

2018 Annual Report



**Delta Agricultural Credit
Association**

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Delta Agricultural Credit Association

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CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

Delta Agricultural Credit Association

(dollars in thousands)

| As of December 31 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|-----------|-----------|-----------|-----------|-----------|
| Statement of Condition Data | | | | | |
| Loans | \$ 48,988 | \$ 49,709 | \$ 50,458 | \$ 49,506 | \$ 41,364 |
| Allowance for loan losses | 104 | 105 | 105 | 121 | 69 |
| Net loans | 48,884 | 49,604 | 50,353 | 49,385 | 41,295 |
| Investment in AgriBank, FCB | 1,196 | 1,196 | 1,196 | 1,196 | 1,196 |
| Other assets | 1,467 | 1,433 | 1,550 | 1,687 | 1,111 |
| Total assets | \$ 51,547 | \$ 52,233 | \$ 53,099 | \$ 52,268 | \$ 43,602 |
| Obligations with maturities of one year or less | \$ 41,976 | \$ 41,446 | \$ 43,144 | \$ 43,157 | \$ 35,027 |
| Total liabilities | 41,976 | 41,446 | 43,144 | 43,157 | 35,027 |
| Protected members' equity | 7 | 12 | 12 | 12 | 13 |
| Capital stock and participation certificates | 158 | 1,857 | 1,760 | 1,712 | 1,827 |
| Unallocated surplus | 9,406 | 8,918 | 8,183 | 7,387 | 6,735 |
| Total members' equity | 9,571 | 10,787 | 9,955 | 9,111 | 8,575 |
| Total liabilities and members' equity | \$ 51,547 | \$ 52,233 | \$ 53,099 | \$ 52,268 | \$ 43,602 |
| For the year ended December 31 | 2018 | 2017 | 2016 | 2015 | 2014 |
| Statement of Income Data | | | | | |
| Net interest income | \$ 1,844 | \$ 1,929 | \$ 1,928 | \$ 1,909 | \$ 1,525 |
| Provision for loan losses | -- | -- | 5 | 53 | 8 |
| Other expenses, net | 1,186 | 1,113 | 987 | 1,094 | 917 |
| Net income | \$ 658 | \$ 816 | \$ 936 | \$ 762 | \$ 600 |
| Key Financial Ratios | | | | | |
| For the Year | | | | | |
| Return on average assets | 1.2% | 1.5% | 1.7% | 1.5% | 1.6% |
| Return on average members' equity | 6.4% | 7.8% | 9.7% | 8.6% | 7.2% |
| Net interest income as a percentage of average earning assets | 3.5% | 3.6% | 3.6% | 3.9% | 4.2% |
| Net charge-offs as a percentage of average loans | 0.0% | -- | 0.0% | 0.0% | 0.0% |
| At Year End | | | | | |
| Members' equity as a percentage of total assets | 18.6% | 20.7% | 18.7% | 17.4% | 19.7% |
| Allowance for loan losses as a percentage of loans | 0.2% | 0.2% | 0.2% | 0.2% | 0.2% |
| Capital ratios effective beginning January 1, 2017: | | | | | |
| Common equity tier 1 ratio | 21.2% | 20.0% | N/A | N/A | N/A |
| Tier 1 capital ratio | 21.2% | 20.0% | N/A | N/A | N/A |
| Total capital ratio | 21.5% | 20.3% | N/A | N/A | N/A |
| Permanent capital ratio | 21.4% | 24.3% | N/A | N/A | N/A |
| Tier 1 leverage ratio | 15.1% | 14.6% | N/A | N/A | N/A |
| Capital ratios effective prior to 2017: | | | | | |
| Permanent capital ratio | N/A | N/A | 22.5% | 21.0% | 23.3% |
| Total surplus ratio | N/A | N/A | 17.8% | 16.5% | 17.8% |
| Core surplus ratio | N/A | N/A | 17.7% | 16.3% | 16.8% |
| Net Income Distributed | | | | | |
| For the Year | | | | | |
| Patronage distributions: | | | | | |
| Cash | \$ 81 | \$ 140 | \$ 110 | \$ 120 | \$ 100 |

MANAGEMENT'S DISCUSSION AND ANALYSIS

Delta Agricultural Credit Association

The following commentary reviews the consolidated financial condition and consolidated results of operations of Delta Agricultural Credit Association (the Association) and its subsidiaries, Delta Agricultural Credit Association, FLCA and Delta Agricultural Credit Association, PCA and provides additional specific information. The accompanying Consolidated Financial Statements and Notes to the Consolidated Financial Statements also contain important information about our financial condition and results of operations.

The Farm Credit System (System) is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. As of January 1, 2019, the System consisted of three Farm Credit Banks, one Agricultural Credit Bank, and 69 customer-owned cooperative lending institutions (associations). The System serves all 50 states, Washington D.C., and Puerto Rico. This network of financial cooperatives is owned and governed by the rural customers the System serves.

AgriBank, FCB (AgriBank), a System Farm Credit Bank, and its District associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). We are an association in the District.

The Farm Credit Administration (FCA) is authorized by Congress to regulate the System. The Farm Credit System Insurance Corporation (FCSIC) ensures the timely payment of principal and interest on Systemwide debt obligations and the retirement of protected borrower capital at par or stated value.

Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially impact our members' investment. To request free copies of AgriBank financial reports, contact us at:

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Our Annual Report is available on our website no later than 75 days after the end of the calendar year and members are provided a copy of such report no later than 90 days after the end of the calendar year. The Quarterly Reports are available on our website no later than 40 days after the end of each calendar quarter. To request free copies of our Annual or Quarterly Reports, contact us as stated above.

FORWARD-LOOKING INFORMATION

This Annual Report includes 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 "anticipate", "believe", "estimate", "may", "expect", "intend", "outlook", and similar expressions are used to identify such forward-looking statements. These statements reflect our current views with respect to future events. However, actual results may differ materially from our expectations due to a number of risks and uncertainties which may be beyond our control. These risks and uncertainties include, but are not limited to:

- Political, legal, regulatory, financial markets, international, and economic conditions and developments in the United States (U.S.) and abroad
- Economic fluctuations in the agricultural and farm-related business sectors
- Unfavorable weather, disease, and other adverse climatic or biological conditions that periodically occur and impact agricultural productivity and income
- Changes in U.S. government support of the agricultural industry and the System as a government-sponsored enterprise, as well as investor and rating agency actions relating to events involving the U.S. government, other government-sponsored enterprises, and other financial institutions
- Actions taken by the Federal Reserve System in implementing monetary policy
- Credit, interest rate, and liquidity risks inherent in our lending activities
- Changes in our assumptions for determining the allowance for loan losses and fair value measurements

AGRICULTURAL AND ECONOMIC CONDITIONS

Our territory is located in rural southeast Arkansas. Crop, timber, and poultry production are the primary agricultural enterprises that influence our portfolio. Commodity markets are being negatively affected by the current U.S. tariff threats.

Corn and soybeans are still experiencing economic stress from a sharp decline in their commodity values. There is an ongoing income and/or expense adjustment for these enterprises. The current Farm Bill and previous strong crop earnings have provided some cushion to the decline of field crop commodity prices. An additional government support program has been implemented to cushion the tariff related decline in commodities. The crop land rents have declined slightly and are basically tied to the equivalence of the predominant share crop rent values. Although there is economic pressure in crop production, crop rents are still attractive to land owners and investors are still buying farmland. Poultry production continues to show profitable margins but new grower contracts and new poultry facility construction has declined significantly from the peak four years ago. Cattle prices have stabilized at a profitable level from the price collapse several years ago. The stress in the row crop sector has been mitigated by additional government support.

The overall field crops, livestock, poultry, and timber economies are sustainable. Our borrowers' capital erosion has been limited in the stressed field crop sector. The poultry and timberland real estate values remain stable. Despite decreasing trends and stress in certain sectors of our portfolio, we experienced a favorable economic environment in 2018.

LOAN PORTFOLIO

Loan Portfolio

Total loans were \$49.0 million at December 31, 2018, a decrease of \$721 thousand from December 31, 2017.

Components of Loans

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|----------------------------------|------------------|------------------|------------------|
| Accrual loans: | | | |
| Real estate mortgage | \$ 32,181 | \$ 34,531 | \$ 36,646 |
| Production and intermediate-term | 16,754 | 14,962 | 13,779 |
| Agribusiness | 53 | 56 | -- |
| Rural residential real estate | -- | -- | 33 |
| Nonaccrual loans | -- | 160 | -- |
| Total loans | <u>\$ 48,988</u> | <u>\$ 49,709</u> | <u>\$ 50,458</u> |

We offer variable, fixed, and adjustable interest rate loan programs to our borrowers. We determine interest margins charged on each lending program based on cost of funds, credit risk, market conditions, and the need to generate sufficient earnings.

Portfolio Distribution

We are chartered to serve certain counties in Arkansas. Approximately 97.3% of our total loan portfolio was in Drew, Ashley, Bradley, Chicot, Desha, and Lincoln counties at December 31, 2018.

Agricultural Concentrations

| As of December 31 | 2018 | 2017 | 2016 |
|-------------------|---------------|---------------|---------------|
| Poultry and eggs | 44.8% | 46.2% | 47.7% |
| Cash grains | 33.2% | 31.9% | 30.9% |
| Farm supplies | 6.3% | 4.2% | 4.0% |
| Beef | 5.7% | 6.1% | 4.2% |
| Forestry | 5.1% | 5.9% | 6.2% |
| Fish | -- | 1.2% | 1.7% |
| Other | 4.9% | 4.5% | 5.3% |
| Total | <u>100.0%</u> | <u>100.0%</u> | <u>100.0%</u> |

Commodities are based on the borrower's primary intended commodity at the time of loan origination and may change due to borrower business decisions as a result of changes in weather, prices, input costs, and other circumstances.

Our production and intermediate-term loan portfolio exhibits some seasonality relating to patterns of operating loans made to crop producers. These loans are normally at their lowest levels following the harvest and then increase in the spring and throughout the rest of the year as borrowers fund operating needs.

Portfolio Credit Quality

The credit quality of our portfolio declined from December 31, 2017. Adversely classified loans increased to 2.6% of the portfolio at December 31, 2018, from 0.9% of the portfolio at December 31, 2017. The decline in credit quality was a result of downgrading one customer in our real estate portfolio and loans for another customer in our production and intermediate-term portfolio being restructured during 2018. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, government agency guarantee programs are used to reduce the risk of loss. At December 31, 2018, \$23.4 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Components of Risk Assets

(dollars in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|--|--------|--------|-------|
| Loans: | | | |
| Nonaccrual | \$ -- | \$ 160 | \$ -- |
| Accruing restructured | 353 | -- | -- |
| Accruing loans 90 days or more past due | -- | -- | -- |
| Total risk loans | 353 | 160 | -- |
| Other property owned | -- | -- | -- |
| Total risk assets | \$ 353 | \$ 160 | \$ -- |
| Total risk loans as a percentage of total loans | 0.7% | 0.3% | -- |
| Nonaccrual loans as a percentage of total loans | -- | 0.3% | -- |
| Current nonaccrual loans as a percentage of total nonaccrual loans | -- | -- | -- |
| Total delinquencies as a percentage of total loans | -- | 0.3% | -- |

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased from December 31, 2017, but have remained at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans were well within our established risk management guidelines.

The decrease in nonaccrual loans was due to the payoff of two loans through the collection of the Farm Service Agency guarantee. Nonaccrual loans remained at an acceptable level at December 31, 2018, 2017, and 2016.

The increase in accruing restructured loans was due to production and intermediate-term loans with one borrower being restructured during 2018.

Allowance for Loan Losses

The allowance for loan losses is an estimate of losses on loans inherent in our portfolio as of the financial statement date. We determine the appropriate level of allowance for loan losses based on the periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

Allowance Coverage Ratios

| As of December 31 | 2018 | 2017 | 2016 |
|--|-------|-------|------|
| Allowance as a percentage of: | | | |
| Loans | 0.2% | 0.2% | 0.2% |
| Nonaccrual loans | -- | 65.6% | -- |
| Total risk loans | 29.5% | 65.6% | -- |
| Net charge-offs as a percentage of average loans | 0.0% | -- | 0.0% |
| Adverse assets to risk funds | 15.2% | 4.8% | 0.6% |

Note: Risk funds includes permanent capital and allowance for loan losses.

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at December 31, 2018.

