# Farm Credit of Western Oklahoma, ACA

# Quarterly Report
# June 30, 2017

The shareholders' investment in Farm Credit of Western Oklahoma, ACA is materially affected by the financial condition and results of operations of CoBank, ACB, (CoBank). The 2016 CoBank Annual Report to Shareholders and the CoBank quarterly shareholders' reports are available free of charge by accessing CoBank's web site, **www.cobank.com**, or may be obtained at no charge by contacting us at Farm Credit of Western Oklahoma, ACA, 3302 Williams Avenue, Woodward, Oklahoma 73801, or by calling 580-256-3465 or toll free 1-800-299-3465.

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

(Dollars in Thousands, Except as Noted)
(Unaudited)

The following discussion summarizes the financial position and results of operations of Farm Credit of Western Oklahoma, ACA for the six months ended June 30, 2017, with comparisons to prior periods. You should read these comments along with the accompanying financial statements and footnotes and the 2016 Annual Report to Shareholders. The accompanying financial statements were prepared under the oversight of our Audit Committee.

Since year end 2016, the moisture has been adequate and above average over much of our area, although pockets of dry conditions still persist. Year-to-date rainfall accumulation has been strong throughout the territory, although the timing has been sporadic. According to USDA, sorghum crop conditions are 4% poor, 34% fair, 61% good, and 1% excellent across the state, with other cash grains falling into similar categories. Cotton growing conditions across the state are shown to be 7% poor, 21% fair, 68% good, and 4% excellent. Oklahoma pasture and range land conditions are estimated to be 1% very poor, 6% poor, 37% fair, 50% good, and 6% excellent. Approximately 49% of topsoil moisture is rated adequate and 57% of subsoil moisture is rated adequate at this time. It remains evident that cash grain commodity prices continue to be under pressure, but opportunities for profitability remain across the subset of commodities we serve. Overall, cattle futures have strengthened over the past year allowing for the likelihood of profitability in the highest commodity concentration of our portfolio.

The total impact on the real estate market from the volatility in commodity prices, increasing interest rates and the narrowing of profitability margins in the agriculture economy has yet to be seen in totality, but the likelihood of real estate prices softening in the future remains possible. Average real estate values in Oklahoma continue to show signs of strength when compared to real estate values nation-wide, but management will continue to evaluate the sustainability of this market strength over time. Although land values are still increasing on average state-wide in Oklahoma, there are pockets of weakness that have been noted in recent months and future land value studies will indicate to what level the current farm economy will impact land values across the region. USDA National Agriculture Statistics indicate that Oklahoma farm real estate values increased by 5.88% in 2016, but the continuation of Oklahoma real estate appreciation remains in question given the other factors previously mentioned.

Although concern over the rural economic environment persists, given the present-day commodity prices and the volatility therein over the past few years, significant equities remain across our customer base. Input costs have not seen the same level of decrease that producers continue to hope for, however some input costs have declined, especially those impacted by the lower energy prices experienced over the recent past. Off-farm income has been negatively impacted by the downturn in the oil and gas economy and it is evident that the volatility and weakness in this market continues. As noted, significant equities remain evident across the portfolio and good financial managers will have the upper hand during this time of lower commodity prices coupled with volatility. A higher level of financial management is expected from our customer base in order to maintain profitability by working to control expenses while maintaining liquidity.

### LOAN PORTFOLIO

Loans outstanding at June 30, 2017 totaled $729.1 million, a decrease of $38.9 million, or 5.06%, from loans of $768.0 million at December 31, 2016. The decrease was primarily due to reduced loan demand combined with seasonal repayments on short and intermediate term loans, real estate mortgage loans, and loans to cooperatives.

### RESULTS OF OPERATIONS

Net income for the six months ended June 30, 2017 was $5.7 million, an increase of $1.0 million, or 22.34%, from the same period ended one year ago. This was driven primarily by an increase in net interest income and mineral income, combined with a decrease in salaries and employee benefits, FCSIC premiums, other operating expenses, and offset in part by a decrease in other noninterest income, increases in occupancy and equipment, information technology services, supervisory and examination costs, and an increase in the provision for credit losses.

