# 2018 THIRD QUARTER REPORT

AGFIRST
FARM CREDIT BANK

# *THIRD QUARTER 2018*

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**CERTIFICATION**

The undersigned certify that we have reviewed the September 30, 2018 quarterly report of AgFirst Farm Credit Bank, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Curtis R. Hancock, Jr.
Chairman of the Board

Leon T. Amerson
Chief Executive Officer & President

Stephen Gilbert
Chief Financial Officer

November 8, 2018

# Report on Internal Control Over Financial Reporting

The Bank's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Bank's Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Bank's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Bank, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Bank, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on its Financial Statements.

The Bank's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2018. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Bank's management concluded that as of September 30, 2018, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Bank's management determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2018.

Leon T. Amerson
Chief Executive Officer & President

Stephen Gilbert
Chief Financial Officer

November 8, 2018

# Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion reviews the financial condition and results of operations of AgFirst Farm Credit Bank (AgFirst or Bank) as of and for the three and nine month periods ended September 30, 2018. These comments should be read in conjunction with the accompanying financial statements, the Notes to the Financial Statements, and the 2017 Annual Report of AgFirst Farm Credit Bank. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the District. The accompanying financial statements were prepared under the oversight of the Audit Committee of the AgFirst Board of Directors.

Key ratios and data reported below, and in the accompanying financial statements, address the financial performance of AgFirst. However, neither the three months nor the nine months results of operations may be indicative of an entire year due to the seasonal nature of a portion of AgFirst's business.

## FORWARD-LOOKING INFORMATION

This quarterly report contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from AgFirst's expectations and predictions due to a number of risks and uncertainties, many of which are beyond AgFirst's control. These risks and uncertainties include, but are not limited to:

- political (including trade and tax policies), legal, regulatory, financial markets, and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural infrastructure, international, and farm-related business sectors, as well as in the general economy;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income of District borrowers;
- changes in United States government support of the agricultural industry and the Farm Credit System (System) as a government-sponsored enterprise (GSE), as well as investor and rating agency reactions to events involving the U.S. government, other GSEs and other financial institutions;
- actions taken by the Federal Reserve System in implementing monetary and fiscal policy, as well as other policies and actions of the federal government that impact the financial services industry and the debt markets;
- credit, interest rate and liquidity risk inherent in lending activities; and
- changes in the Bank's assumptions for determining the allowance for loan losses, other-than-temporary impairment and fair value measurements.

## FINANCIAL CONDITION

### *Loan Portfolio*

AgFirst's loan portfolio consists of direct loans to District Associations (Direct Notes), loan participations/syndications purchased, Correspondent Lending loans (primarily first lien rural residential mortgages), and loans to Other Financing Institutions (OFIs) as shown below:

| **Loan Portfolio** *(dollars in thousands)* | **September 30, 2018** | | **December 31, 2017** | | **September 30, 2017** | |
|---|---|---|---|---|---|---|
| Direct Notes* | $ 16,411,951 | 68.34% | $ 15,838,709 | 67.81% | $ 15,840,167 | 68.36% |
| Participations/Syndications Purchased, net* | 4,254,456 | 17.72 | 4,289,545 | 18.36 | 4,153,498 | 17.93 |
| Correspondent Lending | 3,209,350 | 13.36 | 3,099,334 | 13.27 | 3,038,868 | 13.11 |
| Loans to OFIs | 138,693 | 0.58 | 131,572 | 0.56 | 139,724 | 0.60 |
| Total | $ 24,014,450 | 100.00% | $ 23,359,160 | 100.00% | $ 23,172,257 | 100.00% |

**Net of participations sold.*

Total loans outstanding were $24.014 billion at September 30, 2018, an increase of $655.3 million, or 2.81 percent, compared to total loans outstanding at December 31, 2017 and an increase of $842.2 million, or 3.63 percent, since September 30, 2017. These increases were partially offset by sales of $83.6 million of Correspondent Lending loans during 2018 in order to remain within regulatory limits. Excluding these sales, loan volume at September 30, 2018 increased 3.16 percent compared to 2017 year-end and 4.00 percent compared to September 30, 2017.

Future Bank loan demand is difficult to predict; however, modest growth is expected.

### *Credit Quality*

Credit quality of AgFirst's loans is shown below:

| | **Total Loan Portfolio Credit Quality as of:** | | |
|---|---|---|---|
| **Classification** | **September 30, 2018** | **December 31, 2017** | **September 30, 2017** |
| Acceptable | 93.80% | 99.60% | 99.17% |
| OAEM * | 6.06% | 0.15% | 0.43% |
| Adverse ** | 0.14% | 0.25% | 0.40% |

**Other Assets Especially Mentioned.*
***Adverse loans include substandard, doubtful, and loss loans.*

The decline in credit quality for September 30, 2018 reflected in the table above was primarily due to a decline in the credit quality of a single Direct Note which is discussed in the *Direct Notes* section below. Bank credit quality is expected to slightly deteriorate given expected reduced farm income, higher interest rates, recent weather events, and uncertainty surrounding global trade issues.

In September and October 2018, hurricanes Florence and Michael caused damage in several southeastern states. While it is too early to adequately assess the full impact on borrowers, these hurricanes are not anticipated to have a significant adverse impact on the Bank's overall financial condition and results of operations.

### *Direct Notes*

AgFirst's primary business is to provide funding, operational support, and technology services to District Associations. Each Association, in addition to the Bank, is a federally chartered instrumentality of the United States and is regulated by the Farm Credit Administration (FCA). AgFirst provides a revolving line of credit, referred to as a Direct Note, to each of the District Associations. Each of the Associations funds its earning assets primarily by borrowing under its Direct Note. Lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association. Each GFA contains minimum borrowing base margin, capital, and earnings requirements that must be maintained by the Association.

At September 30, 2018, the total Direct Note volume outstanding was $16.412 billion, an increase of $573.2 million, or 3.62 percent, compared to December 31, 2017. The higher Direct Note volume compared to year-end was driven by increases in Associations' lending in the field crops, forestry, cotton, and grains segments. Compared to September 30, 2017, the increase in Direct Notes resulted from increases in Associations' lending in the poultry, forestry, and field crops segments.

| | Direct Note Credit Quality as of | | | | | |
|---|---|---|---|---|---|---|
| | September 30, 2018 | | December 31, 2017 | | September 30, 2017 | |
| Classification | % Total | # Total | % Total | # Total | % Total | # Total |
| Acceptable | 91.38% | 18 | 100.00% | 19 | 100.00% | 19 |
| OAEM * | 8.62% | 1 | –% | – | –% | – |
| Adverse ** | –% | – | –% | – | –% | – |

**Other Assets Especially Mentioned*
***Adverse loans include substandard, doubtful, and loss loans.*

As reflected in the table above, one Direct Note was classified as OAEM at September 30, 2018. Presently, collection of the full Direct Note amount due is expected from all Associations in accordance with the contractual terms of the debt arrangements, and no allowance has been recorded for any Direct Notes. Virtually all assets of the various Associations are pledged as collateral for their respective Direct Notes. In the opinion of management, all Association Direct Notes are adequately collateralized. The risk funds of an Association, including both capital and the allowance for loan losses, also protect the interest of the Bank should a Direct Note default.

At September 30, 2018, no District Associations were operating under a written agreement with the FCA, and all District Associations were in compliance with GFA covenants.

***Participations/Syndications***

The Participations/Syndications portfolio consists of loan participations and syndications purchased. As of September 30, 2018, this portfolio totaled $4.254 billion, a decrease of $35.1 million, or 0.82 percent, from December 31, 2017. This decrease is primarily due to fewer capital markets transactions coming to market and larger than anticipated payoffs and paydowns.

AgFirst employs a number of management techniques to limit credit risk, including underwriting standards, limits on the amounts of loans purchased from a single originator, and maximum hold positions to a single borrower and commodity. Although the participations/syndications portfolio is comprised of a small number of relatively large loans, it is diversified both geographically and on a commodity basis. Management makes adjustments to credit policy and underwriting standards when appropriate as a part of the ongoing risk management process.

Credit quality statistics for the participations/syndications portfolio are shown in the following chart:

| | Participations/Syndications Credit Quality as of: | | |
|---|---|---|---|
| Classification | September 30, 2018 | December 31, 2017 | September 30, 2017 |
| Acceptable | 98.50% | 97.98% | 95.54% |
| OAEM* | 0.93% | 0.82% | 2.40% |
| Adverse** | 0.57% | 1.20% | 2.06% |

**Other Assets Especially Mentioned.*
***Adverse loans include substandard, doubtful, and loss loans.*

Favorable credit quality in the participations/syndications portfolio reflects continued positive general economic performance.

**Correspondent Lending**

The Correspondent Lending portfolio consists primarily of first lien residential mortgages purchased from Associations. As of September 30, 2018, the Correspondent Lending portfolio totaled $3.209 billion, an increase of $110.0 million, or 3.55 percent, from December 31, 2017. Excluding sales of $83.6 million during 2018 referenced in the *Loan Portfolio* section above, the Correspondent Lending portfolio increased 6.25 percent when compared to 2017 year-end.

As of September 30, 2018, $1.345 billion, or 41.92 percent, of loans in the Correspondent Lending portfolio were guaranteed and $1.864 billion, or 58.08 percent, were non-guaranteed. The guarantees, from the Federal National Mortgage Association (Fannie Mae) and/or Federal Agricultural Mortgage Corporation (Farmer Mac), are in the form of Long-Term Standby Commitments to Purchase which give AgFirst the right to deliver delinquent loans to the guarantor at par. Non-guaranteed loans are reflected in the Bank's allowance for loan losses methodology related to this portfolio.

At September 30, 2018, 99.74 percent of the Correspondent Lending portfolio was classified as acceptable and 0.26 percent was classified as substandard.

Rural home loans, combined with Rural Home Mortgage-backed Securities, are limited to 15.00 percent of the three-month average daily balance of total loans outstanding. Based on September 30, 2018 levels, the Bank has unused capacity of $110.7 million under a total limit of $3.619 billion. The Bank monitors and manages the rural home asset level within the regulatory limit. As discussed in the *Loan Portfolio* section above, during 2018, the Bank sold $83.6 million of rural home loans in order to remain within this limit. See Note 3, *Investments*, in the Notes to the Financial Statements for further discussion of Rural Home Mortgage-backed Securities.

***Nonaccrual Loans***

Nonaccrual loans represent all loans for which there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans for the Bank totaled $26.7 million at September 30, 2018, an increase of 25.37 percent compared to $21.3 million at December 31, 2017. The increase of $5.4 million resulted from $16.6 million of loan balances transferred to nonaccrual status, primarily one loan relationship in the field crops segment totaling $8.2 million. This increase was partially offset by $7.7 million of repayments and $2.8 million of Correspondent Lending loans sold to a guarantor (see *Correspondent Lending* section above). At September 30, 2018, total nonaccrual loans were primarily classified in the rural home loan (57.24 percent of the total), field crops (32.27 percent) and forestry (9.65 percent) segments. Nonaccrual loans were 0.11 percent of total loans outstanding at September 30, 2018 and 0.09 percent at December 31, 2017.

***Troubled Debt Restructurings***

A troubled debt restructuring (TDR) occurs when a borrower is experiencing financial difficulties and a concession is granted to the borrower that the Bank would not otherwise consider. Concessions are granted to borrowers based on either an assessment of the borrower's ability to return to financial viability or a court order. The concessions can be in the form of a modification of terms, rates, or amounts owed. Acceptance of other assets and/or equity as payment may also be considered a concession. The type of alternative financing granted is chosen in order to minimize the loss incurred by the Bank. TDRs decreased $238 thousand since December 31, 2017 and totaled $24.8 million at September 30, 2018. TDRs at September 30, 2018 were comprised of $15.9 million of accruing restructured loans and $8.9 million of nonaccrual restructured loans. Restructured loans were primarily in the nursery/greenhouse (32.52 percent of the total), rural home loan (20.45 percent), field crops (15.75 percent), and forestry (10.39 percent) segments.

***Other Property Owned***

Other property owned (OPO) consists primarily of assets once pledged as loan collateral that were acquired through foreclosure or deeded to the Bank (or a lender group) in satisfaction of secured loans. OPO may be comprised of real estate, equipment, and equity interests in companies or partnerships. OPO increased $309 thousand since

December 31, 2017 and totaled $463 thousand at September 30, 2018 due to the transfer of four rural home properties to OPO. At September 30, 2018, the OPO balance consisted of five rural home holdings.

***Allowance for Loan Losses***

The Bank maintains an allowance for loan losses at a level management considers adequate to provide for probable and estimable credit losses within the loan portfolio as of each reported balance sheet date. The allowance for loan losses was $17.2 million at September 30, 2018, as compared with $14.4 million at December 31, 2017. The allowance at September 30, 2018 included specific reserves of $4.2 million (24.51 percent of the total) and general reserves of $13.0 million (75.49 percent). The increase of $2.8 million from December 31, 2017 to September 30, 2018 resulted primarily from provision expense related to one loan relationship in the field crops segment. See *Provision for Loan Losses* section below for additional details regarding loan loss provision expense and reversals. The general reserves at September 30, 2018 included $3.9 million of allowance provided by the Bank for non-guaranteed loans in the Correspondent Lending portfolio. See further discussion in the *Correspondent Lending* section above. None of the allowance relates to the Direct Note portfolio. See further discussion in the *Direct Notes* section above. The total allowance at September 30, 2018 was comprised primarily of reserves for the rural home loan (25.13 percent of the total), field crops (24.47 percent), and utilities (10.23 percent) segments. The allowance for loan losses was 0.07 percent and 0.06 percent of total loans outstanding at September 30, 2018 and December 31, 2017, respectively. See Note 2, *Loans and Allowance for Loan Losses,* in the Notes to the Financial Statements for further information.

***Liquidity and Funding Sources***

One of AgFirst's primary responsibilities is to maintain sufficient liquidity to fund the lending operations of the District Associations, in addition to its own needs. Along with normal cash flows associated with lending operations, AgFirst has two principle sources of liquidity: the capacity to issue Systemwide Debt Securities through the Federal Farm Credit Banks Funding Corporation; and cash and investments. The Bank also maintains several securities repurchase agreement facilities. In addition, the System has established lines of credit in the event contingency funding is needed to meet obligations of System banks.

The U.S. government does not guarantee, directly or indirectly, Systemwide Debt Securities. However, the Farm Credit System, as a GSE, has benefited from broad access to the domestic and global capital markets. This access has provided the System with a dependable source of competitively priced debt which is critical for supporting the System's mission of providing credit to agriculture and rural America. The implied link between the credit rating of the System and the U.S. government, given the System's status as a GSE and continued concerns regarding the government's borrowing limit and budget imbalances, could pose risk to the System in the future.

AgFirst's primary source of liquidity comes from its ability to issue Systemwide Debt Securities, which are the general unsecured joint and several obligations of the System banks. AgFirst continually raises funds in the debt markets to support its mission, to repay maturing Systemwide Debt Securities, and to meet other obligations.

The System does not have a guaranteed line of credit from the U.S. Treasury or the Federal Reserve. However, the Farm Credit System Insurance Corporation (FCSIC) has an agreement with the Federal Financing Bank (FFB), a federal instrumentality subject to the supervision and direction of the U.S. Treasury, pursuant to which the FFB could advance funds to the FCSIC. Under its existing statutory authority, the FCSIC may use these funds to provide assistance to the System banks in exigent market circumstances which threaten the banks' ability to pay maturing debt obligations. The agreement provides for advances of up to $10 billion and terminates on September 30, 2019, unless otherwise renewed. The decision whether to seek funds from the FFB is at the discretion of the FCSIC. Each funding obligation of the FFB is subject to various terms and conditions and, as a result, there can be no assurance that funding would be available if needed by AgFirst or the System.

Currently, Moody's Investor Service and Fitch Ratings have assigned long-term debt ratings for the System of Aaa and AAA and short-term debt ratings of P-1 and F1, respectively. These are the highest ratings available from these rating agencies. S&P Global Ratings (S&P) maintains the long-term sovereign credit rating of the U.S. government at AA+, which directly corresponds to its AA+ long-term debt rating of the System. These rating agencies base their ratings on many quantitative and qualitative factors, including the System's status as a GSE. Negative changes to the System's credit ratings could reduce earnings by increasing debt funding costs and could also have a material adverse effect on liquidity, the ability to conduct normal business operations, and the Bank's overall financial condition and results of operations. However, AgFirst anticipates continued access to funding necessary to support the District's and Bank's needs.

At September 30, 2018, AgFirst had $30.165 billion in total debt outstanding compared to $29.763 billion at December 31, 2017, an increase of $401.5 million, or 1.35 percent. Debt increased primarily to support a higher level of loans as discussed elsewhere in this report.

Cash and cash equivalents, which decreased $244.0 million from December 31, 2017 to a total of $469.3 million at September 30, 2018, consist primarily of cash on deposit and money market securities that are short-term in nature (from overnight maturities to maturities that range up to 90 days). Incremental movements in cash balances between reporting periods are due primarily to changes in liquidity needs in relation to upcoming debt maturities.

Investments in debt securities totaled $7.965 billion, or 24.34 percent of total assets at September 30, 2018, compared to $8.122 billion, or 25.00 percent, as of December 31, 2017, a decrease of $156.9 million, or 1.93 percent. The majority of investments, $7.558 billion as of September 30, 2018, are classified as being available for sale. Management maintains the available-for-sale liquidity investment portfolio size generally proportionate with that of the loan portfolio and within regulatory and policy guidelines which provide that a System bank may hold certain eligible available-for-sale investments in an amount not to exceed 35.00 percent of its total loans outstanding. Based upon FCA guidelines, at September 30, 2018, the Bank's eligible available-for-sale investments were 32.93 percent of the total loans outstanding.