Additional loan information is included in Notes 3, 9, 10, and 11 to the accompanying Consolidated Financial Statements.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|-----------------------------------|--------|--------|--------|
| Net income | \$ 658 | \$ 816 | \$ 936 |
| Return on average assets | 1.2% | 1.5% | 1.7% |
| Return on average members' equity | 6.4% | 7.8% | 9.7% |

Changes in the chart above relate directly to:

- Changes in income discussed below
- Changes in assets discussed in the Loan Portfolio section
- Changes in capital discussed in the Capital Adequacy section

Changes in Significant Components of Net Income

| (in thousands) | For the year ended December 31 | | | (Decrease) increase in net income | |
|----------------------------|--------------------------------|----------|----------|-----------------------------------|--------------|
| | 2018 | 2017 | 2016 | 2018 vs 2017 | 2017 vs 2016 |
| Net interest income | \$ 1,844 | \$ 1,929 | \$ 1,928 | \$ (85) | \$ 1 |
| Provision for loan losses | -- | -- | 5 | -- | 5 |
| Patronage income | 247 | 242 | 217 | 5 | 25 |
| Other income, net | 36 | 22 | 9 | 14 | 13 |
| Operating expenses | 1,469 | 1,377 | 1,212 | (92) | (165) |
| Provision for income taxes | -- | -- | 1 | -- | 1 |
| Net income | \$ 658 | \$ 816 | \$ 936 | \$ (158) | \$ (120) |

Net Interest Income

Changes in Net Interest Income

| (in thousands) | For the year ended December 31 | |
|---------------------------|--------------------------------|--------------|
| | 2018 vs 2017 | 2017 vs 2016 |
| Changes in volume | \$ (15) | \$ (3) |
| Changes in interest rates | (70) | 4 |
| Net change | \$ (85) | \$ 1 |

There was no income on nonaccrual loans included in net interest income in 2018, 2017, or 2016. Nonaccrual income is recognized when received in cash, collection of the recorded investment is fully expected, and prior charge-offs have been recovered.

Net interest margin (net interest income as a percentage of average earning assets) was 3.5%, 3.6%, and 3.6% in 2018, 2017, and 2016, respectively. Our net interest margin is sensitive to interest rate changes and competition.

Patronage Income

We may receive patronage from AgriBank and other Farm Credit Institutions. Patronage distributions from AgriBank and other Farm Credit Institutions are declared solely at the discretion of each institution's Board of Directors.

Patronage Income

| (in thousands) | For the year ended December 31 | | |
|--------------------------------|--------------------------------|--------|--------|
| | 2018 | 2017 | 2016 |
| Wholesale patronage | \$ 243 | \$ 238 | \$ 212 |
| Other Farm Credit Institutions | 4 | 4 | 5 |
| Total patronage income | \$ 247 | \$ 242 | \$ 217 |

Wholesale patronage income is based on the average balance of our note payable to AgriBank. The patronage rates were 54.1 basis points, 52.1 basis points, and 25.6 basis points in 2018, 2017, and 2016, respectively. The increase in the patronage rate in 2017 was primarily due to a change in AgriBank's capital plan effective July 1, 2017. The capital plan was modified to pay out 100% of net earnings beginning in 2017. Previously, 50% of net earnings was paid. See the Relationship with AgriBank section for further discussion on patronage income.

In addition, the wholesale patronage balance includes equalization. Equalization is determined based on the quarterly average balance of stock in excess of our AgriBank required investment. The equalization rate is targeted at the average cost of funds for all District associations as a group.

Other Income, Net

The change in other income, net was primarily due to our share of distributions from Allocated Insurance Reserve Accounts (AIRA) of \$19 thousand in 2018. The AIRA was established by the FCSIC when premiums collected increased the level of the Farm Credit Insurance Fund beyond the required secured base amount of 2.0% of insured debt. There were no AIRA distributions in 2017 or 2016.

Operating Expenses

Components of Operating Expenses

(dollars in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|--------------------------------|----------|----------|----------|
| Salaries and employee benefits | \$ 909 | \$ 898 | \$ 776 |
| Purchased and vendor services | 351 | 255 | 191 |
| Communications | 22 | 20 | 23 |
| Occupancy and equipment | 32 | 36 | 34 |
| Advertising and promotion | 31 | 35 | 34 |
| Examination | 22 | 21 | 20 |
| Farm Credit System insurance | 22 | 40 | 45 |
| Other | 80 | 72 | 89 |
| Total operating expenses | \$ 1,469 | \$ 1,377 | \$ 1,212 |
| Operating rate | 2.8% | 2.6% | 2.3% |

Salaries and employee benefits expense increased primarily due to an increase in pension expense.

Purchased and vendor services increased as a result of an increase in legal fees related to loan documentation reviews and a rise in accounting and auditing fees.

The Farm Credit System insurance expense decreased in 2018 primarily due to a lower premium rate charged by FCSIC on accrual loans from 15 basis points in 2017 to 9 basis points in 2018. The FCSIC has announced premiums will remain unchanged at 9 basis points for 2019. The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

FUNDING AND LIQUIDITY

We borrow from AgriBank, under a note payable, in the form of a line of credit, as described in Note 5 to the accompanying Consolidated Financial Statements. This line of credit is our primary source of liquidity and is used to fund operations and meet current obligations. At December 31, 2018, we had \$18.4 million available under our line of credit. We generally apply excess cash to this line of credit.

Note Payable Information

(dollars in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|--------------------------------|-----------|-----------|-----------|
| Average balance | \$ 44,360 | \$ 45,287 | \$ 45,689 |
| Average interest rate | 2.6% | 2.3% | 2.3% |

The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

CAPITAL ADEQUACY

Total members' equity was \$9.6 million, \$10.8 million, and \$10.0 million at December 31, 2018, 2017, and 2016, respectively. Total members' equity decreased \$1.2 million from December 31, 2017, primarily due to a decrease in capital stock and participation certificates and patronage distribution accruals, which was partially offset by net income for the year.

Effective January 1, 2017, the FCA Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents leverage.

Regulatory Capital Requirements and Ratios

| As of December 31 | 2018 | 2017 | Regulatory Minimums | Capital Conservation Buffer | Total |
|--|-------|-------|------------------------|-----------------------------------|-------|
| Risk-adjusted: | | | | | |
| Common equity tier 1 ratio | 21.2% | 20.0% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | 21.2% | 20.0% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | 21.5% | 20.3% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | 21.4% | 24.3% | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | | |
| Tier 1 leverage ratio | 15.1% | 14.6% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | 14.8% | 14.1% | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in over three years under the FCA capital requirements. The phase in period ends on December 31, 2019.

Our capital plan is designed to maintain an adequate amount of surplus and allowance for loan losses which represents our reserve for adversity prior to impairment of stock. We manage our capital to allow us to meet member needs and protect member interests, both now and in the future.

Additional discussion of these regulatory ratios is included in Note 6 to the accompanying Consolidated Financial Statements.

Capital ratios are directly impacted by changes in capital, assets, and off-balance sheet commitments. Refer to the Loan Portfolio section for further discussion of the changes in assets. Additional members' equity information is included in Note 6 to the accompanying Consolidated Financial Statements. Refer to Note 6 in our Annual Report for the year ended December 31, 2016, for a more complete description of the ratios effective as of December 31, 2016. We were in compliance with the minimum required capital ratios as of December 31, 2016.

In addition to these regulatory requirements, we establish an optimum common equity tier 1 (CET1) target. This target allows us to maintain a capital base adequate for future growth and investment in new products and services. The target is subject to revision as circumstances change. Our optimum CET1 target is 10.0%, as defined in our 2019 capital plan.

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. We do not foresee any events that would result in this prohibition in 2019.

RELATIONSHIP WITH AGRIBANK

Borrowing

We borrow from AgriBank to fund our lending operations in accordance with the Farm Credit Act. Approval from AgriBank is required for us to borrow elsewhere. A General Financing Agreement (GFA), as discussed in Note 5 to the accompanying Consolidated Financial Statements, governs this lending relationship.

The components of cost of funds under the GFA include:

- A marginal cost of debt component
- A spread component, which includes cost of servicing, cost of liquidity, and bank profit
- A risk premium component, if applicable

We were subject to a 3 basis point and 2 basis point risk premium in 2018 and 2017, respectively. The risk premiums in 2018 and 2017 were triggered by a decline in our risk score. We were not subject to the risk premium component in 2016. Effective January 1, 2019, we were no longer subject to a risk premium. Certain factors may impact our cost of funds, which primarily include market interest rate changes impacting marginal cost of debt as well as changes to pricing methodologies impacting the spread components described above.

The marginal cost of debt approach simulates matching the cost of underlying debt with similar terms as the anticipated terms of our loans to borrowers. This approach substantially protects us from market interest rate risk. We may occasionally engage in funding strategies that result in limited interest rate risk with approval by AgriBank's Asset/Liability Committee.

Investment

We are required to invest in AgriBank capital stock as a condition of borrowing. This investment may be in the form of purchased stock or stock representing distributed AgriBank surplus. As of December 31, 2018, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on association growth in excess of a targeted growth rate, if the District is also growing above a targeted growth rate.

Patronage

AgriBank's 2018 capital plan is intended to provide for adequate capital at AgriBank under capital regulations as well as to create a path to long-term capital optimization within the AgriBank District. The plan optimizes capital at AgriBank; distributing available AgriBank earnings in the form of patronage, either cash or stock. The plan is designed to maintain capital adequacy such that sufficient earnings will be retained in the form of unallocated retained earnings and allocated stock to meet the leverage ratio target and other regulatory or policy constraints prior to any cash patronage distributions.

We receive the following types of discretionary patronage from AgriBank:

- Wholesale patronage which includes:
 - Patronage on our note payable with AgriBank
 - Equalization patronage based on our excess stock in AgriBank

Beginning in 2017, wholesale patronage income earned may be paid in cash and AgriBank stock. Wholesale patronage income for 2018, 2017, and 2016 was paid in cash.

Purchased Services

We purchase various services from AgriBank, including SunStream Business Services, a division of AgriBank. The services include certain financial and retail systems, financial reporting services, technology services, and insurance services.

The total cost of services we purchased from AgriBank was \$113 thousand, \$87 thousand, and \$79 thousand in 2018, 2017, and 2016, respectively.

Impact on Members' Investment

Due to the nature of our financial relationship with AgriBank, the financial condition and results of operations of AgriBank materially impact our members' investment.

OTHER RELATIONSHIPS AND PROGRAMS

Relationships with Other Farm Credit Institutions

CentRic Technology Collaboration: We participate in CentRic Technology Collaboration (CTC) with certain other AgriBank District associations. The CTC facilitates the development and maintenance of certain retail technology systems essential to providing credit and other services to our members. The CTC operations are governed by representatives of each participating association. The expenses of CTC are allocated to each of the participating associations based on an agreed upon formula. The systems developed are owned by each of the participating associations.

Farm Credit Foundations: We have a relationship with Farm Credit Foundations (Foundations), a System service corporation, which involves purchasing human resource information systems, and benefit, payroll, and workforce management services. As of December 31, 2018, 2017, and 2016, our investment in Foundations was \$7 thousand. The total cost of services we purchased from Foundations was \$51 thousand, \$50 thousand, and \$47 thousand in 2018, 2017, and 2016, respectively.

REGULATORY MATTERS

Investment Securities Eligibility

In May 2018, the FCA Board approved a final rule to revise the requirements governing the eligibility of investment securities for System banks and associations. The new regulation revises the eligibility purpose, type, and amount of investments that a System association may hold. The regulation was effective January 1, 2019. We have updated our policies, procedures, and other documentation to ensure compliance with the new regulation. We currently do not have investment securities on our Consolidated Statements of Condition.

REPORT OF MANAGEMENT

Delta Agricultural Credit Association



We prepare the Consolidated Financial Statements of Delta Agricultural Credit Association (the Association) and are responsible for their 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. The Consolidated Financial Statements, in our opinion, fairly present the financial condition of the Association. Other financial information included in the Annual Report is consistent with that in the Consolidated Financial Statements.

To meet our responsibility for reliable financial information, we depend on accounting and internal control systems designed to provide reasonable, but not absolute assurance that assets are safeguarded and transactions are properly authorized and recorded. Costs must be reasonable in relation to the benefits derived when designing accounting and internal control systems. Financial operations audits are performed to monitor compliance. PricewaterhouseCoopers LLP, our independent auditors, audit the Consolidated Financial Statements. They also consider internal controls to the extent necessary to design audit procedures that comply with auditing standards generally accepted in the United States of America. The Farm Credit Administration also performs examinations for safety and soundness as well as compliance with applicable laws and regulations.

The Board of Directors has overall responsibility for our system of internal control and financial reporting. The Board of Directors and its Audit Committee consults regularly with us and meets periodically with the independent auditors and other auditors to review the scope and results of their work. The independent auditors have direct access to the Board of Directors, which is composed solely of directors who are not officers or employees of the Association.