Net interest income for the six months ended June 30, 2017 was $10.5 million an increase of $702 thousand or 7.15%, compared with June 30, 2016. Net interest income increased primarily as a result of increased spread in accrual loan volume.

The provision for credit losses for the six months ended June 30, 2017 was $548 thousand, an increase of $443 thousand, or 421.90%, from the provision for credit losses for the same period ended one year ago. The provision for credit losses increased as a result of increased risk in certain loans however a $517 thousand reduction in the subjective allowance calculation partially offset this.

Noninterest income decreased $102 thousand during the first six months of 2017 compared with the first six months in 2016 primarily due to a decrease in other noninterest income partially offset by an increase in mineral income.

Mineral income of $220 thousand was recognized during the first six months of 2017. Of this amount, quarterly payments totaling $205 thousand were received from CoBank.

During the first six months of 2017, noninterest expense decreased $883 thousand to $6.0 million, primarily due to decreased salaries and employee benefits, FCSIC premiums, and other noninterest expenses. The decrease was partially offset by increases in occupancy and equipment, information technology services, and supervisory and examination costs.

**CAPITAL RESOURCES**

Our shareholders' equity at June 30, 2017 was $147.9 million, an increase from $142.2 million at December 31, 2016. This increase is due to net income and other comprehensive income, offset by stock reductions since year end.

**REGULATORY MATTERS**

On March 10, 2016, the FCA approved new rules ("New Capital Regulations") relating to regulatory capital requirements for System Banks, including CoBank and Associations. The New Capital Regulations became effective January 1, 2017. The stated objectives of the New Capital Regulations are as follows:

- To modernize capital requirements while ensuring that System institutions continue to hold sufficient regulatory capital to fulfill the System's 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 certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

The New Capital Regulations, among other things, replace existing core surplus and total surplus requirements with common equity tier 1 (CET1), tier 1 and total capital (tier 1 plus tier 2) risk-based capital ratio requirements. The New Capital Regulations also add a tier 1 leverage ratio for all System institutions, which replaces the existing net collateral ratio for System Banks. In addition, the New Capital Regulations establish a capital conservation buffer and a leverage buffer; enhance the sensitivity of risk weightings; and, for System Banks only, require additional public disclosures. The revisions to the risk weightings include alternatives to the use of credit ratings, as required by the Dodd-Frank Act.

The New Capital Regulations set the following minimum risk-based requirements:

- A CET1 capital ratio of 4.5 percent;
- A tier 1 capital ratio (CET1 capital plus additional tier 1 capital) of 6 percent; and
- A total capital ratio (tier 1 plus tier 2) of 8 percent.

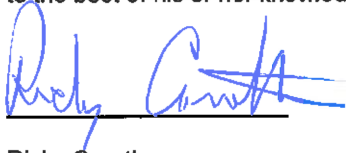
The New Capital Regulations also set a minimum tier 1 leverage ratio (tier 1 divided by total assets) of 4 percent, of which at least 1.5 percent must consist of unallocated retained earnings (URE) and URE equivalents, which are nonqualified allocated equities with certain characteristics of URE.

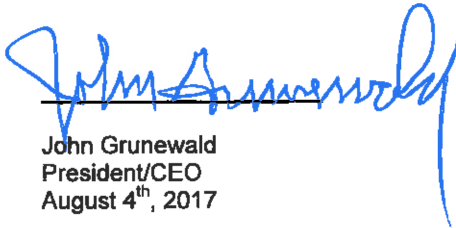
The New Capital Regulations establish a capital cushion (capital conservation buffer) of 2.5 percent above the risk-based CET1, tier 1 and total capital requirements. In addition, the New Capital Regulations establish a leverage capital cushion (leverage buffer) of 1 percent above the tier 1 leverage ratio requirements. If capital ratios fall below the regulatory minimum plus buffer amounts, capital distributions (equity redemptions, cash dividend payments, and cash patronage payments) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval. The New Capital Regulations establish a three-year phase-in of the capital conservation buffer, which began on January 1, 2017. There will be no phase-in of the leverage buffer.

