2017
ANNUAL REPORT

CENTRAL KENTUCKY AGRICULTURAL CREDIT ASSOCIATION

2017 ANNUAL REPORT

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Board of Directors

James Alvin Lyons....Chairman
James C. Rankin III....Vice Chairman
James L. May....Director
Joe Myers....Director
Lee Hood....Director
Mary-Lynn Hinkel....Director
Dan Grigson....Director

Message from the President

UNIQUE

When asked to describe our cooperative organization, I regularly find myself searching for the proper blend of descriptive words or phrases often associated with business-speak. Despite this search for a better phrase, I always seem to come back to one simple word – "unique." By definition, this means an organization that is unlike anything else in the marketplace – a "one of a kind" institution. So, I have decided to embrace the word "unique" and explain why I think it aptly describes Central Kentucky Ag Credit.

The local connection is the first way we are distinctive in the marketplace. With an 84 year history of service to the 17-county Central Kentucky region, we are about as local as you can get. Being local also means we are independent. For decades, the trend among financial institutions has been one of constant merger and acquisition. The result is large, generic institutions with little or no connection to the local communities. We are different. Instead of decision-making in some far-away corporate office, our board of directors is composed of seven individuals from right here in the Bluegrass Region. Five are farmers elected from the cooperative membership and two are appointed outside directors. Coupled with a staff that lives in the communities they serve and you have a local formula that's hard to beat.

The second unique characteristic of Central Kentucky Ag Credit is our structure. Our structure features a traditional lending model. The cornerstone of our business is the relationship between the loan officer and the farmer. In our traditional lending structure, this means the person who you meet, face-to-face, is the person who will visit your farm, analyze your financial information and ultimately service your loan account. In many of today's financial institutions, this model has been replaced with one best described as a series of specialists who each do part of the work. One person in sales, one financial analyst, one collateral valuator, one loan closer and one who handles problems. The challenge raised here is that no one person has the type of holistic or global understanding of your operation that the traditional loan officer would have. Tie this back to the local component and the result is a lender from your community who knows agriculture and handles your credit needs, start-to-finish.

The cooperative model is the final area of distinction. We are unique in the marketplace because of the cooperative model. Under this umbrella are patronage distributions associated with the implementation of cooperative principals. The patronage distributions made in 2017 represent the 20th consecutive year Central Kentucky Ag Credit has paid patronage. From its humble start in 1998 when the total distribution was $453 thousand to this year's record level of $3.5 million, we've come a long way. When we return our profits to you, it reduces your cost of borrowing. You get a market-driven, competitive rate up from Central Kentucky Ag Credit, and then we reduce your effective borrowing costs with our patronage distribution.

Central Kentucky Ag Credit has a mission to serve agriculture and rural communities. This mission reflects our dedication in good times and bad. The Annual Report is a reflection of a cooperative institution fulfilling its mission and continually earning the confidence and trust of stockholders and stakeholders. The report is an opportunity to take inventory of our dependability, reliability and yes, our "uniqueness." I believe it is the distinctive organizational and structural characteristics that make our cooperative unique. With our local connections, traditional lending model and 20 year track record of patronage distributions, we are truly unlike anything else in the marketplace – a "one of a kind" institution.

James W. Caldwell

James W. Caldwell
Chief Executive Officer

March 13, 2018

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Central Kentucky Agricultural Credit Association (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been audited by independent auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2017 Annual Report of Central Kentucky Agricultural Credit Association, 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.

James A. Lyons

James Alvin Lyons
Chairman of the Board

James W. Caldwell

James W. Caldwell
Chief Executive Officer

M. G. Barnett

Marcus G. Barnett
Chief Financial Officer

March 13, 2018

Report on Internal Control Over Financial Reporting

The Association'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 Association's Consolidated 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 Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2017. 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 Association's management concluded that as of December 31, 2017, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2017.

James W. Caldwell
Chief Executive Officer

Marcus G. Barnett
Chief Financial Officer

March 13, 2018

Consolidated Five - Year Summary of Selected Financial Data

(dollars in thousands)	December 31, 2017	2016	2015	2014	2013
Balance Sheet Data					
Cash	**$ 2,028**	$ 1,605	$ 1,250	$ 1,289	$ 1,223
Loans	**471,730**	426,095	407,863	382,146	350,677
Allowance for loan losses	**(4,037)**	(3,695)	(3,771)	(3,892)	(3,593)
Net loans	**467,693**	422,400	404,092	378,254	347,084
Investments in other Farm Credit institutions	**7,117**	7,113	7,079	7,045	7,035
Other property owned	**8**	8	—	640	1,713
Other assets	**16,341**	17,219	15,241	15,123	22,407
Total assets	**$ 493,187**	$ 448,345	$ 427,662	$ 402,351	$ 379,462
Notes payable to AgFirst Farm Credit Bank*	**$ 406,457**	$ 368,038	$ 353,034	$ 334,747	$ 317,656
Accrued interest payable and other liabilities with maturities of less than one year	**6,695**	7,278	6,519	6,211	7,296
Total liabilities	**413,152**	375,316	359,553	340,958	324,952
Capital stock and participation certificates	**4,698**	4,993	6,784	6,744	6,676
Retained earnings					
Allocated	**54,453**	48,344	42,801	37,362	31,503
Unallocated	**20,884**	19,692	18,524	17,287	16,331
Total members' equity	**80,035**	73,029	68,109	61,393	54,510
Total liabilities and members' equity	**$ 493,187**	$ 448,345	$ 427,662	$ 402,351	$ 379,462
Statement of Income Data					
Net interest income	**$ 11,560**	$ 11,096	$ 10,555	$ 10,125	$ 9,462
Provision for (reversal of allowance for) loan losses	**350**	(50)	(35)	350	350
Noninterest income (expense), net	**(317)**	(1,309)	(1,295)	(125)	1,340
Net income	**$ 10,893**	$ 9,837	$ 9,295	$ 9,650	$ 10,452
Key Financial Ratios					
Rate of return on average:					
Total assets	**2.36%**	2.27%	2.30%	2.51%	2.86%
Total members' equity	**14.14%**	13.81%	14.21%	16.43%	20.45%
Net interest income as a percentage of average earning assets	**2.59%**	2.66%	2.71%	2.74%	2.69%
Net (chargeoffs) recoveries to average loans	**(0.002)%**	(0.006)%	(0.022)%	(0.014)%	(0.150)%
Total members' equity to total assets	**16.23%**	16.29%	15.93%	15.26%	14.37%
Debt to members' equity (:1)	**5.16**	5.14	5.28	5.55	5.96
Allowance for loan losses to loans	**0.86%**	0.87%	0.92%	1.02%	1.02%
Permanent capital ratio	**16.91%**	17.79%	17.58%	16.85%	15.99%
Total surplus ratio	**	16.96%	16.28%	15.54%	14.62%
Core surplus ratio	**	16.96%	16.28%	15.54%	14.62%
Common equity tier 1 capital ratio	**16.66%**	**	**	**	**
Tier 1 capital ratio	**16.66%**	**	**	**	**
Total regulatory capital ratio	**17.54%**	**	**	**	**
Tier 1 leverage ratio	**14.63%**	**	**	**	**
Unallocated retained earnings (URE) and URE equivalents leverage ratio	**14.29%**	**	**	**	**
Net Income Distribution					
Estimated patronage refunds:					
Cash	**$ 3,590**	$ 3,105	$ 2,617	$ 2,833	$ 2,969
Nonqualified retained earnings	**6,112**	5,766	5,561	6,021	6,928