The undersigned certify we have reviewed the Association's Annual Report, which has been prepared in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Mike Norris
Chairperson of the Board
Delta Agricultural Credit Association

Mark W. Kaufman
Chief Executive Officer
Delta Agricultural Credit Association

Mary Ann Johnson
Chief Financial Officer
Delta Agricultural Credit Association

March 8, 2019

REPORT OF AUDIT COMMITTEE

Delta Agricultural Credit Association



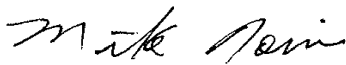
The Consolidated Financial Statements were prepared under the oversight of the Audit Committee. The Audit Committee is composed of the entire Board of Directors of Delta Agricultural Credit Association (the Association). The Audit Committee oversees the scope of the Association's internal audit program, the approval, and independence of PricewaterhouseCoopers LLP (PwC) as independent auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's actions with respect to recommendations arising from those auditing activities. The Audit Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter.

Management is responsible for internal controls and the preparation of the Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the Consolidated Financial Statements in accordance with auditing standards generally accepted in the United States of America and to issue their report based on their audit. The Audit Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Audit Committee reviewed and discussed the audited Consolidated Financial Statements for the year ended December 31, 2018, with management. The Audit Committee also reviewed with PwC the matters required to be discussed by Statement on Auditing Standards AU-C 260, *The Auditor's Communication with Those Charged with Governance*, and both PwC and the internal auditors directly provided reports on any significant matters to the Audit Committee.

The Audit Committee had discussions with and received written disclosures from PwC confirming its independence. The Audit Committee also reviewed the non-audit services provided by PwC, if any, and concluded these services were not incompatible with maintaining PwC's independence. The Audit Committee discussed with management and PwC any other matters and received any assurances from them as the Audit Committee deemed appropriate.

Based on the foregoing review and discussions, and relying thereon, the Audit Committee recommended that the Board of Directors include the audited Consolidated Financial Statements in the Annual Report for the year ended December 31, 2018.



Mike Norris
Chairperson of the Audit Committee
Delta Agricultural Credit Association

Members of the Audit Committee are:

Al Beaty
Bruce Bond
C. Randall Cox
Kim Ellington
Joe Mencer
Mike Norris

March 8, 2019



Report of Independent Auditors

To the Board of Directors of Delta Agricultural Credit Association,

We have audited the accompanying Consolidated Financial Statements of Delta Agricultural Credit Association and its subsidiaries (the Association), which comprise the consolidated statements of condition as of December 31, 2018, 2017, and 2016, and the related consolidated statements of income, changes in members' equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the Consolidated Financial Statements referred to above present fairly, in all material respects, the financial position of Delta Agricultural Credit Association and its subsidiaries as of December 31, 2018, 2017, and 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 8, 2019

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T: (612) 596 6000, www.pwc.com/us*

CONSOLIDATED STATEMENTS OF CONDITION

Delta Agricultural Credit Association

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|--|------------------|------------------|------------------|
| ASSETS | | | |
| Loans | \$ 48,988 | \$ 49,709 | \$ 50,458 |
| Allowance for loan losses | 104 | 105 | 105 |
| Net loans | 48,884 | 49,604 | 50,353 |
| Investment in AgriBank, FCB | 1,196 | 1,196 | 1,196 |
| Accrued interest receivable | 924 | 976 | 1,184 |
| Other assets | 543 | 457 | 366 |
| Total assets | \$ 51,547 | \$ 52,233 | \$ 53,099 |
| LIABILITIES | | | |
| Note payable to AgriBank, FCB | \$ 41,390 | \$ 40,948 | \$ 42,561 |
| Accrued interest payable | 329 | 263 | 256 |
| Patronage distribution payable | 170 | 81 | 140 |
| Other liabilities | 87 | 154 | 187 |
| Total liabilities | 41,976 | 41,446 | 43,144 |
| Contingencies and commitments (Note 10) | | | |
| MEMBERS' EQUITY | | | |
| Protected members' equity | 7 | 12 | 12 |
| Capital stock and participation certificates | 158 | 1,857 | 1,760 |
| Unallocated surplus | 9,406 | 8,918 | 8,183 |
| Total members' equity | 9,571 | 10,787 | 9,955 |
| Total liabilities and members' equity | \$ 51,547 | \$ 52,233 | \$ 53,099 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

Delta Agricultural Credit Association

(in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|---|----------|----------|----------|
| Interest income | \$ 3,007 | \$ 2,959 | \$ 2,966 |
| Interest expense | 1,163 | 1,030 | 1,038 |
| Net interest income | 1,844 | 1,929 | 1,928 |
| Provision for loan losses | -- | -- | 5 |
| Net interest income after provision for loan losses | 1,844 | 1,929 | 1,923 |
| Other income | | | |
| Patronage income | 247 | 242 | 217 |
| Financially related services income | 2 | 4 | 3 |
| Fee income | 13 | 14 | 3 |
| Allocated Insurance Reserve Accounts distribution | 19 | -- | -- |
| Miscellaneous income, net | 2 | 4 | 3 |
| Total other income | 283 | 264 | 226 |
| Operating expenses | | | |
| Salaries and employee benefits | 909 | 898 | 776 |
| Other operating expenses | 560 | 479 | 436 |
| Total operating expenses | 1,469 | 1,377 | 1,212 |
| Income before income taxes | 658 | 816 | 937 |
| Provision for income taxes | -- | -- | 1 |
| Net income | \$ 658 | \$ 816 | \$ 936 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

Delta Agricultural Credit Association

(in thousands)

| | Protected Members' Equity | Capital Stock and Participation Certificates | Unallocated Surplus | Total Members' Equity |
|--|---------------------------------|---|------------------------|-----------------------------|
| Balance as of December 31, 2015 | \$ 12 | \$ 1,712 | \$ 7,387 | \$ 9,111 |
| Net income | -- | -- | 936 | 936 |
| Unallocated surplus designated for patronage distributions | -- | -- | (140) | (140) |
| Capital stock and participation certificates issued | -- | 353 | -- | 353 |
| Capital stock and participation certificates retired | -- | (305) | -- | (305) |
| Balance as of December 31, 2016 | 12 | 1,760 | 8,183 | 9,955 |
| Net income | -- | -- | 816 | 816 |
| Unallocated surplus designated for patronage distributions | -- | -- | (81) | (81) |
| Capital stock and participation certificates issued | -- | 422 | -- | 422 |
| Capital stock and participation certificates retired | -- | (325) | -- | (325) |
| Balance as of December 31, 2017 | 12 | 1,857 | 8,918 | 10,787 |
| Net income | -- | -- | 658 | 658 |
| Unallocated surplus designated for patronage distributions | -- | -- | (170) | (170) |
| Capital stock and participation certificates issued | -- | 471 | -- | 471 |
| Capital stock and participation certificates retired | (5) | (2,170) | -- | (2,175) |
| Balance as of December 31, 2018 | \$ 7 | \$ 158 | \$ 9,406 | \$ 9,571 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Delta Agricultural Credit Association

(in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|---|----------|----------|---------|
| Cash flows from operating activities | | | |
| Net income | \$ 658 | \$ 816 | \$ 936 |
| Depreciation on premises and equipment | 7 | 9 | 9 |
| Provision for loan losses | -- | -- | 5 |
| Changes in operating assets and liabilities: | | | |
| Decrease in accrued interest receivable | 52 | 203 | 214 |
| Increase in other assets | (93) | (94) | (99) |
| Increase in accrued interest payable | 66 | 7 | 44 |
| Decrease in other liabilities | (67) | (33) | (1,539) |
| Net cash provided by (used in) operating activities | 623 | 908 | (430) |
| Cash flows from investing activities | | | |
| Decrease (increase) in loans, net | 593 | 973 | (835) |
| Purchases of premises and equipment, net | -- | (6) | (2) |
| Net cash provided by (used in) investing activities | 593 | 967 | (837) |
| Cash flows from financing activities | | | |
| Increase (decrease) in note payable to AgriBank, FCB, net | 442 | (1,613) | 1,452 |
| Patronage distributions paid | (81) | (140) | (110) |
| Capital stock and participation certificates retired, net | (1,577) | (122) | (75) |
| Net cash (used in) provided by financing activities | (1,216) | (1,875) | 1,267 |
| Net change in cash | -- | -- | -- |
| Cash at beginning of year | -- | -- | -- |
| Cash at end of year | \$ -- | \$ -- | \$ -- |
| Supplemental schedule of non-cash activities | | | |
| Stock financed by loan activities | \$ 315 | \$ 423 | \$ 354 |
| Stock applied against loan principal | 442 | 202 | 230 |
| Stock applied against interest | -- | 2 | 1 |
| Interest transferred to loans | -- | 3 | 15 |
| Patronage distributions payable to members | 170 | 81 | 140 |
| Supplemental information | | | |
| Interest paid | \$ 1,097 | \$ 1,023 | \$ 994 |
| Taxes paid, net | -- | -- | 1 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Delta Agricultural Credit Association

NOTE 1: ORGANIZATION AND OPERATIONS

Farm Credit System and District

The Farm Credit System (System) is a nationwide system of cooperatively owned banks and associations established by Congress to meet the credit needs of American agriculture. As of January 1, 2019, the System consisted of three Farm Credit Banks, one Agricultural Credit Bank, and 69 customer-owned cooperative lending institutions (associations). AgriBank, FCB (AgriBank), a System Farm Credit Bank, and its District associations are collectively referred to as the AgriBank Farm Credit District (AgriBank District or the District). At January 1, 2019, the District consisted of 14 Agricultural Credit Associations (ACA) that each have wholly-owned Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries.

FLCAs are authorized to originate long-term real estate mortgage loans. PCAs are authorized to originate short-term and intermediate-term loans. ACAs are authorized to originate long-term real estate mortgage loans and short-term and intermediate-term loans either directly or through their subsidiaries. Associations are authorized to provide lease financing options for agricultural purposes and are also authorized to purchase and hold certain types of investments. AgriBank provides funding to all associations chartered within the District.

Associations are authorized to provide, either directly or in participation with other lenders, credit and related services to eligible borrowers. Eligible borrowers may include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related service businesses. In addition, associations can participate with other lenders in loans to similar entities. Similar entities are parties that are not eligible for a loan from a System lending institution, but have operations that are functionally similar to the activities of eligible borrowers.

The Farm Credit Administration (FCA) is authorized by Congress to regulate the System banks and associations. We are examined by the FCA and certain association actions are subject to the prior approval of the FCA and/or AgriBank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (FCSIC) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is used to ensure the timely payment of principal and interest on Farm Credit Systemwide debt obligations, to ensure the retirement of protected borrower capital at par or stated value, and for other specified purposes.

At the discretion of the FCSIC, the Insurance Fund is also available to provide assistance to certain troubled System institutions and for the operating expenses of the FCSIC. Each System bank is required to pay premiums into the Insurance Fund until the assets in the Insurance Fund equal 2.0% of the aggregated insured obligations adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments. This percentage of aggregate obligations can be changed by the FCSIC, at its sole discretion, to a percentage it determines to be actuarially sound. The basis for assessing premiums is debt outstanding with adjustments made for nonaccrual loans and impaired investment securities which are assessed a surcharge while guaranteed loans and investment securities are deductions from the premium base. AgriBank, in turn, assesses premiums to District associations each year based on similar factors.

Association

Delta Agricultural Credit Association (the Association) and its subsidiaries, Delta Agricultural Credit Association, FLCA and Delta Agricultural Credit Association, PCA (subsidiaries) are lending institutions of the System. We are a customer-owned cooperative providing credit and credit-related services to, or for the benefit of, eligible members for qualified agricultural purposes in the counties Ashley, Bradley, Chicot, Desha, Drew, and part of Lincoln in the state of Arkansas.

We borrow from AgriBank and provide financing and related services to our members. Our ACA holds all the stock of the FLCA and PCA subsidiaries.

We offer credit life insurance to borrowers and those eligible to borrow.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles and Reporting Policies

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. Preparing financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Principles of Consolidation

The Consolidated Financial Statements present the consolidated financial results of Delta Agricultural Credit Association and its subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

Significant Accounting Policies

Loans: Loans are carried at their principal amount outstanding net of any unearned income, cumulative charge-offs, unamortized deferred fees and costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan interest is accrued and credited to interest income based upon the daily principal amount outstanding. Origination fees, net of related costs, are deferred and recognized over the life of the loan as an adjustment to net interest income.

Generally we place loans in nonaccrual status when principal or interest is delinquent for 90 days or more (unless the loan is well secured and in the process of collection) or circumstances indicate that full collection is not expected.