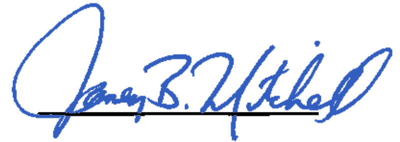
Refer to Note 3 of the accompanying Consolidated Financial Statements for additional detail regarding the capital ratios as of June 30, 2017.

**OTHER MATTERS**

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







| | | |
|---|---|---|
| Ricky Carothers | John Grunewald | Jamey B. Mitchell |
| Chairman of the Board | President/CEO | Chief Financial Officer |
| August 4th, 2017 | August 4th, 2017 | August 4th, 2017 |

## Consolidated Statement of Condition

(Dollars in Thousands)

| | June 30 2017 UNAUDITED | December 31 2016 AUDITED |
|---|---|---|
| **ASSETS** | | |
| Loans | **$ 729,090** | $ 767,955 |
| Less allowance for loan losses | **3,065** | 2,623 |
| Net loans | **726,025** | 765,332 |
| Cash | **2,530** | 4,425 |
| Accrued interest receivable | **15,165** | 12,472 |
| Investment in CoBank, ACB | **25,369** | 25,369 |
| Premises and equipment, net | **4,540** | 3,744 |
| Prepaid benefit expense | **1,276** | 1,141 |
| Other assets | **2,942** | 4,367 |
| **Total assets** | **$ 777,847** | $ 816,850 |
| **LIABILITIES** | | |
| Note payable to CoBank, ACB | **$ 617,244** | $ 658,900 |
| Advance conditional payments | **8,163** | 7,441 |
| Accrued interest payable | **1,048** | 1,045 |
| Patronage distributions payable | **-** | 2,000 |
| Accrued benefits liability | **252** | 258 |
| Reserve for unfunded commitments | **469** | 374 |
| Other liabilities | **2,800** | 4,666 |
| **Total liabilities** | **629,976** | 674,684 |
| **Commitments and Contingencies** | | |
| **SHAREHOLDERS' EQUITY** | | |
| Capital stock | **1,985** | 2,002 |
| Additional paid-in capital | **33,619** | 33,619 |
| Unallocated retained earnings | **112,325** | 106,610 |
| Accumulated other comprehensive (loss)/income | **(58)** | (65) |
| **Total shareholders' equity** | **147,871** | 142,166 |
| **Total liabilities and shareholders' equity** | **$ 777,847** | $ 816,850 |

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

## Consolidated Statement of Comprehensive Income

(Dollars in Thousands)

| UNAUDITED | For the three months ended June 30 **2017** | For the three months ended June 30 2016 | For the six months ended June 30 **2017** | For the six months ended June 30 2016 |
|---|---|---|---|---|
| **INTEREST INCOME** | | | | |
| Loans | **$ 8,516** | $ 8,107 | **$ 17,156** | $ 15,943 |
| **Total interest income** | **8,516** | 8,107 | **17,156** | 15,943 |
| **INTEREST EXPENSE** | | | | |
| Note payable to CoBank | **3,346** | 3,136 | **6,590** | 6,079 |
| Other | **27** | 29 | **52** | 52 |
| **Total interest expense** | **3,373** | 3,165 | **6,642** | 6,131 |
| Net interest income | **5,143** | 4,942 | **10,514** | 9,812 |
| Provision for credit losses | **76** | 115 | **548** | 105 |
| Net interest income after provision for credit losses | **5,067** | 4,827 | **9,966** | 9,707 |
| **NONINTEREST INCOME** | | | | |
| Financially related services income | **5** | 15 | **9** | 17 |
| Loan fees | **8** | 4 | **12** | 10 |
| Patronage refund from Farm Credit Institutions | **708** | 711 | **1,440** | 1,414 |
| Mineral income | **105** | 83 | **220** | 167 |
| Other noninterest income | **2** | 65 | **45** | 220 |
| **Total noninterest income** | **828** | 878 | **1,726** | 1,828 |
| **NONINTEREST EXPENSE** | | | | |
| Salaries and employee benefits | **1,451** | 1,708 | **3,087** | 3,456 |
| Occupancy and equipment | **198** | 152 | **308** | 292 |
| Purchased services from AgVantis, Inc. | **435** | 427 | **875** | 849 |
| Farm Credit Insurance Fund premium | **211** | 230 | **430** | 460 |
| Merger-implementation costs | **-** | 26 | **-** | 26 |
| Supervisory and examination costs | **70** | 56 | **140** | 112 |
| Other noninterest expense | **551** | 815 | **1,137** | 1,665 |
| **Total noninterest expense** | **2,916** | 3,414 | **5,977** | 6,860 |
| **Net income** | **2,979** | 2,291 | **5,715** | 4,675 |
| **OTHER COMPREHENSIVE INCOME** | | | | |
| Amortization of retirement costs | **4** | 1 | **7** | 2 |
| **Comprehensive income** | **$ 2,983** | $ 2,292 | **$ 5,722** | $ 4,677 |