** General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2018.*
*** Not applicable due to changes in regulatory capital requirements effective January 1, 2017.*

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Central Kentucky Agricultural Credit Association (Association) for the year ended December 31, 2017 with comparisons to the years ended December 31, 2016 and December 31, 2015. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Kentucky. Refer to Note 1, *Organization and Operations*, of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association may be materially affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, ***www.agfirst.com,*** or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, ***www.agcreditonline.com***, or by calling 1-859-253-3249, extension 607, or writing Marcus G. Barnett, Central Kentucky Agricultural Credit Association, P. O. Box 1290, Lexington, KY 40588-1290. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

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

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined according to generally accepted accounting principles and is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including current production and economic conditions, loan portfolio composition, collateral value, portfolio quality and prior loan loss experience.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

  Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, other property owned, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

ECONOMIC CONDITIONS

The agricultural economy of the territory serviced by the Association is very diverse. It is comprised of a significant beef concentration, as well as equine and grain. The cattle industry has begun seeing a leveling off of prices since the market decline in late 2015 and early 2016. 2018 prices look to be favorable for the near term as present supply and demand appears to be in balance. Beef usage may soften as it often does in the latter part of the year, but this is typical to the market. The biggest risk to the market may be psychological, stemming from a downward trending stock market. The beef outlook is still somewhat guarded. The equine market has seen considerable improvement over the last couple of years. Recent horse sales in the area have been much stronger, and it appears that this has positively affected the equine real estate market as well. The equine market could be characterized as steady to improving. The grain market continues to be dealing with a very large surplus, which is driving demand and prices down. Other than a weather event or some other event that significantly decreases production, it seems unlikely that an increase in prices is on the horizon for the near future. Overall, the market outlook continues to be uncertain.

Farm size varies and many borrowers in the region have diversified farming operations. This factor, along with numerous opportunities for non-farm employment in the area, significantly impacts the level of dependency on any given commodity. Farm real estate values are mixed with some indication that the market is tightening.

The Association's primary competition continues to come from several banks and one System institution. There has been little change in our market base over the past year. During 2017, the Association targeted certain areas of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types. The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	December 31, 2017		2016		2015	
	(dollars in thousands)					
Real estate mortgage	$ 300,833	63.77 %	$ 268,880	63.10 %	$ 250,887	61.51%
Production and intermediate-term	156,798	33.24	147,903	34.71	147,341	36.13
Rural residential real estate	8,111	1.72	7,838	1.84	7,679	1.88
Processing and marketing	1,168	0.25	1,053	0.25	1,430	0.35
Farm-related business	4,820	1.02	421	0.10	500	0.12
Loans to cooperatives	–	–	–	–	26	0.01
Total	$ 471,730	100.00 %	$ 426,095	100.00 %	$ 407,863	100.00%

While we make loans and provide financial related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loan volume by branch/operating unit for the past three years is as follows:

Branch/Operating Unit	December 31, 2017	2016	2015
Lebanon	26.71%	26.19%	27.13%
Lexington	21.08	19.88	21.66
Paris	15.35	16.45	16.42
Danville	13.84	13.63	15.11
Stanford	11.13	12.20	11.11
Richmond	8.45	8.49	8.22
Frankfort	3.23	2.96	–
Participations Purchased	0.21	0.20	0.35
	100.00%	100.00%	100.00%

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are beef cattle, horses, row crops, and hay/pasture, which constitute approximately 79 percent of the entire portfolio.

Commodity Group	December 31, 2017		2016		2015	
	(dollars in thousands)					
Beef Cattle	$ 222,018	47%	$ 202,749	48%	$ 185,833	46%
Horses	67,458	14	65,673	15	67,228	16
Row Crops	43,782	9	47,564	11	45,459	11
Hay/Pasture	40,063	9	33,084	8	33,026	8
Tobacco	30,569	6	30,729	7	31,231	8
Ag Services	14,237	3	8,506	2	9,661	2
Dairy	8,627	2	10,683	3	11,275	3
Other	44,976	10	27,107	6	24,150	6
Total	$ 471,730	100%	$ 426,095	100%	$ 407,863	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of beef cattle and horse producers. Although a large percentage of the loan portfolio is concentrated in these commodities, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. At December 31, 2017, the Association's total commitments to its ten largest borrowers was $39,236, representing 8.32 percent of total loans. The concentration of large loans has increased somewhat over the past several years. The agricultural enterprise mix of these loans however is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory, the borrowers' ability to supplement borrowings with non-farm income, and the level of guarantees obtained on the portfolio.

The increase in gross loan volume for the twelve months ended December 31, 2017, is primarily attributed to increases in farm real estate loans. The Association has attracted some large real estate loans over the past few years in addition to normal business. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in November and declines in the winter months as commodities are marketed and proceeds are applied to repay the operating loans.

During 2017, the Association continued activity in the selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk.

The main commodity type in the Participations Purchased portfolio is prepared feeds which accounts for 100% of the portfolio. While these participations help spread total portfolio concentration, they also possess unique risks that include exposure to general economic trends, changes in government policy and counterparty risk. The Association manages this risk through routine monitoring, borrowing base reporting and policy driven portfolio limits. Counterparty risks on the entire Participations Purchased portfolio are reduced by the inclusion of System institutions as the lead lender in 100% of the portfolio.

Loan Participations:	December 31, 2017	2016	2015
	(dollars in thousands)		
Participations Purchased – FCS Institutions	$ 1,010	$ 860	$ 1,433
Participations Sold	(32,511)	(34,218)	(29,946)
Total	$ (31,501)	$ (33,358)	$ (28,513)

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2017.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2017, the Association originated and sold into the secondary market loans totaling $11,110.