When a loan is placed in nonaccrual status, we reverse current year accrued interest to the extent principal plus accrued interest before the transfer exceeds the net realizable value of the collateral. Any unpaid interest accrued in a prior year is capitalized to the recorded investment of the loan, unless the net realizable value is less than the recorded investment in the loan, then it is charged-off against the allowance for loan losses. Any cash received on nonaccrual loans is applied to reduce the recorded investment in the loan, except in those cases where the collection of the recorded investment is fully expected and the loan does not have any unrecovered prior charge-offs. In these circumstances interest is credited to income when cash is received. Loans are charged-off at the time they are determined to be uncollectible. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, the borrower has demonstrated payment performance, and the loan is not classified as doubtful or loss.

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a formally restructured loan for regulatory purposes. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as troubled debt restructurings are considered risk loans (as defined below).

Loans that are sold as participations are transferred as entire financial assets, groups of entire financial assets, or participating interests in the loans. The transfers of such assets or participating interests are structured such that control over the transferred assets, or participating interests have been surrendered and that all of the conditions have been met to be accounted for as a sale.

Allowance for Loan Losses: The allowance for loan losses is our best estimate of the amount of losses on loans inherent in our portfolio as of the date of the financial statements. We determine the appropriate level of allowance for loan losses based on periodic evaluation of factors such as loan loss history, estimated probability of default, estimated loss severity, portfolio quality, and current economic and environmental conditions.

Loans in our portfolio that are considered impaired are analyzed individually to establish a specific allowance. A loan is impaired when it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. We generally measure impairment based on the net realizable value of the collateral. Risk loans include nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due. All risk loans are considered to be impaired loans.

We record a specific allowance to reduce the carrying amount of the risk loan by the amount the recorded investment exceeds the net realizable value of collateral. When we deem a loan to be uncollectible, we charge the loan principal and prior year(s) accrued interest against the allowance for loan losses. Subsequent recoveries, if any, are added to the allowance for loan losses.

An allowance is recorded for probable and estimable credit losses as of the financial statement date for loans that are not individually assessed as impaired. We use a two-dimensional loan risk rating model that incorporates a 14-point rating scale to identify and track the probability of borrower default and a separate 6-point scale addressing the loss severity. The combination of estimated default probability and loss severity is the primary basis for recognition and measurement of loan collectability of these pools of loans. These estimated losses may be adjusted for relevant current environmental factors.

Changes in the allowance for loan losses consist of provision activity, recorded in "Provision for loan losses" in the Consolidated Statements of Income, recoveries, and charge-offs.

Investment in AgriBank: Our stock investment in AgriBank is on a cost plus allocated equities basis.

Premises and Equipment: The carrying amount of premises and equipment is at cost, less accumulated depreciation and is included in "Other assets" in the Consolidated Statements of Condition. Calculation of depreciation is generally on the straight-line method over the estimated useful lives of the assets. Gains or losses on disposition are included in "Miscellaneous income, net" in the Consolidated Statements of Income. Depreciation and maintenance and repair expenses are included in "Other operating expenses" in the Consolidated Statements of Income and improvements are capitalized.

Post-Employment Benefit Plans: The District has various post-employment benefit plans in which our employees participate. Expenses related to these plans are included in "Salaries and employee benefits" in the Consolidated Statements of Income.

Certain employees participate in the AgriBank District Retirement Plan. The plan is comprised of two benefit formulas. At their option, employees hired prior to October 1, 2001, are on the cash balance formula or on the final average pay formula. Benefits eligible employees hired between October 1, 2001, and December 31, 2006, are on the cash balance formula. Effective January 1, 2007, the AgriBank District Retirement Plan was closed to new employees. The AgriBank District Retirement Plan utilizes the "Projected Unit Credit" actuarial method for financial reporting and funding purposes.

We also provide certain health insurance benefits to eligible retired employees according to the terms of those benefit plans. The anticipated cost of these benefits is accrued during the employees' active service period.

The defined contribution plan allows eligible employees to save for their retirement either pre-tax, post-tax, or both, with an employer match on a percentage of the employee's contributions. We provide benefits under this plan for those employees that do not participate in the AgriBank District Retirement Plan in the form of a fixed percentage of salary contribution in addition to the employer match. Employer contributions are expensed when incurred.

Income Taxes: The ACA and PCA accrue federal and state income taxes. Deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. Deferred tax assets are recorded if the deferred tax asset is more likely than not to be realized. If the realization test cannot be met, the deferred tax asset is reduced by a valuation allowance. The expected future tax consequences of uncertain income tax positions are accrued.

The FLCA is exempt from federal and other taxes to the extent provided in the Farm Credit Act.

Patronage Program: We accrue patronage distributions according to a prescribed formula approved by the Board of Directors. Generally, we pay the accrued patronage during the first quarter after year end.

Off-Balance Sheet Credit Exposures: Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses. Any reserve for unfunded lending commitments is based on management's best estimate of losses inherent in these instruments, but the commitments have not yet disbursed. Factors such as likelihood of disbursement and likelihood of losses given disbursement are utilized in determining a reserve, if needed. Based on our assessment, any reserve would be recorded in "Other liabilities" in the Consolidated Statements of Condition and a corresponding loss would be recorded in "Provision for credit losses" in the Consolidated Statements of Income. However, no such reserve was necessary as of December 31, 2018, 2017, or 2016.

Cash: For purposes of reporting cash flow, cash includes cash on hand.

Fair Value Measurement: The accounting guidance describes three levels of inputs that may be used to measure fair value.

Level 1 — Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

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:

- Quoted prices for similar assets or liabilities in active markets
- 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, quoted prices that are not current, or principal market information that is not released publicly
- Inputs that are observable such as interest rates and yield curves, prepayment speeds, credit risks, and default rates
- Inputs derived principally from or corroborated by observable market data by correlation or other means

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. These unobservable inputs reflect the reporting entity's own judgments 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.

Recently Issued or Adopted Accounting Pronouncements

We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business. While we are a nonpublic entity, our financial results are closely related to the performance of the combined Farm Credit System. Therefore, we typically adopt accounting pronouncements on the public business entities effective date or aligned with other System institutions, whichever is earlier.

| Standard and effective date | Description | Adoption status and financial statement impact |
|--|--|--|
| In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 "Revenue from Contracts with Customers." This guidance was effective for public business entities on January 1, 2018. | 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 guidance. The guidance sets forth the requirement for new and enhanced disclosures. | We adopted this guidance on January 1, 2018, using the modified retrospective approach, as the majority of our revenues are not subject to the new guidance. The adoption of the guidance did not have a material impact on the financial condition, results of operations, or cash flows. |

| Standard and effective date | Description | Adoption status and financial statement impact |
|---|---|---|
| In March 2017, the FASB issued ASU 2017-07 "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." This guidance was effective for public business entities on January 1, 2018. | This guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. Specifically, the guidance requires non-service cost components of net benefit cost to be recognized in a non-operating income line item of the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. | We adopted this guidance on January 1, 2018. The adoption of the guidance did not impact the Association's financial condition, results of operations, cash flows, or financial statement disclosures. |
| In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities." This guidance was effective for public business entities on January 1, 2018. | The guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial statements. | We adopted this guidance on January 1, 2018. The adoption of this guidance did not impact our financial condition, results of operations, or cash flows, but did impact our fair value disclosures. |
| In February 2016, the FASB issued ASU 2016-02 "Leases." In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements." The guidance is effective for public business entities in its first quarter of 2019 and early adoption is permitted. | The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. When this guidance is adopted, a liability for lease obligations and a corresponding right-of-use asset will be recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months. The guidance includes an optional transition method where an entity is permitted to apply the guidance as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. | We adopted this guidance on January 1, 2019. The adoption of this guidance did not have a material impact on our financial condition, results of operations, and financial statement disclosures, and had no impact on cash flows. |
| In August 2018, the FASB issued ASU 2018-15 "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract." The guidance is effective for our first quarter of 2020 and early adoption is permitted. | The guidance clarifies that implementation costs incurred in a hosting arrangement that is a service contract should be accounted for in the same manner as implementation costs incurred to develop or obtain internal-use software. | We are in the process of reviewing the accounting standard. Based on our preliminary review and analysis, this new guidance is not expected to have a material impact on our financial condition, results of operations, cash flows, and financial statement disclosures. |
| In June 2016, the FASB issued ASU 2016-13 "Financial Instruments – Credit Losses." This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted. | 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. | We have no plans to early adopt this guidance. We are in the process of reviewing the standard. Significant implementation matters yet to be addressed include system selection, drafting of accounting policies and disclosures, and designing processes and controls. We are currently unable to estimate the impact on the financial statements. |

NOTE 3: LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans by Type

(dollars in thousands)

| As of December 31 | 2018 | | 2017 | | 2016 | |
|----------------------------------|-----------|--------|-----------|--------|-----------|--------|
| | Amount | % | Amount | % | Amount | % |
| Real estate mortgage | \$ 32,181 | 65.7% | \$ 34,531 | 69.5% | \$ 36,646 | 72.6% |
| Production and intermediate-term | 16,754 | 34.2% | 15,122 | 30.4% | 13,779 | 27.3% |
| Agribusiness | 53 | 0.1% | 56 | 0.1% | -- | -- |
| Rural residential real estate | -- | -- | -- | -- | 33 | 0.1% |
| Total | \$ 48,988 | 100.0% | \$ 49,709 | 100.0% | \$ 50,458 | 100.0% |

Portfolio Concentrations

Concentrations exist when there are amounts loaned to multiple borrowers engaged in similar activities, which could cause them to be similarly impacted by economic conditions. We lend primarily within agricultural industries.

As of December 31, 2018, volume plus commitments to our ten largest borrowers totaled an amount equal to 23.6% of total loans and commitments.

Total loans plus any unfunded commitments represent a proportionate maximum potential credit risk. However, substantial portions of our lending activities are collateralized. Accordingly, the credit risk associated with lending activities is less than the recorded loan principal. 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. Long-term real estate loans are secured by the first liens on the underlying real property.

Participations

We may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, or comply with the limitations of the FCA Regulations or General Financing Agreement (GFA) with AgriBank.

| Participations Sold (in thousands) | Other Farm Credit Institutions Total Participations Sold | | |
|---------------------------------------|---|-------------------|-------------------|
| | 2018 | 2017 | 2016 |
| | As of December 31 | | |
| Real estate mortgage | \$ (647) | \$ (680) | \$ (710) |
| Production and intermediate-term | (4,052) | (3,788) | (3,424) |
| Total | <u>\$ (4,699)</u> | <u>\$ (4,468)</u> | <u>\$ (4,134)</u> |

We did not have any participation interests purchased as of December 31, 2018, 2017, or 2016.

Credit Quality and Delinquency

We utilize the FCA Uniform Classification System to categorize loans into five credit quality categories. The categories are:

- Acceptable – loans are non-criticized loans representing the highest quality. They are expected to be fully collectible. This category is further differentiated into various probabilities of default.
- Other assets especially mentioned (Special Mention) – loans are currently collectible but exhibit some potential weakness. These loans involve increased credit risk, but not to the point of justifying a substandard classification.
- Substandard – loans exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – loans exhibit similar weaknesses as substandard loans. Doubtful loans have additional weaknesses in existing factors, conditions, and values that make collection in full highly questionable.
- Loss – loans are considered uncollectible.

We had no loans categorized as loss at December 31, 2018, 2017, or 2016.