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

## Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

| UNAUDITED | Capital Stock | Additional Paid-In Capital | Unallocated Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|
| **Balance at December 31, 2015** | $ 2,005 | $ 33,619 | $ 99,976 | $ (28) | $ 135,572 |
| Comprehensive income | | | 4,675 | 2 | 4,677 |
| Stock issued | 82 | | | | 82 |
| Stock retired | (86) | | | | (86) |
| **Balance at June 30, 2016** | $ 2,001 | $ 33,619 | $ 104,651 | $ (26) | $ 140,245 |
| | | | | | |
| **Balance at December 31, 2016** | $ 2,002 | $ 33,619 | $ 106,610 | $ (65) | $ 142,166 |
| Comprehensive income | | | 5,715 | 7 | 5,722 |
| Stock issued | 65 | | | | 65 |
| Stock retired | (82) | | | | (82) |
| **Balance at June 30, 2017** | **$ 1,985** | **$ 33,619** | **$ 112,325** | **$ (58)** | **$ 147,871** |

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

**NOTES TO FINANCIAL STATEMENTS**
(Dollars in Thousands, Except as Noted)
(Unaudited)

## NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Farm Credit of Western Oklahoma, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2016, are contained in the 2016 Annual Report to Shareholders. These unaudited second quarter 2017 financial statements should be read in conjunction with the 2016 Annual Report to Shareholders.

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

In the opinion of management, the unaudited financial information is complete and reflects all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of results for the interim periods. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. Descriptions of the significant accounting policies are included in the 2016 Annual Report to Shareholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

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

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

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

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

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant

assumptions used to estimate the fair value of financial instruments carried at amortized cost. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance is not expected to impact the Association's financial condition or its results of operations.

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

Certain amounts in the prior period financial statements have been reclassified to conform to current financial statement presentation.

**NOTE 2 - LOANS AND ALLOWANCE FOR LOAN LOSSES**

A summary of loans follows.

| | **June 30, 2017** | December 31, 2016 |
|---|---|---|
| Real estate mortgage | **$ 480,803** | $488,311 |
| Production and intermediate-term | **236,149** | 264,265 |
| Agribusiness | **9,836** | 12,976 |
| Rural infrastructure | **1,367** | 1,413 |
| Rural residential real estate | **935** | 990 |
| Total loans | **$729,090** | $767,955 |

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

| | Other Farm Credit Institutions | | Non-Farm Credit Institutions | | Total | |
|---|---|---|---|---|---|---|
| | Purchased | Sold | Purchased | Sold | Purchased | Sold |
| Real estate mortgage | $ 31,715 | $ 17,782 | $ 1,206 | $ - | $ 32,921 | $ 17,782 |
| Production and intermediate-term | 13,832 | 8,839 | - | - | 13,832 | 8,839 |
| Agribusiness | 6,840 | - | - | - | 6,840 | - |
| Rural infrastructure | 1,409 | - | - | - | 1,409 | - |
| Total | $ 53,796 | $ 26,621 | $ 1,206 | $ - | $ 55,002 | $ 26,621 |