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. At December 31, 2017, the guaranteed balance of designated loans under these agreements was $78,263.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than one hundred thousand dollars. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (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.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2017	2016	2015
Acceptable & OAEM	97.32%	98.00%	98.34%
Substandard	2.65%	1.99%	1.66%
Doubtful	0.03%	0.01%	0.00%
Loss	0.00%	0.00%	0.00%
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. The Administrative Office Credit Department monitors and works with loans classified as high-risk. The high-risk assets, including accrued interest, are detailed in the following table:

	December 31,		
High-risk Assets	2017	2016	2015
	(dollars in thousands)		
Nonaccrual loans	$ 1,703	$ 2,045	$ 3,163
Restructured loans	1,242	1,280	298
Accruing loans 90 days past due	20	–	7
Total high-risk loans	2,965	3,325	3,468
Other property owned	8	8	–
Total high-risk assets	$ 2,973	$ 3,333	$ 3,468
Ratios			
Nonaccrual loans to total loans	0.36%	0.48%	0.78%
High-risk assets to total assets	0.60%	0.74%	0.81%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the full collection of principal and/or future interest accruals under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans decreased $342 or 16.72 percent in 2017. This decrease resulted primarily from the partial liquidation of one larger nonaccrual loan, the transfer of a couple of smaller loans back to accrual status, and the transfer of a few smaller loans to nonaccrual status. Of the $1,703 in nonaccrual volume at December 31, 2017, $701 or 41.16 percent, compared to 45.71 percent and 15.57 percent at December 31, 2016 and 2015, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years.

	Year Ended December 31,		
Allowance for Loan Losses Activity:	**2017**	**2016**	**2015**
	(dollars in thousands)		
Balance at beginning of year	$ 3,695	$ 3,771	$ 3,892
Charge-offs:			
Production and intermediate-term	–	(26)	(86)
Rural residential real estate	(14)	–	–
Total charge-offs	(14)	(26)	(86)
Recoveries:		–	
Production and intermediate-term	6	–	–
Total recoveries	6	–	–
Net (charge-offs) recoveries	(8)	(26)	(86)
Provision for (reversal of allowance for) loan losses	350	(50)	(35)
Balance at end of year	$ 4,037	$ 3,695	$ 3,771
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.002)%	(0.006)%	(0.022)%

The net loan charge-offs were primarily associated with charge-offs taken on one small loan account, offset somewhat by recoveries taken on several small loan accounts. The increase in the provision for loan losses was associated with both an increase in the amount of loan reserves allocated to individually evaluated loans and an increase in the amount of loan reserves allocated to collectively evaluated loans.

The allowance for loan losses by loan type for the most recent three years is as follows.

	December 31,		
Allowance for Loan Losses by Type	**2017**	**2016**	**2015**
	(dollars in thousands)		
Real estate mortgage	$ 2,466	$ 2,308	$ 2,204
Production and intermediate-term	1,460	1,296	1,486
Agribusiness	48	13	18
Rural residential real estate	63	78	63
Total loans	$ 4,037	$ 3,695	$ 3,771

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses	December 31,		
as a Percentage of:	**2017**	**2016**	**2015**
Total loans	0.86%	0.87%	0.92%
Nonperforming loans	136.20%	111.13%	108.76%
Nonaccrual loans	237.05%	180.68%	119.24%

Please refer to Note 3, *Loans and Allowance for Loan Losses*, of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was $11,560, $11,096 and $10,555 in 2017, 2016 and 2015, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

	Volume*	**Rate**	**Total**
12/31/17 - 12/31/16			
Interest income	$ 1,421	$ 479	$ 1,900
Interest expense	(583)	(853)	(1,436)
Change in net interest income	$ 838	$ (374)	$ 464
12/31/15 - 12/31/15			
Interest income	$ 1,377	$ 132	$ 1,509
Interest expense	(581)	(387)	(968)
Change in net interest income	$ 796	$ (255)	$ 541

* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

Noninterest Income

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

Noninterest Income	For the Year Ended December 31, 2017	2016	2015	Percentage Increase/(Decrease) 2017/2016	2016/2015
	(dollars in thousands)				
Loan fees	$ 620	$ 591	$ 417	4.91%	41.73%
Patronage refund from other Farm Credit Institutions	6,730	5,138	4,884	30.97	5.20
Gains (losses) on sales of rural home loans	11	9	6	22.22	50.00
Gains (losses) from sales of premises and equipment, net	6	5	–	20.00	100.00
Other noninterest income	34	17	78	105.88	(78.21)
Total noninterest income	$ 7,401	$ 5,760	$ 5,385	28.49%	6.96%

Regarding patronage refunds received from other Farm Credit Institutions, the Association received $3,045 in a patronage refund and $3,662 in a special distribution from the Bank for the year ended December 31, 2017, compared to $2,856 and $2,231 for 2016, and $2,675 and $2,209 for 2015.

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended December 31, 2017	2016	2015	Percentage Increase/(Decrease) 2017/2016	2016/2015
	(dollars in thousands)				
Salaries and employee benefits	$ 3,913	$ 3,682	$ 3,367	6.27%	9.36%
Post retirement benefits	1,432	1,169	1,205	22.50	(2.99)
Occupancy and equipment expense	353	316	328	11.71	(3.66)
Insurance Fund premium	483	515	367	(6.21)	40.33
(Gains) losses on other property owned, net	–	1	59	(100.00)	(98.31)
Other operating expense	1,525	1,439	1,352	5.98	6.43
Total noninterest expense	$ 7,706	$ 7,122	$ 6,678	8.20%	6.65%

Salaries and employee benefits increased in 2017, as compared with 2016, primarily due to increased costs associated with additional staffing, merit increases and bonuses. Post retirement benefits increased $263 or 22.50 percent in 2017 as compared with 2016. During 2017, the method of recording expenses for the Association's defined benefit pension plan and other postretirement benefit plan was modified. This change resulted in the reduction of Other Assets by $1,762 and the reduction of Other Liabilities by $1,467 on the Association's Balance Sheets, and a corresponding increase in postretirement benefit costs on the Association's Statements of Income of $295 during 2017. Refer to Note 9, *Employee Benefit Plans,* of the Notes to the Consolidated Financial Statements, for further information concerning postretirement benefit expenses.

Occupancy and equipment expense increased $37 or 11.71 percent in 2017 as compared with 2016. This increase is primarily associated with increased depreciation expense and rental expenses associated with the opening of a new branch office. Insurance Fund premiums decreased $32 or 6.21 percent for the twelve months ended December 31, 2017, compared to the same period of 2016 due primarily to a decrease in rates charged by the Farm Credit System Insurance Corporation (FCSIC). Other operating expenses increased $86 or 5.98 percent in 2017 as compared with 2016. The increase is primarily associated with an increase in net nonaccrual expenses, public and member relation expenses, and non-property insurance expenses.

