,261</u>	<u>\$ 168,736</u>
	2016				
	First	Second	Third	Fourth	Total
Net interest income	\$ 52,359	\$ 54,740	\$ 53,129	\$ 54,909	\$ 215,137
(Provision for) reversal of loan losses	(4,180)	\$ (109)	\$ (3,368)	\$ 296	(7,361)
Noninterest expense, net	(14,615)	\$ (13,947)	\$ (15,190)	\$ (12,878)	(56,630)
Net income	<u>\$ 33,564</u>	<u>\$ 40,684</u>	<u>\$ 34,571</u>	<u>\$ 42,327</u>	<u>\$ 151,146</u>

NOTE 17 – SUBSEQUENT EVENTS:

The association has evaluated subsequent events through March 13, 2019, which is the date the financial statements were issued or available to be issued and has determined that there were no other events requiring disclosure.

DISCLOSURE INFORMATION AND INDEX

(Unaudited)

Disclosures Required by Farm Credit Administration Regulations

DESCRIPTION OF BUSINESS

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

The descriptions of significant developments that had or could have a material impact on earnings or interest rates to borrowers, patronage or dividends, and acquisitions or dispositions of material assets, if any, required to be disclosed in this section are incorporated herein by reference to "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in this annual report.

DESCRIPTION OF PROPERTY

Capital Farm Credit, ACA (the association) serves its 192-county territory through its main administrative office at 3000 Briarcrest Drive, Suite 601, Bryan, Texas, and through its accounting/administration, agri-insurance, loan processing/review, special assets and marketing/operations offices, which are located in Bryan, Lubbock, Hondo, Round Rock and Devine, Texas. Additionally, there are 66 lending offices located throughout the territory. The association owns the office buildings in Alpine, Bellville, Bowie, Canadian, Childress, Clifton, Crosbyton, Dalhart, Dayton, Dimmitt, Edna, El Campo, Goldthwaite, Hereford, Jourdanton, Kenedy, Kerrville, La Grange, Lamesa, Levelland, Littlefield, Lockhart, Lubbock, Madisonville, Mason, Matador, Muleshoe, Munday, Pampa, Perryton, Rosenberg, San Angelo, San Saba, Snyder, Sonora, Spur, Stamford, Taylor, Temple, Tulia, Uvalde, Vernon, Waco, Wheeler and Wichita Falls, free of debt. The association leases office buildings in Abilene, Austin, Bay City, Boerne, Bryan, Burnet, Conroe, Crockett, Devine, Edinburg, El Paso, Fredericksburg, Georgetown, Harlingen, Hondo, Katy, Kenedy, Laredo, Livingston, New Braunfels, Robstown, Round Rock, San Antonio, Seminole and Winnie, Texas.

In 2018, the association entered into a new lease in Boerne, to accommodate staffing needs in the San Antonio region. In addition, the association entered into a 10 year lease agreement for its Round Rock location, which is expected to be completed in 2019.

Effective March 2017, the association entered into a new lease agreement for the Winnie credit office, a new location for the association. In addition, during 2017, the association began remodeling its Kenedy office location. As a result, the association entered into a new one year lease agreement for a separate facility as contractors complete the project. The association continued to rent on a month-to-month basis through 2018 as the remodeling is expected to be completed in 2019.

During 2016, the association added additional lease space to the Bryan corporate office. In addition, during May 2016, the El Paso credit office relocated to a new leased space.

LEGAL PROCEEDINGS

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

DESCRIPTION OF CAPITAL STRUCTURE

The information required to be disclosed in this section is incorporated herein by reference to Note 10 to the consolidated financial statements, "Members' Equity," included in this annual report.

DESCRIPTION OF LIABILITIES

The description of liabilities required to be disclosed in this section is incorporated herein by reference from Note 9 to the consolidated financial statements, “Note Payable to the Bank,” Note 12, “Employee Benefit Plans” and in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in this annual report.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Notes 2 and 15 to the consolidated financial statements, “Summary of Significant Accounting Policies” and “Commitments and Contingencies,” respectively, included in this annual report.

RELATIONSHIP WITH THE FARM CREDIT BANK OF TEXAS

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

The Farm Credit Bank of Texas’s (Bank) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720-2590 or calling (512) 483-9204. Copies of the Bank’s annual and quarterly stockholder reports can also be requested by e-mailing fcb@farmcreditbank.com.

The association’s quarterly stockholder reports are also available free of charge, upon request. These reports will be available approximately 40 days after quarter end and can be obtained by writing to Capital Farm Credit, P.O. Box 488, Hondo, Texas 78861 or calling (830) 426-4589. Copies of the association’s quarterly stockholder reports can also be requested by e-mailing isela.morales@capitalfarmcredit.com. The association’s annual stockholder report is available on its website at www.capitalfarmcredit.com 75 days after the year end. Copies of the association’s annual stockholder report can also be requested 90 days after the year end.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2018, required to be disclosed, is incorporated herein by reference to the “Five-Year Summary of Selected Consolidated Financial Data” included in this annual report to stockholders.