Investments in debt securities classified as being available-for-sale totaled $7.558 billion at September 30, 2018. Available-for-sale investments at September 30, 2018 included $389.1 million in U.S. Treasury securities, $4.533 billion in U.S. government guaranteed securities, $1.926 billion in U.S. government agency guaranteed securities, and $709.3 million in non-agency asset-backed securities. Since the majority of the portfolio is invested in U.S. government guaranteed and agency securities, the portfolio is highly liquid and potential credit loss exposure is limited.

As of September 30, 2018, AgFirst exceeded all applicable regulatory liquidity requirements. FCA regulations require that the Bank have a liquidity policy that establishes a minimum total "coverage" level of 90 days and that short-term liquidity requirements must be met by certain high quality investments or cash. "Coverage" is defined as the number of days that maturing debt could be funded with eligible cash, cash equivalents, and available-for-sale investments maintained by the Bank.

The FCA classifies eligible liquidity investments according to four liquidity quality levels with level 1 being the highest. The first 15 days of minimum liquidity coverage are met using only level 1 instruments, which include cash and cash equivalents. Days 16 through 30 of minimum liquidity coverage are met using level 1 and level 2 instruments. Level 2 consists primarily of U.S. government guaranteed securities. Days 31 through 90 are met using level 1, level 2, and level 3 securities. Level 3 consists primarily of U.S. government agency investments. The fourth level is a supplemental liquidity buffer which is set to provide coverage to at least 120 days and which consists of level 1, level 2, and level 3 instruments in excess of the 90-day minimum liquidity reserve and asset-backed securities (ABSs).

At September 30, 2018, AgFirst met each of the individual level criteria above and had a total of 218 days of maturing debt coverage compared to 207 days at December 31, 2017. The increase resulted from a change in the timing of upcoming debt maturities. Cash provided by the Bank's operating activities is an additional source of liquidity for the Bank that is not reflected in the coverage calculation.

See Note 3, *Investments*, and Note 4, *Debt*, in the Notes to the Financial Statements for further information.

***Capital Resources***

Total shareholders' equity increased $153.4 million, or 6.84 percent, from December 31, 2017 to $2.396 billion at September 30, 2018. This increase is primarily attributed to 2018 unallocated retained earnings from net income of $226.6 million, partially offset by an increase in net unrealized losses of $69.7 million on investments primarily due to an increase in interest rates lowering the fair value of existing available-for-sale fixed-rate investment securities.

***Regulatory Capital Ratios***

AgFirst's regulatory ratios are shown in the following table:

| | Regulatory Minimum, Including Buffer* | 9/30/18 | 12/31/17 | 9/30/17 |
|---|---|---|---|---|
| Permanent Capital Ratio | 7.00% | 21.40% | 22.21% | 21.60% |
| Common Equity Tier 1 (CET1) Capital Ratio | 7.00% | 20.93% | 21.73% | 21.13% |
| Tier 1 Capital Ratio | 8.50% | 21.37% | 22.18% | 21.57% |
| Total Regulatory Capital Ratio | 10.50% | 21.51% | 22.31% | 21.72% |
| Tier 1 Leverage Ratio | 5.00% | 7.41% | 7.67% | 7.51% |
| Unallocated Retained Earnings (URE) and URE Equivalents Leverage Ratio | 1.50% | 6.44% | 6.72% | 6.55% |

**Includes fully phased-in capital conservation buffers which will be effective January 1, 2020.*

The FCA sets minimum regulatory capital adequacy requirements for System banks and associations. The requirements are based on regulatory ratios as defined by the FCA and include common equity tier 1 (CET1), tier 1 capital, total regulatory capital, permanent capital, tier 1 leverage, and unallocated retained earnings (URE) and URE equivalents leverage ratios.

The permanent capital, CET1, tier 1 capital, and total capital ratios are calculated by dividing the three-month average daily balance of the capital numerator, as defined by the FCA, by a risk-adjusted asset base. Risk-adjusted assets refer to the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. Generally, higher credit conversion factors are applied to assets with more inherent risk. Unlike these ratios, the tier 1 leverage and URE and URE equivalents leverage ratios do not incorporate any risk-adjusted weighting of assets. The tier 1 leverage and URE and URE equivalents leverage ratios are calculated by dividing the three-month average daily balance of the capital numerator, as defined by the FCA, by the three-month average daily balance of total assets adjusted for regulatory deductions.

For all periods presented, AgFirst exceeded minimum regulatory standards for all of the ratios. The Bank's capital ratios declined at September 30, 2018 compared to December 31, 2017 and September 30, 2017. Because these ratios are calculated using a three-month average daily balance for both capital and assets, total Bank declared patronage of $312.5 million in 2017, which represented approximately 90.63 percent of 2017 net income and was accrued at the end of 2017, was not reflected in the December 31, 2017 ratios, but was fully reflected in the ratios at September 30, 2018. The decline in the capital ratios in 2018 compared to September 30, 2017 was primarily due higher average risk-weighted assets in the 2018 period. See *Regulatory Matters* section below for further discussion of capital ratios.

## RESULTS OF OPERATIONS

Net income for the three months ended September 30, 2018 was $74.2 million compared to $83.5 million for the three months ended September 30, 2017, a decrease of $9.2 million, or 11.06 percent. Net income for the nine months ended September 30, 2018 was $226.6 million compared to $247.4 million for the nine months ended September 30, 2017, a decrease of $20.7 million, or 8.38 percent. See below for further discussion of the change in net income by major components.

### *Key Results of Operations Comparisons*

| | Annualized for the Nine Months Ended September 30, 2018 | For the Year Ended December 31, 2017 | Annualized for the Nine Months Ended September 30, 2017 |
|---|---|---|---|
| Return on average assets | 0.95% | 1.09% | 1.05% |
| Return on average shareholders' equity | 13.05% | 14.36% | 14.00% |
| Net interest margin | 1.31% | 1.44% | 1.46% |
| Operating expense as a percentage of net interest income and noninterest income | 30.68% | 26.72% | 28.63% |
| Net (charge-offs) recoveries to average loans | 0.00% | 0.00% | 0.00% |

A decline in net interest income, discussed below, was the primary driver of the decreases in return on average assets, return on average shareholders' equity, and net interest margin as well as the increase in the ratio of operating expense to net interest income. The net (charge-offs) recoveries to average loans ratio remained constant for all periods presented due to minimal net (charge-offs) recoveries. See *Allowance for Loan Losses*, *Net Interest Income*, *Noninterest Income*, and *Noninterest Expenses* sections for further discussion.

### *Net Interest Income*

Net interest income for the three months ended September 30, 2018 was $104.7 million compared to $113.9 million for the same period of 2017, a decrease of $9.2 million or 8.03 percent. For the nine months ended September 30, 2018, net interest income was $308.1 million compared to $336.8 million for the same period of 2017, a decrease of $28.7 million, or 8.52 percent. The net interest margin, which is net interest income as a percentage of average earning assets, was 1.30 percent and 1.31 percent for the three and nine month periods in 2018, respectively, decreases of 15 basis points for both periods compared to the prior year. The decrease in net interest income for both periods resulted from higher rates paid on interest-bearing liabilities which were partially offset by the positive impact of higher yields on interest-earning assets.

No debt was called during the nine months ended September 30, 2018. The Bank called debt totaling $2.297 billion for the same period in the prior year, and was able to lower the cost of funds. Over time, as interest rates change and as assets prepay or reprice, the positive impact on the net interest margin that the Bank has experienced over the last several years from calling debt will continue to diminish.

The effects of changes in volume and interest rates on net interest income for the three and nine months ended September 30, 2018, as compared with the corresponding periods in 2017, are presented in the following table. The table distinguishes between the changes in interest income and interest expense related to average outstanding balances and to the levels of average interest rates.

| | For the Three Months Ended September 30, 2018 vs. September 30, 2017 | | | For the Nine Months Ended September 30, 2018 vs. September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Increase (decrease) due to changes in: | | | Increase (decrease) due to changes in: | | |
| *(dollars in thousands)* | Volume | Rate | Total | Volume | Rate | Total |
| Interest Income: | | | | | | |
| Loans | $ 6,318 | $ 21,839 | $ 28,157 | $ 14,045 | $ 56,068 | $ 70,113 |
| Investments & Cash Equivalents | (80) | 11,941 | 11,861 | 1,150 | 32,646 | 33,796 |
| Total Interest Income | 6,238 | 33,780 | 40,018 | 15,195 | 88,714 | 103,909 |
| Interest Expense: | | | | | | |
| Interest-Bearing Liabilities | 3,424 | 45,744 | 49,168 | 9,180 | 123,426 | 132,606 |
| Changes in Net Interest Income | $ 2,814 | $ (11,964) | $ (9,150) | $ 6,015 | $ (34,712) | $ (28,697) |

### *Provision for Loan Losses*

AgFirst measures risks inherent in its loan portfolio on an ongoing basis and, as necessary, recognizes provision for loan loss expense so that appropriate reserves for loan losses are maintained. Loan loss provision was a net expense of $1.5 million and a net expense of $2.8 million for the three and nine months ended September 30, 2018, respectively, compared to a net reversal of $668 thousand and a net reversal of $143 thousand for the corresponding periods in 2017.

For the three month period ended September 30, 2018, the provision for loan losses included net provision expense for specific reserves of $1.4 million and net provision expense for general reserves of $185 thousand. For the nine month period ended September 30, 2018, the provision for loan losses included net provision expense for specific reserves of $3.5 million and net provision reversals for general reserves of $708 thousand. Provision for loan losses for the three and nine months ended September 30, 2018 primarily resulted from expense in the field crops segment of $1.4 million and $2.8 million, respectively, which was primarily driven by expense related to one loan relationship that was transferred to nonaccrual in 2018.

For the three months ended September 30, 2017, the provision for loan losses included net provision reversals of $1 thousand for specific reserves and net provision reversals of $667 thousand for general reserves. The largest segments included in the total provision reversal for the three month period in 2017 were nursery/greenhouse ($165 thousand reversal), field crops ($150 thousand reversal), utilities ($125 thousand reversal) and rural home loan ($230 thousand expense). For the nine month period in 2017, the provision for loan losses included reversals of $172 thousand for specific reserves and net provision expense of $29 thousand for general reserves. The largest segments included in the total provision reversal for the nine months ended September 30, 2017 were utilities ($450 thousand reversal), tree fruits and nuts ($320 thousand reversal), forestry ($308 thousand reversal), nursery/greenhouse ($100 thousand reversal), field crops ($754 thousand expense), and rural home loan ($665 thousand expense).

See Note 2, *Loans and Allowance for Loan Losses,* in the Notes to the Financial Statements for further information.

### *Noninterest Income*

The following table illustrates the changes in noninterest income:

| **Change in Noninterest Income** | **For the Three Months Ended September 30,** | | | **For the Nine Months Ended September 30,** | | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **2018** | **2017** | **Increase/ (Decrease)** | **2018** | **2017** | **Increase/ (Decrease)** |
| Loan fees | $ 2,228 | $ 2,196 | $ 32 | $ 6,201 | $ 6,432 | $ (231) |
| Building lease income | 807 | 809 | (2) | 2,484 | 2,736 | (252) |
| Gains (losses) on investments, net | 13 | – | 13 | 13 | (258) | 271 |
| Gains (losses) on debt extinguishment | – | (1,447) | 1,447 | 150 | (4,528) | 4,678 |
| Gains (losses) on other transactions | 468 | 178 | 290 | 1,862 | 1,015 | 847 |
| Insurance premium refund | – | – | – | 6,330 | – | 6,330 |
| Other noninterest income | 1,877 | 975 | 902 | 5,997 | 4,290 | 1,707 |
| Total noninterest income | $ 5,393 | $ 2,711 | $ 2,682 | $ 23,037 | $ 9,687 | $ 13,350 |

For the three and nine months ended September 30, 2018 compared to the corresponding periods in 2017, noninterest income increased $2.7 million and $13.4 million, respectively. For the three month period, the increase resulted primarily from lower losses on debt extinguishment. For the nine month period, the increase was due primarily to an insurance premium refund received in 2018 and lower losses on debt extinguishment. Significant line item dollar variances are discussed below.

Losses on debt extinguishment decreased $1.4 million and $4.7 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. No debt was called during the nine months ended September 30, 2018. The gain of $150 thousand in the nine month period for 2018 resulted from discount notes extinguished in the second quarter of 2018 totaling $450.0 million. For 2017, losses on called debt were $1.4 million and $4.5 million for the three and nine month periods, respectively. Debt issuance expense is amortized over the life of the underlying debt security. When debt securities are called prior to maturity, any unamortized issuance cost is expensed. Call options were exercised on bonds totaling $672.0 million and $2.297 billion for the three and nine month periods in 2017, respectively. Debt is called to take advantage of favorable market interest rate changes. The amount of debt issuance cost expensed is dependent upon both the volume and remaining maturity of the debt when called. Losses on called debt are more than offset by interest expense savings realized as called debt is replaced by new debt issued at a lower rate of interest.

For the nine month period ended September 30, 2018, gains on other transactions increased $847 thousand primarily due to $1.6 million in gains on interest rate lock and forward commitment derivatives established by the Bank in 2018 as a result of the sale of Correspondent Lending loans. These gains were partially offset by higher losses from the sale of Corresponding Lending loans of $817 thousand. See the *Correspondent Lending* section above for additional information.

In the first quarter of 2018, the Bank received an insurance premium refund of $6.3 million from the FCSIC which insures the System's debt obligations. This refund is nonrecurring and resulted from the assets of the FCSIC exceeding the secure base amount as defined by the Farm Credit Act.

For the three and nine month periods ended September 30, 2018, other noninterest income increased $902 thousand and $1.7 million, respectively. The increases in both periods were primarily due to increases in patronage received from other Farm Credit institutions of $858 thousand and $713 thousand, respectively. In addition, income from services provided to Farm Credit entities outside the AgFirst District increased $261 thousand and $899 thousand, respectively.

***Noninterest Expenses***

The following table illustrates the changes in noninterest expenses:

| **Change in Noninterest Expenses** | **For the Three Months Ended September 30,** | | | **For the Nine Months Ended September 30,** | | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **2018** | **2017** | **Increase/ (Decrease)** | **2018** | **2017** | **Increase/ (Decrease)** |
| Salaries and employee benefits | $ 15,516 | $ 14,366 | $ 1,150 | $ 47,631 | $ 43,558 | $ 4,073 |
| Occupancy and equipment | 5,786 | 5,481 | 305 | 16,899 | 16,479 | 420 |
| Insurance Fund premiums | 2,044 | 3,373 | (1,329) | 6,171 | 10,452 | (4,281) |
| Other operating expenses | 11,001 | 10,596 | 405 | 30,884 | 28,701 | 2,183 |
| Losses (gains) from other property owned | 16 | (8) | 24 | 75 | 30 | 45 |
| Total noninterest expenses | $ 34,363 | $ 33,808 | $ 555 | $ 101,660 | $ 99,220 | $ 2,440 |

Noninterest expenses for the three and nine months ended September 30, 2018 increased $555 thousand and $2.4 million, respectively, compared to the corresponding periods in 2017. The increase for the three month period resulted primarily from higher salaries and employee benefits offset by lower insurance fund premiums. For the nine month period, the increase was primarily due to higher salaries and employee benefits and other operating expenses, partially offset by a decrease in insurance fund premiums. Significant line item dollar variances are discussed below.

Salaries and employee benefits increased $1.2 million and $4.1 million for the three and nine months ended September 30, 2018, respectively, compared to the same periods in 2017. The increases resulted primarily from $684 thousand and $2.7 million increases for the three and nine month periods, respectively, in salaries and incentives due to normal salary administration and an increase in headcount. Increases of $248 thousand and $743 thousand in pension expense for the three and nine month periods, respectively, primarily resulted from higher anticipated contributions due to an increase in the plan's liability as a result of a decrease in the discount rate used to calculate the liability.

Insurance Fund premiums decreased $1.3 million and $4.3 million for the three and nine month periods ended September 30, 2018, respectively, compared to the same periods in 2017. These decreases resulted primarily from a decrease in the base annual premium rate to 9 basis points in 2018 from 15 basis points in 2017. The FCSIC Board makes premium rate adjustments, as necessary, to maintain their secure base amount which is based upon insured debt outstanding at System banks.

Other operating expenses increased $2.2 million for the nine months ended September 30, 2018 compared to the corresponding period in 2017. The increase was primarily due to a $2.3 million increase in consultant and professional fees predominantly related to technology initiatives.

## REGULATORY MATTERS

### Capital

The following quantitative disclosures contain regulatory disclosures as required for the Bank under Regulation 628.62 and 628.63 for risk-adjusted ratios: common equity tier 1, tier 1 capital and total regulatory capital ratios. As required, these disclosures are made available for at least three years and can be accessed via AgFirst's website at www.agfirst.com.

## SCOPE OF APPLICATION

AgFirst is one of the four banks of the System, a nationwide system of cooperatively owned Banks and Associations, established by Congress and subject to the provisions of the Farm Credit Act of 1971, as amended. The Bank prepares financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the financial services industry.