Income Taxes

The Association recorded a provision for income taxes of $12 for the year ended December 31, 2017, as compared to a benefit of $53 for 2016 and a provision of $2 for 2015. Refer to Note 2, *Summary of Significant Accounting Policies, Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/17	12/31/16	12/31/15
Return on average assets	2.36%	2.27%	2.30%
Return on average members' equity	14.14%	13.81%	14.21%
Net interest income as a percentage of average earning assets	2.59%	2.66%	2.71%
Net (charge-offs) recoveries to average loans	(0.002)%	(0.006)%	(0.022)%

The primary factors influencing the increases in return on average assets and return on members' equity were proportionately larger increases in association net earnings than the increase in assets and members' equity.

Key factors in the growth of net income for future years will be continued improvement in net interest and noninterest income along with a moderate increase in operating expenses and additional provisions made for loan losses. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue to remain healthy and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds." Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA, which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon an agreement between the Bank and the Association.

The weighted average interest rates on the variable rate notes were 2.61 percent for LIBOR-based loans, 2.67 percent for Prime-based loans, and the weighted average remaining maturities were 1.4 years and 1.4 years, respectively, at December 31, 2017. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 3.00 percent and the weighted average remaining maturity was 12.5 years at December 31, 2017. The weighted average interest rate on all interest-bearing notes payable was 2.93 percent and the weighted average remaining maturity was 10.6 years at December 31, 2017.

Variable rate and fixed rate notes payable represent approximately 3.74 percent and 96.26 percent, respectively, of total notes payable at December 31, 2017.

Total notes payable to the Bank at December 31, 2017, was $406,457 as compared to $368,038 at December 31, 2016 and $353,034 at December 31, 2015. The increase of 10.43 percent compared to December 31, 2016 and the increase of 4.25 percent compared to December 31, 2015, was attributable to larger than normal loan growth in the Association. The average volume of outstanding notes payable to the Bank was $380,698 and $358,111 for the years ended December 31, 2017 and 2016, respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in investments and secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

The Association had no lines of credit outstanding from third party financial institutions as of December 31, 2017.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio. The Association utilizes differential pricing for its loans based on credit risk, length of maturity, service cost, and market variables, thereby giving the Association the ability in large part to control its interest rate margins. Net interest income as a percentage of average earning assets was 2.59% for 2017, 2.66% for 2016, and 2.71% for 2015. The decrease in net interest income as a percentage of average earning assets for 2017 as compared to the previous year is primarily due to a decrease in the average interest rate margin realized on the loan portfolio as compared to the previous year.

Relationship with the Bank

In both financial and non-financial areas, the Association has a materially interdependent relationship with the Bank.

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements in this annual report.

The Bank's ability to require additional capital contributions from the Association is discussed in Note 4, *Investment in Other Farm Credit Institutions*, included in this annual report.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding" section of this Management's Discussion and Analysis and in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, included in this annual report.

The Association receives a patronage refund from the Bank which it records on an accrual basis.

In addition to the financial relationships described, the Association may act as a service provider to the Bank on certain participation loans that the Association has sold to the Bank. The Bank also provides operational assistance to the Association in many areas including cash management, accounting and reporting, computer networks and technology.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2017 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings. The Association Board of Directors adopted a change in the maximum member stock requirement, effective March 1, 2016, whereby the maximum requirement was reduced to 2% or $1,000, whichever is less, from the previous requirement of 2% or $3,000, whichever is less.

Total members' equity at December 31, 2017, increased 9.59 percent to $80,035 from the December 31, 2016, total of $73,029. At December 31, 2016, total members' equity increased 7.22 percent from the December 31, 2015 total of $68,109. The increases were primarily attributed to net income, partially offset by cash patronage paid.

Total capital stock and participation certificates were $4,698 on December 31, 2017, compared to $4,993 on December 31, 2016 and $6,784 on December 31, 2015. The decrease was attributed to members redeeming excess stock as a result of the change in maximum stock requirement adopted by the Association Board of Directors on March 1, 2016.

FCA regulations require all Farm Credit institutions to maintain minimum levels of several regulatory capital and leverage ratios. Effective January 1, 2017, the regulatory capital requirements for System Banks and Associations were modified. The new regulations ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted. New regulations replaced total surplus and core surplus ratios with common equity tier 1 (CET1), tier 1 capital, and total capital risk-based capital ratios, as well as a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio remains in effect. The capital ratios are calculated by dividing various levels of capital by a risk-adjusted asset base. Risk-adjusted assets have been defined by FCA regulations as balance sheet assests and off-balance sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. Calculation of permanent capital ratio risk-adjusted assets includes the allowance for loan losses as a deduction from risk-adjusted assets. This differs from the other risk-based capital calculations. The leverage ratios are calculated by dividing various types of capital by total regulatory assets (not risk-adjusted). For all periods represented, the Association exceeded the minimum regulatory standard for all of the ratios.

The following sets forth the regulatory capital ratios, which were effective January 1, 2017:

	2017	Minimum Requirement	Capital Conservation Buffer*	Regulatory Minimum with Capital Conservation Buffer
CET1 capital ratio	16.66%	4.5%	0.625%	5.125%
Tier 1 capital ratio	16.66%	6.0%	0.625%	6.625%
Total capital ratio	17.54%	8.0%	0.625%	8.625%
Permanent capital ratio	16.91%	7.0%	0.000%	7.000%
Tier 1 leverage ratio	14.63%	4.0%	1.000%	5.000%
UREE leverage ratio	14.29%	1.5%	0.000%	1.500%

*-*The capital conservation buffers have a 3 year phase-in period and will become fully effective January 1, 2010. 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.*

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 following sets forth regulatory capital ratios as previously reported:

	2016	2015	2014	2013	2012	Regulatory Minimum with Capital Conservation Buffer
Permanent capital ratio	17.79%	17.58%	16.85%	15.99%	14.18%	7.00%
Total surplus ratio	16.96%	16.28%	15.54%	14.62%	12.80%	7.00%
Core surplus ratio	16.96%	16.28%	15.54%	14.62%	12.69%	3.50%

The decrease in the Association's permanent capital ratio for December 31, 2017 was attributed to increased retained earnings from net income and a proportionately stronger growth in loan volume. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 7, *Members' Equity*, of the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute to borrowers on a patronage basis all or any portion of its available patronage sourced consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) purchase money mortgages and sales contracts, (b) participation loans purchased, (c) loans specified in advance as non-patronage, (d) the Association's defined benefit retirement plan income, (e) extraordinary income resulting from a change in accounting procedure, and (f) other non-patronage income as allowed by law, including lease income, the remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage allocations. The Association declared total patronage allocations of $9,702 in 2017, $8,871 in 2016, and $8,178 in 2015. Of those amounts, the Association declared a cash patronage payable of $3,590 in 2017, $3,105 in 2016 and $2,617 in 2015. The remaining patronage allocations were in the form of allocated retained earnings. With the resulting improvements in earnings and capital levels, the Association increased its cash patronage payout percentage for 2016 and 2017.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to Young*, Beginning** and Small*** farmers.

* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

** Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

*** Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than $250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. Actual program results in 2017 were 100% of program goals or better in all categories.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

	As of December 31, 2017			
	Number of Loans		Amount of Loans	
	Actual	Goal	Actual	Goal
Young	1,166	1,030	86,770	80,000
Beginning	1,211	1,035	93,708	76,000
Small	3,813	3,350	205,548	175,000

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2012 USDA-NASS Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 14,595 reported farmers of which by definition 856 or 5.87 percent were Young, 2,642 or 18.10 percent were Beginning, and 13,999 or 95.92 percent were Small. Comparatively, as of December 31, 2017, the demographics of the Association's agricultural portfolio contained 2,990 farmers, of which by definition 686 or 22.94 percent were Young, 801 or 26.79 percent were Beginning and 2,259 or 75.55 percent were Small.

In addition to our marketing strategies, in 2017 the Association utilized the following strategies and outreach programs:

- Support of 4H, FFA and young farmer organizations through sponsorships and donations.
- Offering loan guarantees and interest rate subsidies through Preferred Lender Programs with Farm Services Administration (FSA).

- FSA Loan Guarantee Fee Subsidy Program.
- Reduced Rate Coordination Programs with the Kentucky Agricultural Finance Corporation.
- Working in collaboration with a Young Farmers Advisory Council to create the Central Kentucky Ag Start Program.

The Association met its 2017 qualitative goals in coordination of programs, FSA Guarantee Loan Volume, Reduced Rate Coordination Program, and statewide youth program advertising and sponsorships.

The Vice President of Information Systems coordinates the Association's efforts for YBS programs. The Association includes YBS goals in the annual strategic plan, and reports on those goals and achievements to the Board of Directors on a quarterly basis.

Demographics

The Association has used the 2012 USDA-NASS Ag Census as our source of demographic data for the counties in our territory. There are several differences in the methods by which the demographic and YBS Farmer data is presented. Young farmers are defined by the FCA as 35 years old or less. The UDSA-NASS Ag Census demographic stratification breaks at 34 years old, which was used to compare to FCA's definition. Beginning farmers are defined by the FCA as having 10 years or less farming experience. There is no measurement matching this definition in the USDA-NASS Ag Census; however the census does identify farmers on their current farm less than 10 years. That statistic may include beginning farmers, but may also include experienced farmers who have recently changed farmsteads. As with the case of the Young information, the Beginning information in the USDA-NASS Ag Census is not an exact comparison to the FCA definition, but will be utilized as the best comparison available. The FCA Small definition matches with the USDA-NASS Ag Census delineation of farm entities with sales of less than $250 thousand. Other data differences: The farmers experience is as of the date of the USDA-NASS Ag Census, while the Association data is compiled as to the date the loan was made. Small farmers is by each individual farm entity from the USDA-NASS Ag Census data, while the Association data is compiled as of the date of the loan and represents the total value of sales of closely related entities rather than individual entities. The USDA-NASS Ag Census data reflects all farms whether they use debt or not. While the statistical results of the USDA-NASS Ag Census do not match the FCA definitions exactly and there are timing issues, they do provide a consistent source of measurement with which to assess Association targets and goals.

REGULATORY MATTERS

On July 25, 2014, the FCA published a proposed rule in the Federal Register to revise the requirements governing the eligibility of investments for System banks and associations. The public comment period ended on October 23, 2014. The FCA expects to issue a final regulation in 2018. The stated objectives of the proposed rule are as follows:

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

FINANCIAL REGULATORY REFORM

Derivatives transactions are subject to myriad regulatory requirements including, among other things, clearing through a third-party central clearinghouse trading on regulated exchanges or other multilateral platforms. Margin is required for these transactions. Derivative transactions that are not subject to mandatory trading and clearing requirements may be subject to minimum margin and capital requirements.

The Commodity Futures Trading Commission and other federal banking regulators have exempted System institutions from certain, but not all, of these new requirements, including for swaps with members, mandatory clearing and minimum margin for non-cleared swaps.

Notwithstanding these exceptions, counterparties of System institutions may require margin or other forms of credit support as a condition to entering into non-cleared transactions because such transactions may subject these counterparties to more onerous capital, liquidity and other requirements absent such margin or credit support. Alternatively, these counterparties may pass on the capital and other costs associated with entering into transactions if insufficient margin or if other credit support is not provided.

The Dodd-Frank Act also created a new federal agency called the Consumer Financial Protection Bureau (CFPB). The CFPB is responsible for regulating the offering of consumer financial products or services under federal consumer financial laws. The Farm Credit Administration retains the responsibility to oversee and enforce compliance by System institutions with relevant rules adopted by the CFPB.

The regulatory requirements that apply to derivatives transactions could affect funding and hedging strategies and increase funding and hedging costs.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

The following Accounting Standards Updates (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. • Changes the present incurred loss impairment guidance for loans to a CECL model. • 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. • Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets. • Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. • 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 Association has begun implementation efforts by establishing a cross-discipline governance structure. The Association 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. • The Association expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including: 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, 2. An allowance will be established for estimated credit losses on debt securities, 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. • The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Association's portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date. • The Association 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. • Lessor accounting activities are largely unchanged from existing lease accounting. • The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification. • Also, expands qualitative and quantitative disclosures of leasing arrangements. • Requires adoption using a modified cumulative effect approach wherein the guidance is applied to all periods presented. • 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. • The Association has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities. • As a lessee the Association 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. • Given the limited changes to lessor accounting, the Association does not expect material changes to recognition or measurement, but it is early in the implementation process and the impact will continue to be evaluated. • The Association is evaluating existing disclosures and may need to provide additional information as a result of adopting the Update. • The Association expects to adopt the guidance in first quarter 2019 using the modified retrospective method and practical expedients for transition.
ASU 2016-01 – Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities	
• The Update amends the presentation and accounting for certain financial instruments, including liabilities measured at fair value under the fair value option and equity investments. • Requires certain equity instruments be measured at fair value, with changes in fair value recognized in earnings. • The guidance also updates fair value presentation and disclosure requirements for financial instruments measured at amortized cost. • Effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years.	• The Association is currently evaluating any impacts to the financial statements. The Association's implementation efforts include the identification of securities within the scope of the guidance, the evaluation of the measurement alternative available for equity securities without a readily determinable fair value, and the related impact to accounting policies, presentation, and disclosures. • Any investments in nonmarketable equity investments accounted for under the cost method of accounting (except for other Farm Credit Institution stock) will be accounted for either at fair value with unrealized gains and losses reflected in earnings or, if elected, using an alternative method. The alternative method is similar to the cost method of accounting, except that the carrying value is adjusted (through earnings) for subsequent observable transactions in the same or similar investment. The Association is currently evaluating which method will be applied to these nonmarketable equity investments. • Additionally, for purposes of disclosing the fair value of loans carried at amortized cost, the Association is evaluating valuation methods to determine the necessary changes to conform to an "exit price" notion as required by the Standard. Accordingly, the fair value amounts disclosed for such loans may change upon adoption. • The Association expects to adopt the guidance in first quarter 2018 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption, except for changes related to nonmarketable equity investments, which is applied prospectively. The Association expects the primary accounting changes will relate to equity investments.

