FARM CREDIT

2018 FINANCIAL INFORMATION

AgFirst Farm Credit Bank and District Associations 2018 Financial Information

INTRODUCTION AND DISTRICT OVERVIEW

The following commentary reviews the Combined Financial Statements of condition and results of operations of AgFirst Farm Credit Bank (AgFirst or the Bank) and the District Agricultural Credit Associations (Associations or District Associations), collectively referred to as the AgFirst District (District), for the years ended December 31, 2018, 2017, and 2016. AgFirst and the District Associations are part of the Farm Credit System (the System), a federally chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations. Cooperatives are organizations that are owned and controlled by their members who use the cooperatives' products or services. The U.S. Congress authorized the creation of the first System institutions in 1916. The System was created to provide support for the agricultural sector because of its significance to the well-being of the U.S. economy and the U.S. consumer. The mission of the System is to provide sound and dependable credit to American farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, and certain farm-related businesses. The System does this by making appropriately structured loans to qualified individuals and businesses at competitive rates and providing financial services and advice to those persons and businesses. AgFirst and each District Association are individually regulated by the Farm Credit Administration (FCA).

The Associations are structured as cooperatives, and each Association is owned by its borrowers. AgFirst also operates as a cooperative. The District Associations, certain Other Financing Institutions (OFIs), other System institutions, and preferred stockholders jointly own AgFirst. As such, the benefits of ownership flow to the same farmer/rancher-borrowers that the System was created to serve.

As of December 31, 2018, the District consisted of the Bank and nineteen District Associations. All nineteen were structured as Agricultural Credit Association (ACA) holding companies, with Federal Land Credit Association (FLCA) and Production Credit Association (PCA) subsidiaries. PCAs originate and service short- and intermediate-term loans; FLCAs originate and service long-term real estate mortgage loans; and ACAs originate and service both long-term real estate mortgage loans and short- and intermediate-term loans.

Farm Credit's funds are raised by the Federal Farm Credit Banks Funding Corporation (the Funding Corporation) and insured by the Farm Credit System Insurance Corporation (FCSIC). The Funding Corporation issues a variety of Federal Farm Credit Banks Combined Systemwide Debt Securities with broad ranges of maturities and structures on behalf of the System banks. Each System bank has exposure to Systemwide credit risk because each bank is jointly and severally liable for all Systemwide debt issued.

AgFirst provides funding and related services to the District Associations, which, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the District Associations, a revolving line of credit, referred to as a "Direct Note." Each Association primarily funds its lending and general corporate activities by borrowing through its Direct Note. Virtually all assets of the Associations secure the Direct Notes. Lending terms are specified in a separate General Financing Agreement (GFA) between AgFirst and each Association, including the subsidiaries of the Associations.

AgFirst and the Associations are chartered to serve eligible borrowers in Alabama, Delaware, Florida, Georgia, Maryland, Mississippi, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia, Puerto Rico, and portions of Kentucky, Louisiana, Ohio, and Tennessee. As of December 31, 2018, two other Farm Credit Banks (FCBs) and an Agricultural Credit Bank (ACB), through a number of associations, provided loans and related services to eligible borrowers in the remaining portion of the United States. While owned by its related associations, each FCB manages and controls its own business activities and operations. The ACB is owned by its related associations as well as other agricultural and rural institutions, including agricultural cooperatives. Associations are not commonly owned or controlled and each manages and controls its own business activities and operations.

While combined District statements reflect the financial and operational interdependence of AgFirst and its Associations, AgFirst does not own or control the Associations. AgFirst publishes Bank-only audited financial statements (electronic version of which is available on AgFirst's website at **www.agfirst.com**) that may be referred to for a more complete analysis of AgFirst's financial condition and results of operations.

Financial Highlights

(dollars in thousands)

As of December 31,	2018	2017	2016
Total loans	**$ 29,592,224**	$ 28,451,807	$ 27,457,966
Allowance for loan losses	**(209,657)**	(193,067)	(182,600)
Net loans	**29,382,567**	28,258,740	27,275,366
Total assets	**38,625,732**	37,810,568	36,821,119
Total shareholders' equity	**6,473,552**	6,249,124	5,881,057

Year Ended December 31,	2018	2017	2016
Net interest income	**$ 1,035,097**	$ 1,038,806	$ 1,036,187
Provision for (reversal of allowance for) loan losses	**23,227**	13,371	(191)
Noninterest income (expense), net	**(425,398)**	(319,108)	(475,227)
Net income	**586,472**	706,327	561,151
Net interest income as a percentage of average earning assets	**2.79 %**	2.88 %	2.96 %
Net (chargeoffs) recoveries to average loans	**(0.02)%**	(0.01)%	0.02 %
Return on average assets	**1.55 %**	1.92 %	1.55 %
Return on average shareholders' equity	**9.03 %**	11.39 %	9.44 %
Operating expense as a percentage of net interest income and noninterest income	**45.47 %**	33.67 %	47.73 %
Average loans	**$ 28,703,679**	$ 27,793,235	$ 26,753,055
Average earning assets	**37,052,762**	36,126,918	34,959,993
Average assets	**37,744,205**	36,837,806	36,217,375

Management's Discussion & Analysis of Financial Condition & Results of Operations

RESULTS OF OPERATIONS

Net Income

District net income totaled $586.5 million for the year ended December 31, 2018, a decrease of $119.9 million from 2017. Net income of $706.3 million for the year ended December 31, 2017 was an increase of $145.2 million from 2016. The primary difference for both periods was a $145.8 million one-time reduction in other operating expenses in 2017 due to a change in the method of recording expenses at participating District entities for the multiemployer pension and postretirement benefits plans. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion:

Change in Net Income *(dollars in thousands)*	**Year Ended December 31,** 2018	2017
Net income (for prior year)	$ 706,327	$ 561,151
Increase (decrease) due to:		
Total interest income	193,482	111,106
Total interest expense	(197,191)	(108,487)
Net interest income	(3,709)	2,619
Provision for loan losses	(9,856)	(13,562)
Noninterest income	28,173	18,066
Noninterest expense	(134,975)	138,832
Provision for income taxes	512	(779)
Total increase (decrease) in net income	(119,855)	145,176
Net income	$ 586,472	$ 706,327

Key Results of Operations Comparisons

Key District results of operations comparisons for years ended December 31 are shown in the following table:

Key Results of Operations Comparisons	**For the Year Ended December 31,** 2018	2017	2016
Return on average assets	1.55%	1.92%	1.55%
Return on average shareholders' equity	9.03%	11.39%	9.44%
Net interest income as a percentage of average earning assets	2.79%	2.88%	2.96%
Operating expense as a percentage of net interest income and noninterest income	45.47%	33.67%	47.73%
Net (charge-offs) recoveries to average loans	(0.02)%	(0.01)%	0.02%

The first two ratios above decreased in 2018 primarily due to a decrease in net income whereas these ratios increased in 2017 due to an increase in net income. The higher net income in 2017 resulted from a reduction in noninterest expenses of $145.8 million from a change in accounting estimate related to the District's multiemployer benefits plans. Excluding the impact of one-time adjustments, these ratios would have remained relatively constant for the periods presented. See *Noninterest Expenses* section below for further information. The lower net interest income as a percentage of average earning assets in 2018 resulted primarily from lower net interest income as discussed below while the decrease in this ratio in 2017 was primarily as a result of higher average earnings assets.

For the operating expense as a percentage of net interest income and noninterest income ratio, operating expense consists primarily of noninterest expenses excluding losses (gains) from other property owned. The fluctuation in this ratio was primarily the result of the one-time adjustment to noninterest expenses discussed above. Excluding the impact of one-time adjustments, this ratio would also have remained relatively constant for the periods presented.

The net (charge-offs) recoveries ratio reflected slightly higher charge-offs in 2018. See *Allowance for Loan Losses, Net Interest Income*, *Noninterest Income*, and *Noninterest Expenses* sections for further discussion.

Interest Income

Total interest income for the year ended December 31, 2018 was $1.663 billion, an increase of $193.5 million, as compared to the same period of 2017. Total interest income for the year ended December 31, 2017 was $1.470 billion, an increase of $111.1 million, as compared to the same period of 2016. For both 2018 and 2017, interest income increased primarily as a result of higher yields on earning assets. The average yield on interest earning assets increased 42 basis points from 2017 to 2018 and 18 basis points from 2016 to 2017. The average volume of interest earning assets increased $925.8 million in 2018 and $1.167 billion in 2017.