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

| | **June 30, 2017** | December 31, 2016 |
|---|---|---|
| Real estate mortgage | | |
| Acceptable | **94.81%** | 95.87% |
| OAEM | **1.36%** | 2.68% |
| Substandard | **3.83%** | 1.45% |
| Total | **100.00%** | 100.00% |
| Production and intermediate-term | | |
| Acceptable | **90.48%** | 94.03% |
| OAEM | **3.22%** | 1.08% |
| Substandard | **6.30%** | 4.89% |
| Total | **100.00%** | 100.00% |
| Agribusiness | | |
| Acceptable | **100.00%** | 100.00% |
| Total | **100.00%** | 100.00% |
| Rural infrastructure | | |
| Acceptable | **100.00%** | 100.00% |
| Total | **100.00%** | 100.00% |
| Rural residential real estate | | |
| Acceptable | **100.00%** | 100.00% |
| Total | **100.00%** | 100.00% |
| Total Loans | | |
| Acceptable | **93.49%** | 95.32% |
| OAEM | **1.94%** | 2.07% |
| Substandard | **4.57%** | 2.61% |
| Total | **100.00%** | 100.00% |

High risk assets consist of impaired loans and other property owned. These nonperforming assets (including related accrued interest) and related credit quality are as follows:

| *(dollars in thousands)* | **June 30, 2017** | December 31, 2016 |
|---|---|---|
| Nonaccrual loans | | |
| Real estate mortgage | **$ 1,186** | $ 124 |
| Production and intermediate-term | **3,583** | 1,017 |
| Total nonaccrual loans | **4,769** | 1,141 |
| Accruing restructured loans | | |
| Real estate mortgage | **84** | 112 |
| Total accruing restructured loans | **84** | 112 |
| Total high risk assets | **$ 4,853** | $ 1,253 |

The Association had no accruing loans 90 days past due and no other property owned for the periods presented.

Additional impaired loan information is as follows:

| | **June 30, 2017** | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired loans with a related allowance for credit losses: | | | | | | |
| Production and intermediate-term | **$ 3,300** | **$ 3,224** | **$ 905** | $ 1,017 | $ 1,012 | $ 47 |
| Total | **$ 3,300** | **$ 3,224** | **$ 905** | $ 1,017 | $ 1,012 | $ 47 |
| Impaired loans with no related allowance for credit losses: | | | | | | |
| Real estate mortgage | **$ 1,270** | **$ 1,257** | | $ 236 | $ 254 | |
| Production and intermediate-term | **283** | **1,623** | | - | 1,349 | |
| Total | **$ 1,553** | **$ 2,880** | | $ 236 | $ 1,603 | |
| Total impaired loans: | | | | | | |
| Real estate mortgage | **$ 1,270** | **$ 1,257** | **$ -** | $ 236 | $ 254 | $ - |
| Production and intermediate-term | **3,583** | **4,847** | **905** | 1,017 | 2,361 | 47 |
| Total | **$ 4,853** | **$ 6,104** | **$ 905** | $ 1,253 | $ 2,615 | $ 47 |

Note: The recorded investment in the loan 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 loan receivable.

| | For the Three Months Ended June 30, 2017 | | For the Three Months Ended June 30, 2016 | |
|---|---|---|---|---|
| | Average Impaired Loans | Interest Income Recognized | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for credit losses: | | | | |
| Production and intermediate-term | $ 2,671 | $ - | $ - | $ - |
| Total | $ 2,671 | $ - | $ - | $ - |
| Impaired loans with no related allowance for credit losses: | | | | |
| Real estate mortgage | $ 1,013 | $ 2 | $ 242 | $ 43 |
| Production and intermediate-term | 847 | - | - | - |
| Total | $ 1,860 | $ 2 | $ 242 | $ 43 |
| Total impaired loans: | | | | |
| Real estate mortgage | $ 1,013 | $ 2 | $ 242 | $ 43 |
| Production and intermediate-term | 3,518 | - | - | - |
| Total | $ 4,531 | $ 2 | $ 242 | $ 43 |

| | For the Six Months Ended June 30, 2017 | | For the Six Months Ended June 30, 2016 | |
|---|---|---|---|---|
| | Average Impaired Loans | Interest Income Recognized | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for credit losses: | | | | |
| Production and intermediate-term | $ 2,083 | $ - | $ - | $ - |
| Total | $ 2,083 | $ - | $ - | $ - |
| Impaired loans with no related allowance for credit losses: | | | | |
| Real estate mortgage | $ 639 | $ 2 | $ 579 | $ 46 |
| Production and intermediate-term | 484 | 1 | - | - |
| Total | $ 1,123 | $ 3 | $ 579 | $ 46 |
| Total impaired loans: | | | | |
| Real estate mortgage | $ 639 | $ 2 | $ 579 | $ 46 |
| Production and intermediate-term | 2,567 | 1 | - | - |
| Total | $ 3,206 | $ 3 | $ 579 | $ 46 |