As of September 30, 2018, the AgFirst District consisted of the Bank and 19 District Associations. All 19 were structured as Agricultural Credit Association (ACA) holding companies, with Production Credit Association (PCA) and Federal Land Credit Association (FLCA) subsidiaries. AgFirst is owned by these 19 Associations. The Bank does not have any subsidiaries requiring consolidation; therefore, there are no consolidated entities for which the total capital requirement is deducted, there are no restrictions on transfer of funds or total capital with other consolidated entities and no subsidiary exists which is below the minimum total capital requirement individually or when aggregated at the Bank's level. In conjunction with other System entities, the Bank jointly owns certain service organizations: the Federal Farm Credit Banks Funding Corporation (Funding Corporation), the FCS Building Association (FCSBA), and the Farm Credit Association Captive Insurance Corporation (Captive). Certain of the Bank's investments in other System institutions, including the investment in the Funding Corporation and FCSBA, are deducted from capital as only the institution that issued the equities may count the amount as capital.

## CAPITAL STRUCTURE

The table below outlines the Bank's capital structure for the capital adequacy calculations as of September 30, 2018:

| *(dollars in thousands)* | 3-Month Average Daily Balance |
|---|---|
| **Common Equity Tier 1 Capital (CET1)** | |
| Common Cooperative Equities: | |
| Statutory minimum purchased borrower stock | $ 23 |
| Other required member purchased stock | 125,189 |
| Allocated equities: | |
| Allocated stock subject to retirement | 184,928 |
| Nonqualified allocated surplus subject to retirement | 453 |
| Unallocated retained earnings | 2,042,635 |
| Paid-in capital | 58,883 |
| Regulatory adjustments and deductions made to CET1* | (69,483) |
| Total CET1 | $ 2,342,628 |
| **Additional Tier 1 Capital (AT1)** | |
| Non-cumulative perpetual preferred stock | $ 49,250 |
| Regulatory adjustments and deductions made to AT1 | – |
| Total AT1 | $ 49,250 |
| Total Tier 1 Capital | $ 2,391,878 |
| **Tier 2 Capital** | |
| Allowance for loan losses | $ 15,685 |
| Reserve for unfunded commitments | 1 |
| Regulatory adjustments and deductions made to total capital | – |
| Total Tier 2 Capital | $ 15,686 |
| Total Regulatory Capital | $ 2,407,564 |

**Primarily investments in other System institutions.*

## CAPITAL ADEQUACY AND CAPITAL BUFFERS

The table below outlines the Bank's risk-weighted assets by exposure calculated on a three-month average daily balance (including accrued interest of that exposure) as of September 30, 2018:

| *(dollars in thousands)* | | Risk-Weighted Assets |
|---|---|---|
| Exposures to: | | |
| Government-sponsored entities, including Direct Notes to Associations | $ | 3,998,420 |
| Depository institutions | | 3,366 |
| Corporate exposures, including borrower loans and leases | | 4,397,663 |
| Residential mortgage loans | | 859,390 |
| Past due > 90 days and nonaccrual loans | | 28,855 |
| Securitizations | | 240,687 |
| Equity investments | | 36,370 |
| Exposures to obligors and other assets | | 122,832 |
| Off-balance sheet exposures | | 1,504,649 |
| Total risk-weighted assets | $ | 11,192,232 |

As of September 30, 2018, the Bank was well-capitalized and exceeded all capital requirements to which it was subject, including applicable capital buffers. The Bank's risk-adjusted capital ratios exceeded the regulatory minimum levels, including the conservation buffer, by a minimum of 12.26 percent. Additionally, the Bank's leverage ratio was 2.41 percent in excess of its required minimum leverage ratio, including the buffer. If the capital ratios fall below the minimum regulatory requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval. The aggregate amount of eligible retained income was $11.4 million as of September 30, 2018.

The following sets forth the regulatory capital ratios as of September 30, 2018:

| Ratio | Regulatory Minimum Requirement | Capital Conservation Buffer | Minimum Requirement, Including Buffer | Capital Ratios as of September 30, 2018 |
|---|---|---|---|---|
| Risk-adjusted ratios: | | | | |
| CET1 Capital* | 4.50% | 1.25% | 5.75% | 20.93% |
| Tier 1 Capital* | 6.00% | 1.25% | 7.25% | 21.37% |
| Total Regulatory Capital* | 8.00% | 1.25% | 9.25% | 21.51% |
| Permanent Capital | 7.00% | 0.00% | 7.00% | 21.40% |
| | | | | |
| Non-risk-adjusted ratios: | | | | |
| Tier 1 Leverage | 4.00% | 1.00% | 5.00% | 7.41% |
| URE and URE Equivalents Leverage | 1.50% | 0.00% | 1.50% | 6.44% |

** The capital conservation buffers over risk-adjusted ratio minimums have a 3-year phase-in period and will become fully effective January 1, 2020. Risk-adjusted ratio minimums will increase 0.625% each year until fully phased in. There is no phase-in period for the tier 1 leverage ratio.*

## CREDIT RISK

System entities have specific lending authorities within their chartered territories. The Bank is subject to credit risk by lending to the District's FLCAs, PCAs, and ACAs as well as Other Financing Institutions (OFIs). The Bank also purchases participations and syndications and first lien residential mortgage loans. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which identifies loans that may be impaired based on characteristics such as probability of default (PD) and loss given default (LGD). Allowance needs by geographic region are only considered in rare circumstances that may not otherwise be reflected in the PD and LGD (flooding, drought, etc.). There was no allowance attributed to a geographic area as of September 30, 2018. See Note 2, *Loans and Allowance for Loan Losses*, and Note 3, *Investments*, in the Notes to the Financial Statements for quantitative disclosures related to the Bank's credit risk.

## CREDIT RISK MITIGATION

### *Credit Risk Mitigation Related to Loans*

The Bank uses various strategies to mitigate credit risk in its lending portfolio. As described in Note 1 of the Bank's Annual Report, a substantial portion of the loan balance is concentrated in notes receivable from the District Associations to fund their earning assets, which collateralize the notes. In addition, the earnings, capital and loan loss reserves of the Associations provide additional layers of protection against losses in their respective retail loan portfolios.

The following table illustrates credit risk mitigants within AgFirst's loan portfolio which reduce capital requirements.

| | September 30, 2018 | | |
|---|---|---|---|
| *(dollars in thousands)* | Amortized Cost | Risk-Weighted Exposures | % of Total Loans |
| Loans with unconditional guarantee | $ 6,349 | $ – | –% |
| Loans with conditional guarantee | 1,350,820 | 273,945 | 6% |
| Direct Notes | 16,455,715 | 3,250,158 | 68% |
| Total | $ 17,812,884 | $ 3,524,103 | 74% |

The following table illustrates AgFirst's loan portfolio by geographic distribution at September 30, 2018. The loan portfolio includes loans in all 50 states and Puerto Rico. This table excludes the Bank's Direct Notes and loans to OFI portfolios.

| *(dollars in thousands)* | | |
|---|---|---|
| North Carolina | $ 1,278,836 | 17 % |
| Georgia | 977,287 | 13 |
| Florida | 569,718 | 8 |
| Virginia | 548,969 | 7 |
| Texas | 397,350 | 5 |
| South Carolina | 377,627 | 5 |
| Maryland | 334,429 | 4 |
| Pennsylvania | 275,065 | 4 |
| Minnesota | 220,412 | 3 |
| California | 212,728 | 3 |
| New York | 196,942 | 3 |
| Kentucky | 191,196 | 3 |
| Missouri | 173,913 | 2 |
| Ohio | 153,310 | 2 |
| Kansas | 131,170 | 2 |
| New Jersey | 112,781 | 2 |
| All Other States | 1,312,073 | 17 |
| | $ 7,463,806 | 100 % |

The following table shows the various major commodity groups in the portfolio based on borrower eligibility and their percentage of the outstanding portfolio volume at September 30, 2018. This table excludes the Bank's Direct Notes and loans to OFI portfolios.

| *(dollars in thousands)* | | |
|---|---|---|
| Rural Home Loan | $ 3,055,048 | 41 % |
| Forestry | 885,084 | 12 |
| Utilities | 701,667 | 9 |
| Processing | 636,868 | 8 |
| Field Crops | 298,300 | 4 |
| Other Real Estate | 224,125 | 3 |
| Tree Fruits and Nuts | 202,564 | 3 |
| Nursery/Greenhouse | 159,412 | 2 |
| Cattle | 135,979 | 2 |
| Dairy | 131,978 | 2 |
| Swine | 116,006 | 2 |
| Other | 916,775 | 12 |
| | $ 7,463,806 | 100 % |

The following table segregates loans based upon repayment dependency by commodity at September 30, 2018. This table excludes the Bank's Direct Notes and loans to OFI portfolios.

| *(dollars in thousands)* | | |
|---|---|---|
| Non-Farm Income | $ 3,384,026 | 45 % |
| Timber | 737,282 | 10 |
| Rural Utilities | 701,667 | 9 |
| Fruit and Vegetables | 411,422 | 6 |
| Processing and Marketing | 372,475 | 5 |
| Grains | 323,766 | 4 |
| Swine | 254,968 | 3 |
| Farm-Related Business | 199,764 | 3 |
| Dairy | 178,861 | 2 |
| Beef | 138,144 | 2 |
| Nursery | 119,475 | 2 |
| Wine | 115,694 | 2 |
| Other | 526,262 | 7 |
| | $ 7,463,806 | 100 % |

The Bank does not use credit default swaps as part of its credit risk management approach.

### *Credit Risk Mitigation Related to Investments*

Credit risk in AgFirst's investment portfolio is largely mitigated by investing primarily in securities issued or guaranteed by the U.S. government or one of its agencies.

The following table shows the investment exposures covered by a guarantee:

| | September 30, 2018 | | | |
|---|---|---|---|---|
| *(dollars in thousands)* | **Amortized Cost** | **Fair Value** | **% of Total Investments** | **Risk-Weighted Exposures** |
| **Unconditional Guarantee:** | | | | |
| U.S. Govt. Treasury Securities | $ 390,082 | $ 389,117 | 5% | $ – |
| U.S. Govt. Guaranteed | 4,586,352 | 4,533,402 | 57% | – |
| **Conditional Guarantee:** | | | | |
| U.S. Govt. Agency Guaranteed | 2,317,168 | 2,276,478 | 28% | 474,317 |
| Total | $ 7,293,602 | $ 7,198,997 | 90% | $ 474,317 |

## COUNTERPARTY CREDIT RISK

See Note 11, *Derivative Financial Instruments and Hedging Activities*, in the Notes to the Financial Statements for further information on any counterparty exposures related to derivatives as of September 30, 2018.

## SECURITIZATION

The Bank has elected to utilize the simplified supervisory formula risk-based capital approach (SSFA) for securitization exposures. As such, the Bank's asset-backed securities (ABS) portfolio is risk weighted on an individual security level. As of September 30, 2018, the ABS risk-weights ranged from 20.00 percent to 130.32 percent, with a weighted average risk-weight of 34.36 percent.

As of September 30, 2018, the Bank did not hold any off-balance sheet securitization exposures nor were any securitization exposures deducted from capital.

Refer to Note 3, *Investments*, in the Notes to the Financial Statements for additional information related to purchases and sales of securitization exposures as well as the amortized cost, unrealized gains/(losses) and fair value of mortgage-backed securities (MBSs) and ABSs held in the investment portfolio.

**EQUITIES**

The Bank does not have significant exposure to equity investments. At September 30, 2018, the Bank has investments in money market funds of $174.7 million classified as equity investments. These balances are accounted for as investment securities but are classified as Cash Equivalents in the Balance Sheet and Statement of Cash Flows. The Bank applies a 20 percent risk-weight for these investments.

**INTEREST RATE RISK**

The following tables represent AgFirst's market value of equity and projected change over the next twelve months in net interest income for various rate movements as of September 30, 2018:

**Net Interest Income**
*(dollars in thousands)*

| Scenarios | Net Interest Income | % Change |
|---|---|---|
| +4.0% Shock | $392,937 | -3.34% |
| +2.0% Shock | $405,141 | -0.34% |
| Base line ** | $406,523 | –% |
| -50% of 3M Tbill *** | $408,564 | 0.50% |

**Market Value of Equity**
*(dollars in thousands)*

| Scenarios | Assets | Liabilities* | Equity* | % Change |
|---|---|---|---|---|
| Book Value | $32,731,827 | $30,384,863 | $2,346,964 | -% |
| +4.0% Shock | $29,372,138 | $27,702,054 | $1,670,084 | -31.16% |
| +2.0% Shock | $30,820,703 | $28,784,034 | $2,036,669 | -16.05% |
| Base line ** | $32,381,262 | $29,955,204 | $2,426,058 | –% |
| -50% of 3M Tbill *** | $33,214,388 | $30,526,904 | $2,687,484 | 10.78% |

**For interest rate risk management, the $49.3 million perpetual preferred stock is included in liabilities rather than equity.*
***Base line uses rates as of the balance sheet date before application of any interest rate shocks.*
****When the three-month Treasury bill interest rate is less than 4 percent, both the minus 200 and minus 400 basis point shocks are replaced with a downward shock equal to one-half of the three-month Treasury bill rate which is 110 basis points.*

**Other Regulatory Matters**

On May 10, 2018, the Farm Credit Administration adopted a final rule that amends the regulations governing investments of System banks and associations. The final rule strengthens eligibility criteria for the investments the banks may purchase and hold. It also implements Section 939A of the Dodd-Frank Act by removing references to and requirements for credit ratings and substitutes the eligibility requirement with other appropriate standards of credit worthiness. In addition, it grants associations greater flexibility regarding the risk management purposes for investments and limits the type and amount of investments that an association may hold. Only securities that are issued by, or are unconditionally guaranteed or insured as to the timely payment of principal and interest by, the U.S. government or its agencies are eligible for association risk management purposes. An association may purchase and hold investments not to exceed 10 percent of its 90-day average daily balance of outstanding loans on the last business day of the quarter. The final rule will become effective January 1, 2019.

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

Please refer to Note 1, *Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*, in the Notes to the Financial Statements, and the 2017 Annual Report of AgFirst Farm Credit Bank for recently issued accounting pronouncements. Additional information is provided in the following table.

The following ASUs were issued by the Financial Accounting Standards Board (FASB) but have not yet been adopted:

| Summary of Guidance | Adoption and Potential Financial Statement Impact |
|---|---|
| ***ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*** | |
| • Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management's estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets.<br>• Changes the present incurred loss impairment guidance for loans to a CECL model.<br>• The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit.<br>• Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets.<br>• Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption.<br>• Effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. | • The Bank has begun implementation efforts by establishing a cross-discipline governance structure. The Bank is currently identifying key interpretive issues, and assessing existing credit loss forecasting models and processes against the new guidance to determine what modifications may be required.<br>• The Bank expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including:<br>1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions,<br>2. An allowance will be established for estimated credit losses on any debt securities,<br>3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans.<br>• The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Bank's portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date.<br>• The Bank expects to adopt the guidance in first quarter 2021. |
| ***ASU 2016-02 – Leases (Topic 842)*** | |
| • Requires lessees to recognize leases on the balance sheet with lease liabilities and corresponding right-of-use assets based on the present value of lease payments.<br>• Lessor accounting activities are largely unchanged from existing lease accounting.<br>• The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification.<br>• Also, expands qualitative and quantitative disclosures of leasing arrangements.<br>• Requires adoption using a modified cumulative effect approach wherein the guidance is applied to all periods presented. A recent amendment provides an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.<br>• Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. | • The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees.<br>• The Bank has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities.<br>• As a lessee the Bank is developing its methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments but does not expect a material change to the timing of expense recognition.<br>• Given the limited changes to lessor accounting, the Bank does not expect material changes to recognition or measurement, but the implementation process and the impact will continue to be evaluated.<br>• The Bank is evaluating existing disclosures and may need to provide additional information as a result of adopting the Update.<br>• The Bank expects to adopt the guidance in first quarter 2019 using the optional modified retrospective method and practical expedients for transition. |

**NOTE:** Shareholder investment in a District Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2764, or writing Matthew Miller, Controller, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Combined information concerning AgFirst Farm Credit Bank and District Associations can also be obtained at the Bank's website, *www.agfirst.com*. AgFirst prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no quarterly report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# Balance Sheets

| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 |
|---|---|---|
| | *(unaudited)* | *(audited)* |
| **Assets** | | |
| Cash | **$ 194,536** | $ 440,768 |
| Cash equivalents | **274,739** | 272,519 |
| Investments in debt securities: | | |
| Available-for-sale (amortized cost of $7,647,535 and $7,683,631, respectively) | **7,557,858** | 7,663,605 |
| Held-to-maturity (fair value of $396,609 and $463,340, respectively) | **407,507** | 458,623 |
| Total investments in debt securities | **7,965,365** | 8,122,228 |
| Loans | **24,014,450** | 23,359,160 |
| Allowance for loan losses | **(17,177)** | (14,381) |
| Net loans | **23,997,273** | 23,344,779 |
| Accrued interest receivable | **88,770** | 74,979 |
| Accounts receivable | **57,263** | 80,267 |
| Equity investments in other Farm Credit institutions | **73,378** | 72,593 |
| Premises and equipment, net | **57,210** | 59,369 |
| Other property owned | **463** | 154 |
| Other assets | **22,830** | 19,801 |
| Total assets | **$ 32,731,827** | $ 32,487,457 |
| **Liabilities** | | |
| Systemwide bonds payable | **$ 25,370,690** | $ 24,829,679 |
| Systemwide notes payable | **4,793,820** | 4,933,312 |
| Accrued interest payable | **109,572** | 81,471 |
| Accounts payable | **22,383** | 356,446 |
| Other liabilities | **39,148** | 43,734 |
| Total liabilities | **30,335,613** | 30,244,642 |
| Commitments and contingencies (Note 8) | | |
| **Shareholders' Equity** | | |
| Perpetual preferred stock | **49,250** | 49,250 |
| Capital stock and participation certificates | **310,140** | 313,752 |
| Additional paid-in-capital | **58,883** | 58,883 |
| Retained earnings | | |
| Allocated | **451** | 492 |
| Unallocated | **2,070,774** | 1,845,194 |
| Accumulated other comprehensive income (loss) | **(93,284)** | (24,756) |
| Total shareholders' equity | **2,396,214** | 2,242,815 |
| Total liabilities and equity | **$ 32,731,827** | $ 32,487,457 |