The following table illustrates the impact of volume and yield changes on interest income:

Net Change in Interest Income *(dollars in thousands)*	**Year Ended December 31,** 2018-2017	2017-2016
Current year increase (decrease) in average earning assets	$ 925,844	$ 1,166,925
Prior year average yield	4.07%	3.89%
Interest income variance attributed to change in volume	37,666	45,351
Current year average earning assets	37,052,762	36,126,918
Current year increase (decrease) in average yield	0.42%	0.18%
Interest income variance attributed to change in yield	155,816	65,755
Net change in interest income	$ 193,482	$ 111,106

Interest Expense

Total interest expense for the year ended December 31, 2018 was $628.2 million, an increase of $197.2 million, as compared to the same period of 2017. Total interest expense for the year ended December 31, 2017 was $431.0 million, an increase of $108.5 million, as compared to the same period of 2016. The increase in interest expense for both years was primarily attributed to higher average rates paid on System debt obligations.

The following table illustrates the impact of volume and rate changes on interest expense:

Net Change in Interest Expense *(dollars in thousands)*	**Year Ended December 31, 2018-2017**	**2017-2016**
Current year increase (decrease) in average interest-bearing liabilities	$ 723,083	$ 373,146
Prior year average rate	1.44%	1.09%
Interest expense variance attributed to change in volume	10,398	4,066
Current year average interest-bearing liabilities	30,692,644	29,969,561
Current year increase (decrease) in average rate	0.61%	0.35%
Interest expense variance attributed to change in rate	186,793	104,421
Net change in interest expense	$ 197,191	$ 108,487

Net Interest Income

Net interest income decreased in 2018 and increased in 2017, as illustrated by the following table:

District Analysis of Net Interest Income
Year Ended December 31,
(dollars in thousands)

	2018			2017			2016		
	Avg. Balance	**Interest**	**Avg. Yield**	**Avg. Balance**	**Interest**	**Avg. Yield**	**Avg. Balance**	**Interest**	**Avg. Yield**
Loans	$ 28,703,679	$ 1,462,622	5.10%	$ 27,793,235	$ 1,316,611	4.74%	$ 26,753,055	$ 1,228,486	4.59%
Investments	8,298,932	199,533	2.40	8,323,126	153,102	1.84	8,195,994	130,102	1.59
Other	50,151	1,093	2.18	10,557	53	0.50	10,944	72	0.66
Total earning assets	37,052,762	1,663,248	4.49	36,126,918	1,469,766	4.07	34,959,993	1,358,660	3.89
Interest-bearing liabilities	30,692,644	(628,151)	2.05	29,969,561	(430,960)	1.44	29,596,415	(322,473)	1.09
Spread			2.44			2.63			2.80
Impact of capital	$ 6,360,118		0.35	$ 6,157,357		0.25	$ 5,363,578		0.16
Net Interest Income (NII) & NII to average earning assets		$ 1,035,097	2.79%		$ 1,038,806	2.88%		$ 1,036,187	2.96%

Net interest income for the year ended December 31, 2018 was $1.035 billion compared to $1.039 billion for the same period of 2017, a decrease of $3.7 million, or 0.36 percent. For the year ended December 31, 2017, net interest income increased $2.6 million, or 0.25 percent, from $1.036 billion in 2016. The net interest margin was 2.79 percent, 2.88 percent, and 2.96 percent for the years ended December 31, 2018, 2017, and 2016, respectively, decreases of nine and eight basis points. The decreases in net interest margin for both years resulted primarily from higher rates paid on interest-bearing liabilities.

No debt was called during the year ended December 31, 2018. The Bank called debt totaling $2.297 billion and $16.597 billion during 2017 and 2016, respectively, 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.

Provision for Loan Losses

AgFirst and the Associations measure risks inherent in their individual portfolios on an ongoing basis and, as necessary, recognize provision for loan loss expense so that appropriate reserves for loan losses are maintained. Provision for loan losses was a net expense of $23.2 million for the year ended December 31, 2018 compared to a net expense of $13.4 million and a net reversal of expense of $191 thousand for the years ended December 31, 2017 and 2016, respectively. The increase in net provision expense in 2018 was due primarily to higher provision expense for specific credits compared to 2017 and 2016.

The $23.2 million in total net provision expense for the year ended December 31, 2018 consisted of $2.6 million of provision expense for general reserves and $20.6 million of provision expense for specific reserves. Total net provision expense in 2018 primarily related to borrowers in the field crops ($13.1 million), dairy ($4.9 million), poultry ($4.9 million), and cotton ($2.3 million) segments, partially offset by provision reversals in the forestry ($3.6 million) segment.

For the year ended December 31, 2017, the $13.4 million in total net provision expense consisted of $8.9 million of provision expense for general reserves and $4.5 million of provision expense for specific reserves. Total net provision expense in 2017 primarily related to borrowers in the cattle ($5.0 million), poultry ($4.3 million), field crops ($4.0 million), and rural home loan ($1.4 million) segments, partially offset by provision reversals in the nursery/greenhouse ($2.7 million) and utilities ($1.2 million) segments.

The $191 thousand in total net provision reversals for the year ended December 31, 2016 consisted of $8.8 million of net provision reversals for specific reserves and $8.6 million of provision expense for general reserves. For 2016, net provision reversals primarily related to borrowers in the other real estate ($5.0 million), forestry ($3.4 million), nursery/greenhouse ($2.6 million), and tree fruits and nuts ($2.0 million) segments, partially offset by provision expense in the poultry ($2.8 million), grains ($2.6 million), field crops ($2.0 million), dairy ($1.5 million), and swine ($1.3 million) segments.

See the *Loan Portfolio* section below for further information.

Noninterest Income

Noninterest income for years ended December 31 is shown in the following table:

Noninterest Income *(dollars in thousands)*	For the Year Ended December 31, 2018	2017	2016	Increase (Decrease) 2018/2017	2017/2016
Loan fees	$ 31,477	$ 30,917	$ 30,105	$ 560	$ 812
Fees for financially related services	11,461	10,811	10,685	650	126
Building lease income	3,412	3,650	3,623	(238)	27
Net impairment losses	–	–	(14,947)	–	14,947
Gains (losses) on investments, net	13	(258)	23,822	271	(24,080)
Gains (losses) on debt extinguishment	150	(4,528)	(29,900)	4,678	25,372
Gains (losses) on other transactions	5,422	6,086	6,201	(664)	(115)
Insurance premium refund	21,086	–	–	21,086	–
Other noninterest income	13,278	11,448	10,471	1,830	977
Total noninterest income	$ 86,299	$ 58,126	$ 40,060	$ 28,173	$ 18,066

Total noninterest income increased $28.2 million from 2017 to 2018 primarily due to an insurance premium refund received in 2018 and lower losses on debt extinguishment. The $18.1 million increase in noninterest income from 2016 to 2017 was primarily a result of lower losses on debt extinguishment and lower impairment losses, partially offset by lower investment gains. Significant line item variances are discussed below.

Net impairment losses on investments of $14.9 million recorded in 2016 resulted primarily from $13.2 million in impairment losses which were recognized as a result of the sale in August, 2016 of all of the Bank's ineligible available-for-sale investment securities which totaled $129.4 million. The additional $1.7 million of impairment losses recorded in 2016 also related to these ineligible securities. No impairment losses were recorded during 2018 and 2017.

Gains (losses) on investments during 2018, 2017, and 2016 were the result of investment activities related to managing the composition and overall size of the investment portfolio. These transactions benefitted the Bank by reducing carrying costs and improving liquidity. During 2018, the District sold securities totaling $11.7 million which resulted in a net gain of $13 thousand. During 2017, the District sold securities totaling $77.4 million which resulted in a net loss of $258 thousand. During 2016, the District sold securities totaling $144.4 million which resulted in a net gain of $23.8 million.

Losses on debt extinguishment decreased $4.7 million and $25.4 million for the years ended December 31, 2018 and 2017, respectively. No debt was called during the year ended December 31, 2018. The gain of $150 thousand in 2018 resulted from discount notes extinguished totaling $450.0 million. In 2017 and 2016, losses on called debt were $4.5 million and $29.9 million, respectively. Debt issuance expense is amortized over the life of the underlying debt security, so when debt securities are called prior to maturity, unamortized issuance costs are recognized as losses on debt extinguishment. Call options were exercised on bonds totaling $2.297 billion in 2017 and $16.597 billion in 2016. 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.

An insurance premium refund of $21.1 million from the FCSIC, which insures the System's debt obligations, was recorded in the first quarter of 2018. This refund is nonrecurring and resulted from the assets of the FCSIC exceeding the secure base amount as defined by the Farm Credit Act.