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

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

DIRECTORS AND SENIOR OFFICERS

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

NAME	POSITION	ELECTED/ EMPLOYED	TERM EXPIRES
John Malazzo	Chairman & Stockholder-Elected Director	2015	2019
Carl Sample	Vice Chairman & Stockholder-Elected Director	2016	2020
Paul Aelvoet	Stockholder-Elected Director	2018	2022
Larry Boleman	Stockholder-Elected Director	2016	2020
Richard Counts*	Director-Elected Director	2017	2021
Dale Crenwelge	Stockholder-Elected Director	2017	2021
Kelly Gaskins	Stockholder-Elected Director	2018	2022
Dale Hoelscher	Stockholder-Elected Director	2015	2019
Jerred Hurst	Director-Elected Director	2018	2022
Kenton B. Kimball	Stockholder-Elected Director	2015	2019
Terry McAlister	Stockholder-Elected Director	2018	2022
Phillip Munden	Stockholder-Elected Director	2017	2021
Lance D. Morris	Stockholder-Elected Director	2015	2019
Gary L. Palousek	Stockholder-Elected Director	2015	2019
Danny Parker	Stockholder-Elected Director	2017	2021
Ronnie Riddle	Stockholder-Elected Director	2016	2020
Roy Allan Schmidt	Stockholder-Elected Director	2017	2021
Lloyd Shoppa*	Director-Elected Director	2015	2019
R.H. "Steve" Stevens*	Director-Elected Director	2017	2021
Sharleen Walkoviak	Director-Elected Director	2018	2022
James L. Wedel	Stockholder-Elected Director	2017	2021
Lowell Woodward	Stockholder-Elected Director	2018	2022
Joe David Yates	Stockholder-Elected Director	2018	2022
Ben R. Novosad	Chief Executive Officer	1976	----
Don VandeVanter	Senior Vice President, CFO	1999	----
Mark L. Hiler	Senior Vice President, COO	1980	----
Patricia A. Gonzales	Senior Vice President, Accounting & Administration	1999	----
Roy A. West	Chief Home Lending/Loan Processing Officer	1998	----
Mark Loveland	Senior Vice President, Credit	1997	----
Jay Stewart	Senior Vice President, Chief Lending Officer	2001	----
Jeff Norte	Chief Credit Officer	2010	----
Wes Sutton	Senior Vice President, General Counsel	2018	----

*Director-Elected Director: a director-appointed director who is not a stockholder, director, officer, employee or agent of a Farm Credit System institution (other than as an outside director of the association or its subsidiaries).

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

John Malazzo raises cotton and corn and has a cattle production operation in Brazos, Burleson and Milam counties, Texas. Mr. Malazzo resides in Caldwell, Texas. Mr. Malazzo also serves on the board of Producers Co-op of Bryan, Texas, which provides agricultural goods and services to farmers and ranchers.

Carl Sample resides in Smiley, Texas, and is a contract poultry grower and also has a cattle operation in Gonzales County, Texas.

Paul Aelvoet is a self-employed farmer/rancher in Medina County, Texas, and resides in Hondo, Texas. He is managing partner of Aelvoet Partners and of D/A Cattle Co, which are farming and ranching operations. Mr. Aelvoet serves as director for the Hill Country District Livestock Show Association and Co-Chairman of the Hondo 4H Booster Club.

Larry Boleman serves as the associate vice chancellor and professor emeritus for agriculture for Texas A&M AgriLife and resides in College Station, Texas. Dr. Boleman owns Boleman Cattle Company, a cow/calf operation headquartered in College Station, Brazos County, Texas, which raises commercial grade beef cattle for show and regular market channels.

Richard Counts is a retired certified public accountant and consultant. Mr. Counts resides in Colorado County, Texas.

Dale Crenwelge resides in Comfort, Kerr County, Texas, and his principal occupation is ranching and real estate investment and development. Mr. Crenwelge's business interests include serving as president or general partner of Grobe-Lich Properties LTD, DKBC I LTD, DKBC II LTD, Pine Ridge Developers LLC, Oak Creek/Mopac Self Storage LP, Crenwelge LLC, The Reserve at Falling Water LTD, Pantego American U Store LTD, DeSoto Preferred Storage LTD, Austin Mini Storage, Vega Altamesa SS LP, D and D Terrell County Ranch Partner, and Dancing Hill, LLC. Mr. Crenwelge serves on the board of Hill Country Memorial Hospital and Centurions of Kendall County.

Kelly Gaskins resides in Shamrock, Wheeler County, Texas, and is a self-employed owner of agricultural and pipeline construction businesses which operate under the names of Buzzard Roost Dirt Works Inc., Kelly Gaskins Farms and KG Farm Service, Gaskins Double G Corporation, Hoptoad Enterprises, Circle TK Land and Cattle and Salt Cedar Farm, Inc.

Dale Hoelscher farms and ranches in Bell, Falls, Milam and Robertson counties, and resides in Bell County, Texas. He primarily grows corn, cotton and wheat and also has a cow/calf operation. Mr. Hoelscher's business interests include Hoelscher Brothers Farm and R & D Hoelscher Farm LLC, a farming and ranching operation. Mr. Hoelscher currently serves as director of Producers Co-op in Bryan, Texas, which provides feed, chemical, supplies and fuel to farmers and ranchers in the regional area.

Jerred Hurst resides in Lubbock, Lubbock County, Texas, and is the chief technology officer for Primitive Social, a digital agency specializing in web design and development, branding, inbound marketing, and social media. In addition, he is a stockholder in Hurst Farm Supply, a leading equipment dealership in West Texas, as well as CTO and co-owner of Fastpay Payroll, which provides companies with payroll solutions.