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

| June 30, 2017 | 30-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or less than 30 Days Past Due | Recorded Investment in Loans | Recorded Investment Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 239 | $ 765 | $ 1,004 | $ 489,640 | $ 490,644 | $ - |
| Production and intermediate-term | 3,758 | 371 | 4,129 | 237,299 | 241,428 | - |
| Agribusiness | - | - | - | 9,875 | 9,875 | - |
| Rural infrastructure | - | - | - | 1,368 | 1,368 | - |
| Rural residential real estate | - | - | - | 940 | 940 | - |
| Total | $ 3,997 | $ 1,136 | $ 5,133 | $ 739,122 | $ 744,255 | $ - |

| 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 | Recorded Investment in Loans | Recorded Investment Accruing Loans 90 Days or More Past Due |
|---|---|---|---|---|---|---|
| Real estate mortgage | $ 3,343 | $ - | $ 3,343 | $ 492,898 | $ 496,241 | $ - |
| Production and intermediate-term | 295 | 98 | 393 | 268,359 | 268,752 | - |
| Agribusiness | - | - | - | 13,027 | 13,027 | - |
| Rural infrastructure | - | - | - | 1,413 | 1,413 | - |
| Rural residential real estate | - | - | - | 994 | 994 | - |
| Total | $ 3,638 | $ 98 | $ 3,736 | $ 776,691 | $ 780,427 | $ - |

A summary of changes in the allowance for loan losses is as follows:

| | Balance at March 31, 2017 | Charge-offs | Recoveries | Provision for Loan Losses/ (Loan Loss Reversals) | Balance at June 30, 2017 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 335 | $ - | $ - | $ 44 | $ 379 |
| Production and intermediate-term | 2,688 | 9 | 3 | (28) | 2,654 |
| Agribusiness | 38 | - | - | (16) | 22 |
| Rural infrastructure | 10 | - | - | - | 10 |
| Total | $ 3,071 | $ 9 | $ 3 | $ - | $ 3,065 |

| | Balance at December 31, 2016 | Charge-offs | Recoveries | Provision for Loan Losses/ (Loan Loss Reversals) | Balance at June 30, 2017 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 293 | $ - | $ - | $ 86 | $ 379 |
| Production and intermediate-term | 2,295 | 17 | 6 | 370 | 2,654 |
| Agribusiness | 25 | - | - | (3) | 22 |
| Rural infrastructure | 10 | - | - | - | 10 |
| Total | $ 2,623 | $ 17 | $ 6 | $ 453 | $ 3,065 |

| | Balance at March 31, 2016 | Charge-offs | Recoveries | Provision for Loan Losses/ (Loan Loss Reversals) | Balance at June 30, 2016 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 256 | $ - | $ - | $ (3) | $ 253 |
| Production and intermediate-term | 1,934 | - | 3 | (91) | 1,846 |
| Agribusiness | 18 | - | - | 4 | 22 |
| Rural infrastructure | 17 | - | - | (6) | 11 |
| Rural residential real estate | 1 | - | - | (1) | - |
| Total | $ 2,226 | $ - | $ 3 | $ (97) | $ 2,132 |

| | Balance at December 31, 2015 | Charge-offs | Recoveries | Provision for Loan Losses/ (Loan Loss Reversals) | Balance at June 30, 2016 |
|---|---|---|---|---|---|
| Real estate mortgage | $ 243 | $ - | $ - | $ 10 | $ 253 |
| Production and intermediate-term | 1,975 | 8 | 5 | (126) | 1,846 |
| Agribusiness | 26 | - | - | (4) | 22 |
| Rural infrastructure | 18 | - | - | (7) | 11 |
| Rural residential real estate | 1 | - | - | (1) | - |
| Total | $ 2,263 | $ 8 | $ 5 | $ (128) | $ 2,132 |

The Association maintains a separate reserve for unfunded commitments, which is included in Liabilities on the Association's Consolidated Statement of Condition. The related provision for the reserve for unfunded commitments is included as part of the provision for credit losses on the Consolidated Statement of Comprehensive income, along with the provision for loan losses.