Other noninterest income increased by $1.8 million and $977 thousand for the years ended December 31, 2018 and 2017, respectively, compared to the prior years. The increase in 2018 resulted primarily from an increase of $1.2 million in income from services provided to Farm Credit entities outside the AgFirst District and an increase of $465 thousand in patronage received from other Farm Credit institutions. The increase in 2017 was primarily due to a $1.5 million increase in patronage received from other Farm Credit institutions, partially offset by a decrease of $467 thousand from previously forfeited earnest money recognized in 2016 on the sale of OPO properties.

Noninterest Expenses

Noninterest expenses for years ended December 31 are shown in the following table:

Noninterest Expenses *(dollars in thousands)*	For the Year Ended December 31, 2018	2017	2016	Increase (Decrease) 2018/2017	2017/2016
Salaries and employee benefits	$ 304,769	$ 290,015	$ 277,588	$ 14,754	$ 12,427
Occupancy and equipment	43,834	42,897	42,711	937	186
Insurance Fund premiums	22,465	36,622	40,643	(14,157)	(4,021)
Other operating expenses	138,864	(235)	152,772	139,099	(153,007)
Losses (gains) from other property owned	1,172	6,830	1,247	(5,658)	5,583
Total noninterest expenses	$ 511,104	$ 376,129	$ 514,961	$ 134,975	$(138,832)

Total noninterest expenses increased $135.0 million and decreased $138.8 million for the years ended December 31, 2018 and 2017, respectively. The increase in 2018 and the decrease in 2017 were primarily due to a one-time expense reduction of $145.8 million recognized in 2017 due to a change in the method of recording expenses at participating District entities for the multiemployer pension and postretirement benefits plans. Significant line item variances are discussed below.

Salaries and employee benefits expenses increased $14.8 million and $12.4 million for the years ended December 31, 2018 and 2017, respectively. The increases for both 2018 and 2017 resulted primarily from increases of $9.2 million and $9.6 million, respectively, in salaries and incentives due to normal salary administration. In 2018, a $2.2 million increase in group health insurance, which resulted primarily from an additional premium holiday in 2017 compared to 2018, and a $1.7 million increase in pension costs, primarily due to higher service costs, also contributed to the increase. In 2017, a $4.7 million increase in other postretirement benefits was partially offset by a $3.2 million decrease in group health insurance premium costs resulting from the premium holidays in 2017 discussed above. Further discussion of postretirement benefits expenses is included in the discussion of other operating expenses below.

Insurance Fund premiums decreased $14.2 million and $4.0 million for the years ended December 31, 2018 and 2017, respectively, compared to the prior years. These decreases resulted primarily from decreases in the base annual premium rate. The base annual premium rate was 9 basis points in 2018, 15 basis points in 2017, 16 basis points in the first half of 2016, and 18 basis points in the second half of 2016. The FCSIC Board makes premium rate adjustments, as necessary, to maintain the secure base amount, which is based upon insured debt outstanding at System banks. The insurance fund premium rate will remain at 9 basis points for at least the first half of 2019.

Other operating expenses increased $139.1 million and decreased $153.0 million for the years ended December 31, 2018 and 2017, respectively, compared to the prior years. The increase in 2018 and the decrease in 2017 resulted primarily from the one-time expense reduction mentioned above. Prior to 2017, expense was recorded based on allocations of actuarially determined costs and any differences between recorded expense and actual contributions were recorded in Other Assets or Other Liabilities on the Balance Sheets. For 2017 and future years, participating entities will record postretirement benefit costs based on the actual contributions to the plans. This change caused the District to modify its accounting estimates recorded in Other Assets and Other Liabilities since the assets and liabilities do not impact future contributions to the plans. The change in estimate resulted in a reduction of Other Liabilities of $186.9 million and an increase in Accumulated Other Comprehensive Income (AOCI) of $39.2 million on the District's Balance Sheets, and a total reduction of noninterest expenses of $145.8 million during 2017.

Losses from other property owned decreased $5.7 million and increased $5.6 million during 2018 and 2017, respectively. The decrease in losses in 2018 resulted primarily from lower writedowns of $3.4 million and higher gains on sales of $2.3 million. The increase in 2017 was primarily a result of lower gains on sale of $5.0 million. See *Other Property Owned* section below for further discussion.

Provision for Income Taxes

Provision for income taxes decreased to $593 thousand in 2018 from $1.1 million in 2017.

LOAN PORTFOLIO

The District's aggregate loan portfolio consists primarily of loans made by the Associations to eligible borrowers located within their chartered territories. Diversification of the loan volume by FCA loan type at December 31 is shown in the following table:

Loan Types *(dollars in thousands)*	2018		2017		2016	
Real Estate Mortgage	$ 14,832,199	50.12%	$ 14,092,944	49.54%	$ 13,238,788	48.21%
Production and Intermediate-term	7,081,438	23.93	7,044,930	24.76	7,248,346	26.40
Rural Residential Real Estate	3,592,326	12.14	3,431,905	12.06	3,228,215	11.76
Processing and Marketing	1,658,946	5.60	1,442,935	5.07	1,450,352	5.28
Power and Water/Waste Disposal	601,693	2.03	629,317	2.21	581,249	2.12
Loans to Cooperatives	573,169	1.94	662,604	2.33	625,642	2.28
Communication	531,590	1.80	466,975	1.64	473,352	1.72
Farm-Related Business	380,606	1.29	363,137	1.28	321,956	1.17
Loans to OFIs	134,387	0.45	131,572	0.46	122,573	0.45
International	122,137	0.41	98,625	0.35	100,860	0.37
Lease Receivables	10,643	0.04	12,358	0.04	13,595	0.05
Other (including Mission Related)	73,090	0.25	74,505	0.26	53,038	0.19
Total	$ 29,592,224	100.00%	$ 28,451,807	100.00%	$ 27,457,966	100.00%

Total loans outstanding were $29.592 billion at December 31, 2018, an increase of $1.140 billion, or 4.01 percent, compared to total loans outstanding at December 31, 2017. Loans outstanding at the end of 2017 increased $993.8 billion, or 3.62 percent, compared to December 31, 2016.

In 2018, loan demand benefitted from moderate growth in the poultry, rural home loans, cotton, field crops, and grains segments. Modest demand in rural home loans, poultry, grains, beef, and timber contributed to the loan growth in 2017. Future District loan demand is difficult to predict; however, modest growth is expected in 2019.

Each loan in the District's portfolio is classified according to a Uniform Classification System, which is used by all System institutions. Below are the classification definitions:

- *Acceptable* – Assets are expected to be fully collectible and represent the highest quality. In addition, these assets may include loans with properly executed and structured guarantees that might otherwise be classified as Other Assets Especially Mentioned (OAEM) or adverse.
- *OAEM* – Assets are currently collectible but exhibit some potential weakness.
- *Substandard* – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- *Doubtful* – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- *Loss* – Assets are considered uncollectible.

Credit quality of District loans including accrued interest at December 31 is shown in the following table:

Credit Quality	2018	2017	2016
Acceptable	95.32%	95.27%	95.00%
OAEM	2.63	2.62	2.87
Adverse*	2.05	2.11	2.13
Total	100.00%	100.00%	100.00%

* *Adverse loans include substandard, doubtful, and loss loans.*

Continued improvement in the general economy has resulted in sustained strong credit quality for the District. Credit quality is expected to slightly deteriorate in 2019 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 within the AgFirst District. These hurricanes did not have a significant impact on the District's overall financial condition and results of operations.

Delinquencies (loans 90 days or more past due) were 0.37 percent of total loan assets at year-end 2018 compared to 0.38 percent and 0.40 percent at year-end 2017 and 2016, respectively.

Nonperforming assets for the District represented 1.40 percent of total loans and other property owned, or $413.2 million, compared to 1.33 percent, or $377.3 million, for 2017, and 1.48 percent, or $407.0 million, for 2016. Nonperforming assets consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

The District recognized net loan charge-offs of $6.6 million and $2.9 million in 2018 and 2017, respectively, and net loan recoveries of $4.2 million in 2016. As a percentage of total average loans, net charge-offs for the District were 0.02 percent for 2018 compared to net charge-offs of 0.01 percent for 2017 and net recoveries of 0.02 percent in 2016. The Bank as well as each Association maintains an allowance for loan losses, determined by its management based upon its unique situation.

The District employs a number of risk management techniques to limit credit exposures. The District has adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell loan participations to enhance the diversification of their portfolios. The District utilizes guarantees from U.S. government agencies/departments, including the Federal Agricultural Mortgage Corporation (Farmer Mac), the Farm Service Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2018, the District collectively had $3.042 billion (10.28 percent of the total loan portfolio) under such government or GSE guarantees, compared to $3.201 billion (11.25 percent) and $3.245 billion (11.82 percent) at December 31, 2017 and 2016, respectively.