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

# Statements of Income

*(unaudited)*

| *(dollars in thousands)* | For the Three Months Ended September 30, 2018 | For the Three Months Ended September 30, 2017 | For the Nine Months Ended September 30, 2018 | For the Nine Months Ended September 30, 2017 |
|---|---|---|---|---|
| **Interest Income** | | | | |
| Investment securities and other | **$ 50,545** | $ 38,684 | **$ 142,842** | $ 109,046 |
| Loans | **211,843** | 183,686 | **595,143** | 525,030 |
| Total interest income | **262,388** | 222,370 | **737,985** | 634,076 |
| **Interest Expense** | **157,646** | 108,478 | **429,922** | 297,316 |
| Net interest income | **104,742** | 113,892 | **308,063** | 336,760 |
| Provision for (reversal of allowance for) loan losses | **1,544** | (668) | **2,806** | (143) |
| Net interest income after provision for loan losses | **103,198** | 114,560 | **305,257** | 336,903 |
| **Noninterest Income** | | | | |
| Loan fees | **2,228** | 2,196 | **6,201** | 6,432 |
| Building lease income | **807** | 809 | **2,484** | 2,736 |
| Gains (losses) on investments, net | **13** | — | **13** | (258) |
| Gains (losses) on debt extinguishment | **—** | (1,447) | **150** | (4,528) |
| Gains (losses) on other transactions | **468** | 178 | **1,862** | 1,015 |
| Insurance premium refund | **—** | — | **6,330** | — |
| Other noninterest income | **1,877** | 975 | **5,997** | 4,290 |
| Total noninterest income | **5,393** | 2,711 | **23,037** | 9,687 |
| **Noninterest Expenses** | | | | |
| Salaries and employee benefits | **15,516** | 14,366 | **47,631** | 43,558 |
| Occupancy and equipment | **5,786** | 5,481 | **16,899** | 16,479 |
| Insurance Fund premiums | **2,044** | 3,373 | **6,171** | 10,452 |
| Other operating expenses | **11,001** | 10,596 | **30,884** | 28,701 |
| Losses (gains) from other property owned | **16** | (8) | **75** | 30 |
| Total noninterest expenses | **34,363** | 33,808 | **101,660** | 99,220 |
| Net income | **$ 74,228** | $ 83,463 | **$ 226,634** | $ 247,370 |

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

# Statements of Comprehensive Income

*(unaudited)*

| *(dollars in thousands)* | For the Three Months Ended September 30, 2018 | For the Three Months Ended September 30, 2017 | For the Nine Months Ended September 30, 2018 | For the Nine Months Ended September 30, 2017 |
|---|---|---|---|---|
| **Net income** | **$ 74,228** | $ 83,463 | **$ 226,634** | $ 247,370 |
| Other comprehensive income: | | | | |
| Unrealized gains (losses) on investments | **(16,954)** | 1,901 | **(69,652)** | 2,730 |
| Change in value of cash flow hedges | **73** | 191 | **749** | 464 |
| Employee benefit plans adjustments | **125** | 92 | **375** | 277 |
| Other comprehensive income (Note 5) | **(16,756)** | 2,184 | **(68,528)** | 3,471 |
| Comprehensive income | **$ 57,472** | $ 85,647 | **$ 158,106** | $ 250,841 |

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

# Statements of Changes in Shareholders' Equity

*(unaudited)*

| *(dollars in thousands)* | Perpetual Preferred Stock | Capital Stock and Participation Certificates | Additional Paid-In-Capital | Retained Earnings Allocated | Retained Earnings Unallocated | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2016 | $ 49,250 | $ 301,905 | $ 58,883 | $ 559 | $ 1,817,004 | $ (2,353) | $ 2,225,248 |
| Comprehensive income | | | | | 247,370 | 3,471 | 250,841 |
| Capital stock/participation certificates issued/(retired), net | | 1,118 | | | | | 1,118 |
| Dividends paid on perpetual preferred stock | | | | | (841) | | (841) |
| Retained earnings retired | | | | (65) | | | (65) |
| Patronage distribution adjustment | | 2 | | | (191) | | (189) |
| Balance at September 30, 2017 | $ 49,250 | $ 303,025 | $ 58,883 | $ 494 | $ 2,063,342 | $ 1,118 | $ 2,476,112 |
| | | | | | | | |
| Balance at December 31, 2017 | $ 49,250 | $ 313,752 | $ 58,883 | $ 492 | $ 1,845,194 | $ (24,756) | $ 2,242,815 |
| **Comprehensive income** | | | | | **226,634** | **(68,528)** | **158,106** |
| **Capital stock/participation certificates issued/(retired), net** | | **(3,612)** | | | | | **(3,612)** |
| **Dividends paid on perpetual preferred stock** | | | | | **(1,191)** | | **(1,191)** |
| **Retained earnings retired** | | | | **(41)** | | | **(41)** |
| **Patronage distribution adjustment** | | | | | **137** | | **137** |
| **Balance at September 30, 2018** | **$ 49,250** | **$ 310,140** | **$ 58,883** | **$ 451** | **$ 2,070,774** | **$ (93,284)** | **$ 2,396,214** |

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

# Statements of Cash Flows

*(unaudited)*

| *(dollars in thousands)* | For the Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | **$ 226,634** | $ 247,370 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation on premises and equipment | **5,988** | 6,221 |
| Amortization of net deferred loan (fees) costs and premium amortization (discount accretion) | **1,188** | 977 |
| Premium amortization (discount accretion) on investment securities | **3,913** | 8,458 |
| (Premium amortization) discount accretion on bonds and notes | **68,303** | 43,153 |
| Provision for loan losses | **2,806** | (143) |
| (Gains) losses on other property owned, net | **45** | 31 |
| (Gains) losses on investments, net | **(13)** | 258 |
| (Gains) losses on debt extinguishment | **(150)** | 4,528 |
| (Gains) losses on other transactions | **(1,862)** | (1,015) |
| Net change in loans held for sale | **2,406** | 4,935 |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in accrued interest receivable | **(13,791)** | (9,593) |
| (Increase) decrease in accounts receivable | **23,004** | 12,117 |
| Increase (decrease) in accrued interest payable | **28,101** | 15,943 |
| Increase (decrease) in accounts payable | **(21,607)** | (15,860) |
| Change in other, net | **(4,422)** | (12,344) |
| Total adjustments | **93,909** | 57,666 |
| Net cash provided by (used in) operating activities | **320,543** | 305,036 |
| **Cash flows from investing activities:** | | |
| Investment securities purchased | **(1,830,217)** | (2,119,266) |
| Investment securities sold or matured | **1,914,277** | 2,142,045 |
| Net (increase) decrease in loans | **(660,265)** | (263,388) |
| (Increase) decrease in investments in other Farm Credit System institutions | **(785)** | (919) |
| Purchase of premises and equipment, net | **(3,829)** | (5,128) |
| Proceeds from sale of other property owned | **61** | 686 |
| Net cash provided by (used in) investing activities | **(580,758)** | (245,970) |
| **Cash flows from financing activities:** | | |
| Bonds and notes issued | **12,008,176** | 14,203,819 |
| Bonds and notes retired | **(11,674,810)** | (14,185,075) |
| Capital stock and participation certificates issued/retired, net | **(3,612)** | 1,118 |
| Cash distribution to shareholders | **(312,319)** | (252,847) |
| Dividends paid on perpetual preferred stock | **(1,191)** | (841) |
| Retained earnings retired | **(41)** | (65) |
| Net cash provided by (used in) financing activities | **16,203** | (233,891) |
| Net increase (decrease) in cash and cash equivalents | **(244,012)** | (174,825) |
| Cash and cash equivalents, beginning of period | **713,287** | 811,748 |
| Cash and cash equivalents, end of period | **$ 469,275** | $ 636,923 |
| | | |
| **Supplemental schedule of non-cash activities:** | | |
| Receipt of property in settlement of loans | **$ 414** | $ 43 |
| Change in unrealized gains (losses) on investments, net | **(69,652)** | 2,730 |
| Employee benefit plans adjustments | **(375)** | (277) |
| **Non-cash changes related to derivatives:** | | |
| Increase (decrease) in bonds and notes | **$ —** | $ (92) |
| Decrease (increase) in other assets | **—** | 92 |
| **Supplemental information:** | | |
| Interest paid | **$ 333,518** | $ 238,220 |

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

# Notes to the Financial Statements

*(unaudited)*

**Note 1 — Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements**

***Organization***

The accompanying financial statements include the accounts of AgFirst Farm Credit Bank (AgFirst or Bank). AgFirst and its related Agricultural Credit Associations (Associations or District Associations) are collectively referred to as the AgFirst District (District). A complete description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations of the Bank as of and for the year ended December 31, 2017 are contained in the 2017 Annual Report to Shareholders. These unaudited interim financial statements should be read in conjunction with the latest Annual Report to Shareholders.

***Basis of Presentation***

In the opinion of management, the accompanying financial statements contain all adjustments necessary for a fair statement of results for the periods presented. These adjustments are of a normal recurring nature, unless otherwise disclosed.

Certain amounts in the prior period's financial statements have been reclassified to conform to the current period presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The results of any interim period are not necessarily indicative of those to be expected for a full year.

***Significant Accounting Policies***

The Bank's accounting and reporting policies conform with U.S. generally accepted accounting principles (GAAP) and practices in the financial services industry. To prepare the financial statements in conformity with GAAP, management must make estimates based on assumptions about future economic and market conditions (for example, unemployment, market liquidity, real estate prices, etc.) that affect the reported amounts of assets and liabilities at the date of the financial statements, income and expenses during the reporting period, and the related disclosures. Although these estimates contemplate current conditions and expectations of change in the future, it is reasonably possible that actual conditions may be different than anticipated, which could materially affect results of operations and financial condition.

Management has made significant estimates in several areas, including loans and allowance for loan losses (Note 2, *Loans and Allowance for Loan Losses*), investment securities and other-than-temporary impairment (Note 3, *Investments*), and financial instruments (Note 6, *Fair Value Measurement*). Actual results could differ from those estimates.

For further details of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, from the latest Annual Report.

***Accounting Standards Updates (ASUs) Issued During the Period***

The following ASUs were issued by the Financial Accounting Standards Board (FASB) since the most recent year end:

- In October 2018, the FASB issued ASU 2018-16—Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes. The amendments in this Update permit use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815 in addition to the UST, the LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate, and the SIFMA Municipal Swap Rate. For public business entities that already have adopted the amendments in Update 2017-12, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.

Early adoption is permitted in any interim period upon issuance of this Update if an entity already has adopted Update 2017-12. The amendments should be adopted on a prospective basis.

- In August 2018, the FASB issued ASU 2018-15 Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption.

- In August 2018, the FASB issued ASU 2018-14 Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans. The amendments in this Update remove disclosures that are no longer considered cost beneficial, clarify the specific requirements of certain disclosures, and add new disclosure requirements identified as relevant. Although narrow in scope, the amendments are considered an important part of the FASB's efforts to improve the effectiveness of disclosures in the notes to financial statements by applying concepts in the Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements. The amendments are effective for public business entities for fiscal years ending after December 15, 2020. Early adoption is permitted.

- In August 2018, the FASB issued ASU 2018-13 Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. The amendments are part of the FASB's disclosure framework project. The project's objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity's financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Entities may early adopt the provisions in whole upon issuance or may early adopt any removed or modified disclosures upon issuance and delay adoption of the additional disclosures until their effective date.

- In July 2018, the FASB issued ASU 2018-11 Leases (Topic 842): Targeted Improvements. The amendments are intended to reduce costs and ease implementation of the leases standard for financial statement preparers. It addresses certain areas identified as possible sources of unnecessary cost or complexity in the standard. Specifically, the amendments provide an option to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements and a practical expedient that permits lessors to not separate nonlease components from the associated lease component if certain conditions are met. For entities that have not adopted Topic 842 before the issuance of this Update, the effective date and transition requirements for the amendments related to separating components of a contract are the same as the effective date and transition requirements in ASU 2016-02.

- In July 2018, the FASB issued ASU 2018-10 Codification Improvements to Topic 842, Leases. The amendments affect narrow aspects of the guidance issued in ASU 2016-02. Specifically, the Update corrects, clarifies or changes inconsistent language to improve application of the guidance in ASU 2016-02. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in ASU 2016-02.

- In July 2018, the FASB issued ASU 2018-09 Codification Improvements. The amendments affect a wide variety of Topics in the Codification. They apply to all reporting entities within the scope of the affected accounting guidance. The Board has an ongoing project on its agenda about improvements to clarify the Codification or to correct unintended application of guidance. Those items generally are not expected to have a significant effect on current accounting practice. The transition and effective date guidance is based on the facts and circumstances of each amendment.

- In February 2018, the FASB issued ASU 2018-03 Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this Update include items brought to the Board's attention by stakeholders. The amendments clarify certain aspects of the guidance issued in ASU 2016-01. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted ASU 2016-01.

- In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted.

***ASUs Pending Effective Date***
For a detailed description of the ASUs below, see the latest Annual Report.

Potential effects of ASUs issued in previous periods:

- In August 2017, the FASB issued ASU 2017-12 Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The Update is intended to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Bank is in the process of evaluating the guidance and what effects it may have on the statements of financial condition and results of operations.

- In March 2017, the FASB issued ASU 2017-08 Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update will be effective for interim and annual periods beginning after December 15, 2018 for public business entities. Early adoption is permitted. The Bank is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

- In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Bank is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

- In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This Update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Early adoption is permitted. The Bank is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

***Accounting Standards Effective During the Period***

There were no changes in the accounting principles applied from the latest Annual Report, other than any discussed below.

No recently adopted accounting guidance issued by the FASB had a significant effect on the current period reporting. See the most recent Annual Report for a detailed description of each of the standards below:

- In March 2017, the FASB issued ASU 2017-07 Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost related to the income statement presentation of the components of net periodic benefit cost for an entity’s sponsored defined benefit pension and other postretirement plans. The amendments were effective January 1, 2018 for the Bank. Adoption in 2018 did not have a material effect on the Bank’s financial statements, but did require reclassification of certain periodic pension costs to Other Operating Expenses.

- In February 2017, the FASB issued ASU 2017-05 Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The Update clarifies whether certain transactions are within the scope of the guidance on derecognition and the accounting for partial sales of nonfinancial assets, and defines the term in substance nonfinancial asset. The amendments conform the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. The amendments were effective January 1, 2018 for the Bank. Adoption in 2018 had no impact on the statements of financial condition and results of operations of the Bank.

- In January 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also support more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The ASU was effective January 1, 2018 for the Bank. The amendments were applied prospectively. Adoption of the guidance in 2018 had no impact on the statements of financial condition and results of operations.

- In January 2016, the FASB issued ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The Update was intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP.

  Transition Information

  - The Bank identified investment securities affected by this Update and adopted the guidance on January 1, 2018.
  - The amendments related to equity securities without readily determinable fair values were applied prospectively to equity investments that existed as of the date of adoption.
  - Application of the amendments did not require a cumulative effect adjustment.
  - Adoption did not have an impact on the Bank's financial condition or results of operations.
  - The new standard did result in changes to certain disclosures.

- In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance changed the recognition of revenue from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance also included expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Based on input received from stakeholders, the FASB issued several additional Updates that generally provided clarifying guidance where there was the potential for diversity in practice, or address the cost and complexity of applying Topic 606.

  Transition Information

  - The Bank identified ancillary revenues affected by this Update and adopted the guidance on January 1, 2018.
  - The amendments were applied using the modified retrospective approach.
  - The Bank elected to only apply the guidance to contracts that were not completed at the date of initial application.
  - Subtopics 610-20 on gains and losses from the derecognition of nonfinancial assets, and 340-40 on other assets and deferred costs-contracts with customers were adopted using the same transition options.
  - Adoption did not have an impact on the Bank's financial condition or results of operations.
  - The new standard did result in enhanced disclosures about revenue (see Note 9, *Revenue from Contracts with Customers*).