Kenton B. Kimball farms and ranches in Stratford, Texas. Mr. Kimball is the owner and president of Kimball Cattle Inc., a farming and cattle business, with current operations in northeast Oklahoma. Mr. Kimball has also owned and managed agricultural operations in Sherman County, Texas in the past.

Terry McAlister resides in Electra, Texas, and farms and ranches in Wichita and Wilbarger counties. Mr. McAlister is president and CEO of McAlister Properties Inc. and has ownership in McAlister Farm and McAlister Properties, farming and ranching operations. He serves as a board member of North Texas Boll Weevil Eradication Program.

Lance D. Morris farms cotton, wheat and milo in Crosby, Dickens and Floyd counties and resides in Crosbyton, Texas. He owns Morris Farms, which is a farming and ranching operation. Mr. Morris is on the board of directors of the Associated Cotton Growers and White River Municipal Water District. He has an appointed position to the Crosby County Appraisal Review Board.

Phillip Munden is a full-time rancher and farmer, and owns 4M Cattle Company, a small farm and ranch construction business in Bosque County, Texas, near Walnut Springs. Mr. Munden is a board member of the Bosque Soil and Water Conservation District.

Gary L. Palousek is a self-employed farmer raising cotton, milo and corn in Willacy County, Texas and operates his businesses individually and as a partner of Las Dos Palmas Farms. Mr. Palousek resides and maintains an office in Raymondville, Texas. He is director and secretary-treasurer of the Willacy County Drainage District No. 2 and is committeeman of Willacy County Farm Service Agency.

Danny Parker is engaged in row crop farming and a cow/calf operation in Uvalde and Reeves counties and conducts his business as Danny Parker Farms. Mr. Parker resides in Uvalde, Texas, and serves as vice chairman of the board of directors of the Gulf Compress in Corpus Christi, Texas, a cotton compress and warehouse business. Mr. Parker is also a member of the Uvalde County Livestock Show Steer Committee and the Commercial Replacement Heifer Show Committee. He also serves as chairman of the sounding board for the Winter Garden Boll Weevil Zone.

Ronnie Riddle is owner and operator of Riddle Farms, a farming and ranching operation headquartered in Jones County, Texas near Hamlin. He resides in Abilene, Texas, and farms in Fisher, Stonewall, Jones and Haskell counties. Mr. Riddle is a board member of the Texas Trail Council of the Boy Scouts of America.

Roy Allan Schmidt resides in Burton, Texas, and has a cow/calf operation in Menard and Washington counties. Mr. Schmidt owns and operates La Bahia Antiques LLC, and he is president of Labahia Turn Verein.

Lloyd Shoppa is a businessman residing in Wharton and Colleyville, Texas. Mr. Shoppa is chairman of Shoppa's Farm Supply Inc. and Shoppa's Material Handling Inc. These companies sell farm equipment, parts and service as well as forklift sales, parts and service.

R. H. "Steve" Stevens is a certified public accountant with Stevens & Mathews LLP in Houston, Harris County, Texas. Mr. Stevens resides in Houston, Texas, and is a member of the board of partners for ANCO Insurance in Bryan, Texas, member of the board of directors of the Houston Livestock Show and Rodeo and member of the board of directors of the American Quarter Horse Association. Mr. Stevens also has a cattle/horse operation in Burleson County, Texas.

Sharleen Walkoviak resides in Houston, Texas and is a co-owner of Covenant Technology Services LLC, which provides outsourced IT and consulting services and is based in Houston, Harris County, Texas. She is a member of the board of directors of the Houston Livestock Show and Rodeo. She is also a director for Books Between Kids and serves on the development council for the George Bush School of Government and Public Service.

James L. Wedel is a farmer in Bailey and Parmer counties, growing organic corn, cotton, wheat, peanuts, soybeans and forage sorghum. He resides in Lubbock, Texas, and currently serves on the board of Plains Cotton Growers and Texas Corn Producers. Mr. Wedel is an appointed director of the Organic Trade Association - Farmers Advisory Council, Texas Department of Agriculture - Organic Industry Advisory Board and the Llano Estacado Regional Water Planning Group. He is president of the Texas Organic Cotton Marketing Cooperative, Double W Farms Inc. and Paradise Plantation Inc. Mr. Wedel performs business as James Wedel Farms and Paradise Plantation, Inc., both of which are family farming partnerships.

Lowell Woodward ranches in Pecos, Crockett, Brewster and Upton counties, and resides in Pecos County, Texas. Mr. Woodward raises sheep, goats, cattle and horses, and has a hunting operation. He is a director of the Texas Sheep and Goat Raisers Association and owns Woodward Inc., an apartment complex.

Joe David Yates resides in Mason, Texas, and ranches in Texas and New Mexico. Mr. Yates sells ranch real estate in Texas, New Mexico and Oklahoma, with an office in Mason, Texas. He is the owner and president of Joe David Yates Inc., is part owner of Bay City Feeds, a feed operation in Bay City, Texas, is the vice president/secretary of Stewart Ranch with operations in Texas and New Mexico, and is also board member of the Texas Quarter Horse Association.

Ben R. Novosad is president and chief executive officer of the association. Mr. Novosad began his career with the Federal Land Bank Association of Bryan in 1976, and in 1986 was named president and chief executive officer. As a 1975 graduate of Texas A&M University, Mr. Novosad received his B.S. in agricultural economics. He currently serves on the Farm Credit System's President's Advisory Committee and the Farm Credit System's Risk Management Committee. He also serves on the Texas Agricultural Lifetime Leadership Program (TALL) Advisory Board of Directors. In 2004, Mr. Novosad was inducted into the Tyrus R. Timm Honor Registry of Former Students of Agricultural Economics at Texas A&M University.