The Associations serve primarily all or a portion of fifteen states and Puerto Rico. Additionally, AgFirst and the Associations actively purchase and sell loans and loan participations with non-District institutions. The resulting geographic diversity is a natural credit risk-reducing factor. The geographic distribution of the District's loan volume outstanding by state at December 31 is shown in the following table:

District Loan Volume by State

State	2018	2017	2016
North Carolina	17%	17%	16%
Georgia	11	11	11
Virginia	10	10	10
Florida	8	8	8
Pennsylvania	8	8	8
Ohio	7	7	7
Maryland	6	6	6
South Carolina	6	6	5
Alabama	4	4	3
Kentucky	3	3	3
Mississippi	2	2	2
Texas	2	2	2
Louisiana	2	2	2
Delaware	2	2	2
Other	12	12	15
Total	100%	100%	100%

Only three states have loan volume representing 10.00 percent or more of the total. Commodity diversification, guarantees, and borrowers with significant reliance on non-farm income further mitigate the geographic concentration risk in these states.

The diversity of commodity types mitigates credit risk to the District. The District's credit portfolios are comprised of a number of segments having varying, and in some cases complementary, agricultural characteristics. Commodity and industry categories are based on the Standard Industrial Classification system published by the federal government. This system is used to assign commodity or industry categories based on the largest agricultural commodity of the customer. The aggregate credit portfolio of the District by major commodity segments based on borrower eligibility at December 31 is shown in the following table:

	Percent of Portfolio		
Commodity Group	**2018**	**2017**	**2016**
Forestry	13%	14%	14%
Rural Home	12	12	12
Poultry	11	10	10
Field Crops	10	10	9
Cattle	7	7	7
Grains	7	6	6
Other Real Estate	5	5	5
Dairy	5	4	4
Corn	4	5	5
Processing	4	4	4
Utilities	3	3	4
Tree Fruits and Nuts	3	3	3
Nursery/Greenhouse	3	3	3
Cotton	3	2	2
Swine	3	2	3
Other	7	10	9
Total	100%	100%	100%

As illustrated in the above chart, at December 31, 2018 and 2017, the District had concentrations of 10.00 percent or greater in only four commodities: forestry, rural home, poultry, and field crops. All four commodities have geographic dispersion over the entire AgFirst footprint.

Forestry is divided principally into hardwood and softwood production and value-added processing. The timber from hardwood production is further processed into furniture, flooring, and high-grade paper and is generally located at the more northern latitudes and higher elevations of the District. Softwood timber production is typically located in the coastal plains of the AgFirst District footprint and is used for building materials for the housing market and pulp to make paper and hygiene products. Timber producers at the Associations range in size from less than fifty acres to thousands of acres, with value-added processing being conducted at sawmills, planer mills, and paper mills.

The District's rural home loans consist primarily of first lien residential mortgages purchased by the Bank's Correspondent Lending Unit. At December 31, 2018, 40.15 percent of these loans were guaranteed by the Federal National Mortgage Association (Fannie Mae) and/or Farmer Mac, thereby limiting credit risk to AgFirst. The guarantees 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. This guarantee program ended in 2013. Non-guaranteed loans are reflected in the Bank's allowance for loan losses methodology related to this portfolio.

Poultry concentrations within the District are further limited through the number of farm units producing poultry. Poultry concentration is further dispersed as production is segregated among chicken, turkey, and egg production.

The field crops commodity group represents a diverse group of commodities, including fruits, vegetables, and other non-grain crops, which are grown throughout the AgFirst District.

The diversity of income sources supporting District loan repayments, including a prevalence of non-farm income among the borrowers, further mitigates credit risk to AgFirst as demonstrated by the following table as of December 31:

	Percent of Portfolio		
Commodity Group	**2018**	**2017**	**2016**
Non-Farm Income	35%	35%	34%
Grains	12	12	12
Poultry	10	10	10
Timber	7	7	7
Fruit & Vegetables	5	4	4
Dairy	4	4	5
Beef	4	4	4
Rural Utilities	3	3	4
Swine	3	3	3
Farm Related Business	3	3	2
Cotton	3	2	2
Landlords	2	2	2
Tobacco	2	2	2
Nursery	2	2	2
Other	5	7	7
Total	100%	100%	100%

As a result of the improved economy and the District's efforts to resolve problem assets, the District's high-risk assets continue to be a small percentage of the total loan volume and total assets. Nonperforming assets (including related accrued interest) and related credit quality statistics are as follows:

	December 31,		
(dollars in thousands)	2018	2017	2016
Nonaccrual loans:			
Real estate mortgage	$ 115,131	$ 118,073	$ 125,359
Production and intermediate-term	113,667	99,646	105,026
Loans to cooperatives	7,492	–	–
Processing and marketing	3,395	2,827	5,389
Farm-related business	1,492	3,224	4,335
Rural residential real estate	19,691	15,037	10,390
Lease receivables	312	50	83
Total	$ 261,180	$ 238,857	$ 250,582
Accruing restructured loans:			
Real estate mortgage	$ 63,898	$ 64,234	$ 59,943
Production and intermediate-term	51,237	47,100	52,488
Processing and marketing	560	–	–
Farm-related business	389	439	1,596
Rural residential real estate	3,740	3,011	2,920
Other (including Mission Related)	8,582	8,958	9,050
Total	$ 128,406	$ 123,742	$ 125,997
Accruing loans 90 days or more past due:			
Real estate mortgage	$ 104	$ –	$ 113
Production and intermediate-term	603	75	–
Rural residential real estate	145	–	–
Lease receivables	188	–	–
Total	$ 1,040	$ 75	$ 113
Total nonperforming loans	$ 390,626	$ 362,674	$ 376,692
Other property owned	22,538	14,655	30,281
Total nonperforming assets	$ 413,164	$ 377,329	$ 406,973
Nonaccrual loans as a percentage of total loans	0.88%	0.84%	0.91%
Nonperforming assets as a percentage of total loans and other property owned	1.40%	1.33%	1.48%
Nonperforming assets as a percentage of capital	6.38%	6.04%	6.92%

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 combined District at December 31, 2018 were $261.2 million compared to $238.9 million at December 31, 2017. Nonaccrual loans increased $22.3 million during the year ended December 31, 2018 due primarily to loan balances transferred to nonaccrual status of $171.6 million, recoveries of charge-offs of $7.9 million and advances on nonaccrual loans of $5.6 million. Offsetting these increases were $112.9 million of repayments, reinstatements to accrual status of $20.9 million, charge-offs of uncollectible balances of $14.4 million, and transfers to other property owned of $13.0 million. At December 31, 2018, total nonaccrual loans were primarily in the field crops (29.17 percent of the total), poultry (10.00 percent), grains (8.86 percent), cattle (7.07 percent), rural home loan (8.05 percent), and dairy (5.75 percent) segments. Nonaccrual loans were 0.88 percent of total loans outstanding at December 31, 2018 compared to 0.84 percent and 0.91 percent at December 31, 2017 and 2016, respectively.

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 and District Associations 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 and District Associations. TDRs totaled $192.7 million at December 31, 2018, compared to $196.0 million at December 31, 2017. At December 31, 2018, TDRs were comprised of $128.4 million of accruing restructured loans and $64.3 million of nonaccrual restructured loans. Restructured loans were primarily in the field crops (20.10 percent of the total), poultry (13.33 percent), cattle (7.40 percent), tree fruits and nuts (6.33 percent), forestry (6.30 percent), dairy (5.29 percent), and cotton (5.01 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 and District Associations (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 $7.9 million during 2018 to $22.5 million at December 31, 2018 due to property received in settlement of loans of $16.2 million, partially offset by disposals of $7.7 million and writedowns of OPO of $596 thousand. At December 31, 2018, the largest OPO holding was in the forestry segment and totaled $4.5 million (20.00 percent of the total). See discussion of OPO expense in the *Noninterest Expenses* section above.