Credit Quality of Loans

| (dollars in thousands) | Acceptable | | Special Mention | | Substandard/ Doubtful | | Total | |
|----------------------------------|------------------|--------------|-----------------|-------------|--------------------------|-------------|------------------|---------------|
| | Amount | % | Amount | % | Amount | % | Amount | % |
| As of December 31, 2018 | | | | | | | | |
| Real estate mortgage | \$ 31,104 | 94.8% | \$ 794 | 2.4% | \$ 933 | 2.8% | \$ 32,831 | 100.0% |
| Production and intermediate-term | 14,426 | 84.7% | 2,224 | 13.1% | 376 | 2.2% | 17,026 | 100.0% |
| Agribusiness | 55 | 100.0% | -- | -- | -- | -- | 55 | 100.0% |
| Rural residential real estate | -- | -- | -- | -- | -- | -- | -- | -- |
| Total | <u>\$ 45,585</u> | <u>91.4%</u> | <u>\$ 3,018</u> | <u>6.0%</u> | <u>\$ 1,309</u> | <u>2.6%</u> | <u>\$ 49,912</u> | <u>100.0%</u> |
| As of December 31, 2017 | | | | | | | | |
| Real estate mortgage | \$ 34,320 | 97.3% | \$ 511 | 1.4% | \$ 456 | 1.3% | \$ 35,287 | 100.0% |
| Production and intermediate-term | 14,952 | 97.5% | 371 | 2.4% | 16 | 0.1% | 15,339 | 100.0% |
| Agribusiness | 59 | 100.0% | -- | -- | -- | -- | 59 | 100.0% |
| Rural residential real estate | -- | -- | -- | -- | -- | -- | -- | -- |
| Total | <u>\$ 49,331</u> | <u>97.4%</u> | <u>\$ 882</u> | <u>1.7%</u> | <u>\$ 472</u> | <u>0.9%</u> | <u>\$ 50,685</u> | <u>100.0%</u> |

| As of December 31, 2016 | Acceptable | | Special Mention | | Substandard/ Doubtful | | Total | |
|----------------------------------|------------------|--------------|-----------------|-----------|--------------------------|-------------|------------------|---------------|
| | Amount | % | Amount | % | Amount | % | Amount | % |
| Real estate mortgage | \$ 37,596 | 100.0% | \$ -- | -- | \$ -- | -- | \$ 37,596 | 100.0% |
| Production and intermediate-term | 13,957 | 99.6% | -- | -- | 56 | 0.4% | 14,013 | 100.0% |
| Agribusiness | -- | -- | -- | -- | -- | -- | -- | -- |
| Rural residential real estate | 33 | 100.0% | -- | -- | -- | -- | 33 | 100.0% |
| Total | <u>\$ 51,586</u> | <u>99.9%</u> | <u>\$ --</u> | <u>--</u> | <u>\$ 56</u> | <u>0.1%</u> | <u>\$ 51,642</u> | <u>100.0%</u> |

Note: Accruing loans include accrued interest receivable.

Aging Analysis of Loans

| (in thousands) | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total |
|----------------------------------|--------------------------------|-------------------|--|------------------|
| As of December 31, 2018 | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ 32,831 | \$ 32,831 |
| Production and intermediate-term | -- | -- | 17,026 | 17,026 |
| Agribusiness | -- | -- | 55 | 55 |
| Rural residential real estate | -- | -- | -- | -- |
| Total | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 49,912</u> | <u>\$ 49,912</u> |

| As of December 31, 2017 | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total |
|----------------------------------|--------------------------------|-------------------|--|------------------|
| Real estate mortgage | \$ -- | \$ -- | \$ 35,287 | \$ 35,287 |
| Production and intermediate-term | 160 | 160 | 15,179 | 15,339 |
| Agribusiness | -- | -- | 59 | 59 |
| Rural residential real estate | -- | -- | -- | -- |
| Total | <u>\$ 160</u> | <u>\$ 160</u> | <u>\$ 50,525</u> | <u>\$ 50,685</u> |

| As of December 31, 2016 | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total |
|----------------------------------|--------------------------------|-------------------|--|------------------|
| Real estate mortgage | \$ -- | \$ -- | \$ 37,596 | \$ 37,596 |
| Production and intermediate-term | -- | -- | 14,013 | 14,013 |
| Agribusiness | -- | -- | -- | -- |
| Rural residential real estate | -- | -- | 33 | 33 |
| Total | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 51,642</u> | <u>\$ 51,642</u> |

Note: Accruing loans include accrued interest receivable.

There were no loans 90 days or more past due and still accruing interest at December 31, 2018, 2017, or 2016.

Risk Loans

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. Interest income recognized and cash payments received on nonaccrual risk loans are applied as described in Note 2.

Risk Loan Information

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|---|--------|--------|-------|
| Nonaccrual loans: | | | |
| Current as to principal and interest | \$ -- | \$ -- | -- |
| Past due | -- | 160 | -- |
| Total nonaccrual loans | -- | 160 | -- |
| Accruing restructured loans | 353 | -- | -- |
| Accruing loans 90 days or more past due | -- | -- | -- |
| Total risk loans | \$ 353 | \$ 160 | \$ -- |
| Volume with specific allowance | \$ -- | \$ 160 | \$ -- |
| Volume without specific allowance | 353 | -- | -- |
| Total risk loans | \$ 353 | \$ 160 | \$ -- |
| Total specific allowance | \$ -- | \$ 16 | \$ -- |
| For the year ended December 31 | | | |
| Income on accrual risk loans | \$ 15 | \$ -- | -- |
| Income on nonaccrual loans | -- | -- | -- |
| Total income on risk loans | \$ 15 | \$ -- | \$ -- |
| Average risk loans | \$ 282 | \$ 323 | \$ 96 |

Note: Accruing loans include accrued interest receivable.

We had nonaccrual production and intermediate-term loans of \$160 thousand at December 31, 2017. We had no nonaccrual loans at December 31, 2018, or 2016.

Additional Impaired Loan Information by Loan Type

| (in thousands) | As of December 31, 2018 | | | For the year ended December 31, 2018 | |
|---|-------------------------|--------------------------|-------------------|--------------------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | -- | \$ -- | \$ -- |
| Production and intermediate-term | -- | -- | -- | 35 | -- |
| Total | \$ -- | \$ -- | -- | \$ 35 | \$ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | -- | \$ -- | \$ -- |
| Production and intermediate-term | 353 | 359 | -- | 247 | 15 |
| Total | \$ 353 | \$ 359 | -- | \$ 247 | \$ 15 |
| Total impaired loans: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | -- | \$ -- | \$ -- |
| Production and intermediate-term | 353 | 359 | -- | 282 | 15 |
| Total | \$ 353 | \$ 359 | -- | \$ 282 | \$ 15 |

| | As of December 31, 2017 | | | For the year ended December 31, 2017 | |
|---|-------------------------|--------------------------------|----------------------|---|----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Production and intermediate-term | 160 | 147 | 16 | 322 | -- |
| Total | \$ 160 | \$ 147 | \$ 16 | \$ 322 | \$ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ -- | \$ 1 | \$ -- |
| Production and intermediate-term | -- | 21 | -- | -- | -- |
| Total | \$ -- | \$ 21 | \$ -- | \$ 1 | \$ -- |
| Total impaired loans: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ -- | \$ 1 | \$ -- |
| Production and intermediate-term | 160 | 168 | 16 | 322 | -- |
| Total | \$ 160 | \$ 168 | \$ 16 | \$ 323 | \$ -- |
| | | | | | |
| | As of December 31, 2016 | | | For the year ended December 31, 2016 | |
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Loans | Interest Income Recognized |
| Impaired loans with a related allowance for loan losses: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Production and intermediate-term | -- | -- | -- | 57 | -- |
| Total | \$ -- | \$ -- | \$ -- | \$ 57 | \$ -- |
| Impaired loans with no related allowance for loan losses: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Production and intermediate-term | -- | 21 | -- | 39 | -- |
| Total | \$ -- | \$ 21 | \$ -- | \$ 39 | \$ -- |
| Total impaired loans: | | | | | |
| Real estate mortgage | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Production and intermediate-term | -- | 21 | -- | 96 | -- |
| Total | \$ -- | \$ 21 | \$ -- | \$ 96 | \$ -- |

The recorded investment in the loan is the unpaid principal amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.

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

We had no commitments to lend additional money to borrowers whose loans were classified as risk loans at December 31, 2018.

Troubled Debt Restructurings (TDRs)

Included within our loans are TDRs. These loans have been modified by granting a concession in order to maximize the collection of amounts due when a borrower is experiencing financial difficulties. All risk loans, including TDRs, are analyzed within our allowance for loan losses.

We completed TDRs of certain production and intermediate-term loans during the year ended December 31, 2018. Our recorded investment in these loans just prior to restructuring was \$450 thousand and immediately following the restructuring was \$341 thousand during the year ended December 31, 2018. The recorded investment in the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment. There were no TDRs that occurred during the years ended December 31, 2017, or 2016.

The primary type of modification was deferral of principal. There were no TDRs that defaulted during the years ended December 31, 2018, 2017, or 2016 in which the modification was within twelve months of the respective reporting period.

TDRs outstanding in the production and intermediate-term loan category totaled \$353 thousand, all of which were in accrual status at December 31, 2018. There were no TDRs outstanding at December 31, 2017, or 2016.

There were no commitments to lend to borrowers whose loans have been modified in a TDR at December 31, 2018.

Allowance for Loan Losses

Changes in Allowance for Loan Losses

(in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|--------------------------------|--------|--------|--------|
| Balance at beginning of year | \$ 105 | \$ 105 | \$ 121 |
| Provision for loan losses | -- | -- | 5 |
| Loan recoveries | -- | -- | 1 |
| Loan charge-offs | (1) | -- | (22) |
| Balance at end of year | \$ 104 | \$ 105 | \$ 105 |

Changes in Allowance for Loan Losses and Year End Recorded Investments by Loan Type

| (in thousands) | Real Estate Mortgage | Production and Intermediate-Term | Agribusiness | Rural Residential Real Estate | Total |
|---|-------------------------|-------------------------------------|--------------|----------------------------------|-----------|
| Allowance for loan losses: | | | | | |
| Balance as of December 31, 2017 | \$ 82 | \$ 23 | \$ -- | \$ -- | \$ 105 |
| (Reversal of) provision for loan losses | (13) | 13 | -- | -- | -- |
| Loan recoveries | -- | -- | -- | -- | -- |
| Loan charge-offs | -- | (1) | -- | -- | (1) |
| Balance as of December 31, 2018 | \$ 69 | \$ 35 | \$ -- | \$ -- | \$ 104 |
| Ending balance: individually evaluated for impairment | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Ending balance: collectively evaluated for impairment | \$ 69 | \$ 35 | \$ -- | \$ -- | \$ 104 |
| Recorded investment in loans outstanding: | | | | | |
| Ending balance as of December 31, 2018 | \$ 32,831 | \$ 17,026 | \$ 55 | \$ -- | \$ 49,912 |
| Ending balance: individually evaluated for impairment | \$ -- | \$ 353 | \$ -- | \$ -- | \$ 353 |
| Ending balance: collectively evaluated for impairment | \$ 32,831 | \$ 16,673 | \$ 55 | \$ -- | \$ 49,559 |
| Allowance for loan losses: | | | | | |
| Balance as of December 31, 2016 | \$ 41 | \$ 64 | \$ -- | \$ -- | \$ 105 |
| Provision for (reversal of) loan losses | 41 | (41) | -- | -- | -- |
| Loan recoveries | -- | -- | -- | -- | -- |
| Loan charge-offs | -- | -- | -- | -- | -- |
| Balance as of December 31, 2017 | \$ 82 | \$ 23 | \$ -- | \$ -- | \$ 105 |
| Ending balance: individually evaluated for impairment | \$ -- | \$ 16 | \$ -- | \$ -- | \$ 16 |
| Ending balance: collectively evaluated for impairment | \$ 82 | \$ 7 | \$ -- | \$ -- | \$ 89 |
| Recorded investment in loans outstanding: | | | | | |
| Ending balance as of December 31, 2017 | \$ 35,287 | \$ 15,339 | \$ 59 | \$ -- | \$ 50,685 |
| Ending balance: individually evaluated for impairment | \$ -- | \$ 160 | \$ -- | \$ -- | \$ 160 |
| Ending balance: collectively evaluated for impairment | \$ 35,287 | \$ 15,179 | \$ 59 | \$ -- | \$ 50,525 |

| | Real Estate Mortgage | Production and Intermediate-Term | Agribusiness | Rural Residential Real Estate | Total |
|---|-------------------------|-------------------------------------|--------------|----------------------------------|------------------|
| Allowance for loan losses: | | | | | |
| Balance as of December 31, 2015 | \$ 55 | \$ 66 | \$ -- | \$ -- | \$ 121 |
| (Reversal of) provision for loan losses | (14) | 19 | -- | -- | 5 |
| Loan recoveries | -- | 1 | -- | -- | 1 |
| Loan charge-offs | -- | (22) | -- | -- | (22) |
| Balance as of December 31, 2016 | <u>\$ 41</u> | <u>\$ 64</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 105</u> |
| Ending balance: individually evaluated for impairment | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> |
| Ending balance: collectively evaluated for impairment | <u>\$ 41</u> | <u>\$ 64</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 105</u> |
| Recorded investment in loans outstanding: | | | | | |
| Ending balance as of December 31, 2016 | <u>\$ 37,596</u> | <u>\$ 14,013</u> | <u>\$ --</u> | <u>\$ 33</u> | <u>\$ 51,642</u> |
| Ending balance: individually evaluated for impairment | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> |
| Ending balance: collectively evaluated for impairment | <u>\$ 37,596</u> | <u>\$ 14,013</u> | <u>\$ --</u> | <u>\$ 33</u> | <u>\$ 51,642</u> |

The recorded investment in the loan is the unpaid principal amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off of the investment.

NOTE 4: INVESTMENT IN AGRIBANK

As of December 31, 2018, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on association growth in excess of a targeted growth rate, if the District is also growing above a targeted growth rate.