**Note 2 — Loans and Allowance for Loan Losses**

The Bank maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Bank has been identified. See Note 3, *Loans and Allowance for Loan Losses*, from the latest Annual Report for further discussion.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. The Bank manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Bank sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

A summary of loans outstanding at period end follows:

| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Direct notes | $ 16,411,951 | $ 15,838,709 |
| Real estate mortgage | 1,106,754 | 1,096,159 |
| Production and intermediate-term | 958,590 | 1,123,633 |
| Loans to cooperatives | 481,238 | 527,654 |
| Processing and marketing | 909,124 | 763,024 |
| Farm-related business | 61,633 | 71,471 |
| Communication | 265,724 | 226,371 |
| Power and water/waste disposal | 537,836 | 556,165 |
| Rural residential real estate | 3,055,196 | 2,956,332 |
| International | 79,556 | 52,637 |
| Lease receivables | – | 6,752 |
| Loans to other financing institutions (OFIs) | 138,693 | 131,572 |
| Other (including Mission Related) | 8,155 | 8,681 |
| Total loans | $ 24,014,450 | $ 23,359,160 |

A substantial portion of the Bank's loan portfolio consists of notes receivable from District Associations (Direct Notes). These notes are used by the Associations to fund their loan portfolios, which collateralize the notes. Therefore, the Bank's concentration of credit risk in various agricultural commodities associated with these notes approximates that of the District as a whole. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. A substantial portion of the Associations' lending activities is collateralized, and their exposure to credit loss associated with lending activities is reduced accordingly. The risk funds of an Association, including both capital and the allowance for loan losses, also protect the interest of the Bank.

The Bank may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. During 2018, the Bank purchased $423.0 million of residential mortgage loans from various System associations and sold $86.4 million from the portfolio. These amounts are not included in the table below. The following tables present the principal balance of participation loans at periods ended:

| | September 30, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within AgFirst District | | Within Farm Credit System | | Outside Farm Credit System | | Total | |
| *(dollars in thousands)* | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Direct notes | $ – | $ – | $ – | $ 1,038,858 | $ – | $ – | $ – | $ 1,038,858 |
| Real estate mortgage | 761,923 | 198,926 | 435,244 | 41,090 | – | – | 1,197,167 | 240,016 |
| Production and intermediate-term | 527,926 | 238,346 | 652,430 | 120,122 | 139,194 | – | 1,319,550 | 358,468 |
| Loans to cooperatives | – | 59,840 | 540,968 | – | – | – | 540,968 | 59,840 |
| Processing and marketing | 293,952 | 364,669 | 324,997 | 310,333 | 966,609 | – | 1,585,558 | 675,002 |
| Farm-related business | 43,433 | 4,501 | – | – | 22,807 | – | 66,240 | 4,501 |
| Communication | – | 114,327 | 380,292 | – | – | – | 380,292 | 114,327 |
| Power and water/waste disposal | – | 55,865 | 594,939 | – | – | – | 594,939 | 55,865 |
| Rural residential real estate | 148 | – | – | – | – | – | 148 | – |
| International | – | 37,436 | 117,109 | – | – | – | 117,109 | 37,436 |
| Other (including Mission Related) | 8,257 | – | – | – | – | – | 8,257 | – |
| Total | $ 1,635,639 | $ 1,073,910 | $ 3,045,979 | $ 1,510,403 | $ 1,128,610 | $ – | $ 5,810,228 | $ 2,584,313 |

| | December 31, 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within AgFirst District | | Within Farm Credit System | | Outside Farm Credit System | | Total | |
| *(dollars in thousands)* | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold | Participations Purchased | Participations Sold |
| Direct notes | $ – | $ – | $ – | $ 1,015,836 | $ – | $ – | $ – | $ 1,015,836 |
| Real estate mortgage | 740,241 | 99,921 | 354,871 | 45,621 | – | – | 1,095,112 | 145,542 |
| Production and intermediate-term | 747,486 | 323,438 | 689,174 | 200,016 | 222,698 | – | 1,659,358 | 523,454 |
| Loans to cooperatives | – | 62,825 | 591,369 | – | – | – | 591,369 | 62,825 |
| Processing and marketing | 277,271 | 335,175 | 302,906 | 316,193 | 836,019 | – | 1,416,196 | 651,368 |
| Farm-related business | 53,036 | 7,387 | – | – | 25,970 | – | 79,006 | 7,387 |
| Communication | – | 132,807 | 359,838 | – | – | – | 359,838 | 132,807 |
| Power and water/waste disposal | – | 54,654 | 594,342 | – | 18,026 | – | 612,368 | 54,654 |
| Rural residential real estate | 157 | – | – | – | – | – | 157 | – |
| International | – | 34,127 | 86,919 | – | – | – | 86,919 | 34,127 |
| Lease receivables | 6,752 | – | – | – | – | – | 6,752 | – |
| Other (including Mission Related) | 8,819 | – | – | – | – | – | 8,819 | – |
| Total | $ 1,833,762 | $ 1,050,334 | $ 2,979,419 | $ 1,577,666 | $ 1,102,713 | $ – | $ 5,915,894 | $ 2,628,000 |

A significant source of liquidity for the Bank is the repayments of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

| | September 30, 2018 | | | |
|---|---|---|---|---|
| *(dollars in thousands)* | Due Less Than 1 Year | Due 1 Through 5 Years | Due After 5 Years | Total |
| Direct notes | $ 646,756 | $ 2,887,955 | $ 12,877,240 | $ 16,411,951 |
| Real estate mortgage | 13,052 | 230,543 | 863,159 | 1,106,754 |
| Production and intermediate-term | 134,449 | 506,694 | 317,447 | 958,590 |
| Loans to cooperatives | 26,861 | 343,897 | 110,480 | 481,238 |
| Processing and marketing | 57,433 | 573,015 | 278,676 | 909,124 |
| Farm-related business | 8,357 | 33,820 | 19,456 | 61,633 |
| Communication | 18,241 | 176,323 | 71,160 | 265,724 |
| Power and water/waste disposal | 11,987 | 194,805 | 331,044 | 537,836 |
| Rural residential real estate | 90,173 | 12,412 | 2,952,611 | 3,055,196 |
| International | – | 57,579 | 21,977 | 79,556 |
| Loans to OFIs | 116,011 | 6,485 | 16,197 | 138,693 |
| Other (including Mission Related) | 89 | 2,391 | 5,675 | 8,155 |
| Total loans | $ 1,123,409 | $ 5,025,919 | $ 17,865,122 | $ 24,014,450 |
| Percentage | 4.68% | 20.93% | 74.39% | 100.00% |

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

The following table shows the recorded investment of loans, classified under the FCA Uniform Loan Classification System, as a percentage of the recorded investment of total loans by loan type as of:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| **Direct notes:** | | |
| Acceptable | 91.38% | 100.00% |
| OAEM | 8.62 | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |
| **Real estate mortgage:** | | |
| Acceptable | 97.83% | 97.62% |
| OAEM | 1.27 | 0.28 |
| Substandard/doubtful/loss | 0.90 | 2.10 |
| | 100.00% | 100.00% |
| **Production and intermediate-term:** | | |
| Acceptable | 97.85% | 96.17% |
| OAEM | 1.45 | 2.86 |
| Substandard/doubtful/loss | 0.70 | 0.97 |
| | 100.00% | 100.00% |
| **Loans to cooperatives:** | | |
| Acceptable | 98.30% | 98.43% |
| OAEM | – | – |
| Substandard/doubtful/loss | 1.70 | 1.57 |
| | 100.00% | 100.00% |
| **Processing and marketing:** | | |
| Acceptable | 100.00% | 100.00% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |
| **Farm-related business:** | | |
| Acceptable | 100.00% | 86.12% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | 13.88 |
| | 100.00% | 100.00% |
| **Communication:** | | |
| Acceptable | 95.61% | 100.00% |
| OAEM | 4.39 | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| **Power and water/waste disposal:** | | |
| Acceptable | 100.00% | 100.00% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |
| **Rural residential real estate:** | | |
| Acceptable | 99.74% | 99.78% |
| OAEM | – | – |
| Substandard/doubtful/loss | 0.26 | 0.22 |
| | 100.00% | 100.00% |
| **International:** | | |
| Acceptable | 100.00% | 100.00% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |
| **Lease receivables:** | | |
| Acceptable | –% | 100.00% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | – |
| | –% | 100.00% |
| **Loans to OFIs:** | | |
| Acceptable | 100.00% | 100.00% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |
| **Other (including Mission Related):** | | |
| Acceptable | 100.00% | 100.00% |
| OAEM | – | – |
| Substandard/doubtful/loss | – | – |
| | 100.00% | 100.00% |
| **Total loans:** | | |
| Acceptable | 93.80% | 99.60% |
| OAEM | 6.06 | 0.15 |
| Substandard/doubtful/loss | 0.14 | 0.25 |
| | 100.00% | 100.00% |

The following tables provide an aging analysis of the recorded investment in past due loans as of:

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | **30 Through 89 Days Past Due** | **90 Days or More Past Due** | **Total Past Due** | **Not Past Due or Less Than 30 Days Past Due** | **Total Loans** |
| Direct notes | $ – | $ – | $ – | $ 16,455,715 | $ 16,455,715 |
| Real estate mortgage | – | 3,375 | 3,375 | 1,110,295 | 1,113,670 |
| Production and intermediate-term | 2 | 376 | 378 | 963,454 | 963,832 |
| Loans to cooperatives | – | – | – | 482,180 | 482,180 |
| Processing and marketing | – | – | – | 911,887 | 911,887 |
| Farm-related business | – | – | – | 61,919 | 61,919 |
| Communication | – | – | – | 265,861 | 265,861 |
| Power and water/waste disposal | – | – | – | 541,226 | 541,226 |
| Rural residential real estate | 7,512 | 5,527 | 13,039 | 3,050,200 | 3,063,239 |
| International | – | – | – | 79,853 | 79,853 |
| Loans to OFIs | – | – | – | 139,018 | 139,018 |
| Other (including Mission Related) | – | – | – | 8,292 | 8,292 |
| Total | $ 7,514 | $ 9,278 | $ 16,792 | $ 24,069,900 | $ 24,086,692 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | 30 Through 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Not Past Due or Less Than 30 Days Past Due | Total Loans |
| Direct notes | $ – | $ – | $ – | $ 15,877,300 | $ 15,877,300 |
| Real estate mortgage | 1,701 | 3,438 | 5,139 | 1,097,541 | 1,102,680 |
| Production and intermediate-term | 1,481 | 714 | 2,195 | 1,125,718 | 1,127,913 |
| Loans to cooperatives | – | – | – | 528,662 | 528,662 |
| Processing and marketing | – | – | – | 765,412 | 765,412 |
| Farm-related business | – | – | – | 71,735 | 71,735 |
| Communication | – | – | – | 226,553 | 226,553 |
| Power and water/waste disposal | – | – | – | 558,562 | 558,562 |
| Rural residential real estate | 50,249 | 4,807 | 55,056 | 2,908,490 | 2,963,546 |
| International | – | – | – | 52,815 | 52,815 |
| Lease receivables | – | – | – | 6,766 | 6,766 |
| Loans to OFIs | – | – | – | 131,818 | 131,818 |
| Other (including Mission Related) | – | – | – | 8,785 | 8,785 |
| Total | $ 53,431 | $ 8,959 | $ 62,390 | $ 23,360,157 | $ 23,422,547 |

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

| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 |
|---|---|---|
| **Nonaccrual loans:** | | |
| Real estate mortgage | $ 4,262 | $ 7,761 |
| Production and intermediate-term | 466 | 2,364 |
| Loans to cooperatives | 8,208 | – |
| Rural residential real estate | 13,772 | 11,178 |
| Total | $ 26,708 | $ 21,303 |
| **Accruing restructured loans:** | | |
| Real estate mortgage | $ 648 | $ 1,042 |
| Production and intermediate-term | 8,062 | 8,768 |
| Rural residential real estate | 2,953 | 1,866 |
| Other (including Mission Related) | 4,203 | 4,302 |
| Total | $ 15,866 | $ 15,978 |
| **Accruing loans 90 days or more past due:** | | |
| Total | $ – | $ – |
| Total nonperforming loans | $ 42,574 | $ 37,281 |
| Other property owned | 463 | 154 |
| Total nonperforming assets | $ 43,037 | $ 37,435 |
| Nonaccrual loans as a percentage of total loans | 0.11% | 0.09% |
| Nonperforming assets as a percentage of total loans and other property owned | 0.18% | 0.16% |
| Nonperforming assets as a percentage of capital | 1.80% | 1.67% |

The following table presents information related to the recorded investment of impaired loans at period end. Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan.

| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 |
|---|---|---|
| **Impaired nonaccrual loans**: | | |
| Current as to principal and interest | $ 16,484 | $ 6,709 |
| Past due | 10,224 | 14,594 |
| Total | $ 26,708 | $ 21,303 |
| **Impaired accrual loans:** | | |
| Restructured | $ 15,866 | $ 15,978 |
| 90 days or more past due | – | – |
| Total | $ 15,866 | $ 15,978 |
| Total impaired loans | $ 42,574 | $ 37,281 |
| Additional commitments to lend | $ 1,108 | $ – |

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

| *(dollars in thousands)* | September 30, 2018 | | | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2018 | |
|---|---|---|---|---|---|---|---|
| **Impaired Loans** | **Recorded Investment** | **Unpaid Principal Balance** | **Related Allowance** | **Average Impaired Loans** | **Interest Income Recognized on Impaired Loans** | **Average Impaired Loans** | **Interest Income Recognized on Impaired Loans** |
| **With a related allowance for credit losses:** | | | | | | | |
| Real estate mortgage | $ – | $ – | $ – | $ – | $ – | $ 11 | $ – |
| Production and intermediate-term | – | – | – | – | – | 56 | – |
| Loans to cooperatives | 8,208 | 8,478 | 3,638 | 8,080 | 47 | 7,892 | 45 |
| Rural residential real estate | 3,177 | 3,127 | 437 | 3,128 | – | 1,365 | – |
| Other (including Mission Related) | 4,203 | 4,139 | 135 | 4,140 | 64 | 4,200 | 195 |
| Total | $ 15,588 | $ 15,744 | $ 4,210 | $ 15,348 | $ 111 | $ 13,524 | $ 240 |
| **With no related allowance for credit losses:** | | | | | | | |
| Real estate mortgage | $ 4,910 | $ 5,900 | $ – | $ 7,374 | $ 2,538 | $ 7,117 | $ 2,601 |
| Production and intermediate-term | 8,528 | 16,990 | – | 8,496 | 156 | 8,115 | 635 |
| Loans to cooperatives | – | – | – | – | – | – | – |
| Rural residential real estate | 13,548 | 13,049 | – | 12,789 | 164 | 13,341 | 493 |
| Other (including Mission Related) | – | – | – | – | – | – | – |
| Total | $ 26,986 | $ 35,939 | $ – | $ 28,659 | $ 2,858 | $ 28,573 | $ 3,729 |
| **Total:** | | | | | | | |
| Real estate mortgage | $ 4,910 | $ 5,900 | $ – | $ 7,374 | $ 2,538 | $ 7,128 | $ 2,601 |
| Production and intermediate-term | 8,528 | 16,990 | – | 8,496 | 156 | 8,171 | 635 |
| Loans to cooperatives | 8,208 | 8,478 | 3,638 | 8,080 | 47 | 7,892 | 45 |
| Rural residential real estate | 16,725 | 16,176 | 437 | 15,917 | 164 | 14,706 | 493 |
| Other (including Mission Related) | 4,203 | 4,139 | 135 | 4,140 | 64 | 4,200 | 195 |
| Total | $ 42,574 | $ 51,683 | $ 4,210 | $ 44,007 | $ 2,969 | $ 42,097 | $ 3,969 |

| *(dollars in thousands)* | December 31, 2017 | | | Year Ended December 31, 2017 | |
|---|---|---|---|---|---|
| **Impaired Loans** | **Recorded Investment** | **Unpaid Principal Balance** | **Related Allowance** | **Average Impaired Loans** | **Interest Income Recognized on Impaired Loans** |
| **With a related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 182 | $ 182 | $ 25 | $ 126 | $ – |
| Production and intermediate-term | 169 | 169 | 33 | 148 | – |
| Rural residential real estate | 2,820 | 2,820 | 495 | 57 | – |
| Other (including Mission Related) | 4,302 | 4,290 | 153 | 4,330 | 267 |
| Total | $ 7,473 | $ 7,461 | $ 706 | $ 4,661 | $ 267 |
| **With no related allowance for credit losses:** | | | | | |
| Real estate mortgage | $ 8,621 | $ 12,045 | $ – | $ 8,902 | $ 297 |
| Production and intermediate-term | 10,963 | 19,358 | – | 13,236 | 1,964 |
| Rural residential real estate | 10,224 | 10,057 | – | 9,454 | 396 |
| Other (including Mission Related) | – | – | – | – | – |
| Total | $ 29,808 | $ 41,460 | $ – | $ 31,592 | $ 2,657 |
| **Total:** | | | | | |
| Real estate mortgage | $ 8,803 | $ 12,227 | $ 25 | $ 9,028 | $ 297 |
| Production and intermediate-term | 11,132 | 19,527 | 33 | 13,384 | 1,964 |
| Rural residential real estate | 13,044 | 12,877 | 495 | 9,511 | 396 |
| Other (including Mission Related) | 4,302 | 4,290 | 153 | 4,330 | 267 |
| Total | $ 37,281 | $ 48,921 | $ 706 | $ 36,253 | $ 2,924 |