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

(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
	December 31, 2018				
Real estate mortgage	$ 72,251	$ 47,109	$ 119,360	$ 14,851,257	$ 14,970,617
Production and intermediate-term	42,690	50,526	93,216	7,070,380	7,163,596
Loans to cooperatives	68	–	68	574,160	574,228
Processing and marketing	285	3,338	3,623	1,661,911	1,665,534
Farm-related business	2,462	961	3,423	379,386	382,809
Communication	–	–	–	531,726	531,726
Power and water/waste disposal	–	–	–	603,938	603,938
Rural residential real estate	44,708	9,040	53,748	3,547,720	3,601,468
International	–	–	–	122,936	122,936
Lease receivables	213	188	401	10,279	10,680
Loans to OFIs	–	–	–	134,721	134,721
Other (including Mission Related)	–	339	339	73,491	73,830
Total	$ 162,677	$ 111,501	$ 274,178	$ 29,561,905	$ 29,836,083

(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
	December 31, 2017				
Real estate mortgage	$ 57,790	$ 42,995	$ 100,785	$ 14,116,210	$ 14,216,995
Production and intermediate-term	36,022	56,464	92,486	7,022,256	7,114,742
Loans to cooperatives	–	–	–	663,838	663,838
Processing and marketing	459	2,761	3,220	1,444,785	1,448,005
Farm-related business	2,348	247	2,595	362,268	364,863
Communication	–	–	–	467,502	467,502
Power and water/waste disposal	–	–	–	631,817	631,817
Rural residential real estate	55,025	6,266	61,291	3,379,607	3,440,898
International	–	–	–	98,952	98,952
Lease receivables	–	–	–	12,390	12,390
Loans to OFIs	–	–	–	131,818	131,818
Other (including Mission Related)	367	546	913	74,352	75,265
Total	$ 152,011	$ 109,279	$ 261,290	$ 28,405,795	$ 28,667,085

(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
	December 31, 2016				
Real estate mortgage	$ 49,883	$ 50,006	$ 99,889	$ 13,250,044	$ 13,349,933
Production and intermediate-term	39,914	49,172	89,086	7,223,079	7,312,165
Loans to cooperatives	–	–	–	626,605	626,605
Processing and marketing	213	5,388	5,601	1,448,885	1,454,486
Farm-related business	866	429	1,295	322,323	323,618
Communication	–	–	–	473,579	473,579
Power and water/waste disposal	–	–	–	583,793	583,793
Rural residential real estate	46,018	5,280	51,298	3,185,697	3,236,995
International	–	–	–	101,844	101,844
Lease receivables	–	–	–	13,626	13,626
Loans to OFIs	–	–	–	122,772	122,772
Other (including Mission Related)	103	–	103	53,604	53,707
Total	$ 136,997	$ 110,275	$ 247,272	$ 27,405,851	$ 27,653,123

Each District institution maintains an allowance for loan losses at a level management considers adequate to provide for probable and estimable credit losses within its respective loan and finance lease portfolios as of each reported balance sheet date. The District increases the allowance by recording a provision for loan losses in the income statement. Loan losses are recorded against and serve to decrease the allowance when management determines that any portion of a loan or lease is uncollectible. Any subsequent recoveries are added to the allowance. Management’s evaluations consider factors which include, among other things, loan loss experience, portfolio quality, loan portfolio composition, current agricultural production conditions, and general economic conditions.

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

(dollars in thousands)	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Communication	Power and Water/Waste Disposal	Rural Residential Real Estate	International	Lease Receivables	Other Loans **	Total
Activity related to allowance for credit losses:										
Balance at December 31, 2017	$ 82,686	$ 86,037	$ 10,977	$ 2,237	$ 2,935	$ 7,262	$ 151	$ 54	$ 728	$ 193,067
Charge-offs	(1,689)	(11,254)	(906)	–	(304)	(371)	–	(16)	–	(14,540)
Recoveries	1,933	5,519	171	–	2	278	–	–	–	7,903
Provision for loan losses	3,046	10,356	9,145	410	(1,424)	886	353	331	124	23,227
Loan type reclassification	102	3	–	–	–	–	–	64	(169)	–
Balance at December 31, 2018	$ 86,078	$ 90,661	$ 19,387	$ 2,647	$ 1,209	$ 8,055	$ 504	$ 433	$ 683	$ 209,657
Balance at December 31, 2016	$ 77,629	$ 81,548	$ 10,342	$ 2,987	$ 3,040	$ 6,008	$ 186	$ 38	$ 822	$ 182,600
Charge-offs	(2,873)	(6,007)	(133)	–	–	(401)	–	(1)	–	(9,415)
Recoveries	3,423	2,577	265	–	16	173	–	29	28	6,511
Provision for loan losses	4,404	7,744	503	(750)	(121)	1,482	(35)	(37)	181	13,371
Loan type reclassification	103	175	–	–	–	–	–	25	(303)	–
Balance at December 31, 2017	$ 82,686	$ 86,037	$ 10,977	$ 2,237	$ 2,935	$ 7,262	$ 151	$ 54	$ 728	$ 193,067
Balance at December 31, 2015	$ 79,176	$ 80,611	$ 8,087	$ 2,449	$ 1,933	$ 5,268	$ 106	$ 41	$ 946	$ 178,617
Charge-offs	(3,520)	(6,079)	(348)	–	–	(539)	–	–	–	(10,486)
Recoveries	9,012	4,507	686	–	–	433	–	3	19	14,660
Provision for loan losses	(6,996)	2,611	1,902	538	1,107	846	80	(6)	(273)	(191)
Loan type reclassification	(43)	(102)	15	–	–	–	–	–	130	–
Balance at December 31, 2016	$ 77,629	$ 81,548	$ 10,342	$ 2,987	$ 3,040	$ 6,008	$ 186	$ 38	$ 822	$ 182,600
Allowance on loans evaluated for impairment:										
Individually	$ 6,348	$ 20,838	$ 3,983	$ –	$ –	$ 1,057	$ –	$ 108	$ 377	$ 32,711
Collectively	79,730	69,823	15,404	2,647	1,209	6,998	504	325	306	176,946
PCI***	–	–	–	–	–	–	–	–	–	–
Balance at December 31, 2018	$ 86,078	$ 90,661	$ 19,387	$ 2,647	$ 1,209	$ 8,055	$ 504	$ 433	$ 683	$ 209,657
Individually	$ 3,942	$ 13,291	$ 17	$ –	$ –	$ 844	$ –	$ –	$ 624	$ 18,718
Collectively	78,744	72,746	10,960	2,237	2,935	6,418	151	54	104	174,349
PCI***	–	–	–	–	–	–	–	–	–	–
Balance at December 31, 2017	$ 82,686	$ 86,037	$ 10,977	$ 2,237	$ 2,935	$ 7,262	$ 151	$ 54	$ 728	$ 193,067
Individually	$ 5,636	$ 10,326	$ 154	$ –	$ –	$ 437	$ –	$ –	$ 605	$ 17,158
Collectively	71,993	71,222	10,188	2,987	3,040	5,571	186	38	217	165,442
PCI***	–	–	–	–	–	–	–	–	–	–
Balance at December 31, 2016	$ 77,629	$ 81,548	$ 10,342	$ 2,987	$ 3,040	$ 6,008	$ 186	$ 38	$ 822	$ 182,600
Recorded investment in loans evaluated for impairment:										
Individually	$ 330,684	$ 164,389	$ 10,420	$ –	$ –	$ 1,280,829	$ –	$ 567	$ 8,503	$ 1,795,392
Collectively	14,637,896	6,999,207	2,612,151	531,726	603,938	2,320,592	122,936	10,113	200,048	28,038,607
PCI***	2,037	–	–	–	–	47	–	–	–	2,084
Ending balance at December 31, 2018	$ 14,970,617	$ 7,163,596	$ 2,622,571	$ 531,726	$ 603,938	$ 3,601,468	$ 122,936	$ 10,680	$ 208,551	$ 29,836,083
Individually	$ 320,369	$ 144,163	$ 6,062	$ –	$ –	$ 1,414,184	$ –	$ 229	$ 8,918	$ 1,893,925
Collectively	13,894,608	6,970,579	2,470,644	467,502	631,817	2,026,655	98,952	12,161	198,165	26,771,083
PCI***	2,018	–	–	–	–	59	–	–	–	2,077
Ending balance at December 31, 2017	$ 14,216,995	$ 7,114,742	$ 2,476,706	$ 467,502	$ 631,817	$ 3,440,898	$ 98,952	$ 12,390	$ 207,083	$ 28,667,085
Individually	$ 291,064	$ 150,529	$ 12,733	$ –	$ –	$ 1,652,900	$ –	$ 305	$ 9,050	$ 2,116,581
Collectively	13,056,781	7,161,636	2,391,976	473,579	583,793	1,584,054	101,844	13,321	167,429	25,534,413
PCI***	2,088	–	–	–	–	41	–	–	–	2,129
Ending balance at December 31, 2016	$ 13,349,933	$ 7,312,165	$ 2,404,709	$ 473,579	$ 583,793	$ 3,236,995	$ 101,844	$ 13,626	$ 176,479	$ 27,653,123

** Includes the loan types Loans to cooperatives, Processing and marketing, and Farm-related business.*
*** Includes Loans to OFIs and Mission Related loans.*
**** Purchased credit impaired loans.*

The allowance for loan losses was $209.7 million at December 31, 2018, as compared with $193.1 million and $182.6 million at December 31, 2017 and 2016, respectively. Activity which increased the allowance during 2018 included provision expense of $23.2 million and loan recoveries of $7.9 million, partially offset by charge-offs of $14.5 million. Recoveries during 2018 were related primarily to borrowers in the forestry (29.62 percent of the total), nursery/greenhouse (15.86 percent), cattle (14.31 percent), and field crops (7.65 percent) segments. The largest commodity segments included in charge-offs during 2018 were the cattle (32.28 percent of the total), dairy (17.28 percent), poultry (11.23 percent), and field crops (9.00 percent) segments. See *Provision for Loan Losses* section above for details regarding changes to the allowance from provision expense (reversal). The allowance at December 31, 2018 included specific reserves of $32.7 million (15.60 percent of the total) and $176.9 million (84.40 percent) of general reserves. The largest commodity segments included in the allowance at December 31, 2018 were the field crops (18.10 percent of the total), poultry (14.04 percent), forestry (9.10 percent), cattle (7.61 percent), and grains (7.02 percent) segments.