Don VandeVanter serves as senior vice president and chief financial officer for the association. He is responsible for the financial administration and capital management of the association. Mr. VandeVanter, a certified public accountant, has worked for the association since 1999 and in Farm Credit since 1987. He is a 1984 graduate of the University of Texas with a degree in accounting. Prior to his time with Farm Credit, he worked in public accounting.

Mark L. Hiler serves as the association's senior vice president and chief operating officer, and was employed in 1980 with the Federal Land Bank Association of Uvalde. He served as chief executive officer of that association prior to its merger with Southwest Federal Land Bank Association in 1995. He served Southwest as president/chief operating officer until its merger with Capital Farm Credit in 2006. Mr. Hiler holds a B.B.A. in finance and M.S. in agriculture from Texas A&M University.

Patricia A. Gonzales serves as the association's senior vice president, accounting and administration. She is responsible for managing the association's accounting and human resources. She is a certified public accountant and was employed as chief financial officer in May 1999 for Southwest Texas ACA until its merger with Capital Farm Credit in 2006. She was previously employed as vice president/controller of the Farm Credit Bank of Texas for 12 years. Prior to her time with Farm Credit, she worked in public accounting.

Roy A. West was employed as chief credit officer in April 1998 and currently serves as the association's chief home lending/loan processing officer. He was previously employed as director of credit of the Farm Credit Bank of Texas and vice president of the Capital of Texas Federal Land Bank Association.

Mark Loveland serves the association as regional vice president, credit. Prior to his employment with the association, he was chief credit officer of First Ag Credit, FCS. He has also held several positions with the Farm Credit Bank of Texas including director of credit operations, engineer/appraiser, mineral representative and loan officer. He has over 32 years of service with the Farm Credit System.

Jay Stewart serves the association as senior vice president, chief lending officer. Mr. Stewart has 22 years of Farm Credit experience, including 14 years with Capital Farm Credit as branch manager, regional president, and has served in his current role since 2010. He also served six years with the Farm Credit Administration as a commissioned examiner. He received his B.S. and M.Agr. in agricultural economics from Texas A&M University.

Jeff Norte serves the association as chief credit officer. Mr. Norte has been with the association since September 2010. Prior to joining the association, he served in various credit and risk positions, including overseeing credit for CoBank's corporate and international portfolio, as well as several years as a regulator in Kansas City with the FDIC. He is a veteran of the military, serving with the U.S. Army. Mr. Norte is a certified public accountant and received his M.B.A from Concordia University Texas.

Wesley Sutton serves as the association's general counsel and manages the legal department. Mr. Sutton earned his undergraduate degree from Erskine College and his juris doctorate from the University of South Carolina School of Law and is a member of the South Carolina Bar and the State Bar of Texas. Prior to his employment with the association, he was general counsel and executive vice president with AgSouth Farm Credit. He has also held several positions in the legal department at AgFirst Credit Bank and has over 17 years of service with the Farm Credit System.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

During 2016 the Compensation Committee was charged with evaluating if association directors were being compensated consistent with compensation in the market for directors of associations with similar size and responsibility. Peer data obtained through this evaluation indicated that the association was under market when comparing annual compensation for directors of other comparably sized associations. As a result of this evaluation, the Compensation Committee determined that the following changes would bring all directors to market in relation to the peer group effective January 2017:

- Increased monthly retainer from \$1,250 per month to \$1,500 per month
- All other elements of compensation remained unchanged.

During 2018 directors were compensated for their service to the association in the form of an honorarium of \$1,500 per month, \$500 for each board meeting attended, \$600 per meeting for Audit Committee meetings, \$500 per meeting for committee meetings attended other than Audit Committee, \$500 per meeting, per day for all other meetings, \$200 per meeting for conference calls and \$200 for travel days when required. Committee chairmen received an additional \$200 per meeting for committee meetings. The board chairman and vice chairman were compensated \$800 per meeting for each board meeting attended, and directors were also reimbursed for certain expenses incurred while representing the association in an official capacity. Mileage for attending official meetings during 2018 was paid at the IRS approved rate of 54.5 cents per mile for the year. A copy of the travel policy is available to stockholders of the association upon request.

Number of Days Served

Director	Board Meetings	Other Official Activities	Total Compensation in 2018
Paul Aelvoet	10	7	\$ 25,000
Larry Boleman	10	8	26,900
Richard Counts	8	11	27,500
Dale Crenwelge	9	9	27,500
Kelly Gaskins	10	12	29,000
Dale Hoelscher	10	9	26,900
Jerred Hurst *	1	1	1,400
Kenton B. Kimball	10	18	33,500
John Malazzo	10	27	40,200
Terry McAlister	10	13	28,200
Lance D. Morris	9	13	30,200
Phillip Munden	10	24	36,100
Gary L. Palousek	10	12	29,000
Danny Parker	10	10	28,000
Ronnie Riddle	10	10	29,100
Carl Sample	10	22	36,200
Roy Allan Schmidt	9	9	25,500
Lloyd Shoppa	6	7	23,600
Steve Stevens	9	12	27,900
Sharleen Walkoviak *	1	0	500
James L. Wedel	10	11	28,500
Lowell Woodward	10	12	28,600
Joe David Yates	10	16	29,400
			\$ 618,700

* Appointed to the board of directors in September 2018.