A summary of changes in the reserve for unfunded commitments follows:

| | For the Three Months Ended June 30 | | For the Six Months Ended June 30 | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Balance at beginning of period | **$ 393** | $ 264 | **$ 374** | $ 243 |
| Provision for unfunded commitments | **76** | 212 | **95** | 233 |
| Total | **$ 469** | $ 476 | **$ 469** | $ 476 |

Additional information on the allowance for credit losses follows:

| | Allowance for Credit Losses Ending Balance at June 30, 2017 | | | | Recorded Investments in Loans Outstanding Ending Balance at June 30, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Individually evaluated for impairment | | Collectively evaluated for impairment | | Individually evaluated for impairment | | Collectively evaluated for impairment | |
| Real estate mortgage | $ | - | $ | 379 | $ | 1,371 | $ | 489,273 |
| Production and intermediate-term | | 905 | | 1,749 | | 3,676 | | 237,752 |
| Agribusiness | | - | | 22 | | - | | 9,875 |
| Rural infrastructure | | - | | 10 | | - | | 1,368 |
| Rural residential real estate | | - | | - | | - | | 940 |
| Total | $ | 905 | $ | 2,160 | $ | 5,047 | $ | 739,208 |

| | Allowance for Credit Losses Ending Balance at December 31, 2016 | | | | Recorded Investments in Loans Outstanding Ending Balance at December 31, 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| | Individually evaluated for impairment | | Collectively evaluated for impairment | | Individually evaluated for impairment | | Collectively evaluated for impairment | |
| Real estate mortgage | $ | - | $ | 293 | $ | 236 | $ | 496,005 |
| Production and intermediate-term | | 47 | | 2,248 | | 1,018 | | 267,734 |
| Agribusiness | | - | | 25 | | - | | 13,027 |
| Rural infrastructure | | - | | 10 | | - | | 1,413 |
| Rural residential real estate | | - | | - | | - | | 994 |
| Total | $ | 47 | $ | 2,576 | $ | 1,254 | $ | 779,173 |

A restructuring of a debt constitutes a troubled debt restructuring (TDR) 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. The Association recorded no TDRs during the six months ended June 30, 2017. The Association had no TDRs within the previous 12 months and for which there were subsequent payment defaults during the period. There were no additional commitments to lend to borrowers whose loans have been modified in troubled debt restructuring at June 30, 2017.

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

| | Loans modified as TDRs | | | | TDRs in Nonaccrual Status* | | | |
|---|---|---|---|---|---|---|---|---|
| | **June 30, 2017** | | December 31, 2016 | | **June 30, 2017** | | December 31, 2016 | |
| Real estate mortgage | **$** | **84** | $ | 124 | **$** | - | $ | - |
| Total | **$** | **84** | $ | 124 | **$** | - | $ | - |

* Represents the portion of loans modified as TDRs (first column) that are in nonaccrual status.

**NOTE 3 - CAPITAL**

Effective January 1, 2017, the regulatory capital requirements for System Banks and Associations were modified. The new regulations replaced existing core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk based capital ratios. The new regulations also added a tier 1 leverage ratio and an unallocated retained earning equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. Farm Credit Administration regulations require us to maintain minimums for various regulatory capital ratios.

In addition, the New Capital Regulations establish a capital conservation buffer and a leverage buffer; enhance the sensitivity of risk weightings; and, for System Banks only, require additional public disclosures. The revisions to the risk weightings include alternatives to the use of credit ratings, as required by the Dodd-Frank Act.