Due to positive economic conditions impacting borrowers in economically sensitive segments combined with management's emphasis on underwriting standards, the credit quality of the District loan portfolio has remained sound. Periods of uncertainty in the general economic environment create the potential for prospective risks in the loan portfolio.

INVESTMENTS

The Bank is responsible for meeting the District's funding, liquidity and asset/liability management needs. Along with normal cash flows associated with lending operations, the District has two primary 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 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 Bank's investments are primarily classified as available-for-sale investments. Refer to the Bank's 2018 Annual Report for additional information related to investments. District Associations have regulatory authority to enter into certain guaranteed investments, generally mortgage-backed or asset-backed securities which are classified as held-to-maturity investments. See *Regulatory Matters* section below for further information regarding recent regulation changes related to investments.

	December 31, 2018			
(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
District Bank investments	$ 8,030,676	$ 49,432	$ (96,018)	$ 7,984,090
District Association investments	48,267	2,312	(453)	50,126
Total District investments	$ 8,078,943	$ 51,744	$ (96,471)	$ 8,034,216

	December 31, 2017			
(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
District Bank investments	$ 8,142,254	$ 53,371	$ (68,680)	$ 8,126,945
District Association investments	63,525	2,670	(822)	65,373
Total District investments	$ 8,205,779	$ 56,041	$ (69,502)	$ 8,192,318

	December 31, 2016			
(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
District Bank investments	$ 8,029,633	$ 66,638	$ (59,504)	$ 8,036,767
District Association investments	79,328	2,218	(1,492)	80,054
Total District investments	$ 8,108,961	$ 68,856	$ (60,996)	$ 8,116,821

During 2018, the FCA approved the Bank's request to include its held-to-maturity RHMS securities, which totaled approximately $341.4 million at December 31, 2018, in its liquidity portfolio. The Bank then reclassified these securities, all of which had short remaining tenors, to available-for-sale.

CAPITAL

Capital serves to support future asset growth, investment in new products and services, and to provide protection against credit, interest rate, and other risks, as well as operating losses. A sound capital position is critical to provide protection to investors in Systemwide Debt Securities and to ensure long-term financial success.

Total District shareholders' equity at December 31, 2018 was $6.474 billion, compared to $6.249 billion and $5.881 billion at December 31, 2017 and 2016, respectively. The $224.4 million increase in 2018 resulted primarily from an increase in retained earnings from net income of $586.5 million and an increase of $39.5 million in employee benefit plans adjustments. These increases in shareholders' equity were offset by decreases from cash distributions declared of $274.4 million, retained earnings retired of $82.7 million, increases in net unrealized losses on investments of $29.5 million, and net capital stock and participation certificates retired of $14.1 million. The $368.1 million increase in 2017 resulted primarily from an increase in retained earnings from net income of $706.3 million and an increase of $14.1 million in employee benefit plans adjustments. These increases in shareholders' equity were offset by decreases from cash distributions declared of $237.4 million, retained earnings retired of $84.8 million, increases in net unrealized losses on investments of $22.6 million, and net capital stock and participation certificates retired of $8.4 million.

During 2016, the Bank repurchased, through privately negotiated transactions, and subsequently cancelled, Class B Perpetual Non-Cumulative Fixed-to-Floating Rate Subordinated Preferred Stock with par value totaling $65.8 million. The effect of the repurchases on shareholders' equity was to reduce preferred stock outstanding by $65.8 million, and to increase additional paid-in capital by $18.9 million. There were no repurchases of preferred stock during 2018 and 2017.

The following table summarizes AOCI balances at period end:

	December 31,		
(dollars in thousands)	2018	2017	2016
Accumulated Other Comprehensive Income (Loss)			
Unrealized gain (loss) on investment securities	$ (49,129)	$ (19,635)	$ 3,013
Derivatives and hedging activity	886	18	(838)
Employee benefit plans activity	(322,942)	(362,435)	(376,498)
Total accumulated other comprehensive income (loss)	$ (371,185)	$ (382,052)	$ (374,323)

The Farm Credit Administration sets minimum regulatory capital requirements for Banks and Associations.

Regulatory Capital Requirements and Ratios

As of December 31, 2018	Primary Components of Numerator	Regulatory Minimums	Minimum with Buffer*	Bank	District Associations
Risk adjusted:					
Common equity tier 1 capital ratio	Unallocated retained earnings (URE), common cooperative equities (qualifying capital stock and allocated equity)[1]	4.5%	7.0%	21.20%	13.93% - 39.65%
Tier 1 capital ratio	CET1 Capital, non-cumulative perpetual preferred stock	6.0%	8.5%	21.64%	13.93% - 39.65%
Total capital ratio	Tier 1 Capital, allowance for loan losses[2], common cooperative equities[3] and term preferred stock and subordinated debt[4]	8.0%	10.5%	21.79%	15.65% - 40.90%
Permanent capital ratio	Retained earnings, common stock, non-cumulative perpetual preferred stock and subordinated debt, subject to certain limits	7.0%	7.0%	21.67%	14.89% - 40.13%
Non-risk adjusted:					
Tier 1 leverage ratio	Tier 1 Capital	4.0%	5.0%	7.53%	13.22% - 35.58%
UREE leverage ratio	URE and URE Equivalents	1.5%	1.5%	6.58%	8.13% - 36.28%

**The new capital requirements have a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. There is no phase-in of the leverage buffer. Amounts shown reflect the full capital conservation buffer.*
[1] Equities outstanding 7 or more years
[2] Capped at 1.25% of risk-adjusted assets
[3] Outstanding 5 or more years, but less than 7 years
[4] Outstanding 5 or more years

EMPLOYEE BENEFIT PLANS

The Bank and certain District Associations participate in two District sponsored defined benefit pension plans. These plans include the multiemployer AgFirst Farm Credit Retirement Plan which is a final average pay plan (FAP Plan) and the multiemployer Independent Associations' Retirement Plan (IAR Plan), which is a final average pay plan. In addition, the Bank and 18 District Associations participate in a multiemployer defined benefit other postretirement benefits plan (OPEB Plan), the Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plan, and the Bank and all 19 District Associations participate in the Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), a multiemployer defined contribution 401(k) plan. In addition to the multiemployer defined benefit plans above, one Association also sponsors a single employer defined benefit plan, the First South Farm Credit, ACA Retirement Plan (FS Plan).

The FAP Plan covers eligible employees of 15 Associations and AgFirst hired prior to January 1, 2003. The IAR Plan covers eligible employees of three ACAs whose employment date is prior to January 1, 2009. The FS Plan covers eligible employees of a single ACA whose employment date is prior to January 1, 2009. Each plan is noncontributory. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. Pension benefits are primarily based on eligible compensation and years of service. The District entities funded $48.5 million, $45.4 million, and $33.8 million into these retirement plans for each of the three years ended December 31, 2018, 2017, and 2016, respectively. The expenses of these retirement plans included in noninterest expenses were $34.5 million for 2018, $42.7 million for 2017, and $46.1 million for 2016. The plans' respective prepaid retirement expenses or liabilities are reflected in Other Assets or Other Liabilities in the District's Combined Balance Sheets.

In addition to providing pension benefits, the District provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the District employees may become eligible for the benefits if they reach early retirement age while working for the Bank or District Associations. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. The OPEB Plan includes other Farm Credit System employees that are not employees of the Bank or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the District's Balance Sheets but are included in the Combined Statement of Condition for the Farm Credit System. The OPEB Plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in salaries and employee benefit costs on the District's Statements of Income were $7.7 million for 2018, $7.0 million for 2017, and $13.1 million for 2016. At December 31, 2018, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition is $181.8 million.