During 2018 there were seven board meetings with three consisting of a two-day meeting and four consisting of a one-day meeting (directors reflecting 10 or more days in board meeting attendance attended all board meetings held in 2018).

The aggregate compensation paid to directors in 2018, 2017 and 2016 was \$618,700, \$629,400 and \$564,100, respectively. Additional detail regarding director compensation paid for committee service (which is included in the table above) is as follows:

Committee					
Director	Audit	Compensation	Governance	Other*	Total
Paul Aelvoet	\$ -	\$ -	\$ 2,500	\$ 1,000	\$ 3,500
Larry Boleman	-	-	4,200	1,000	5,200
Richard Counts	2,400	-	-	2,700	5,100
Dale Crenwelge	-	-	3,000	1,500	4,500
Kelly Gaskins	-	2,500	-	3,200	5,700
Dale Hoelscher	-	2,500	-	1,700	4,200
Jerred Hurst	-	-	-	500	500
Kenton B. Kimball	4,000	-	-	6,200	10,200
John Malazzo	3,000	1,500	3,000	5,400	12,900
Terry McAlister	3,000	-	-	3,700	6,700
Lance D. Morris	-	3,500	-	3,700	7,200
Phillip Munden	1,800	-	3,000	7,400	12,200
Gary L. Palousek	-	2,500	-	3,200	5,700
Danny Parker	-	1,500	700	2,500	4,700
Ronnie Riddle	-	-	3,000	2,000	5,000
Carl Sample	1,800	1,000	1,000	7,700	11,500
Roy Allan Schmidt	-	-	3,000	1,500	4,500
Lloyd Shoppa	-	1,500	-	1,700	3,200
Steve Stevens	3,000	-	-	3,700	6,700
James L. Wedel	-	2,500	-	2,700	5,200
Lowell Woodward	-	2,500	-	3,200	5,700
Joe David Yates	3,000	-	-	4,700	7,700
	<u>\$ 22,000</u>	<u>\$ 21,500</u>	<u>\$ 23,400</u>	<u>\$ 70,900</u>	<u>\$ 137,800</u>

*Other includes the following meetings that were held: credit, compensation training, director development, national director conference, Texas District Conference, Director Advancement Program (DAP), Farm Credit Council and FCBT stockholder, Review, Audit and Appraisal Workgroup (RAAW) conference, compliance and audit conference.

The aggregate amount of reimbursement for travel, subsistence and other related expenses paid to directors and on their behalf was \$282,483, \$296,988 and \$279,109 in 2018, 2017 and 2016, respectively.

COMPENSATION OF SENIOR OFFICERS

Compensation Discussion and Analysis – Senior Officers

A critical factor to the association’s success is its ability to attract, develop and retain staff that are knowledgeable and efficient in their ability to support the association in the execution of its strategic objectives and delivery of association results that maximize the value received by its membership. The association operates utilizing a compensation program which focuses on the performance and contributions of its employees in achieving the association’s financial and operational objectives, all for the ultimate benefit of its membership. The association’s board of directors, based on recommendations of its Compensation Committee, establishes the salary and approves the incentive programs utilizing data derived from independent third-party compensation specialists in the financial services sector to ensure incentive structures are in line with market-comparable positions. Studies provided by third-party compensation specialists form the foundation for evaluation and establishment of salary and incentive plans used by the association.

Chief Executive Officer (CEO) Compensation Table and Policy

CEO Compensation

Name of Individual	Year	Salary (a)	Long Term Incentives (b)	Current Year Incentives (c)	Other (d)	Change in Pension Value (e)	Total*
Ben R. Novosad, CEO	2018	\$ 836,505	\$ 319,120	\$ 320,928	\$ 37,214	\$ (3,375)	\$ 1,510,392
	2017	804,363	284,427	291,957	33,813	182,035	1,596,595
	2016	773,426	277,493	325,052	29,056	27,805	1,432,832

(a) Gross salary

(b) Cash payout of long term incentives

(c) Cash payout of annual incentives

(d) Includes contributions to 401(k) and defined contribution plans, automobile benefits which may exceed \$5,000 and premiums paid for life insurance

(e) Change in pension value represents the change in the actuarial present value of the accumulated benefit under the defined benefit pension plan, the Farm Credit Bank of Texas Pension Plan, from the prior fiscal year to the current fiscal year.

Refer to Note 12 – Employee Benefit Plans for detailed explanation on the increase to the retiree welfare plan’s projected benefit obligation and corresponding impact to change in pension value.

*The table above does not include the estimated LTI incentive accruals of \$1,000,456. For details regarding these accruals see disclosure more fully discussed within the Long Term Incentives section of this discussion and analysis.

Pension Benefits Table

The following table presents the total annual benefit provided from the defined benefit pension plan applicable to the CEO for the year ended December 31, 2018:

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit	Payments During 2018
Ben R. Novosad	Farm Credit Bank of Texas Pension Plan	43.99	\$ 3,268,313	\$ -

The “Present Value of Accumulated Benefits” will be actuarially determined based on the association’s CEO participation in the defined benefit pension plan.