ASU 2014-09 – Revenue from Contracts With Customers (Topic 606) and subsequent related Updates	
• Requires that revenue from contracts with customers be recognized upon transfer of control of a good or service, and transfers of nonfinancial assets, in an amount equaling the consideration expected to be received. • Changes the accounting for certain contract costs, including whether they may be offset against revenue in the Consolidated Statements of Income, and requires additional disclosures about revenue and contract costs. • May be adopted using a full retrospective approach or a modified, cumulative effect approach wherein the guidance is applied only to existing contracts as of the date of initial application, and to new contracts transacted after that date. • Effective for reporting periods beginning after December 15, 2017. Early application is not permitted.	• The Association's revenue is the sum of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of the Association's revenues will not be affected. • The Association is performing an assessment of revenue contracts as well as working with industry participants on matters of interpretation and application. Accounting policies will not change materially since the principles of revenue recognition from the Update are largely consistent with existing guidance and current business practices. The Association has not identified material changes to the timing or amount of revenue recognition. • The Association expects a minor change to the presentation of costs for certain underwriting activities which will be presented in expenses rather than the current presentation against the related revenues. The Association will provide qualitative disclosures of performance obligations related to revenue recognition and will continue to evaluate disaggregation for significant categories of revenue in the scope of the guidance. • The Association intends to adopt the guidance in first quarter 2018 using the modified retrospective method with a cumulative-effect adjustment to opening retained earnings.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1, *Organization and Operations*, of the Consolidated Financial Statements included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, developments that had or could have a material impact on patronage or dividends, changes in patronage policies and practices, and concentrations of assets, if any, is incorporated in *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* included in this Annual Report.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Kentucky:

Location	Description	Form of Ownership
640 South Broadway Lexington	Administrative	Owned
640 South Broadway Lexington	Branch	Owned
485 N Danville Bypass Danville	Branch	Owned
1000 Ival James Boulevard Richmond	Branch	Owned
201 Commerce Drive Paris	Branch	Owned
842 W Main Lebanon	Branch	Owned
106 Agriculture Way Stanford	Branch	Owned
1120 US Highway 127 South Frankfort	Branch	Leased

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 11, *Commitments and Contingencies*, of the Consolidated Financial Statements included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7, *Members' Equity*, of the Consolidated Financial Statements included in this Annual Report.

Description of Liabilities

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 9 and 11 of the Consolidated Financial Statements included in this Annual Report.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
James W. Caldwell	*President and Chief Executive Officer* - since January, 2009
Jonathan T. Noe	*Vice President and Chief Lending Officer* – since September, 2008
Robert G. Anderson	*Vice President Information Systems* - since January, 1999
Marcus G. Barnett	*Vice President and Chief Financial Officer* – since August, 2004
Shane Turner	*Vice President and Chief Risk Officer* – since October, 2017

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2017, 2016 and 2015, is as follows:

Name of Individual or Number in Group	Year	Received Compensation: Salary	Bonus	Total Received	Perquisites and Other Compensation: Change in Pension**	Perq./ Other*	Total Perq. and Other	Total Compensation
James W. Caldwell	2017	$ 285,011	$ 5,400	$ 290,411	$ 87,365	$ 8,085	$ 95,450	$ 385,861
James W. Caldwell	2016	$ 267,510	$ 3,900	$ 271,410	$ 292,747	$ 8,606	$ 301,353	$ 572,763
James W. Caldwell	2015	$ 250,009	$ 3,900	$ 253,909	$ 196,770	$ 9,248	$ 206,018	$ 459,927
5	2017	$ 670,876	$ 45,093	$ 715,969	$ 512,262	$ 5,747	$ 518,009	$ 1,233,978
5	2016	$ 637,624	$ 28,951	$ 666,575	$ 386,094	$ 5,473	$ 391,567	$ 1,058,142
5	2015	$ 602,623	$ 32,162	$ 634,785	$ 91,954	$ –	$ 91,954	$ 726,739

**The Perquisites/Other amount disclosed in the above chart includes automobile compensation, cost of group insurance in excess of $50,000, and spousal travel.*

This figure is a third party actuarial determination of the change in present value of the estimated pension cash flows.* ***Please refer to information provided below giving further explanation of assumptions used in order to calculate the present value of pension benefits.

The total compensation paid during 2017 to any senior officer, or to any other employee included in the aggregate group total as reported in the table above is available and will be disclosed to the shareholders of the institution upon request.

On October 3, 2012, FCA adopted a regulation that requires enhanced disclosures pertaining to Senior Officer compensation, specifically additional information pertaining to the present value of pension benefits and the change in the present value of pension benefits from the previous year.

The present value of pension benefits is the value at a specific date of the expected future benefit payment stream based on actuarial assumptions, chiefly the discount rate. Other assumptions are also used, such as expected retirement age and life expectancy. Actuarial assumptions are updated periodically. Changes in the actuarial assumptions can increase or decrease the pension values.

The discount rate, which is derived using an AA corporate bond yield curve, is updated every year based on the interest rate environment at December 31. A decrease in the discount rate will normally increase the present values and vice versa. A decrease in the discount rate assumption from the prior year caused the pension values to increase at December 31, 2017.

In addition to the discount rate, other factors such as increases in compensation or additional years of service for plan participants will also cause a change in the present value of pension benefits. Specifically, an additional year of service leading up to the earliest unreduced retirement date and increases in compensation may lead to increases in present value of pension benefits. An additional year of service past the unreduced retirement date may lead to a decrease in the present value of pension benefits.

In October 2014, the Society of Actuaries issued revised mortality tables and a mortality improvement scale for use by actuaries, insurance companies, governments, benefit plan sponsors and others in setting assumptions regarding life expectancy in the United States for purposes of estimating pension and other postemployment benefit obligations, costs and required contribution amounts. The new mortality tables indicated substantial life expectancy improvements since the last study published in 2000. The adoption of these new tables at December 31, 2016 resulted in increased pension values as the benefit payments are expected to be made for a longer time span.