The District also participates in the defined contribution 401(k) Plan which qualifies as a 401(k) plan as defined by the Internal Revenue Code. The District contributes $0.50 or $1.00 for each $1.00 of the employee's first 6.00 percent of contribution (based on total compensation) up to the maximum employer contribution of 3.00 or 6.00 percent of total compensation, dependent upon each District entity's policy. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were $14.4 million, $13.3 million, and $12.3 million for the years ended December 31, 2018, 2017, and 2016, respectively. Beginning in 2015,

contributions include an additional 3.00 percent of eligible compensation for employees who are not covered under the FAP Plan, the IAR Plan, or the FS Plan.

In addition to the multiemployer plans above, AgFirst and certain District Associations individually sponsor defined benefit and defined contribution retirement plans and offer a FCBA supplemental 401(k) plan for certain key employees. These plans are nonqualified; therefore, the associated liabilities are included in the District's Combined Balance Sheets in Other Liabilities. The District entities contributed $1.2 million for the year ended December 31, 2018, and $1.2 million and $1.1 million for the years ended December 31, 2017 and 2016, respectively, into these supplemental retirement plans. The supplemental retirement plans are unfunded and had a projected benefit obligation of $25.2 million and a net under-funded status of $25.2 million at December 31, 2018. The expenses of these nonqualified plans included in the District's noninterest expenses were $2.8 million, $2.4 million, and $2.5 million for the years ended December 31, 2018, 2017, and 2016, respectively.

The funding status and the amounts recognized in the Combined Balance Sheet of the District for postretirement benefit plans follows:

	Pension Benefits			Unfunded
(dollars in thousands)	FAP Plan	IAR Plan	FS Plan	Benefit Plans
December 31, 2018				
Projected benefit obligations	$ 904,759	$ 74,494	$ 103,636	$ 25,231
Fair value of plan assets	810,268	65,868	76,558	–
Funded (unfunded) status	(94,491)	(8,626)	(27,078)	(25,231)
Accumulated benefit obligation	$ 841,942	$ 64,241	$ 94,493	$ 20,791
Assumptions used to determine benefit obligations:				
Discount rate	4.45%	4.55%	3.75%	4.40%
Expected long-term rate of return	5.80%	5.50%	6.50%	N/A*
Rate of compensation increase	3.90%	5.10%	5.00%	Varies

	Pension Benefits			Unfunded
(dollars in thousands)	FAP Plan	IAR Plan	FS Plan	Benefit Plans
December 31, 2017				
Projected benefit obligations	$ 1,023,674	$ 82,918	$ 110,149	$ 27,822
Fair value of plan assets	884,570	67,840	84,537	–
Funded (unfunded) status	(139,104)	(15,078)	(25,612)	(27,822)
Accumulated benefit obligation	$ 942,920	$ 69,467	$ 98,737	$ 21,926
Assumptions used to determine benefit obligations:				
Discount rate	3.70%	3.75%	4.30%	3.75%
Expected long-term rate of return	5.90%	5.40%	7.50%	N/A*
Rate of compensation increase	3.90%	5.10%	5.00%	Varies

	Pension Benefits			Unfunded
(dollars in thousands)	FAP Plan	IAR Plan	FS Plan	Benefit Plans
December 31, 2016				
Projected benefit obligations	$ 912,907	$ 70,737	$ 100,773	$ 24,451
Fair value of plan assets	793,907	59,209	72,405	–
Funded (unfunded) status	(119,000)	(11,528)	(28,368)	(24,451)
Accumulated benefit obligation	$ 839,424	$ 59,156	$ 90,332	$ 19,559
Assumptions used to determine benefit obligations:				
Discount rate	4.30%	4.45%	4.60%	4.35%
Expected long-term rate of return	5.40%	4.90%	7.50%	N/A*
Rate of compensation increase	$ 3.90%	$ 5.20%	$ 5.00%	Varies

** Not applicable.*

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 became effective January 1, 2019.

Farm Bill

The Agricultural Improvement Act of 2018 (Farm Bill) was signed into law on December 20, 2018. This new Farm Bill will govern an array of federal farm and food programs, including commodity price support payments, farm credit, conservation programs, research, rural development and foreign and domestic food programs for five years through 2023. The new Farm Bill continues to provide support for crop insurance and commodity support programs, strengthen livestock disaster programs, and provides dairy producers with an updated voluntary margin protection program that will provide additional risk management options to dairy operations.

The Farm Bill also clarifies and updates the Insurance Corporation's authorities to act as conservator or receiver of a System institution. The Congressional Conference Committee report states that Congress intends "for the authorities of the Corporation to be functionally equivalent to the parallel authorities of the Federal Deposit Insurance Corporation." In addition, the Farm Bill provides, among other authorities, the Insurance Corporation with the authority to organize, and the Farm Credit Administration to charter, a System bridge bank, which has all the powers of a System bank with a maximum life span of five years.

Many provisions of the Farm Bill will require the United States Department of Agriculture to develop rules and procedures to fully implement these authorities. The timing for the issuance of those rules is uncertain.

LIBOR TRANSITION

On July 27, 2017, the United Kingdom Financial Conduct Authority (the Conduct Authority) announced that it will no longer persuade or compel such banks to submit rates for the calculation of the LIBOR rates after 2021. The Conduct Authority regulates the panel banks that submit quotes for the purpose of calculating LIBOR to the Intercontinental Exchange (ICE) Benchmark Administration (the entity that is responsible for calculating LIBOR). Accordingly, it is uncertain whether the ICE Benchmark Administration will continue to quote LIBOR after 2021. Furthermore, in the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee (ARRC) of the Federal Reserve Board and the Federal Reserve Bank of New York. Specifically, the ARRC has proposed the Secured Overnight Financing Rate (SOFR) as the recommended alternative to LIBOR and the Federal Reserve Bank of New York began publishing SOFR in April of 2018. SOFR is based on a broad segment of the overnight Treasury repurchase market and is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

At this time, it is not possible to predict, among other uncertainties, whether (i) LIBOR will be discontinued, (ii) the effect of any changes to the methodology for calculating LIBOR, or (iii) any establishment of alternative reference rates or any other reforms to LIBOR that may be enacted in the United Kingdom, in the United States or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for LIBOR based instruments, including certain of the Systemwide Debt Securities, System borrowings, loans, investments, derivatives, other System assets and liabilities and preferred stock that are indexed to LIBOR. Accordingly, reform of, or the replacement or disappearance of, LIBOR and the proposed regulation of LIBOR and other "benchmarks" may adversely affect the rates of interest the System pays on its Systemwide Debt Securities (including changes to their value and liquidity, return, and usefulness for intended purpose), on other borrowings and preferred stock, as well as the value of and return on loans and investments and the value and effectiveness of derivatives. This could adversely affect the System's cash flows. Moreover, if LIBOR is replaced, System institutions will need to take steps to restructure their debt and derivatives, which could adversely affect operations.

The System institutions are currently evaluating the potential impact of the eventual replacement of the LIBOR benchmark interest rate, including the possibility of using SOFR as the alternative to LIBOR. While each system institution is required by the regulator to have a transition plan, the transition from LIBOR to SOFR is expected to be complex and to include the development of term and credit adjustments to minimize, to the extent possible, discrepancies between LIBOR and SOFR. Accordingly, the transition may introduce additional basis risk for market participants, including when an alternative index, e.g., SOFR, exists in conjunction with LIBOR. There can be no guarantee that SOFR will become the dominant alternative to U.S. dollar LIBOR or that SOFR will be widely used. In addition, other alternatives may or may not be developed with additional complications.

Changes in LIBOR may result in interest rates and/or payments that are higher or lower than, or that do not otherwise correlate over time with, the interest rates and/or payments that would have been associated with LIBOR-based Systemwide Debt Securities, or loans or investments that are based on LIBOR, which may increase or decrease the payments to be made on such LIBOR-based Systemwide Debt Securities, or loans or investments that are based on LIBOR.

OTHER MATTERS

See the *Direct Notes* section of *Management's Discussion & Analysis of Financial Condition & Results of Operations* in the 2018 AgFirst Farm Credit Bank Annual Report for a discussion of the Bank's funding to District Associations.