The CEO and three other senior officers of the association participate in the Farm Credit Bank of Texas Pension Plan (the Pension Plan), which is a qualified defined benefit retirement plan. Compensation, as defined in the Pension Plan, includes wages, incentive compensation and deferrals to the 401(k) and flexible spending account plans, but excludes annual leave or sick leave that may be paid in cash at the time of termination, retirement, or transfer of employment, severance payments, retention bonuses, taxable fringe benefits, and any other payments. Pension Plan benefits are based on the average of monthly eligible compensation over 60 consecutive months that produce the highest average after 1996 (FAC60). The Pension Plan’s benefit formula for a Normal Retirement Pension is the sum of (a) 1.65 percent of FAC60 times “Years of Benefit Service” and (b) 0.50 percent of (i) FAC60 in excess of Social Security

covered compensation times (ii) “Years of Benefit Service” (not to exceed 35). The present value of the senior officers’ accumulated Pension Plan is calculated assuming retirement had occurred at the measurement date used for financial statement reporting purposes with retirement at age 65. The Pension Plan’s benefit formula for the Normal Retirement Pension assumes that the senior officer is married on the date the annuity begins, that the spouse is exactly two years younger than the senior officer and that the benefit is payable in the form of a 50 percent joint and survivor annuity. If any of those assumptions are incorrect, the benefit is recalculated to be the actuarial equivalent benefit.

Compensation of Other Senior Officers

The following table summarizes the compensation paid to all senior officers, excluding the CEO, of the association during 2018, 2017 and 2016. Amounts reflected in the table are presented in the year the compensation was paid.

<u>Name of Group</u>	<u>Year</u>	<u>Salary (a)</u>	<u>Long Term Incentives (b)</u>	<u>Current Year Incentives (c)</u>	<u>Deferred Compensation (d)</u>	<u>Other (e)</u>	<u>Change in Pension Value (f)</u>	<u>Total*</u>
Aggregate No. of Senior Officers in Year Excluding CEO								
9	2018	\$ 2,483,679	\$ 715,307	\$ 762,446	\$ 250,000	\$ 522,051	\$ (273,568)	\$ 4,459,915
10	2017	\$ 2,595,596	\$ 757,653	\$ 788,372	\$ -	\$ 256,958	\$ 1,883,217	6,281,796
10	2016	2,506,034	704,577	873,995	-	272,907	1,585,700	5,943,213

(a) Gross salary

(b) Cash payout of long term incentives

(c) Cash payout of annual incentives

(d) Nonqualified deferred compensation earnings for one of the senior officers

(e) Includes contributions to 401(k) and defined contribution plans, automobile benefits which may exceed \$5,000 and premiums paid for life insurance.

(f) Change in pension value represents the change in the actuarial present value of the accumulated benefit under the defined benefit pension plan, the Farm Credit Bank of Texas Pension Plan, from the prior fiscal year to the current fiscal year.

Refer to Note 12 – Employee Benefit Plans for detailed explanation on the increase to the retiree welfare plan’s projected benefit obligation and corresponding impact to change in pension value.

*The table above does not include the estimated LTI incentive accruals of \$2,252,816. For details regarding these accruals see disclosure more fully discussed within the Long Term Incentives section of this discussion and analysis.

Pension Benefits Table

The following table presents the total annual benefit provided from the defined benefit pension plan applicable to senior officers for the year ended December 31, 2018:

<u>Number</u>	<u>Plan Name</u>	<u>Number of Years Credited Service</u>	<u>Present Value of Accumulated Benefit</u>	<u>Payments During 2018</u>
Aggregate No. of Senior Officers in Year Excluding CEO (Three Persons)	Farm Credit Bank of Texas Pension Plan	39.20	\$ 9,393,800	\$ ---

The “Present Value of Accumulated Benefits” will be actuarially determined based on the association’s senior officers’ participation in the defined benefit pension plan.

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

Additional Nonqualified Supplemental 401(k) Plan:

During 2018, the association continued to plan for succession for key members of senior management that are reaching retirement eligibility. In conjunction with this plan, the association entered into an agreement with one of its senior management team members that called for a one time discretionary contribution into the Farm Credit Benefits Alliance Nonqualified Supplemental 401(k) Plan (“the Plan”). The association evaluated the need to restore a portion of benefits lost as a result of the addition of a member to the association’s senior management team, and as a result developed a plan to address this shortfall. The association funded this plan during 2018. At December 31, 2018, the association completed the funding of this supplemental compensation program. Therefore, there was no remaining obligation to the association. Expenses of the plan relating to this agreement for 2018, 2017 and 2016 were \$250,000, \$0 and \$0 respectively.

Incentive Plan for Officers and Employees:

The association utilizes two incentive plans: the annual (short-term) incentive plan (STI) based on individual and association performance which drives behavior that supports annual association goals, and the Long Term Incentive plan (LTI), which was developed to reward key employees for achievement of the association’s long-term goals and objectives. Both plans utilize parameters for measuring achievement at either threshold, target or superior performance levels. The LTI evaluates performance annually and is earned over a rolling three-year performance period.

Annual (Short-Term) Incentive Plan (STI)

The STI plan is a balanced scorecard plan which rewards employees for achieving desired business goal objectives for the year. The STI is an annual plan that is administered by the board.

At the beginning of each plan year, the board reviews and approves STI plan performance objectives for the association and the award matrix by which all incentives under the STI shall be calculated. Each STI plan participant is assigned an incentive award target calculated as a percentage of base pay which may be awarded if the association and participant achieve target performance goals. Failure to meet minimum thresholds for individual goals will result in no incentive, while achievement at superior levels for individual goals will result in the maximum incentive opportunity available at that salary grade for that goal. Potential individual award percentages vary based upon an employee’s job grade level and are higher for those persons serving to direct performance of the association which includes its senior lending staff and senior officers. Award payments vary depending upon the extent to which the association goals are achieved.