On February 4, 2015, the FCA Board approved the final rule, “Disclosure to Shareholders; Pension Benefit Disclosures.” The rule amends FCA regulations to exclude employee compensation from being reported in the Summary Compensation Table if the employee would be considered a “highly compensated employee” solely because of payments related to or change(s) in value of the employee’s qualified pension plan provided that the plan was available to all similarly situated employees on the same basis at the time the employee joined the plan.

Additional information on pension benefits related to the CEO and the highest paid officers as a group for the year ended December 31, 2017 is as follows:

Pension Benefits Table
As of December 31, 2017

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits**	Payments During 2017
James W. Caldwell	2017	Independent Associations Retirement Plan	37	$ 2,380,468	$ –
Senior Officers and Highly Compensated Employees:					
5	2017	Independent Associations Retirement Plan	*28	$ 3,691,846	$ –

** Represents the average years of credited service for the group.*

This figure is a third party actuarial determination of the present value of the estimated pension cash flows.* ***Please refer to information provided above giving further explanation of assumptions used in order to calculate the present value of pension benefits.

In addition to a base salary, the branch lending staff can earn additional compensation under an incentive plan. There were no material changes to the incentive plan adopted for 2017 as the plan design continues to motivate new business development. In addition to this incentive plan for the lending staff, the entire Association staff, including senior officers, may receive a bonus at the discretion of the Board of Directors. While discretionary, these bonuses are generally based on the efforts of staff, including senior officers, in striving to accomplish business plan objectives such as profitability, growth, credit quality and overall performance. All of these bonuses were paid in the 2017 calendar year. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Directors

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $25,955 for 2017, $38,362 for 2016 and $19,529 for 2015.

Subject to approval by the board, the Association may allow the chairman of the board of directors, the chairman of the audit committee, and other director's honoraria of $650, $600 and $550 respectively for attendance at meetings, committee meetings, or special assignments. Directors also receive $100 for participation in board or committee related conference calls. In 2017, total cash compensation paid to directors as a group was $62,750. No non-cash compensation was paid to directors in 2017.

The following represents certain information regarding the directors of the Association and their principal occupations:

James Alvin Lyons was re-elected to a four-year term on the Board of Directors at the 2016 Annual Meeting. His current term expires in 2020. He presently serves as Chairman of the Board, a position he has held since April 2011. During the past 5 years, Mr. Lyons has produced alfalfa, corn, soybeans, wheat, tobacco, has a commercial cow-calf program and backgrounds feeder cattle on his farming operation in Scott County. Mr. Lyons serves as a Board member of the Scott County Farm Bureau and is a member of the Scott County Beef Improvement Board. In addition, he serves as a member of the Scott County Rural Land Management Board and as a director of the Kentucky Ag Leadership Program Alumni. Mr. Lyons is also a Magistrate on the Scott County Fiscal Court. Since January 2018, Mr. Lyons has served as a director for the AgFirst Farm Credit Bank. During 2017, Mr. Lyons served 10 days at Association Board meetings, 14 days in other official activities, participated in 2 conference calls, and was paid $15,800 in compensation.

James C. ("Jim") Rankin III was elected to a four-year term on the Board of Directors at the 2016 Annual Meeting. His current term expires in 2020. He presently serves as Vice Chairman of the Board, a position he has held since February 2014. During the past 5 years, Mr. Rankin has produced soybeans, wheat and alfalfa on his farming operation in Bourbon County. Mr. Rankin owns thoroughbred mares, and boards mares and foals. He also raises and trains thoroughbreds for racing. In addition, Mr. Rankin partners with his sons in the thoroughbred horse operation, in a cow/calf operation, feeders, hay and grain. During 2017, Mr. Rankin served 9 days at Association Board meetings, 13 days in other official activities, participated in 2 conference calls, and was paid $12,300 in compensation.

James L. May was re-elected to a four-year term on the Board of Directors at the 2015 Annual Meeting. His current term expires in 2019. He served as Chairman of the Board from 1999 to 2011, and previously served as Vice Chairman of the Board from April 1991. He currently serves as the Chairman of the Board Compensation Committee. During the past five years, Mr. May and his wife have owned Mayhaven Farm LLC in Lincoln County where they have produced corn, hay, soybeans, wheat, have backgrounded feeder cattle, and have a 125 head cow/calf program in addition to operating a retail agricultural seed business. In addition, Mr. May serves as Chairman of the Lincoln County Extension Council. From January, 2006 through December 2017, Mr. May served as a director for the AgFirst Farm Credit Bank. During 2017, Mr. May served 10 days at Association Board meetings, 0 days in other official activities, participated in 1 conference call, and was paid $5,600 in compensation.

Joe Myers was elected to a four-year term on the Board of Directors at the 2014 Annual Meeting. His current term expires in 2018. During the past 5 years, Mr. Myers has owned and operated Myers Angus Farm, a 60 head purebred angus cow operation on his farming operation in Mercer County, marketing registered bulls, females, and embryos throughout Kentucky, multiple states, and foreign countries. He also serves as a Beef Sire Analyst for Select Sires, Inc. where he is responsible for purchasing/leasing bulls to enter into the A.I. Genetics Program. He is also a former Farm Manager for Anderson Circle Farms. Mr. Myers serves on the Kentucky Angus Association Board, the Central Kentucky Angus Association Board, and the Mercer County Cattleman's Board. During 2017, Mr. Myers served 10 days at Association Board meetings, 5 days in other official activities, participated in 1 conference call, and was paid $8,350 in compensation.

Lee Hood was elected to a four-year term on the Board of Directors at the 2017 Annual Meeting. Her current term expires in 2021. During the past 5 years, Ms. Hood has served as Chief Financial officer for Clements Ag Supply, Inc. in Springfield, Kentucky. She owns and leases land in Washington County were she operates a cow/calf operation, backgrounds feeder cattle, and produces 300 acres of hay. Ms. Hood also serves as Chairman of the Washington County Ag Development Board. During 2017, Ms. Hood served 9 days at Association Board meetings, 4 days in other official activities, participated in 0 conference calls, and was paid $7,150 in compensation.

Pursuant to the Agricultural Credit Act of 1987 and in compliance with Association Bylaws, the Association Board of Directors first elected during 2001 a member to the Board who is not a director, officer, employee or shareholder of any Farm Credit System institution (i.e. Outside Director).

Dan Grigson was first elected as an Outside Director by the Association Board of Directors in 2017. His current term expires in April 2021. Mr. Grigson retired from the University of Kentucky College of Agriculture in 2017 where he served as an Agricultural Extension Agent from 1974 through 2016. He currently serves on the staff of the Spurlin Funeral Home. During the past 5 years Mr. Grigson has served as a director of the Buffalo Springs Cemetery Board. He has also served as a director of the Lincoln County Fair Board, and as Vice President of the Lincoln County Farm Bureau Federation. During 2017, Mr. Grigson served 4 days at Association Board meetings, 0 days in other official activities, participated in 0 conference calls, and was paid $2,200 in compensation.