Combined Balance Sheets

(unaudited)

(dollars in thousands)	As of December 31, 2018	2017	2016
Assets			
Cash	**$ 471,436**	$ 499,451	$ 591,491
Cash equivalents	**100,000**	272,519	262,624
Investments in debt securities:			
Available for sale (amortized cost of $7,988,624, $7,683,631, and $7,488,279, respectively)	**7,939,196**	7,663,605	7,490,841
Held to maturity (fair value of $95,020, $528,713, and $625,980, respectively)	**90,319**	522,148	620,682
Total investments in debt securities	**8,029,515**	8,185,753	8,111,523
Loans	**29,592,224**	28,451,807	27,457,966
Allowance for loan losses	**(209,657)**	(193,067)	(182,600)
Net loans	**29,382,567**	28,258,740	27,275,366
Loans held for sale	**4,175**	14,046	17,561
Accrued interest receivable	**261,660**	227,323	205,487
Accounts receivable	**47,846**	49,339	57,102
Equity investments in other Farm Credit institutions	**44,089**	40,292	34,610
Premises and equipment, net	**208,196**	197,492	194,283
Other property owned	**22,538**	14,655	30,281
Other assets	**53,710**	50,958	40,791
Total assets	**$ 38,625,732**	$ 37,810,568	$ 36,821,119
Liabilities			
Systemwide bonds payable	**$ 25,807,367**	$ 24,829,679	$ 22,660,317
Systemwide and other notes payable	**5,619,167**	5,949,507	7,442,928
Accrued interest payable	**112,345**	83,221	59,273
Accounts payable	**321,166**	316,960	257,249
Advanced conditional payments	**4,360**	10,175	4,368
Other liabilities	**287,775**	371,902	515,927
Total liabilities	**32,152,180**	31,561,444	30,940,062
Shareholders' Equity			
Perpetual preferred stock	**49,250**	49,250	49,250
Protected borrower equity	**502**	502	513
Capital stock and participation certificates	**158,734**	169,716	174,877
Additional paid-in-capital	**82,573**	82,573	82,573
Retained earnings			
Allocated	**2,154,332**	2,097,179	1,971,423
Unallocated	**4,399,346**	4,231,956	3,976,744
Accumulated other comprehensive income (loss)	**(371,185)**	(382,052)	(374,323)
Total shareholders' equity	**6,473,552**	6,249,124	5,881,057
Total liabilities and equity	**$ 38,625,732**	$ 37,810,568	$ 36,821,119

Combined Statements of Income

(unaudited)

(dollars in thousands)	For the year ended December 31, 2018	2017	2016
Interest Income			
Investments	**$ 199,533**	$ 153,102	$ 130,102
Loans	**1,462,622**	1,316,611	1,228,486
Other	**1,093**	53	72
Total interest income	**1,663,248**	1,469,766	1,358,660
Interest Expense	**628,151**	430,960	322,473
Net interest income	**1,035,097**	1,038,806	1,036,187
Provision for (reversal of allowance for) loan losses	**23,227**	13,371	(191)
Net interest income after provision for loan losses	**1,011,870**	1,025,435	1,036,378
Noninterest Income			
Loan fees	**31,477**	30,917	30,105
Fees for financially related services	**11,461**	10,811	10,685
Building lease income	**3,412**	3,650	3,623
Total other-than-temporary impairment losses	**—**	—	(4,665)
Portion of loss recognized in other comprehensive income	**—**	—	(10,282)
Net other-than-temporary impairment losses	**—**	—	(14,947)
Gains (losses) on investments, net	**13**	(258)	23,822
Gains (losses) on debt extinguishment	**150**	(4,528)	(29,900)
Gains (losses) on other transactions	**5,422**	6,086	6,201
Insurance premium refund	**21,086**	—	—
Other noninterest income	**13,278**	11,448	10,471
Total noninterest income	**86,299**	58,126	40,060
Noninterest Expenses			
Salaries and employee benefits	**304,769**	290,015	277,588
Occupancy and equipment	**43,834**	42,897	42,711
Insurance Fund premiums	**22,465**	36,622	40,643
Other operating expenses	**138,864**	(235)	152,772
Losses (gains) from other property owned	**1,172**	6,830	1,247
Total noninterest expenses	**511,104**	376,129	514,961
Income before income taxes	**587,065**	707,432	561,477
Provision for income taxes	**593**	1,105	326
Net income	**$ 586,472**	$ 706,327	$ 561,151

DISTRICT ASSOCIATIONS

Associations	Direct Notes	% of Direct Note Total	Total Assets	Total Allowance and Capital	Total Regulatory Capital Ratio	Nonperforming Loans as a % of Total Loans	ROA
(dollars in thousands)							
AgCarolina	$ 917,038	5.25%	$ 1,210,636	$ 278,134	20.32%	2.70%	2.43%
AgChoice	1,557,913	8.92	2,006,737	420,896	18.99	0.62	2.72
AgCredit	1,673,338	9.58	2,058,534	357,384	20.25	0.66	3.08
AgGeorgia	695,597	3.98	950,840	245,163	23.84	4.38	2.36
AgSouth	1,461,549	8.37	1,884,862	405,436	20.92	1.06	2.94
ArborOne	418,933	2.40	518,963	100,579	18.52	5.26	1.76
Cape Fear	742,744	4.25	958,543	217,047	21.15	2.27	2.15
Carolina	1,239,668	7.10	1,611,359	335,782	21.12	1.24	2.55
Central Florida	442,646	2.54	563,348	112,370	20.54	4.04	2.62
Central Kentucky	441,115	2.53	535,837	92,003	18.12	0.94	2.41
Colonial	484,103	2.77	692,521	188,968	26.52	0.49	2.76
First South	1,717,671	9.84	2,200,023	437,641	18.29	0.30	2.12
Florida	915,039	5.24	1,204,720	274,324	20.52	1.11	2.19
MidAtlantic	2,181,496	12.50	2,881,880	665,040	21.09	2.34	2.43
Northwest Florida	204,857	1.17	296,140	88,335	28.32	1.59	2.37
Puerto Rico	97,533	0.56	157,138	56,251	40.90	7.33	2.07
River Valley	451,508	2.59	563,363	104,763	17.86	1.95	2.02
Southwest Georgia	393,455	2.25	495,820	90,704	15.65	0.77	2.62
Virginias	1,422,676	8.15	1,909,651	455,691	23.10	1.42	2.81

AgFirst Farm Credit Bank

AgFirst Farm Credit Bank
1901 Main Street
Columbia, SC 29201
800-845-1745
www.agfirst.com

AgFirst District Associations

AgCarolina Farm Credit, ACA
4000 Poole Road
Raleigh, NC 27610
919-250-9500
http://www.agcarolina.com

AgChoice Farm Credit, ACA
300 Winding Creek Blvd.
Mechanicsburg, PA 17050
717-796-9372
http://www.agchoice.com

AgCredit Agricultural Credit Association
610 W. Lytle Street
Fostoria, OH 44830-3422
419-435-7758
http://www.agcredit.net

AgGeorgia Farm Credit, ACA
468 Perry Parkway
Perry, GA 31069
478-987-8300
http://www.aggeorgia.com

AgSouth Farm Credit, ACA
26 South Main Street
Statesboro, GA 30458
912-764-9091
http://www.agsouthfc.com

ArborOne, ACA
800 Woody Jones Blvd.
Florence, SC 29501
843-662-1527
http://www.arborone.com

Cape Fear Farm Credit, ACA
333 East Russell Street
Fayetteville, NC 28302
910-323-9188
http://www.capefearfarmcredit.com

Carolina Farm Credit, ACA
146 Victory Lane
Statesville, NC 28625
704-873-0276
http://www.carolinafarmcredit.com

Central Kentucky Agricultural Credit Association
640 S. Broadway
Lexington, KY 40508
859-253-3249
http://www.agcreditonline.com

Colonial Farm Credit, ACA
7104 Mechanicsville Turnpike
Mechanicsville, VA 23111
804-746-4581
http://www.colonialfarmcredit.com

Farm Credit of Central Florida, ACA
115 S. Missouri Ste. 400
Lakeland, FL 33815
863-682-4117
http://www.farmcreditcfl.com

Farm Credit of Florida, ACA
11903 Southern Boulevard Ste. 200
Royal Palm Beach, FL 33411
561-965-9001
http://farmcreditfl.com

Farm Credit of Northwest Florida, ACA
5052 Highway 90 East
Marianna, FL 32446
850-526-4910
http://www.farmcredit-fl.com

Farm Credit of the Virginias, ACA
106 Sangers Lane
Staunton, VA 24401
540-886-3435
http://www.farmcreditofvirginias.com

First South Farm Credit, ACA
574 Highland Colony Parkway, Ste. 100
Ridgeland, MS 39157
601-977-8396
http://www.firstsouthfarmcredit.com

MidAtlantic Farm Credit, ACA
45 Aileron Court
Westminster, MD 21157
410-848-1033
http://www.mafc.com

Puerto Rico Farm Credit, ACA
213 Domenech Ave.
Hato Rey, PR 00918
787-753-0579
http://www.prfarmcredit.com

River Valley AgCredit, ACA
408 East Broadway
Mayfield, KY 42066
270-247-5613
http://www.rivervalleyagcredit.com

Southwest Georgia Farm Credit, ACA
305 Colquitt Highway
Bainbridge, GA 39817
229-246-0384
http://wwwswgafarmcredit.com