Investment in AgriBank

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|-----------------------------------|-----------------|-----------------|-----------------|
| Required stock investment | \$ 1,050 | \$ 1,001 | \$ 1,120 |
| Allocated excess stock investment | 146 | 195 | 76 |
| Total investment | <u>\$ 1,196</u> | <u>\$ 1,196</u> | <u>\$ 1,196</u> |

Excess stock investment is recorded when the required investment in AgriBank is lower than our total investment. AgriBank's capital plan provides for annual retirement of AgriBank stock and optimizes capital at the Bank by distributing all available Bank earnings in the form of patronage, either in cash or stock. During the first half of 2017 and in 2016, the Bank's capital plan distributed 50 percent of Bank earnings in cash and retired stock on a quarterly basis.

NOTE 5: NOTE PAYABLE TO AGRIBANK

Our note payable to AgriBank represents borrowings, in the form of a line of credit, to fund our loan portfolio. The line of credit is governed by a GFA and our assets serve as collateral.

Note Payable Information

(dollars in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|--|-----------|-----------|-----------|
| Line of credit | \$ 60,000 | \$ 60,000 | \$ 60,000 |
| Outstanding principal under the line of credit | 41,390 | 40,948 | 42,561 |
| Interest rate | 2.8% | 2.6% | 2.3% |

Our note payable matures March 31, 2019, at which time the note will be renegotiated. We were subject to a 3 basis point and 2 basis point risk premium in 2018 and 2017, respectively. The risk premiums in 2017 and 2018 were triggered by a decline in our risk score. We were not subject to the risk premium component in 2016. Effective January 1, 2019, we were no longer subject to a risk premium.

The GFA provides for limitations on our ability to borrow funds based on specified factors or formulas relating primarily to outstanding balances, credit quality, and financial condition. Additionally, we have requirements to maintain an effective program of internal controls over financial reporting. At December 31, 2018, and throughout the year, we were not declared in default under any GFA covenants or provisions.

NOTE 6: MEMBERS' EQUITY

Capitalization Requirements

In accordance with the Farm Credit Act, each borrower is required to invest in us as a condition of obtaining a loan. Effective July 1, 2018, our capital bylaws were amended to reflect changes to the stock purchase requirement. As authorized by the Agricultural Credit Act and our capital bylaws, the Board of

Directors has adopted a capital plan that establishes a stock purchase requirement for obtaining a loan of 2.0% of the customer's total loan(s) or one thousand dollars, whichever is less. The Board of Directors may increase the amount of required investment to the extent authorized in the capital bylaws. The borrower acquires ownership of the capital stock at the time the loan is made. The aggregate par value of the stock is added to the principal amount of the related obligation. We retain a first lien on the stock or participation certificates owned by customers. During the third quarter of 2018, stock in excess of the 2.0% or one thousand dollars requirement was retired.

Protection Mechanisms

Under the Farm Credit Act, certain borrower equity is protected. We are required to retire protected borrower equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock and participation certificates that were outstanding as of January 6, 1988, or were issued prior to October 6, 1988 as a requirement for obtaining a loan. If we were to be unable to retire protected borrower equity at par value or stated value, the FCSIC would provide the amounts needed to retire this equity.

Regulatory Capitalization Requirements

Regulatory Capital Requirements and Ratios

| As of December 31 | 2018 | 2017 | Regulatory Minimums | Capital Conservation Buffer | Total |
|--|-------|-------|---------------------|-----------------------------|-------|
| Risk-adjusted: | | | | | |
| Common equity tier 1 ratio | 21.2% | 20.0% | 4.5% | 2.5%* | 7.0% |
| Tier 1 capital ratio | 21.2% | 20.0% | 6.0% | 2.5%* | 8.5% |
| Total capital ratio | 21.5% | 20.3% | 8.0% | 2.5%* | 10.5% |
| Permanent capital ratio | 21.4% | 24.3% | 7.0% | N/A | 7.0% |
| Non-risk-adjusted: | | | | | |
| Tier 1 leverage ratio | 15.1% | 14.6% | 4.0% | 1.0% | 5.0% |
| Unallocated retained earnings and equivalents leverage ratio | 14.8% | 14.1% | 1.5% | N/A | 1.5% |

*The 2.5% capital conservation buffer over risk-adjusted ratio minimums is being phased in over three years under the FCA capital requirements. The phase in period ends on December 31, 2019.

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

Risk-adjusted assets have been defined by the FCA Regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes effective January 1, 2017, 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 with terms at origination of less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

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

These ratios are based on a three-month average daily balance in accordance with FCA Regulations and are calculated as follows (not all items below may be applicable to our Association):

- Common equity tier 1 ratio is statutory minimum purchased member stock, other required member stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to retirement, unallocated retained earnings as regulatorily prescribed, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required member 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 for loan losses and reserve for credit losses subject to 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 as regulatorily prescribed, paid-in capital, subordinated debt, and preferred stock subject to certain limitations, less certain allocated and purchased investments in other System institutions divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.
- UREE leverage ratio is unallocated retained earnings as regulatorily prescribed, paid-in capital, allocated surplus not subject to retirement 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.

Effective January 1, 2017, the regulatory capital requirements allow for allotment agreements for only the permanent capital ratio and, as such, any stock in excess of our AgriBank required investment was not included in the common equity tier 1, tier 1 capital, total capital, or leverage ratios. We included 12.2% and 16.3% of our investment in AgriBank as permanent capital at December 31, 2018, and 2017, respectively.

Refer to Note 6 in our 2016 Annual Report for a more complete description of the ratios effective as of December 31, 2016. We were in compliance with the minimum required capital ratios as of December 31, 2016.

Description of Equities

The following represents information regarding classes and number of shares of stock outstanding. All shares are stated at a \$5.00 par value.

| As of December 31 | Number of Shares | | |
|----------------------------------|------------------|---------|---------|
| | 2018 | 2017 | 2016 |
| Class A common stock (protected) | 1,435 | 2,354 | 2,354 |
| Class B common stock (at-risk) | 79 | 1,286 | 1,536 |
| Class C common stock (at-risk) | 31,590 | 370,220 | 350,523 |

Under our bylaws, we are also authorized to issue Class D and Class E common stock, Series 2 participation certificates, and Class F preferred stock. Each of these classes of common stock is at-risk and nonvoting with a \$5.00 par value per share. Currently, no stock of these classes has been issued.

Only holders of Class C common stock have voting rights. Our bylaws do not prohibit us from paying dividends on any classes of stock. However, no dividends have been declared to date.

Our bylaws generally permit stock and participation certificates to be retired at the discretion of our Board of Directors and in accordance with our capitalization plans, provided prescribed capital standards have been met. At December 31, 2018, we exceeded the prescribed standards. We do not anticipate any significant changes in capital that would affect the normal retirement of stock.

In the event of our liquidation or dissolution, according to our bylaws, any remaining assets after payment or retirement of all liabilities will be distributed first, pro rata to holders of Class F preferred stock, and second, pro rata to all holders of common stock and participation certificates.

In the event of impairment, losses will be absorbed first, pro rata by holders of all classes of common stock and participation certificates and then pro rata by holders of Class F preferred stock. However, protected stock will be retired at par value regardless of impairment.

All classes of stock are transferable to other customers who are eligible to hold such class of stock as long as we meet the regulatory minimum capital requirements.

Patronage Distributions

We accrued patronage distributions of \$170 thousand, \$81 thousand, and \$140 thousand at December 31, 2018, 2017, and 2016, respectively. Generally, the patronage distributions are paid in cash during the first quarter after year end. The Board of Directors may authorize a distribution of earnings provided we meet all statutory and regulatory requirements.

The FCA Regulations prohibit patronage distributions to the extent they would reduce our permanent capital ratio below the minimum permanent capital adequacy standards. Additionally, effective January 1, 2017, patronage distributions may be restricted or prohibited without prior FCA approval if capital ratios fall below the total requirements, including the buffer amounts.

NOTE 7: INCOME TAXES

The Tax Cuts and Jobs Act (the Act) was enacted in December of 2017. This Act contained various tax law changes, including a federal statutory tax rate change to 21% from 34%, effective January 1, 2018. Because deferred tax assets and liabilities are expected to be recognized in the Association's tax return in a future year, when the new statutory tax rate would be applicable, the deferred tax assets and liabilities as of December 31, 2017, were valued using a blended federal/state effective tax rate based on the new federal statutory tax rate. The effect of this revaluation was recognized in our provision for income taxes for the year ended December 31, 2017.

Provision for Income Taxes

| Provision for Income Taxes | | | |
|--|--------|-------|--------|
| (dollars in thousands) | | | |
| For the year ended December 31 | 2018 | 2017 | 2016 |
| Current: | | | |
| Federal | \$ -- | \$ -- | \$ 1 |
| State | -- | -- | -- |
| Total current | \$ -- | \$ -- | \$ 1 |
| Deferred: | | | |
| Federal | \$ (5) | \$ 2 | \$ (6) |
| State | -- | -- | -- |
| Increase (decrease) in valuation allowance | 5 | (2) | 6 |
| Total deferred | -- | -- | -- |
| Provision for income taxes | \$ -- | \$ -- | \$ 1 |
| Effective tax rate | 0.0% | 0.0% | 0.1% |

Reconciliation of Taxes at Federal Statutory Rate to Provision for Income Taxes

| (in thousands) | | | |
|--|--------|--------|--------|
| For the year ended December 31 | 2018 | 2017 | 2016 |
| Federal tax at statutory rates | \$ 138 | \$ 277 | \$ 318 |
| State tax, net | 3 | -- | 1 |
| Patronage distributions | (36) | (28) | (46) |
| Effect of non-taxable entity | (91) | (248) | (265) |
| Increase (decrease) in valuation allowance | 5 | (2) | 6 |
| Other | (19) | 1 | (13) |
| Provision for income taxes | \$ -- | \$ -- | \$ 1 |

Deferred Income Taxes

Tax laws require certain items to be included in our tax returns at different times than the items are reflected on our Consolidated Statements of Income. Some of these items are temporary differences that will reverse over time. We record the tax effect of temporary differences as deferred tax assets and liabilities netted on our Consolidated Statements of Condition.

Deferred Tax Assets and Liabilities

| (in thousands) | | | |
|--------------------------------|-------|-------|-------|
| As of December 31 | 2018 | 2017 | 2016 |
| Allowance for loan losses | \$ 13 | \$ 13 | \$ 10 |
| Postretirement benefit accrual | 17 | 18 | 14 |
| Other assets | 10 | 4 | 13 |
| Total deferred tax assets | 40 | 35 | 37 |
| Valuation allowance | (40) | (35) | (37) |
| Deferred tax assets, net | \$ -- | \$ -- | \$ -- |
| Gross deferred tax assets | \$ 40 | \$ 35 | \$ 37 |

A valuation allowance for the deferred tax assets was necessary at December 31, 2018, 2017, and 2016, because we determined that the deferred tax asset was not completely realizable due to our minimal current tax liability over the past several years, caused primarily by the patronage program.

We have not provided for deferred income taxes on patronage allocations received from AgriBank prior to 1993. Such allocations, distributed in the form of stock, are subject to tax only upon conversion to cash. Our intent is to permanently maintain this investment in AgriBank. With respect to the AgriBank stock distributed in 2002, the Board of Directors has passed a resolution that, should this stock ever be converted to cash, creating a tax liability, an equal amount will be distributed to patrons at that time under our patronage program. Our total permanent investment in AgriBank is \$1.2 million. Additionally, we have not provided deferred income taxes on accumulated FLCA earnings of \$5.0 million as it is our intent to permanently maintain this equity in the FLCA or to distribute the earnings to members in a manner that results in no additional tax liability to us.

Our income tax returns are subject to review by various United States taxing authorities. We record accruals for items that we believe may be challenged by these taxing authorities. However, we had no uncertain income tax positions at December 31, 2018. In addition, we believe we are no longer subject to income tax examinations for years prior to 2015.

NOTE 8: EMPLOYEE BENEFIT PLANS**Pension and Post-Employment Benefit Plans**

Complete financial information for the pension and post-employment benefit plans may be found in the AgriBank 2018 Annual Report.

The Farm Credit Foundations Plan Sponsor and Trust Committees provide oversight of the benefit plans. These governance committees are comprised of elected or appointed representatives (senior leadership and/or Board of Director members) from the participating organizations. The Plan Sponsor Committee is responsible for employer decisions regarding all benefit plans including retirement benefits. These decisions could include plan design changes, vendor changes, determination of employer subsidies (if any), and termination of specific benefit plans. Any action to change or terminate the retirement plan can only occur at the direction of the AgriBank District participating employers. The Trust Committee is responsible for fiduciary and plan administrative functions.