A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows:

| *(dollars in thousands)* | Direct Note | Real Estate Mortgage | Production and Intermediate-term | Agribusiness* | Communication | Power and Water/Waste Disposal | Rural Residential Real Estate | International | Other** | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **Activity related to the allowance for credit losses:** | | | | | | | | | | |
| Balance at June 30, 2018 | $ – | $ 1,561 | $ 2,125 | $ 5,384 | $ 830 | $ 1,090 | $ 4,174 | $ 40 | $ 465 | $ 15,669 |
| Charge-offs | – | – | – | – | – | – | (36) | – | – | (36) |
| Recoveries | – | – | – | – | – | – | – | – | – | – |
| Provision for loan losses | – | 38 | 199 | 1,102 | 56 | (92) | 180 | 94 | (33) | 1,544 |
| Balance at September 30, 2018 | $ – | $ 1,599 | $ 2,324 | $ 6,486 | $ 886 | $ 998 | $ 4,318 | $ 134 | $ 432 | $ 17,177 |
| | | | | | | | | | | |
| Balance at December 31, 2017 | $ – | $ 1,635 | $ 3,040 | $ 3,633 | $ 744 | $ 1,128 | $ 3,908 | $ 28 | $ 265 | $ 14,381 |
| Charge-offs | – | – | (50) | – | – | – | (125) | – | – | (175) |
| Recoveries | – | – | 145 | 14 | – | – | 6 | – | – | 165 |
| Provision for loan losses | – | (36) | (811) | 2,839 | 142 | (130) | 529 | 106 | 167 | 2,806 |
| Balance at September 30, 2018 | $ – | $ 1,599 | $ 2,324 | $ 6,486 | $ 886 | $ 998 | $ 4,318 | $ 134 | $ 432 | $ 17,177 |
| | | | | | | | | | | |
| Balance at June 30, 2017 | $ – | $ 2,266 | $ 3,482 | $ 3,753 | $ 794 | $ 1,778 | $ 3,039 | $ 41 | $ 242 | $ 15,395 |
| Charge-offs | – | – | – | – | – | – | (5) | – | – | (5) |
| Recoveries | – | 1 | 27 | – | – | – | – | – | – | 28 |
| Provision for loan losses | – | (250) | (362) | (166) | (34) | (92) | 232 | – | 4 | (668) |
| Balance at September 30, 2017 | $ – | $ 2,017 | $ 3,147 | $ 3,587 | $ 760 | $ 1,686 | $ 3,266 | $ 41 | $ 246 | $ 14,750 |
| | | | | | | | | | | |
| Balance at December 31, 2016 | $ – | $ 2,569 | $ 3,039 | $ 3,287 | $ 899 | $ 1,997 | $ 2,688 | $ 58 | $ 246 | $ 14,783 |
| Charge-offs | – | – | – | – | – | – | (89) | – | – | (89) |
| Recoveries | – | 35 | 164 | – | – | – | – | – | – | 199 |
| Provision for loan losses | – | (554) | (89) | 300 | (139) | (311) | 667 | (17) | – | (143) |
| Loan type reclassification | – | (33) | 33 | – | – | – | – | – | – | – |
| Balance at September 30, 2017 | $ – | $ 2,017 | $ 3,147 | $ 3,587 | $ 760 | $ 1,686 | $ 3,266 | $ 41 | $ 246 | $ 14,750 |
| | | | | | | | | | | |
| **Allowance on loans evaluated for impairment:** | | | | | | | | | | |
| Individually | $ – | $ – | $ – | $ 3,638 | $ – | $ – | $ 437 | $ – | $ 135 | $ 4,210 |
| Collectively | – | 1,599 | 2,324 | 2,848 | 886 | 998 | 3,881 | 134 | 297 | 12,967 |
| Balance at September 30, 2018 | $ – | $ 1,599 | $ 2,324 | $ 6,486 | $ 886 | $ 998 | $ 4,318 | $ 134 | $ 432 | $ 17,177 |
| | | | | | | | | | | |
| Individually | $ – | $ 25 | $ 33 | $ – | $ – | $ – | $ 495 | $ – | $ 153 | $ 706 |
| Collectively | – | 1,610 | 3,007 | 3,633 | 744 | 1,128 | 3,413 | 28 | 112 | 13,675 |
| Balance at December 31, 2017 | $ – | $ 1,635 | $ 3,040 | $ 3,633 | $ 744 | $ 1,128 | $ 3,908 | $ 28 | $ 265 | $ 14,381 |
| | | | | | | | | | | |
| **Recorded investment in loans evaluated for impairment:** | | | | | | | | | | |
| Individually | $ 16,455,715 | $ 158,077 | $ 8,528 | $ 8,208 | $ – | $ – | $ 1,318,495 | $ – | $ 4,203 | $ 17,953,226 |
| Collectively | – | 955,593 | 955,304 | 1,447,778 | 265,861 | 541,226 | 1,744,744 | 79,853 | 143,107 | 6,133,466 |
| Balance at September 30, 2018 | $ 16,455,715 | $ 1,113,670 | $ 963,832 | $ 1,455,986 | $ 265,861 | $ 541,226 | $ 3,063,239 | $ 79,853 | $ 147,310 | $ 24,086,692 |
| | | | | | | | | | | |
| Individually | $ 15,877,300 | $ 149,853 | $ 13,102 | $ – | $ – | $ – | $ 1,422,934 | $ – | $ 4,302 | $ 17,467,491 |
| Collectively | – | 952,827 | 1,114,811 | 1,365,809 | 226,553 | 558,562 | 1,540,612 | 52,815 | 143,067 | 5,955,056 |
| Balance at December 31, 2017 | $ 15,877,300 | $ 1,102,680 | $ 1,127,913 | $ 1,365,809 | $ 226,553 | $ 558,562 | $ 2,963,546 | $ 52,815 | $ 147,369 | $ 23,422,547 |

**Includes the loan types: Loans to Cooperatives, Processing and Marketing, and Farm-related Business.*
***Includes the loan types: Mission Related Loans, Loans to OFIs, and Lease Receivables.*

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented. The tables do not include any purchased credit impaired loans.

| *(dollars in thousands)* | Three Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| **Outstanding Recorded Investment** | **Interest Concessions** | **Principal Concessions** | **Other Concessions** | **Total** | **Charge-offs** |
| **Pre-modification** | | | | | |
| Rural residential real estate | $ – | $ 158 | $ – | $ 158 | |
| Total | $ – | $ 158 | $ – | $ 158 | |
| **Post-modification** | | | | | |
| Rural residential real estate | $ – | $ 165 | $ – | $ 165 | $ – |
| Total | $ – | $ 165 | $ – | $ 165 | $ – |

| *(dollars in thousands)* | Nine Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| **Outstanding Recorded Investment** | **Interest Concessions** | **Principal Concessions** | **Other Concessions** | **Total** | **Charge-offs** |
| **Pre-modification** | | | | | |
| Real estate mortgage | $ 69 | $ 5,953 | $ – | $ 6,022 | |
| Production and intermediate-term | – | 169 | – | 169 | |
| Loans to cooperatives | – | 3,229 | – | 3,229 | |
| Rural residential real estate | 232 | 998 | – | 1,230 | |
| Total | $ 301 | $ 10,349 | $ – | $ 10,650 | |
| **Post-modification** | | | | | |
| Real estate mortgage | $ 69 | $ 5,836 | $ – | $ 5,905 | $ – |
| Production and intermediate-term | – | 95 | – | 95 | (49) |
| Loans to cooperatives | – | 3,229 | – | 3,229 | – |
| Rural residential real estate | 240 | 1,026 | – | 1,266 | – |
| Total | $ 309 | $ 10,186 | $ – | $ 10,495 | $ (49) |

| *(dollars in thousands)* | Three months ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| **Outstanding Recorded Investment** | **Interest Concessions** | **Principal Concessions** | **Other Concessions** | **Total** | **Charge-offs** |
| **Pre-modification** | | | | | |
| Rural residential real estate | $ 155 | $ – | $ | $ 155 | |
| Total | $ 155 | $ – | $ | $ 155 | |
| **Post-modification** | | | | | |
| Rural residential real estate | $ 166 | $ – | $ | $ 166 | $ – |
| Total | $ 166 | $ – | $ | $ 166 | $ – |

| *(dollars in thousands)* | Nine months ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| **Outstanding Recorded Investment** | **Interest Concessions** | **Principal Concessions** | **Other Concessions** | **Total** | **Charge-offs** |
| **Pre-modification** | | | | | |
| Rural residential real estate | $ 349 | $ 132 | $ – | $ 481 | |
| Total | $ 349 | $ 132 | $ – | $ 481 | |
| **Post-modification** | | | | | |
| Rural residential real estate | $ 394 | $ 135 | $ – | $ 529 | $ – |
| Total | $ 394 | $ 135 | $ – | $ 529 | $ – |

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

The following table presents outstanding recorded investment for TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the period. Payment default is defined as a payment that was thirty days or more past due.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(dollars in thousands)* | **2018** | **2017** | **2018** | **2017** |
| **Defaulted troubled debt restructurings:** | | | | |
| Rural residential real estate | $ 162 | $ 169 | $ 445 | $ 397 |
| Total | $ 162 | $ 169 | $ 445 | $ 397 |

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

| | Total TDRs | | Nonaccrual TDRs | |
|---|---|---|---|---|
| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 | September 30, 2018 | December 31, 2017 |
| Real estate mortgage | $ 3,495 | $ 7,363 | $ 2,847 | $ 6,321 |
| Production and intermediate-term | 8,665 | 9,606 | 603 | 838 |
| Loans to cooperatives | 3,461 | – | 3,461 | – |
| Rural residential real estate | 4,966 | 3,757 | 2,013 | 1,891 |
| Other (including Mission Related) | 4,203 | 4,302 | – | – |
| Total | $ 24,790 | $ 25,028 | $ 8,924 | $ 9,050 |
| Additional commitments to lend | $ – | $ – | | |

The following table presents foreclosure information as of period end:

| *(dollars in thousands)* | September 30, 2018 |
|---|---|
| Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession | $ 463 |
| Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process | $ 752 |

## Note 3 — Investments

***Equity Investments in Other Farm Credit System Institutions***

Equity investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. These investments are carried at cost and evaluated for impairment based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

***Investments in Debt Securities***

The Bank's investments in debt securities consist primarily of mortgage-backed securities (MBSs) collateralized by U.S. government or U.S. agency guaranteed residential and commercial mortgages (agency securities). They are held to maintain a liquidity reserve, manage short-term surplus funds, and manage interest rate risk. These securities meet the applicable FCA regulatory guidelines related to government agency guaranteed investments.

Included in the available-for-sale investments in debt securities are non-agency asset-backed securities (ABSs) which must meet the applicable FCA regulatory guidelines that require them to be high quality, senior class, and rated in the top category (AAA/Aaa) by Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. To achieve these ratings, the securities may have a guarantee of timely payment of principal and interest, credit enhancements achieved through over-collateralization or other means, priority of payments for senior classes over junior classes, or bond insurance. All of the non-agency securities owned have one or more credit enhancement features.

The FCA considers a non-agency security ineligible if it falls below AAA/Aaa credit rating criteria and requires Farm Credit System (System) institutions to provide notification to the FCA when a security becomes ineligible. At September 30, 2018, the Bank held no ineligible available-for-sale investments in debt securities.

Held-to-maturity investments in debt securities consist of Mission Related Investments (MRIs) acquired primarily under the Rural Housing Mortgage-Backed Securities (RHMS) and Rural America Bond (RAB) pilot programs. RHMS must be fully guaranteed by a government agency or government sponsored enterprise. RABs are private placement securities, which generally have some form of credit enhancement.

In its Conditions of Approval for the program, the FCA generally considers an RAB ineligible if its investment rating, based on the internal 14-point risk rating scale used to also grade loans, falls below 9. Any other bonds purchased under the MRI program, approved on a case-by-case basis by the FCA, may have different eligibility requirements. The FCA requires System institutions to provide notification when a security becomes ineligible. At

September 30, 2018, the Bank held one RAB totaling $277 thousand whose credit quality had deteriorated beyond the program limits.

Effective December 31, 2014, the FCA ended the pilot programs approved after 2004 as part of the Investment in Rural America initiative. Each institution participating in such programs may continue to hold its investment through the maturity dates for the investments, provided the institution continues to meet all approval conditions. The FCA can consider future participation in these programs on a case-by-case basis.

An agreement with a commercial bank requires AgFirst to maintain $50.0 million as a compensating balance. At September 30, 2018, the Bank held $41.9 million in U.S. Treasury securities for that purpose. The remainder of the compensating balance was held in cash in a demand deposit account. These securities are excluded when calculating the amount of eligible liquidity investments.

The Bank also holds certain equity investments in Money Market funds. These funds are accounted for as investment securities but are classified as Cash Equivalents in the Balance Sheet and Statement of Cash Flows.

During the first nine months of 2018, proceeds from sales of investments were $11.7 million and realized gains were $13 thousand. During the first nine months of 2017, proceeds from sales of investments were $77.2 million and realized losses were $258 thousand.

**Available-for-sale**

A summary of the amortized cost and fair value of debt securities held as available-for-sale investments at period end follows:

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Yield** |
| U.S. Govt. Treasury Securities | $ 390,082 | $ 1 | $ (966) | $ 389,117 | 2.10% |
| U.S. Govt. Guaranteed | 4,586,352 | 28,229 | (81,179) | 4,533,402 | 2.54 |
| U.S. Govt. Agency Guaranteed | 1,954,627 | 5,191 | (33,759) | 1,926,059 | 2.46 |
| Non-Agency ABSs | 716,474 | 80 | (7,274) | 709,280 | 2.05 |
| Total | $ 7,647,535 | $ 33,501 | $ (123,178) | $ 7,557,858 | 2.45% |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Yield** |
| U.S. Govt. Treasury Securities | $ 490,570 | $ 2 | $ (475) | $ 490,097 | 1.31% |
| U.S. Govt. Guaranteed | 4,536,232 | 35,601 | (36,620) | 4,535,213 | 2.06 |
| U.S. Govt. Agency Guaranteed | 2,022,077 | 6,618 | (21,852) | 2,006,843 | 1.90 |
| Non-Agency ABSs | 634,752 | 84 | (3,384) | 631,452 | 1.60 |
| Total | $ 7,683,631 | $ 42,305 | $ (62,331) | $ 7,663,605 | 1.93% |

**Held-to-maturity**

A summary of the amortized cost and fair value of debt securities held as held-to-maturity investments at period end follows:

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** | **Yield** |
| U.S. Govt. Agency Guaranteed | $ 362,541 | $ 4,631 | $ (16,753) | $ 350,419 | 3.04% |
| RABs and Other | 44,966 | 1,411 | (187) | 46,190 | 5.97 |
| Total | $ 407,507 | $ 6,042 | $ (16,940) | $ 396,609 | 3.36% |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Yield |
| U.S. Govt. Agency Guaranteed | $ 401,810 | $ 7,438 | $ (6,166) | $ 403,082 | 3.25% |
| RABs and Other | 56,813 | 3,628 | (183) | 60,258 | 6.68 |
| Total | $ 458,623 | $ 11,066 | $ (6,349) | $ 463,340 | 3.68% |

A summary of the contractual maturity, estimated fair value and amortized cost of investment securities at September 30, 2018 follows:

**Available-for-sale**

| | Due in 1 Year or Less | | Due After 1 Year Through 5 Years | | Due After 5 Years Through 10 Years | | Due After 10 Years | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(dollars in thousands)* | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield |
| U.S. Govt. Treasury Securities | $ 324,766 | 2.08% | $ 64,351 | 2.21 % | $ – | – % | $ – | – % | $ 389,117 | 2.10 % |
| U.S. Govt. Guaranteed | – | – | 10,902 | 2.69 | 180,530 | 2.95 | 4,341,970 | 2.52 | 4,533,402 | 2.54 |
| U.S. Govt. Agency Guaranteed | 52,773 | 2.17 | 147,957 | 2.57 | 208,201 | 2.43 | 1,517,128 | 2.46 | 1,926,059 | 2.46 |
| Non-Agency ABSs | 3,465 | 2.43 | 659,177 | 2.02 | 46,638 | 2.43 | – | – | 709,280 | 2.05 |
| Total fair value | $ 381,004 | 2.10% | $ 882,387 | 2.13 % | $ 435,369 | 2.65 % | $ 5,859,098 | 2.51 % | $ 7,557,858 | 2.45 % |
| Total amortized cost | $ 381,658 | | $ 889,388 | | $ 439,348 | | $ 5,937,141 | | $ 7,647,535 | |

**Held-to-maturity**

| | Due in 1 Year or Less | | Due After 1 Year Through 5 Years | | Due After 5 Years Through 10 Years | | Due After 10 Years | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(dollars in thousands)* | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield |
| U.S. Govt. Agency Guaranteed | $ 3 | 5.08 % | $ – | – % | $ – | – % | $ 362,538 | 3.04 % | $ 362,541 | 3.04 % |
| RABs and Other | 2,945 | 5.75 | 4,552 | 5.63 | 11,985 | 6.12 | 25,484 | 5.99 | 44,966 | 5.97 |
| Total amortized cost | $ 2,948 | 5.75 % | $ 4,552 | 5.63 % | $ 11,985 | 6.12 % | $ 388,022 | 3.23 % | $ 407,507 | 3.36 % |
| Total fair value | $ 2,949 | | $ 4,603 | | $ 12,462 | | $ 376,595 | | $ 396,609 | |

A substantial portion of these investments has contractual maturities in excess of ten years. However, expected maturities for these types of securities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

An investment is considered impaired if its fair value is less than its cost. This also applies to those securities other-than-temporarily impaired for which a credit loss has been recognized but noncredit-related losses continue to remain unrealized. The following tables show the fair value and gross unrealized losses for all investments that have been in a continuous unrealized loss position aggregated by investment category at each reporting period. A continuous unrealized loss position for an investment is measured from the date the impairment was first identified.

| | September 30, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or Greater | | Total | |
| *(dollars in thousands)* | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Govt. Treasury Securities | $ 312,401 | $ (752) | $ 27,285 | $ (214) | $ 339,686 | $ (966) |
| U.S. Govt. Guaranteed | 1,213,177 | (23,114) | 1,822,925 | (58,065) | 3,036,102 | (81,179) |
| U.S. Govt. Agency Guaranteed | 556,556 | (4,702) | 1,145,630 | (45,810) | 1,702,186 | (50,512) |
| Non-Agency ABSs | 404,582 | (4,116) | 260,679 | (3,158) | 665,261 | (7,274) |
| RABs and Other | 161 | (3) | 2,654 | (184) | 2,815 | (187) |
| Total | $ 2,486,877 | $ (32,687) | $ 3,259,173 | $ (107,431) | $ 5,746,050 | $ (140,118) |

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or Greater | | Total | |
| *(dollars in thousands)* | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Govt. Treasury Securities | $ 413,053 | $ (182) | $ 27,193 | $ (293) | $ 440,246 | $ (475) |
| U.S. Govt. Guaranteed | 1,356,044 | (14,059) | 1,415,892 | (22,561) | 2,771,936 | (36,620) |
| U.S. Govt. Agency Guaranteed | 334,739 | (1,454) | 1,380,697 | (26,564) | 1,715,436 | (28,018) |
| Non-Agency ABSs | 438,392 | (2,569) | 162,935 | (815) | 601,327 | (3,384) |
| RABs and Other | 341 | – | 3,450 | (183) | 3,791 | (183) |
| Total | $ 2,542,569 | $ (18,264) | $ 2,990,167 | $ (50,416) | $ 5,532,736 | $ (68,680) |

The recording of an impairment is predicated on: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, and (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the Bank intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss recognized equals the full difference between amortized cost and fair value of the security. When the Bank does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment loss is separated into credit loss and noncredit loss. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

The Bank performs periodic credit reviews, including other-than-temporary impairment (OTTI) analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the creditworthiness of bond insurers, and (7) volatility of the fair value changes.