For calendar year 2018, the board approved the following goal performance measures, weightings and performance goals:

<u>Performance Measures</u>	<u>Weight</u>	<u>Performance Goals Target</u>	<u>2018 Actual Performance</u>	<u>Performance Achievement</u>
Acceptable credit quality as percentage of total loans	10%	96.00%	96.58%	Between target and superior
Net charge-offs as percentage of average loans plus other property owned	15%	0.15%	0.01%	superior
Nonearning assets as percentage of loans plus other property owned	20%	0.75%	0.66%	between target and superior
Return on equity results compared to System peer group	40%	3rd or 4th of System peers	1st	superior
Growth in average accrual loan volume serviced compared to overchartered peer group	15%	>105.00% of growth in average volume of peer group	326.90% of growth in average volume of peer group	superior
Total	<u>100%</u>			

As part of this plan the association has also established parameters for goal performance which define threshold and superior levels of incentive opportunities when more or less than the targeted goals are achieved. If less than the threshold level of performance is achieved for a particular performance measure, no incentives will be awarded for that performance measure. Financial results for 2018 resulted in the association's achievement of goal performance which overall achieves superior goals in three of the five measures. As a result, the board approved and the association accrued an estimated payment of \$14,242,963 in STI incentives. As specified by the plan, these incentives are to be paid by March 15, 2019.

Long Term Incentive Plan (LTI)

The purpose of the association's LTI is to offer a financial rewards package to key employees based on the long-term performance of the association. The board is the administrator of the LTI. The board has retained the authority to review and approve plan participants, the incentives prior to payment, and the LTI metrics and goals as presented by the CEO and members of management. Any additions or deletions to the participant list must be submitted for board approval prior to the beginning of a performance period (the consecutive 36-month period beginning January 1 and ending December 31). Each participant is assigned an incentive award goal, calculated as a percentage of base salary at the beginning of the performance period at threshold, target and superior performance levels.

At the beginning of each calendar year, the board approves the LTI plan objectives for the association and the award formula or matrix by which all awards under this plan are based. Since its inception in 2011, the LTI plan established goals and metrics which management and the board felt were long term in nature and fostered the long-term health and viability of the association and its stockholders. These goals included loan volume growth, operating efficiency and capital distributions to the association's stockholders. The association's vision is to be the partner of choice for lending and related services in rural America through outstanding people, performance and member value. The board believes the goals established for the LTI support this vision.

For the LTI performance period 2018-2020, the board approved the following goal performance measures, weightings and performance goals, which are consistent with goals established for the LTI plan performance periods of 2017-2019 and 2016-2018.

Performance Measures	Performance Goals	
	Target	Weight
Capital distributions as a percentage of average loan volume	1.0%	33.3%
Three-year average growth rate for period end of accrual loans	5.0%	33.3%
Annual operating expenses as % of Net interest income plus other income (Efficiency) compared to System peer group	3 rd of large system associations	33.4%

The actual/projected results for LTI performance and the estimated incentives based upon the performance for each of the three performance periods are as follows:

Plan Period	Capital Distributions	Growth	Efficiency	CEO LTI	Senior Officer LTI	Other Officers LTI
2016-2018	superior	at target	superior	\$ 310,905	\$ 810,790	\$ 581,070
2017-2019 projected	superior	between threshold and target	superior	304,842	738,317	615,432
2018-2020 projected	superior	between threshold and target	superior	384,709	703,709	610,650

Other

Employees who use their personal automobile for business purposes were reimbursed during 2018 at the IRS-approved rate of 54.5 cents per mile.

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

TRANSACTIONS WITH DIRECTORS AND SENIOR OFFICERS

The association's policies on loans to and transactions with its officers and directors, required to be disclosed in this section, are incorporated herein by reference from Note 13 to the consolidated financial statements, "Related Party Transactions," included in this annual report.

DIRECTORS' AND SENIOR OFFICERS' INVOLVEMENT IN CERTAIN LEGAL PROCEEDINGS

During the past five years, none of the association's officers or directors has been involved in legal proceedings that are material to an evaluation of the ability or integrity of any person who served as director or senior officer at any time during the year just ended.

RELATIONSHIP WITH INDEPENDENT AUDITORS

No change in auditors has taken place since the last annual report to stockholders and no disagreements with auditors has occurred that the association is required to report to the Farm Credit Administration under part 621 of the FCA regulations governing this disclosure.

Fees for professional services paid by the association during 2018 to PricewaterhouseCoopers are as follows:

<u>Service Category</u>	<u>Fees</u>
Annual audit services	\$ 40,000
Non-audit services*	\$ 900
	<u>\$ 40,900</u>

*Non-audit services includes fees related to the financial statement disclosure checklist which was approved by the association's audit committee.

Fees paid in January 2019 related to 2018 audit services were \$95,769.

RELATIONSHIP WITH UNINCORPORATED BUSINESS ENTITIES

The association and the Bank made investments in a limited partnership, the Advantage Capital Ag Partners L.P., that will provide junior capital to rural and agriculture businesses in the United States. This partnership is a Rural Business Investment Company (RBIC), and the investment by the association and the Bank is allowed under the Mission-Related Investment authorities granted in the Farm Credit Act. The association's investment in RBIC was \$11,624, \$11,573 and \$6,775 at December 31, 2018, 2017 and 2016, respectively. This investment is included in "other assets" on the balance sheet.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers dated March 13, 2019, and the report of management in this annual report to stockholders, are incorporated herein by reference.