A summary of select capital ratios as of June 30, 2017, based on a three-month average and minimums follows.

| | **As of June 30, 2017** | **Regulatory Minimums** | **Capital Conversation Buffer** | **Total** |
|---|---|---|---|---|
| Risk Adjusted: | | | | |
| Common equity tier 1 ratio | 16.50% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | 16.50% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | 16.98% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | 16.57% | 7.0% | - | 7.0% |
| | | | | |
| Non-risk-adjusted: | | | | |
| tier 1 leverage ratio | 15.68% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | 17.19% | 1.5% | - | 1.5% |

* The 2.5% capital conservation buffer over risk-adjusted ratio minimums will be phased in over three years under the FCA capital requirements.

If capital ratios fall below the regulatory minimum plus buffer amounts, capital distributions (equity redemptions, cash dividend payments, and cash patronage payments) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval. The New Capital Regulations establish a three-year phase-in of the capital conservation buffer, which began on January 1, 2017. There will be no phase-in of the leverage buffer.

The following tables present the activity in the accumulated other comprehensive loss, net of tax by component:

| | For the Three Months Ended June 30 | | For the Six Months Ended June 30 | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Pension and other benefit plans: | | | | |
| Beginning balance | **$ (62)** | $ (27) | **$ (65)** | $ (28) |
| Amounts reclassified from accumulated other comprehensive | **4** | 1 | **7** | 2 |
| Ending balance | **$ (58)** | $ (26) | **$ (58)** | $ (26) |

The following table represents reclassifications out of accumulated other comprehensive income/(loss).

| | Amount Reclassified from Accumulated Other Comprehensive Income/(Loss) For the Three Months Ended June 30 | | Location of Gain/Loss Recognized in Statement of Income |
|---|---|---|---|
| | **2017** | 2016 | |
| Pension and other benefit plans: | | | |
| Net actuarial loss | **$ 4** | $ 1 | Salaries and employee benefits |
| Total reclassifications | **$ 4** | $ 1 | |

| | Amount Reclassified from Accumulated Other Comprehensive Income/(Loss) For the Six Months Ended June 30 | | Location of Gain/Loss Recognized in Statement of Income |
|---|---|---|---|
| | **2017** | 2016 | |
| Pension and other benefit plans: | | | |
| Net actuarial loss | **$ 7** | $ 2 | Salaries and employee benefits |
| Total reclassifications | **$ 7** | $ 2 | |

The Association began construction on a Tuttle branch office building during 2016 and the funding is expected to come from unallocated retained earnings.

**NOTE 4 - 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 the principal or most advantageous market for the asset or liability. See Note 2 to the 2016 Annual Report to Shareholders for a more complete description.

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

| | Fair Value Measurement Using | | | Total Fair Value |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | |
| Assets held in nonqualified benefits trusts | | | | |
| **June 30, 2017** | **$ 293** | **$ -** | **$ -** | **$ 293** |
| December 31, 2016 | $ 242 | $ - | $ - | $ 242 |

During the first six months of 2017, the Association recorded no transfers in or out of Levels 1, 2, or 3. The Association had no liabilities measured at fair value on a recurring basis at June 30, 2017 or December 31, 2016.

Assets measured at fair value on a non-recurring basis for each of the fair value hierarchy values are summarized below:

| | Fair Value Measurement Using | | | Total Fair Value | Total Gains/(Losses) |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | | |
| **June 30, 2017**<br>**Loans** | **$ -** | **$ -** | **$ 2,395** | **$ 2,395** | **$ (872)** |
| December 31, 2016<br>Loans | $ - | $ - | $ 970 | $ 970 | $ (47) |

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 takes into account unobservable inputs such as income and expense, comparable sales, replacement cost and comparability adjustments.

The Association had no liabilities measured at fair value on a non-recurring basis at June 30, 2017 or December 31, 2016.

**Valuation Techniques**

As more fully discussed in Note 2 to the 2016 Annual Report to Shareholders, 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. The following presents a brief summary of the valuation techniques used by the Association for assets and liabilities, subject to fair value measurement.

*Assets Held in Non-Qualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

*Loans*

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

**NOTE 5 - SUBSEQUENT EVENTS**

The Association has evaluated subsequent events through August 4, 2017 which is the date the financial statements were issued, and no material subsequent events were identified.