The Bank uses the present value of cash flows expected to be collected from each debt security to determine the amount of credit loss. This technique requires assumptions related to the underlying collateral, including default rates, amount and timing of prepayments, and loss severity. Assumptions can vary widely from security to security and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics, and collateral type.

Significant inputs used to estimate the amount of credit loss include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan-to-collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings. The Bank obtains assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party.

Based on the credit reviews discussed above, none of the securities currently in the Bank's portfolio were determined to be other-than-temporarily impaired.

For the nine months ended September 30, 2018, net unrealized losses of $69.7 million were recognized in OCI on available-for-sale investments in debt securities that are not other-than-temporarily impaired.

The Bank has not recognized any credit losses as the impairments are deemed temporary and result from non-credit related factors. The Bank has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities. Substantially all of these investments were in U.S. government agency securities and the Bank expects these securities would not be settled at a price less than their amortized cost.

The following table summarizes gains (losses) for the period related to equity securities:

| (dollars in thousands) | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|
| **Net gains (losses) on equity securities** | | |
| Net gains (losses) recognized | $ 1,480 | $ 53 |
| Less realized net gains (losses) | 1,260 | 18 |
| Unrealized gains (losses) | $ 220 | $ 35 |

## Note 4 — Debt

### *Bonds and Notes*

AgFirst, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued jointly by the System banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide Debt Securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any assets of the banks.

In accordance with FCA regulations, each issuance of Systemwide Debt Securities ranks equally with other unsecured Systemwide Debt Securities. Systemwide Debt Securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide Debt Securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The following table provides a summary of AgFirst's participation in outstanding Systemwide Debt Securities by maturity. Weighted average interest rates include the effect of related derivative financial instruments.

| (dollars in thousands) | September 30, 2018 Bonds | | Discount Notes | | Total | |
|---|---|---|---|---|---|---|
| Maturities | Amortized Cost | Weighted Average Interest Rate | Amortized Cost | Weighted Average Interest Rate | Amortized Cost | Weighted Average Interest Rate |
| One year or less | $ 6,605,303 | 1.70% | $ 4,793,820 | 2.20% | $ 11,399,123 | 1.91% |
| Greater than one year to two years | 6,005,631 | 1.92 | – | – | 6,005,631 | 1.92 |
| Greater than two years to three years | 3,540,135 | 2.01 | – | – | 3,540,135 | 2.01 |
| Greater than three years to four years | 2,256,880 | 2.16 | – | – | 2,256,880 | 2.16 |
| Greater than four years to five years | 1,631,245 | 2.30 | – | – | 1,631,245 | 2.30 |
| Greater than five years | 5,331,496 | 2.83 | – | – | 5,331,496 | 2.83 |
| Total | $ 25,370,690 | 2.11% | $ 4,793,820 | 2.20% | $ 30,164,510 | 2.13% |

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at September 30, 2018 was 154 days.

## Note 5 — Shareholders' Equity

### *Perpetual Preferred Stock*

Payment of dividends or redemption price on issued Preferred Stock may be restricted if the Bank fails to satisfy applicable minimum capital adequacy, surplus, and collateral requirements.

***Accumulated Other Comprehensive Income***

The following presents activity related to AOCI for the periods presented below:

**Changes in Accumulated Other Comprehensive Income by Component** *(a)*

| *(dollars in thousands)* | For the Three Months Ended September 30, 2018 | For the Three Months Ended September 30, 2017 | For the Nine Months Ended September 30, 2018 | For the Nine Months Ended September 30, 2017 |
|---|---|---|---|---|
| **Investment Securities:** | | | | |
| Balance at beginning of period | $ (72,724) | $ 3,390 | $ (20,026) | $ 2,561 |
| Other comprehensive income before reclassifications | (16,941) | 1,901 | (69,639) | 2,472 |
| Amounts reclassified from AOCI | (13) | – | (13) | 258 |
| Net current period other comprehensive income | (16,954) | 1,901 | (69,652) | 2,730 |
| Balance at end of period | $ (89,678) | $ 5,291 | $ (89,678) | $ 5,291 |
| **Cash Flow Hedges:** | | | | |
| Balance at beginning of period | $ 694 | $ (565) | $ 18 | $ (838) |
| Other comprehensive income before reclassifications | (4) | (57) | 12 | (103) |
| Amounts reclassified from AOCI | 77 | 248 | 737 | 567 |
| Net current period other comprehensive income | 73 | 191 | 749 | 464 |
| Balance at end of period | $ 767 | $ (374) | $ 767 | $ (374) |
| **Employee Benefit Plans:** | | | | |
| Balance at beginning of period | $ (4,498) | $ (3,891) | $ (4,748) | $ (4,076) |
| Other comprehensive income before reclassifications | – | – | – | – |
| Amounts reclassified from AOCI | 125 | 92 | 375 | 277 |
| Net current period other comprehensive income | 125 | 92 | 375 | 277 |
| Balance at end of period | $ (4,373) | $ (3,799) | $ (4,373) | $ (3,799) |
| **Total Accumulated Other Comprehensive Income:** | | | | |
| Balance at beginning of period | $ (76,528) | $ (1,066) | $ (24,756) | $ (2,353) |
| Other comprehensive income before reclassifications | (16,945) | 1,844 | (69,627) | 2,369 |
| Amounts reclassified from AOCI | 189 | 340 | 1,099 | 1,102 |
| Net current period other comprehensive income | (16,756) | 2,184 | (68,528) | 3,471 |
| Balance at end of period | $ (93,284) | $ 1,118 | $ (93,284) | $ 1,118 |

**Reclassifications Out of Accumulated Other Comprehensive Income** *(b)*

| *(dollars in thousands)* | For the Three Months Ended September 30, 2018 | For the Three Months Ended September 30, 2017 | For the Nine Months Ended September 30, 2018 | For the Nine Months Ended September 30, 2017 | Income Statement Line Item |
|---|---|---|---|---|---|
| **Investment Securities:** | | | | | |
| Sales gains & losses | $ 13 | $ – | $ 13 | $ (258) | Gains (losses) on investments, net |
| Holding gains & losses | – | – | – | – | Net other-than-temporary impairment |
| Net amounts reclassified | 13 | – | 13 | (258) | |
| **Cash Flow Hedges:** | | | | | |
| Interest income | (73) | (191) | (749) | (464) | See Note 11. |
| Gains (losses) on other transactions | (4) | (57) | 12 | (103) | See Note 11. |
| Net amounts reclassified | (77) | (248) | (737) | (567) | |
| **Employee Benefit Plans:** | | | | | |
| Periodic pension costs | (125) | (92) | (375) | (277) | See Note 7. |
| Net amounts reclassified | (125) | (92) | (375) | (277) | |
| Total reclassifications for period | $ (189) | $ (340) | $ (1,099) | $ (1,102) | |

*(a) Amounts in parentheses indicate debits to AOCI.*
*(b) Amounts in parentheses indicate debits to profit/loss.*

## Note 6 — Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

The classifications within the fair value hierarchy are as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. Level 1 assets and liabilities could include investment securities and derivative contracts that are traded in an active exchange market, in addition to certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Level 2 assets and liabilities could include investment securities that are traded in active, non-exchange markets and derivative contracts that are traded in active, over-the-counter markets.

Level 3 inputs are unobservable and supported by little or no market activity. Level 3 assets and liabilities could include investments and derivative contracts whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, and other instruments for which the determination of fair value requires significant management judgment or estimation. Level 3 assets and liabilities could also include investments and derivative contracts whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

For a complete discussion of the inputs and other assumptions considered in assigning various assets and liabilities to the fair value hierarchy levels, see the most recent Annual Report to Shareholders.

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Bank had no transfers of assets or liabilities measured on a recurring basis into or out of Level 1 or Level 2 during the reporting period.

| *(dollars in thousands)* | **Mortgage Servicing Rights, Net** | **Forward Contracts, Net** |
|---|---|---|
| Balance at December 31, 2017 | $ – | $ – |
| Gains or (losses) included in earnings | – | – |
| Gains or (losses) included in OCI | – | – |
| Purchases | – | – |
| Sales | – | – |
| Issuances | 1,084 | 1,413 |
| Settlements | – | (1,413) |
| Transfers in and/or out of Level 3 | – | – |
| Balance at September 30, 2018 | $ 1,084 | $ – |

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. Other Financial Instruments are not measured at fair value in the statement of financial position, but their fair values are estimated as of each period end date. The following tables summarize the carrying amounts of these assets and liabilities at period end, and their related fair values.

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | **Total Carrying Amount** | **Level 1** | **Level 2** | **Level 3** | **Total Fair Value** |
| **Recurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Investments in debt securities available-for-sale: | | | | | |
| U.S. Govt. Treasury Securities | $ 389,117 | $ – | $ 389,117 | $ – | $ 389,117 |
| U.S. Govt. Guaranteed | 4,533,402 | – | 4,533,402 | – | 4,533,402 |
| U.S. Govt. Agency Guaranteed | 1,926,059 | – | 1,926,059 | – | 1,926,059 |
| Non-Agency ABSs | 709,280 | – | 709,280 | – | 709,280 |
| Total investments in debt securities available-for-sale | 7,557,858 | – | 7,557,858 | – | 7,557,858 |
| Federal funds sold, securities purchased under resale agreements, and other | 100,000 | – | 100,000 | – | 100,000 |
| Interest rate swaps and forward contracts | – | – | – | – | – |
| Money market funds | 174,739 | 174,739 | – | – | 174,739 |
| Mortgage servicing rights | 1,170 | – | – | 1,170 | 1,170 |
| Assets held in trust funds | 14,561 | 14,561 | – | – | 14,561 |
| Recurring Assets | $ 7,848,328 | $ 189,300 | $ 7,657,858 | $ 1,170 | $ 7,848,328 |
| **Liabilities:** | | | | | |
| Interest rate swaps and forward contracts | $ – | $ – | $ – | $ – | $ – |
| Mortgage servicing rights | 86 | – | – | 86 | 86 |
| Collateral liabilities | – | – | – | – | – |
| Recurring Liabilities | $ 86 | $ – | $ – | $ 86 | $ 86 |
| **Nonrecurring Measurements** | | | | | |
| **Assets:** | | | | | |
| Impaired loans | $ 11,378 | $ – | $ – | $ 11,378 | $ 11,378 |
| Other property owned | 463 | – | – | 515 | 515 |
| Nonrecurring Assets | $ 11,841 | $ – | $ – | $ 11,893 | $ 11,893 |
| **Other Financial Instruments** | | | | | |
| **Assets:** | | | | | |
| Cash | $ 194,536 | $ 194,536 | $ – | $ – | $ 194,536 |
| Investments in debt securities held-to-maturity | 407,507 | – | 350,419 | 46,190 | 396,609 |
| Loans | 23,985,895 | – | – | 23,563,799 | 23,563,799 |
| Other Financial Assets | $ 24,587,938 | $ 194,536 | $ 350,419 | $ 23,609,989 | $ 24,154,944 |
| **Liabilities:** | | | | | |
| Systemwide debt securities | $ 30,164,510 | $ – | $ – | $ 29,750,369 | $ 29,750,369 |
| Other Financial Liabilities | $ 30,164,510 | $ – | $ – | $ 29,750,369 | $ 29,750,369 |

| | December 31, 2017 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(dollars in thousands)* | | Total Carrying Amount | | Level 1 | | Level 2 | | Level 3 | | Total Fair Value |
| **Recurring Measurements** | | | | | | | | | | |
| **Assets:** | | | | | | | | | | |
| Investments in debt securities available-for-sale: | | | | | | | | | | |
| U.S. Govt. Treasury Securities | $ | 490,097 | $ | – | $ | 490,097 | $ | – | $ | 490,097 |
| U.S. Govt. Guaranteed | | 4,535,213 | | – | | 4,535,213 | | – | | 4,535,213 |
| U.S. Govt. Agency Guaranteed | | 2,006,843 | | – | | 2,006,843 | | – | | 2,006,843 |
| Non-Agency ABSs | | 631,452 | | – | | 631,452 | | – | | 631,452 |
| Total investments in debt securities available-for-sale | | 7,663,605 | | – | | 7,663,605 | | – | | 7,663,605 |
| Federal funds sold, securities purchased under resale agreements, and other | | 150,000 | | – | | 150,000 | | – | | 150,000 |
| Interest rate swaps and forward contracts | | – | | – | | – | | – | | – |
| Money market funds | | 122,519 | | 122,519 | | – | | – | | 122,519 |
| Assets held in trust funds | | 13,086 | | 13,086 | | – | | – | | 13,086 |
| Recurring Assets | $ | 7,949,210 | $ | 135,605 | $ | 7,813,605 | $ | – | $ | 7,949,210 |
| **Liabilities:** | | | | | | | | | | |
| Interest rate swaps and forward contracts | $ | – | $ | – | $ | – | $ | – | $ | – |
| Collateral liabilities | | – | | – | | – | | – | | – |
| Recurring Liabilities | $ | – | $ | – | $ | – | $ | – | $ | – |
| **Nonrecurring Measurements** | | | | | | | | | | |
| **Assets:** | | | | | | | | | | |
| Impaired loans | $ | 6,767 | $ | – | $ | – | $ | 6,767 | $ | 6,767 |
| Other property owned | | 154 | | – | | – | | 168 | | 168 |
| Nonrecurring Assets | $ | 6,921 | $ | – | $ | – | $ | 6,935 | $ | 6,935 |
| **Other Financial Instruments** | | | | | | | | | | |
| **Assets:** | | | | | | | | | | |
| Cash | $ | 440,768 | $ | 440,768 | $ | – | $ | – | $ | 440,768 |
| Investments in debt securities held-to-maturity | | 458,623 | | – | | 403,082 | | 60,258 | | 463,340 |
| Loans | | 23,338,012 | | – | | – | | 23,201,602 | | 23,201,602 |
| Other Financial Assets | $ | 24,237,403 | $ | 440,768 | $ | 403,082 | $ | 23,261,860 | $ | 24,105,710 |
| **Liabilities:** | | | | | | | | | | |
| Systemwide debt securities | $ | 29,762,991 | $ | – | $ | – | $ | 29,619,713 | $ | 29,619,713 |
| Other Financial Liabilities | $ | 29,762,991 | $ | – | $ | – | $ | 29,619,713 | $ | 29,619,713 |

## SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

### Investments in Debt Securities

The fair values of predominantly all Level 3 investments in debt securities have consistent inputs, valuation techniques and correlation to changes in underlying inputs. The models used to determine fair value for these instruments use certain significant unobservable inputs within a discounted cash flow or market comparable pricing valuation technique. Such inputs generally include discount rate components including risk premiums, prepayment estimates, default estimates and loss severities.

These Level 3 assets would decrease (increase) in value based upon an increase (decrease) in discount rates, defaults, or loss severities. Conversely, the fair value of these assets would generally increase (decrease) in value if the prepayment input were to increase (decrease).

Generally, a change in the assumption used for defaults is accompanied by a directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite change in the assumption used for prepayments. Unobservable inputs for loss severities do not normally increase or decrease based on movements in the other significant unobservable inputs for these Level 3 assets.

**Derivative Instruments**
Level 3 derivative instruments consist of forward contracts that represent a hedge of an unrecognized firm commitment to purchase agency securities at a future date. The value of the forward is the difference between the fair value of the security at inception of the forward and the measurement date. Significant inputs for these valuations would be discount rate and volatility. These Level 3 derivatives would decrease (increase) in value based upon an increase (decrease) in the discount rate.