Pension Plan: Certain employees participate in the AgriBank District Retirement Plan, a District-wide multi-employer defined benefit retirement plan. The Department of Labor has determined the plan to be a governmental plan; therefore, the plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). As the plan is not subject to ERISA, the plan's benefits are not insured by the Pension Benefit Guaranty Corporation. Accordingly, the amount of accumulated benefits that participants would receive in the event of the plan's termination is contingent on the sufficiency of the plan's net assets to provide benefits at that time. This plan is noncontributory and covers certain eligible District employees. The assets, liabilities, and costs of the plan are not segregated by participating entities. As such, plan assets are available for any of the participating employers' retirees at any point in time. Additionally, if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers. Further, if we choose to stop participating in the plan, we may be required to pay an amount based on the underfunded status of the plan. Because of the nature of the plan, any individual employer is not able to unilaterally change the provisions of the plan. If an employee transfers to another employer within the same plan, the employee benefits under the plan transfer. Benefits are based on salary and years of service. There is no collective bargaining agreement in place as part of this plan.

AgriBank District Retirement Plan Information

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|--|-------------|-------------|-------------|
| Unfunded liability | \$ 274,450 | \$ 352,516 | \$ 374,305 |
| Projected benefit obligation | 1,272,063 | 1,371,013 | 1,269,625 |
| Fair value of plan assets | 997,613 | 1,018,497 | 895,320 |
| Accumulated benefit obligation | 1,125,682 | 1,184,550 | 1,096,913 |
| For the year ended December 31 | 2018 | 2017 | 2016 |
| Total plan expense | \$ 51,900 | \$ 44,730 | \$ 53,139 |
| Our allocated share of plan expenses | 95 | 78 | 86 |
| Contributions by participating employers | 90,000 | 90,000 | 90,000 |
| Our allocated share of contributions | 157 | 147 | 140 |

The unfunded liability reflects the net of the fair value of the plan assets and the projected benefit obligation at the date of these Consolidated Financial Statements. The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to the measurement date based on assumed future compensation levels. The accumulated benefit obligation is the actuarial present value of the benefits attributed to employee service rendered before the measurement date and based on current employee service and compensation. The funding status is subject to many variables including performance of plan assets and interest rate levels. Therefore, changes in assumptions could significantly affect these estimates.

Costs are determined for each individual employer based on costs directly related to their current employees as well as an allocation of the remaining costs based proportionately on the estimated projected liability of the employer under this plan. We recognize our proportional share of expense and contribute a proportional share of funding. Our allocated share of plan expenses is included in "Salaries and employee benefits" in the Consolidated Statements of Income.

Benefits paid to participants in the District were \$68.6 million in 2018. While the plan is a governmental plan and is not subject to minimum funding requirements, the employers contribute amounts necessary on an actuarial basis to provide the plan with sufficient assets to meet the benefits to be paid to participants. The amount of the total District employer contributions expected to be paid into the pension plan during 2019 is \$90.0 million. Our allocated share of these pension contributions is expected to be \$169 thousand. The amount ultimately to be contributed and the amount ultimately recognized as expense as well as the timing of those contributions and expenses, are subject to many variables including performance of plan assets and interest rate levels. These variables could result in actual contributions and expenses being greater than or less than the amounts reflected in the District financial statements.

Retiree Medical Plans: District employers also provide certain health insurance benefits to eligible retired employees according to the terms of the benefit plans. The anticipated costs of these benefits are accrued during the period of the employee's active status.

Retiree Medical Plan Information

(in thousands)

| For the year ended December 31 | 2018 | 2017 | 2016 |
|--------------------------------|-------|------|------|
| Postretirement benefit expense | \$ -- | \$ 3 | \$ 3 |
| Our cash contributions | 5 | 5 | 7 |

Postretirement benefit costs are included in "Salaries and employee benefits" in the Consolidated Statements of Income. Our cash contributions are equal to the benefits paid.

Defined Contribution Plans

We participate in a District-wide defined contribution plan. For employees hired before January 1, 2007, employee contributions are matched dollar for dollar up to 2.0% and 50 cents on the dollar on the next 4.0% on both pre-tax and post-tax contributions. The maximum employer match is 4.0%. For employees hired after December 31, 2006, we contribute 3.0% of the employee's compensation and will match employee contributions dollar for dollar up to a maximum of 6.0% on both pre-tax and post-tax contributions. The maximum employer contribution is 9.0%.

Employer contribution expenses for the defined contribution plan, included in "Salaries and employee benefits" in the Consolidated Statements of Income, were \$34 thousand, \$31 thousand, and \$26 thousand in 2018, 2017, and 2016, respectively. These expenses were equal to our cash contributions for each year.

NOTE 9: RELATED PARTY TRANSACTIONS

In the ordinary course of business, we may enter into loan transactions with our officers, directors, their immediate family members, and other organizations with which such persons may be associated. Such transactions may be subject to special approval requirements contained in the FCA Regulations and are made on the same terms, including interest rates, amortization schedules, and collateral, as those prevailing at the time for comparable transactions with other persons. In our opinion, none of these loans outstanding at December 31, 2018, involved more than a normal risk of collectability.

Related Party Loans Information

(in thousands)

| As of December 31 | 2018 | 2017 | 2016 |
|--------------------------------|-----------|-----------|-----------|
| Total related party loans | \$ 3,865 | \$ 3,758 | \$ 3,789 |
| For the year ended December 31 | 2018 | 2017 | 2016 |
| Advances to related parties | \$ 12,261 | \$ 12,209 | \$ 10,551 |
| Repayments by related parties | 12,746 | 11,793 | 10,878 |

The related parties can be different each year end primarily due to changes in the composition of the Board of Directors and the mix of organizations with which such persons may be associated. Advances and repayments on loans in the preceding chart are related to those considered related parties at year end.

As discussed in Note 5, we borrow from AgriBank, in the form of a line of credit, to fund our loan portfolio. All interest expense as shown on the Consolidated Statements of Income was paid to AgriBank. Total patronage received from AgriBank was \$243 thousand, \$238 thousand, and \$212 thousand in 2018, 2017, and 2016, respectively. Refer to Note 4 for stock investment in AgriBank information.

We purchase various services from AgriBank, including SunStream Business Services, a division of AgriBank FCB. The services include certain financial and retail systems, financial reporting services, technology services, and insurance services. The total cost of services we purchased from AgriBank was \$113 thousand, \$87 thousand, and \$79 thousand in 2018, 2017, and 2016, respectively.

We also purchase human resource information systems, and benefit, payroll, and workforce management services from Farm Credit Foundations (Foundations). As of December 31, 2018, 2017, and 2016, our investment in Foundations was \$7 thousand. The total cost of services purchased from Foundations was \$51 thousand, \$50 thousand, and \$47 thousand in 2018, 2017, and 2016, respectively.

NOTE 10: CONTINGENCIES AND COMMITMENTS

In the normal course of business, we have various contingent liabilities and commitments outstanding, which may not be reflected in the Consolidated Financial Statements. We do not anticipate any material losses because of these contingencies or commitments.

We may be named as a defendant in certain lawsuits or legal actions in the normal course of business. At the date of these Consolidated Financial Statements, our management team was not aware of any material actions. However, management cannot ensure that such actions or other contingencies will not arise in the future.

We have commitments to extend credit to satisfy the financing needs of our borrowers. These financial instruments involve, to varying degrees, elements of credit risk that may be 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 loan contract. At December 31, 2018, we had commitments to extend credit of \$9.1 million.

Commitments to extend credit generally have fixed expiration dates or other termination clauses and we may require payment of a fee. If commitments to extend credit remain unfulfilled or have not expired, they may have credit risk not recognized in the financial statements. Many of the commitments to extend credit will expire without being fully drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. The credit risk involved in issuing these financial instruments is essentially the same as that involved in extending loans to borrowers and we apply the same credit policies. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on management's credit evaluation of the borrower.

NOTE 11: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three input levels that may be used to measure fair value. Refer to Note 2 for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at December 31, 2018, 2017, or 2016.

Non-Recurring

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. The following represents a summary of the assets, valuation techniques, and inputs used to measure fair value on a non-recurring basis:

Impaired loans: The fair value of impaired loans was \$151 thousand at December 31, 2017, which were valued using Level 3 inputs. The fair value represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses observable market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they are classified as Level 3. We had no impaired loans measured on a non-recurring basis at December 31, 2018, or 2016.

NOTE 12: SUBSEQUENT EVENTS

We have evaluated subsequent events through March 8, 2019, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our 2018 Consolidated Financial Statements or disclosure in the Notes to Consolidated Financial Statements.

DISCLOSURE INFORMATION REQUIRED BY REGULATIONS

Delta Agricultural Credit Association
(Unaudited)

Description of Business

General information regarding the business is incorporated herein by reference from Note 1 to the Consolidated Financial Statements in this Annual Report.

The description of significant business developments, if any, is incorporated herein by reference from the Management's Discussion and Analysis section of this Annual Report.

Description of Property

Property Information

| Location | Description | Usage |
|----------------|-------------|--------------|
| Dermott, AR | Owned | Headquarters |
| Monticello, AR | Leased | Branch |

Legal Proceedings

Information regarding legal proceedings is discussed in Note 10 to the Consolidated Financial Statements in this Annual Report. We were not subject to any enforcement actions as of December 31, 2018.

Additional Regulatory Capital Disclosure

Regulatory Capital Ratios Pursuant to FCA Regulation 620.5

| As of December 31 | 2013 | 2012 |
|-------------------------|-------|-------|
| Permanent capital ratio | 23.5% | 23.2% |
| Total surplus ratio | 17.8% | 17.3% |
| Core surplus ratio | 16.8% | 16.4% |

Refer to the Consolidated Five-Year Summary of Selected Financial Data at the beginning of this Annual Report for capital ratio calculations for the past five years.

Description of Capital Structure

Information regarding our capital structure is discussed in Note 6 to the Consolidated Financial Statements in this Annual Report.

Description of Liabilities

Information regarding liabilities is discussed in Notes 5, 6, 7, 8, and 10 to the Consolidated Financial Statements in this Annual Report. All debt and other liabilities in the financial statements are uninsured.

Selected Financial Data

The Consolidated Five-Year Summary of Selected Financial Data is presented at the beginning of this Annual Report.

Management's Discussion and Analysis

Information regarding any material aspects of our financial condition, changes in financial condition, and results of operations are discussed in the Management's Discussion and Analysis section of this Annual Report.

Board of Directors

Board of Directors as of December 31, 2018, including business experience during the last five years

| Name | Term | Principal occupation and other business affiliations |
|--|-----------------|---|
| Al Beaty Outside Director Service Began: 1990 | 1/2018-1/2021 | Principal occupation: Retired Other business affiliations: Director: Drew County Farm Bureau, involved in insurance sales |
| Bruce Bond Service Began: 2014 | 3/2017 - 3/2020 | Principal occupation: Self-employed cotton and grain farmer Other business affiliations: Director: Lake Village Seed and Tire, a farm supply store Director: Crooked Bayou Watershed, involved in drainage management Director: Eudora Western Drainage District, involved in drainage management |
| C. Randall Cox Vice Chairperson Service Began: 1997 | 3/2018 - 3/2021 | Principal occupation: Retired cotton and grain farmer |
| Kim Ellington Service Began: 2004 | 3/2016 - 3/2019 | Principal occupation: Self-employed grain and sod farmer |
| Joe Mencer Service Began: 2011 | 3/2018 - 3/2021 | Principal occupation: Self-employed cotton and grain farmer Other business affiliations: Director: USA Rice Federation, involved in rice promotion Director: Arkansas Rice Federation, involved in rice promotion Director: Arkansas Boll Weevil Eradication Foundation, involved in boll weevil eradication Director: Chicot County Farm Bureau, involved in insurance sales Director: Lake Village Seed and Tire, a farm supply store Director: Chicot County Conservation District, involved in soil and water conservation Director: Delta Grain and Gin, involved in cotton ginning Director: Agricultural Council of Arkansas, involved in Arkansas agricultural promotions |
| Mike Norris Chairperson Service Began: 2002 | 3/2018 - 3/2021 | Principal occupation: Self-employed cotton and grain farmer |

Pursuant to our bylaws, directors are paid a per diem of \$125 per day for attendance at board meetings and other special meetings. Directors serving on the loan committee are paid a per diem of \$75 per day. Directors are also provided with \$100 thousand 24-hour Accidental Death and Dismemberment insurance coverage while traveling on association business. The annual premium cost to us is \$20 per director.