MEMBER/SHAREHOLDER PRIVACY

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

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

The association has a policy to make a concerted effort to finance young, beginning or small farmers and ranchers, and producers or harvesters of aquatic products (YBS program). For purposes of the association’s YBS program, young producers are defined as those age 35 or younger. Beginning producers are defined as producers with 10 years or less of experience at farming, ranching or producing or harvesting aquatic products. A small producer is defined as one who normally generates less than \$250,000 in annual gross sales of agricultural or aquatic products. Using statistics obtained from a United States Department of Agriculture census and information from the association’s loan accounting records as of June 30, 2018, the following table compares the percentage of YBS farmers in the association’s territory (based on USDA data) with the percentage of YBS customers in the association’s loan portfolio. While the measurement (farmers) used in the USDA census information is not directly comparable to the measurement (customers) used by the association, the statistics presented herein serve as a quantitative measurement of the association’s success in attracting and making loans to young, beginning and/or small farmers that live or have operations in the association’s territory.

In the following table, 4.0 percent of the farmers in the association’s territory are “Young” farmers while 18.1 percent of our customers that live or operate in the association’s territory meet the “Young” criterion. The same explanation applies to the Beginning and Small categories.

<u>FARMERS, RANCHERS, AND PRODUCERS OR HARVESTERS OF AQUATIC PRODUCTS</u>	<u>FARMERS IN TERRITORY</u>	<u>ASSOCIATION CUSTOMERS</u>
<u>CLASSIFIED AS:</u>		
Young	4.0%	18.1%
Beginning	20.8%	67.8%
Small	95.5%	89.1%

At December 31, 2018, the association had the following number of loans and volume outstanding in its YBS Program (loans may fit in one, two or all three categories):

<u>YOUNG</u>		<u>BEGINNING</u>		<u>SMALL</u>	
<u>Number of Loans</u>	<u>Volume</u>	<u>Number of Loans</u>	<u>Volume</u>	<u>Number of Loans</u>	<u>Volume</u>
4,890	\$895,771	16,422	\$4,102,169	21,871	\$4,758,269

The association maintains a policy that directs management to implement a program that strives to fully utilize its resources to: (A) attract and retain YBS customers, (B) implement lending programs and/or services that meet the needs of YBS customers and (C) develop quantitative standards that may be used to measure the number of YBS customers served as compared to the number in the CFC territory. Management has implemented programs to address each component by:

Attracting and retaining YBS customers – The employees of Capital Farm Credit are involved in working with youth livestock programs that have historically produced individuals who become farmers and ranchers in the future. Hundreds of hours are spent annually serving in various capacities that promote livestock shows and sales for youth across the state, and Capital Farm Credit spends thousands of dollars sponsoring and contributing to these programs. These programs are spread across the state and include county, regional and statewide shows and involve both 4-H and FFA programs.

In addition, CFC sponsors and supports programs and organizations around the state that are targeted at young, beginning or small farmers or ranchers, some in cooperation with various county and statewide organizations but also with the Texas A&M AgriLife Extension Service. Programs such as the “Next Generation Program” and others have been successful in helping to educate and provide knowledge and other resources to thousands of individuals who are taking steps to initiate or increase their involvement in agriculture or increase the size and productivity of their existing operations. The association is concerned about the next generation of agriculture and utilizes its programs and personnel to help develop those who will be producing food and fiber after the current generation of farmers and ranchers retires.

The involvement and support of these programs also helps YBS farmers/ranchers become aware of Capital Farm Credit and understand how its loan programs and services can be of value to them as they improve or expand their current operations but also aids them in improving or expanding their operation regardless of whether they do business with Capital Farm Credit.

Implementing lending programs and/or services that meet the needs of YBS customers – The association implemented a policy that permits the association to provide constructive credit to serve any financing need of YBS customers that are taking demonstrated steps to become more fully engaged as a full-time farmer or rancher. Also, the association has adopted underwriting standards that contain flexible criteria that permit the credit needs of customers to be met when the customer falls short of meeting an established standard but has one or more compensating strengths to offset the area of weakness. These flexible criteria, while still requiring reasonable and prudent underwriting standards, allow customers who engage in agriculture operations less than full-time to have the capital resources they need to begin or grow their operations. In addition, the association cooperates with government agencies to structure loans with third party guarantees when the applicant does not have sufficient equity or proven repayment sources to qualify for credit by themselves. These cooperative efforts allow YBS customers to begin an agriculture operation, maintain their operation through stressful periods or make expansions in herd size, facilities or acreage.

Developing quantitative standards that may be used to measure the number of YBS customers served as compared to the number in the CFC territory – In each year’s business plan, the board establishes YBS goals and develops quantitative standards to measure the level of success in achieving the established goals. The business plan also defines how and when the standards will be measured and assigns responsibility to an officer for monitoring, tracking and reporting the standards. The progress in achieving the goals is reported to the board of directors each quarter. Through this process, the board is able to evaluate if the programs implemented by management are successful in achieving the goals in the business plan and are successful in achieving compliance with the board’s policy direction to serve the needs of YBS customers.

Capital Farm Credit

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