Generally, for derivative instruments which are subject to changes in the value of the underlying referenced instrument, change in the assumption used for default rate is accompanied by directionally similar change in the risk premium component of the discount rate (specifically, the portion related to credit risk) and a directionally opposite change in the assumption used for prepayment rates.

Unobservable inputs for discount rate and volatility do not increase or decrease based on movements in other significant unobservable inputs for these Level 3 instruments.

**Inputs to Valuation Techniques**
Management determines the Bank's valuation policies and procedures. Internal valuation processes are calibrated annually by an independent consultant. Fair value measurements are analyzed on a periodic basis. Documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing.

Quoted market prices are generally not available for the instruments presented below. Accordingly, fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements**

| *(dollars in thousands)* | Fair Value | Valuation Technique(s) | Unobservable Input | Range |
|---|---|---|---|---|
| Impaired loans and other property owned | $ 11,893 | Appraisal | Income and expense | * |
| | | | Comparable sales | * |
| | | | Replacement cost | * |
| | | | Comparability adjustments | * |
| Forward contracts | $ – | Discounted cash flow | Estimated future cash flows | |
| Mortgage servicing rights, net | $ 1,084 | Discounted cash flow | Constant prepayment rate | |
| | | | Probability of default | |
| | | | Loss severity | |
| | | | Fees and costs | |

**Information about Recurring and Nonrecurring Level 2 Fair Value Measurements**

| | Valuation Technique(s) | Input |
|---|---|---|
| Debt securities available-for-sale | Discounted cash flow | Constant prepayment rate |
| | | Probability of default |
| | | Loss severity |
| | Quoted prices | Price for similar security |
| | Vendor priced | ** |
| Federal funds sold, securities purchased under resale agreements and other | Carrying value | Par/principal and appropriate interest yield |
| Interest rate swaps | Discounted cash flow | Annualized volatility |
| | | Counterparty credit risk |
| | | Own credit risk |

**Information about Other Financial Instrument Fair Value Measurements**

| | Valuation Technique(s) | Input |
|---|---|---|
| Loans | Discounted cash flow | Prepayment forecasts<br>Probability of default<br>Loss severity |
| Cash and cash equivalents | Carrying value | Par/principal and appropriate interest yield |
| Debt securities held-to-maturity | Discounted cash flow | Constant prepayment rate<br>Prepayment rates<br>Probability of default<br>Risk adjusted spread<br>Loss severity |
| | Quoted prices | Price for similar security |
| | Vendor priced | ** |
| Systemwide debt securities | Discounted cash flow | Benchmark yield curve<br>Derived yield spread<br>Own credit risk |
| Cash collateral | Carrying value | Par/principal and appropriate interest yield |

**Ranges for this type of input are not useful because each collateral property is unique.*
***The inputs used to estimate fair value for assets and liabilities that are obtained from third party vendors are not included in the table as the specific inputs applied are not provided by the vendor.*

## Note 7 — Employee Benefit Plans

Following are retirement and other postretirement benefit expenses for the Bank:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(dollars in thousands)* | 2018 | 2017 | 2018 | 2017 |
| Pension | $ 1,751 | $ 1,476 | $ 5,252 | $ 4,430 |
| 401k | 782 | 683 | 2,347 | 2,073 |
| Other postretirement benefits | 224 | 216 | 731 | 723 |
| Total | $ 2,757 | $ 2,375 | $ 8,330 | $ 7,226 |

Following are retirement and other postretirement benefit contributions for the Bank. Projections are based upon actuarially determined amounts as of the most recent measurement date of December 31, 2017.

| *(dollars in thousands)* | Actual YTD Through 9/30/18 | Projected Contributions for Remainder of 2018 | Projected Total Contributions 2018 |
|---|---|---|---|
| Pensions | $ 418 | $ 5,958 | $ 6,376 |
| Other postretirement benefits | 731 | 263 | 994 |
| Total | $ 1,149 | $ 6,221 | $ 7,370 |

Contributions in the above table include allocated estimates of funding for multiemployer plans in which the Bank participates. These amounts may change when a total funding amount and allocation is determined by the respective Plans' Sponsor Committees. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2018.

Further details regarding employee benefit plans are contained in the most recent Annual Report to Shareholders.

## Note 8 — Commitments and Contingencies

Under the Farm Credit Act of 1971, each System bank is primarily liable for its portion of Systemwide bond and discount note obligations. Additionally, the four banks are jointly and severally liable for the bonds and notes of the other System banks under the terms of the Joint and Several Liability Allocation Agreement. Published in the

Federal Register, the agreement prescribes the payment mechanisms to be employed in the event one of the banks is unable to meet its debt obligations.

In the event a bank is unable to timely pay principal or interest on an insured debt obligation for which the bank is primarily liable, the Farm Credit System Insurance Corporation (FCSIC) must expend amounts in the Insurance Fund to the extent available to ensure the timely payment of principal and interest on the insured debt obligation. The provisions of the Farm Credit Act providing for joint and several liability of the banks on the obligation cannot be invoked until the amounts in the Insurance Fund have been exhausted. However, because of other mandatory and discretionary uses of the Insurance Fund, there is no assurance that there will be sufficient funds to pay the principal or interest on the insured debt obligation.

Once joint and several liability provisions are initiated, the FCA is required to make "calls" to satisfy the liability first on all non-defaulting banks in the proportion that each non-defaulting bank's available collateral (collateral in excess of collateralized obligations) bears to the aggregate available collateral of all non-defaulting banks. If these calls do not satisfy the liability, then a further call would be made in proportion to each non-defaulting bank's remaining assets. Upon making a call on non-defaulting banks with respect to a Systemwide Debt Security issued on behalf of a defaulting bank, the FCA is required to appoint FCSIC as the receiver for the defaulting bank. The receiver would be required to expeditiously liquidate assets of the bank.

AgFirst did not anticipate making any payments on behalf of its co-obligors under the Joint and Several Liability Allocation Agreement for any of the periods presented. The total amount outstanding and the carrying amount of the Bank's liability under the agreement are as follows:

| *(dollars in billions)* | | **9/30/18** | | **12/31/17** |
|---|---|---|---|---|
| Total System bonds and notes | $ | 268.462 | $ | 265.169 |
| AgFirst bonds and notes | $ | 30.165 | $ | 29.763 |

From time to time, legal actions are pending against the Bank in which claims for money damages are asserted. On at least a quarterly basis, the Bank assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Bank. No material liabilities have been recorded for any claims that may be pending.

## Note 9 - Revenue from Contracts with Customers

On January 1, 2018, Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606) became effective. The core principle of the new standard is that companies should 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.

The Bank maintains contracts with customers, primarily other System entities, to provide support services in various areas such as accounting, lending transactions, consulting, insurance, and information technology. The Bank does not generally incur costs to obtain contracts. As most of the contracts are to provide access to expertise or system capacity that the Bank maintains, there are no material incremental costs to fulfill these contracts that should be capitalized. Total revenue recognized from contracts with customers was as follows:

| *(dollars in thousands)* | | **Three Months Ended September 30, 2018** | | **Nine Months Ended September 30, 2018** |
|---|---|---|---|---|
| **Revenue recognized from contracts with customers:** | | | | |
| At a point in time | $ | 111 | $ | 377 |
| Over time | | 1,253 | | 3,675 |
| Total | $ | 1,364 | $ | 4,052 |

## Note 10 — Additional Financial Information

### *Offsetting of Financial and Derivative Assets*

| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Derivatives | $ – | $ – |
| Reverse repurchase and similar arrangements | 100,000 | 150,000 |
| Gross Amount of Recognized Assets | 100,000 | 150,000 |
| Derivatives | – | – |
| Reverse repurchase and similar arrangements | – | – |
| Gross Amounts Offset in the Balance Sheets | – | – |
| **Net Amounts of Assets Presented in the Balance Sheets** | $ 100,000 | $ 150,000 |
| Financial Instruments | (100,000) | (150,000) |
| Derivatives | – | – |
| Cash Collateral Received | – | – |
| Gross Amounts Not Offset in the Balance Sheets | (100,000) | (150,000) |
| **Net Amount** | $ – | $ – |

A description of any rights of setoff associated with recognized derivative assets and liabilities subject to enforceable master netting arrangements is located in Note 11, *Derivative Financial Instruments and Hedging Activities*.

The reverse repurchase agreements are accounted for as collateralized lending.

### *Combined ACA Only Financial Data (Unaudited)*

Condensed financial information for the combined District Associations follows. All significant transactions and balances between the Associations are eliminated in combination.

Combined financial statements of the District Associations and the Bank are included in the AgFirst Farm Credit Bank and District Associations' Third Quarter 2018 Report and 2017 Annual Report. Eliminations for all significant transactions and balances between the Bank and the District Associations are reflected in the combined financial statements included in that report. In addition, the multiemployer structure of certain of the District's retirement and benefit plans results in the recording of these plans only in the District's combined financial statements.

**Balance Sheets**

| *(dollars in thousands)* | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Cash and investments in debt securities | $ 76,477 | $ 122,448 |
| Loans | 21,737,516 | 20,970,757 |
| Allowance for loan losses | (185,567) | (178,686) |
| Net loans | 21,551,949 | 20,792,071 |
| Other assets | 869,955 | 992,530 |
| Total assets | $ 22,498,381 | $ 21,907,049 |
| Direct note | $ 17,451,150 | $ 16,854,904 |
| Other liabilities | 286,932 | 519,562 |
| Total liabilities | 17,738,082 | 17,374,466 |
| Capital stock and participation certificates | 186,731 | 187,568 |
| Additional paid-in-capital | 23,691 | 23,691 |
| Retained earnings | 4,579,291 | 4,352,783 |
| Accumulated other comprehensive income (loss) | (29,414) | (31,459) |
| Total shareholders' equity | 4,760,299 | 4,532,583 |
| Total liabilities and shareholders' equity | $ 22,498,381 | $ 21,907,049 |

| **Statements of Income** *(dollars in thousands)* | **For the Nine Months Ended September 30, 2018** | **2017** |
|---|---|---|
| Interest income | $ 845,167 | $ 767,560 |
| Interest expense | 383,854 | 329,483 |
| Net interest income | 461,313 | 438,077 |
| Provision for (reversal of allowance for) loan losses | 11,823 | 8,797 |
| Net interest income after provision for (reversal of allowance for) loan losses | 449,490 | 429,280 |
| Noninterest income | 155,037 | 137,845 |
| Noninterest expenses | | |
| Salaries and employee benefits | 197,272 | 193,285 |
| Occupancy and equipment | 15,567 | 14,725 |
| Insurance Fund premiums | 10,542 | 16,888 |
| Other operating expenses | 61,926 | 57,675 |
| Losses (gains) from other property owned | 129 | 1,575 |
| Total noninterest expenses | 285,436 | 284,148 |
| Income (loss) before taxes | 319,091 | 282,977 |
| Provision for income taxes | 528 | 644 |
| Net income | $ 318,563 | $ 282,333 |

## Note 11 — Derivative Financial Instruments and Hedging Activities

One of the Bank's goals is to minimize interest rate sensitivity by managing the repricing characteristics of assets and liabilities so that the net interest margin is not adversely affected by movements in interest rates. The Bank maintains an overall interest rate risk management strategy that may incorporate the use of derivative instruments to achieve that goal. The primary derivative type used by the Bank has been interest rate swaps, that convert fixed interest rate debt to a lower floating interest rate than was achievable from issuing floating rate debt with identical repricing characteristics. Interest rate swaps may allow the Bank to lower funding costs, diversify sources of funding, or alter interest rate exposures arising from mismatches between assets and liabilities. Under these arrangements, the Bank agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating rate index.

The Bank may also purchase interest rate derivatives, such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on its floating-rate assets. In addition, the Bank may also fix a price to be paid in the future which qualifies as a derivative forward contract.

As a result of interest rate fluctuations, interest income and interest expense related to hedged variable-rate assets and liabilities, respectively, will increase or decrease. Another result of interest rate fluctuations is that hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effects of any earnings variability or unrealized changes in market value are expected to be substantially offset by the Bank's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. The Bank considers its strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The primary types of derivative instruments used and the amount of activity for the periods presented is summarized in the following table:

| | **For the Nine Months Ended September 30, 2018** | | **2017** | |
|---|---|---|---|---|
| **Notional Amounts** *(dollars in millions)* | **Receive-Fixed Swaps** | **Forward Contracts** | **Receive-Fixed Swaps** | **Forward Contracts** |
| Balance at beginning of period | $ – | $ – | $ 50 | $ 1 |
| Additions | – | 121 | – | 7 |
| Maturities/amortization | – | (121) | (50) | (7) |
| Terminations | – | – | – | – |
| Balance at end of period | $ – | $ – | $ – | $ 1 |

By using derivative instruments, the Bank exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the Bank's credit risk will equal the fair value gain in the derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the Bank, thus creating a repayment risk for the Bank. When the fair value of the derivative contract is negative, the Bank owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the Bank transacts with counterparties that have an investment grade credit rating from a major rating agency and also monitors the credit standing of, and levels of exposure to, individual counterparties. The Bank typically enters into master agreements that contain netting provisions. These provisions allow the Bank to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts.

Counterparty exposure related to derivatives at:

| *(dollars in millions)* | **September 30, 2018** | **December 31, 2017** |
|---|---|---|
| Estimated Gross Credit Risk | $– | $– |
| Percent of Notional | –% | –% |

There was no cash or securities collateral held or posted for the periods presented.

The Bank's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the Committee's oversight of the Bank's asset/liability and treasury functions. The ALCO is responsible for approving hedging strategies that are developed within parameters established by the Bank's Board of Directors through the analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the Bank's overall interest rate risk-management strategies.

***Fair Value Hedges***

For derivative instruments designated as fair value hedges, the gains or losses on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings. The Bank includes the gain or loss on the hedged items in the same line item (interest expense) as the offsetting loss or gain on the related interest rate swaps. Gains and losses on each derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

***Cash Flow Hedges***

From time to time, the Bank may acquire when-issued securities, generally government agency guaranteed bonds. The when-issued transactions are contracts to purchase securities that will not be delivered until 30 or more days in the future. These purchase commitments are considered derivatives (cash flow hedges) in the form of forward contracts. Any differences in market value of the contracted securities, between the purchase and reporting or settlement date, represent the value of the forward contracts. These amounts are included in OCI, and Other Liabilities or Other Assets as appropriate, as firm commitments in the Bank's Balance Sheet for each period end. As of the periods presented, the Bank had not committed to purchase any when-issued bonds.

For derivative instruments that are designated and qualify as a cash flow hedge, such as the Bank's forward contracts, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

***Derivatives Not Designated as Hedges***

The Bank may enter into interest rate lock commitments, which are commitments to originate mortgage loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Bank may also manage market risk on interest rate lock commitments and mortgage loans held for sale with corresponding forward sale commitments. Residential mortgage loans held for sale are recorded at fair value with changes in fair value recorded in Noninterest Income. Changes in mark-to-market from both interest rate lock commitments and corresponding forward sale commitments related to residential mortgage loans are included in Noninterest Income.

***Fair Values of Derivative Instruments***

There were no derivative assets or liabilities designated as hedging instruments at the periods ended September 30, 2018 and December 31, 2017.

The following table sets forth the amount of net gain (loss) on derivatives recognized in earnings and, for cash flow hedges, the amount of net gain (loss) recognized in AOCI for the nine month periods presented. See Note 5, *Shareholders' Equity*.

| *(dollars in thousands)* | Location of Gain or (Loss) Recognized in, or Reclassified from AOCI into, Income | Amount of Gain or (Loss) Recognized in, or Reclassified from AOCI into, Income | | Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) | | Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) | |
|---|---|---|---|---|---|---|---|
| | | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| **Cash Flow Hedges:** | | | | | | | |
| Firm Commitments | Interest Income | $ (749) | $ (464) | $ – | $ – | $ – | $ – |
| Forward Contracts | Gains (Losses) on Other Transactions | 12 | (103) | – | – | 12 | (103) |

The following table represents the fair value of derivative instruments not designated as hedging instruments for the periods presented:

| *(dollars in thousands)* | Balance Sheet Classification – Assets | 9/30/18 Fair Value | Balance Sheet Classification – Liabilities | 9/30/18 Fair Value |
|---|---|---|---|---|
| Forward contracts | Other Assets | $ – | Other Liabilities | $ – |
| Total | | $ – | | $ – |

The following table sets forth the amount of net gain (loss) on derivatives recognized in earnings. No gain (loss) was recognized in AOCI for the nine month periods presented. See Note 5, *Shareholders' Equity*.

| *(dollars in thousands)* | Location of Gain or (Loss) Recognized in Income | Amount of Gain or (Loss) Recognized in Income * | |
|---|---|---|---|
| | | 2018 | 2017 |
| **Fair Value Derivatives:** | | | |
| Forward Contracts | Gains (Losses) on Other Transactions | $ 1,628 | $ – |

** Represents total gain or loss for fair value hedges and effective portion for cash flow hedges.*

## Note 12 — Subsequent Events

The Bank evaluated subsequent events and determined that, except as described below, there were none requiring disclosure through November 8, 2018, which was the date the financial statements were issued.

On October 15, 2018, the Bank's Board of Directors indicated an intention to declare, in December 2018, a special patronage distribution between $110.0 million and $130.0 million.