Information regarding compensation paid to each director who served during 2018 follows:

| Name | Number of Days Served | | Compensation Paid for Service on a Board Committee | Name of Committee | Total Compensation Paid in 2018 |
|----------------------------------|-----------------------|---------------------------|--|-------------------|---------------------------------|
| | Board Meetings | Other Official Activities | | | |
| Al Beaty, Outside Director | 5.0 | 5.0 | \$ -- | | \$ 1,250 |
| Bruce Bond | 4.0 | 5.0 | -- | | 1,125 |
| C. Randall Cox, Vice Chairperson | 6.0 | 13.0 | 525 | Loan | 2,025 |
| Kim Ellington | 5.0 | 3.0 | -- | | 1,000 |
| Joe Mencer | 5.0 | 4.0 | -- | | 1,125 |
| Mike Norris, Chairperson | 6.0 | 13.0 | 525 | Loan | 2,025 |
| | | | | | <u>\$ 8,550</u> |

Senior Officers

Senior Officers as of December 31, 2018, including business experience during the last five years

| Name and Position | Business experience and other business affiliations |
|-------------------------|--|
| Mark W. Kaufman | Business experience: Chief Executive Officer (CEO) since June 2002 |
| Kerry Hartness | Business experience: Chief Credit Officer (CCO) since April 2017 Loan Officer for Delta Agricultural Credit Association from December 2015 to April 2017 Research Assistant for Monsanto Company from January 2013 to December 2015 Other business affiliations: Director: Drew County Farm Bureau, involved in insurance sales |
| Keith Hunter | Business experience: Vice President (VP) since January 2005 Other business affiliations: Director: Chicot County Conservation District, involved in soil and water conservation |
| Mary Ann Johnson | Business experience: Chief Financial Officer (CFO) since January 1990 |

Senior Officer Compensation

We believe the design and governance of our CEO, senior officer, and highly compensated individuals compensation program is consistent with the highest standards of risk management and provides total compensation that promotes our mission to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America.

The CEO, senior officer, and highly compensated individuals are compensated with a mix of direct cash and retirement plans generally available to all employees. We do not offer any short-term or long-term incentives to our CEO, senior officers, or highly compensated individuals.

Base Salary: The CEO, senior officer, and highly compensated individuals base salaries reflect the officer's experience and level of responsibility. Base salaries are subject to review and approval by our Board of Directors and are subject to adjustment based on changes in responsibilities or competitive market conditions.

Retirement Plans: We have various post-employment benefit plans which are generally available to all Association employees, including the CEO, senior officers, and highly compensated individuals based on dates of service to the Association and are not otherwise differentiated by position, unless specifically stated. Information regarding the post-employment benefit plans is included in Notes 2 and 8 to the accompanying Consolidated Financial Statements in this Annual Report.

Other Components of Compensation: Additionally, compensation associated with any group term life insurance premiums, disability insurance premiums, or other taxable reimbursements may be made available to the CEO, senior officer, and highly compensated individuals based on job criteria or similar plans available to all employees.

Compensation to the CEO, Senior Officers, and Highly Compensated Individuals

| (in thousands) | | | | | | |
|---|------|--------|-------|--------------------------|---------|--------|
| Name | Year | Salary | Bonus | Deferred/ Perquisites | Other | Total |
| Mark W. Kaufman, CEO | 2018 | \$ 115 | \$ -- | \$ 1 | \$ (16) | \$ 100 |
| Mark W. Kaufman, CEO | 2017 | 110 | -- | 1 | 120 | 231 |
| Mark W. Kaufman, CEO | 2016 | 105 | -- | 1 | 58 | 164 |
| Aggregate Number of Senior Officers and Highly Compensated Individuals, excluding CEO | | | | | | |
| Four | 2018 | \$ 340 | \$ -- | \$ 1 | \$ 61 | \$ 402 |
| Four | 2017 | 318 | -- | 1 | 194 | 513 |
| Four | 2016 | 286 | -- | 1 | 126 | 413 |

The amount in the "Other" category in the preceding table primarily includes:

- Employer match on defined contribution plans available to all employees.
- Changes in the value of pension benefits. The change in value of the pension benefits is defined as the change in the vested portion of the present value of the accumulated benefit obligation from December 31 of the prior year to December 31 of the most recent year for the District-wide Pension Plan, as disclosed in Note 8 to the Consolidated Financial Statements in this Annual Report. This change in value does not represent cash payments made by the Association during the year, but rather is an estimate of the change in the Association's future obligations under the pension plan. The change in the value of the pension benefits is highly sensitive to discount rates used to value the plan liabilities to participants.

No tax reimbursements are made to the CEO, senior officer, and highly compensated individuals.

The value of the pension benefits from December 31, 2017 to December 31, 2018, changed primarily due to interest cost, accumulation of an additional year of credited service by plan participants, and changes in actuarial assumptions.

Members may request information on the compensation to the individuals included in the preceding table during 2018.

Pension Benefits Attributable to the CEO, Senior Officers, and Highly Compensated Individuals

(dollars in thousands)

2018

| Name | Plan | Years of Credited Service | Present Value of Accumulated Benefits | Payments Made During the Reporting Period |
|---|-----------------------------------|---------------------------|---------------------------------------|---|
| Mark W. Kaufman, CEO | AgriBank District Retirement Plan | 42.0 | \$ 929 | \$ -- |
| Aggregate Number of Senior Officers and Highly Compensated Individuals, excluding CEO | | | | |
| Three | AgriBank District Retirement Plan | 25.1 | \$ 822 | \$ -- |

The change in composition of the aggregate senior officer and highly compensated individuals can have a significant impact on the calculation of the accumulated pension benefits.

Effective January 1, 2007, the AgriBank District Retirement Plan was closed to new employees. Therefore, any employee starting employment with the AgriBank District after that date is not eligible to be in the plan.

Transactions with Senior Officers and Directors

Information regarding related party transactions is discussed in Note 9 to the Consolidated Financial Statements in this Annual Report.

Travel, Subsistence, and Other Related Expenses

Directors and senior officers are reimbursed for reasonable travel, subsistence, and other related expenses associated with business functions. A copy of our policy for reimbursing these costs is available by contacting us at:

P.O Box 750
 Dermott, AR 71638
 (870) 538-3258
 www.deltaaca.com

The total directors' travel, subsistence, and other related expenses were \$22 thousand, \$13 thousand, and \$13 thousand in 2018, 2017, and 2016, respectively.

Involvement in Certain Legal Proceedings

No events occurred during the past five years that are material to evaluating the ability or integrity of any person who served as a director or senior officer on January 1, 2019, or at any time during 2018.

Member Privacy

The FCA Regulations protect members' nonpublic personal financial information. Our directors and employees are restricted from disclosing information about our Association or our members not normally contained in published reports or press releases.

Relationship with Qualified Public Accountant

There were no changes in independent auditors since the last Annual Report to members and we are in agreement with the opinion expressed by the independent auditors. The total financial statement audit fees paid during 2018 were \$68 thousand. Our engagement letter commits to reimbursing the external auditor for reasonable out-of-pocket expenses as incurred for travel.

Financial Statements

The Report of Management, Report of Audit Committee, Report of Independent Auditors, Consolidated Financial Statements, and Notes to Consolidated Financial Statements are presented prior to this portion of the Consolidated Financial Statements in this Annual Report.

Young, Beginning, and Small Farmers and Ranchers

Information regarding credit and services to young, beginning, and small farmers and ranchers, and producers or harvesters of aquatic products is discussed in an addendum to this Annual Report.

YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS

Delta Agricultural Credit Association

(Unaudited)

We have specific programs in place to serve the credit and related needs of young, beginning, and small farmers and ranchers (YBS) in our territory. The definitions of YBS as developed by the Farm Credit Administration (FCA) follow:

- Young: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the loan transaction date.
- Beginning: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the loan transaction date.
- Small: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250 thousand in annual gross sales of agricultural or aquatic products.

Our Demographic Study Revision for farmers, ranchers, and producers of aquatic products is based on our information from the end of fourth quarter 2018. The source of YBS information for the comparison of Young, Beginning, and Small Farmers in our territory is the 2012 United States Department of Agriculture Census and the Chicot County Extension Service. Our portfolio statistics are based on number of loans, while the census data is based on number of farms. While the numbers are fairly similar, the difference in methodology should be taken into consideration. In addition, note that our Association includes Ashley, Bradley, Chicot, Desha, Drew, and Lincoln counties. Only 30% of Lincoln County is in our territory.

The total number of Young, Beginning, and Small farmers in our territory was 76 young farmers, 265 beginning farmers, and 306 small farmers. Our Young, Beginning, and Small farmer program consisted of 66 young farmers, which is 88% of the market, 148 beginning farmers, which is 56% of the market, and 135 small farmers, which is 44% of the market in our territory.

There are approximately 30 agricultural lending institution offices in our territory. We make up 7% of the business of these agricultural lending agencies. Our market share of the YBS producers exceeds our physical presence in the community. It is very difficult for a YBS operation to become a viable operation with today's economic, environmental, governmental, and social forces. Efforts have succeeded in creating a larger percentage of YBS numbers in our portfolio than exists in our territory. We will continue to emphasize YBS portfolio growth.

Mission Statement

Our mission is to provide support for the YBS farmers. As a farmer-owned cooperative, we will promote and assist these farmers with their careers by providing a competitive and dependable source of constructive credit.

Quantitative Goals

Annual quantitative targets for YBS farmers are to increase our new volume in dollars by 1% and increase our percentage of share in the territory by a minimum of 1%.

The following are the results of our YBS gross 2018 year end loan numbers and volumes compared to 2017:

- Young – no change in number of loans; 0.6% increase in volume
- Beginning – 18.2% increase in loan numbers; 30.8% increase in volume
- Small – 0.1% increase in loan numbers; 52.2% increase in volume

The goal of increased new loan volume was met in all three categories (rounding up for Young).

YBS loan numbers, territory share percentage, and portfolio share percentages increased across the board. The goal of increased share of territory percentage was met in all three categories.

Qualitative Goals and Outreach Programs

Annual qualitative goals for YBS farmers are to maintain our current borrowers as well as attract new YBS borrowers with an acceptable credit classification. In addition, we want to have 90% of these new and existing loans having a risk rating of 9 or better. While we did maintain current YBS borrowers and gained new YBS borrowers with acceptable credit, our risk rating goal percentage was unmet with 89% of our YBS loans having risk ratings of 5 to 9.

We have developed lending methodologies for YBS farmers. Credit factors have been specifically developed and are in use by the lending staff. The Farm Service Agency (FSA) Guarantee Program is used in many cases to offset credit risk associated with the inadequate collateral or capital exhibited by many YBS farmers.

Safety and Soundness of the Program

We will review any loan request with the intent to make the loan if the credit and eligibility criteria can be met. We will use the FSA Guarantee Program to reduce risk associated with YBS loans, if applicable. The credit and services offered to YBS farmers are provided in a safe and sound manner.

FUNDS HELD PROGRAM

Delta Agricultural Credit Association
(Unaudited)

Purpose

The purpose of this policy is to establish standardized documentation and procedures on the uses of the Funds Held feature.

Policy

Funds Held Account Purpose. It is the intention of the Association to make available the Funds Held feature to borrowers for the purpose of escrowing available funds to be applied to future scheduled payments of principal, interest payable, and other collateral expenses such as property taxes and insurance.

Funds Held Account Balance Maximum. Funds Held principal balance cannot exceed the related loan's outstanding principal balance. Recommended maximum balance not to exceed the equivalent of 50% of the current outstanding principal loan balance.

Interest will accrue on Funds Held at a simple rate of interest that may be changed by the Association from time to time. The interest rate may never exceed the interest rate charged on the related loan. Interest rates are currently reported on each customer's loan statement.

A 1099-INT Form will be sent to borrowers and reported to the IRS in accordance with IRS regulations. Funds Held interest income will be reported on an "accrual basis", as opposed to 1098 Interest Paid reporting which is on a "cash basis".

Availability of Funds Held Balances for Withdrawal. The Association wishes to avoid potential abuse of this feature. The Association is not a chartered depository institution. Therefore, a Funds Held account cannot be treated as a deposit account from which funds can be withdrawn on demand.

Customers can withdraw funds upon approval by one loan officer after receipt of a written customer request. Withdrawals must be for an eligible purpose under the Funds Held program.

Borrowers shall be provided adequate disclosures regarding:

- The fact that Funds Held balances are uninsured, including an explanation of the risk in the event of liquidation of the institution;
- Limits on amounts that can be paid into Funds Held;
- Interest rates that will be paid; and
- Withdrawal guidelines or restrictions.

Responsibility

The management will be responsible for monitoring and approving Funds Held withdrawals. The management may delegate Funds Held withdrawal approvals to branch managers.

Association management shall report to the Board of Directors, on an annual basis, information concerning customer's use of the Funds Held account.

The Board of Directors will periodically review the adequacy of the provisions of this policy.



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