Mary-Lynn Hinkel was first elected as an Outside Director by the Association Board of Directors in 2014. She was reelected in 2016, and her current term expires in April 2020. She currently serves as the Chairman of the Board Audit Committee. Ms. Hinkel serves as HR Staffing Coordinator for CMTA Consulting Engineers, recruiting staff for eight offices located throughout the U.S. Previously, Ms. Hinkel was Associate Director of Tax Services at Dean, Dorton, Allen, Ford, PLLC where she provided compliance services including tax, financial statements and accounting for business, individuals, and non-profit organizations. Her services concentrated in physicians and the healthcare industry, manufacturing, and real estate of closely-held and family-owned businesses. During the past 5 years Ms. Hinkel has served on the United Way of the Bluegrass Agency Review Executive Committee, and as a Banking Committee member for Equestrian Events, Inc. She has served as a past member of the Finance Committee and Education Committee for the Cathedral of Christ the King, and has served as past Treasurer and President of the Parent Teacher Organization for Christ the King School. She has also served as a Board Member and Treasurer for Lexington and Central Kentucky Youth Salute. During 2017, Ms. Hinkel served 8 days at Association Board meetings, 8 days in other official activities, participated in 2 conference calls, and was paid $9,500 in compensation.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 10, *Related Party Transactions*, of the Consolidated Financial Statements included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

Transactions Other Than Loans

There have been no transactions that occurred at any time during the year ended December 31, 2017, between the Association and senior officers or directors, their immediate family members or any organizations with which they are affiliated, which require reporting per FCA regulations. There were no transactions with any senior officer or director related to the purchase or retirement of preferred stock of the Association for the year ended December 31, 2017.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Involvement in Unincorporated Business Entities

The Association holds no equity investments in Unincorporated Business Entities (UBEs) at December 31, 2017.

Relationship with Independent Auditors

There were no changes in or material disagreements with our independent auditors on any matter of accounting principle or financial statement disclosure during this period.

Aggregate fees incurred by the Association for services rendered by its independent auditors for the year ended December 31, 2017 were as follows:

	2017
Independent Auditors	
PricewaterhouseCoopers LLP	
Audit services	$ 61,977
Total	$ 61,977

Audit fees were for the annual audit of the consolidated financial statements.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 13, 2018 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-859-253-3249, or writing Marcus G. Barnett, Chief Financial Officer, Central Kentucky Agricultural Credit Association, P.O. Box 1290, Lexington, Kentucky 40588-1290, or accessing the website, ***www.agcreditonline.com.*** The Association prepares an electronic version of the Annual Report which is available on the Association's website within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* section included in this Annual Report to the shareholders.

Shareholder Investment

Shareholder investment in the Association may be materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at ***www.agfirst.com***. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Central Kentucky Agricultural Credit Association (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditors for 2017, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 *(The Auditor's Communication With Those Charged With Governance)*. The Committee discussed with PwC its independence from Central Kentucky Agricultural Credit Association. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2017. The foregoing report is provided by the following independent directors, who constitute the Committee:

Mary-Lynn Hinkel

Mary-Lynn Hinkel
Chairman of the Audit Committee

Members of Audit Committee

James Alvin Lyons
James C. Rankin III
James L. May
Joe Myers
Lee Hood
Dan Grigson

March 13, 2018

Report of Independent Auditors

To the Board of Directors and Management of
Central Kentucky Agricultural Credit Association

We have audited the accompanying consolidated financial statements of Central Kentucky Agricultural Credit Association and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2017, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in members' equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Central Kentucky Agricultural Credit Association and its subsidiaries as of December 31, 2017, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP
Certified Public Accountants
Miami, Florida

March 13, 2018

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2017	2016	2015
Assets			
Cash	**$ 2,028**	$ 1,605	$ 1,250
Loans	**471,730**	426,095	407,863
Allowance for loan losses	**(4,037)**	(3,695)	(3,771)
Net loans	**467,693**	422,400	404,092
Loans held for sale	**133**	1,428	150
Accrued interest receivable	**6,467**	5,781	5,137
Investments in other Farm Credit institutions	**7,117**	7,113	7,079
Premises and equipment, net	**2,960**	3,014	2,926
Other property owned	**8**	8	—
Accounts receivable	**6,758**	5,135	4,930
Other assets	**23**	1,861	2,098
Total assets	**$ 493,187**	$ 448,345	$ 427,662
Liabilities			
Notes payable to AgFirst Farm Credit Bank	**$ 406,457**	$ 368,038	$ 353,034
Accrued interest payable	**1,007**	815	756
Patronage refunds payable	**3,694**	3,195	2,711
Accounts payable	**536**	709	501
Other liabilities	**1,458**	2,559	2,551
Total liabilities	**413,152**	375,316	359,553
Commitments and contingencies (Note 11)			
Members' Equity			
Capital stock and participation certificates	**4,698**	4,993	6,784
Retained earnings			
Allocated	**54,453**	48,344	42,801
Unallocated	**20,884**	19,692	18,524
Total members' equity	**80,035**	73,029	68,109
Total liabilities and members' equity	**$ 493,187**	$ 448,345	$ 427,662

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

Consolidated Statements of Comprehensive Income

(dollars in thousands)	For the year ended December 31, 2017	2016	2015
Interest Income			
Loans	**$ 22,243**	$ 20,343	$ 18,834
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	**10,683**	9,247	8,279
Net interest income	**11,560**	11,096	10,555
Provision for (reversal of allowance for) loan losses	**350**	(50)	(35)
Net interest income after provision for (reversal of allowance for) loan losses	**11,210**	11,146	10,590
Noninterest Income			
Loan fees	**620**	591	417
Lease income	**33**	17	19
Patronage refunds from other Farm Credit institutions	**6,730**	5,138	4,934
Gains (losses) on sales of rural home loans, net	**11**	9	6
Gains (losses) on sales of premises and equipment, net	**6**	5	—
Other noninterest income	**1**	—	9
Total noninterest income	**7,401**	5,760	5,385
Noninterest Expense			
Salaries and employee benefits	**3,913**	3,682	3,367
Postretirement benefits (Notes 2 and 9)	**1,432**	1,169	1,205
Occupancy and equipment	**353**	316	328
Insurance Fund premiums	**483**	515	367
(Gains) losses on other property owned, net	**—**	1	59
Other operating expenses	**1,525**	1,439	1,352
Total noninterest expense	**7,706**	7,122	6,678
Income before income taxes	**10,905**	9,784	9,297
Provision for income taxes	**12**	(53)	2
Net income	**10,893**	9,837	9,295
Other comprehensive income	**—**	—	—
Comprehensive income	**$ 10,893**	$ 9,837	$ 9,295

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Total Members' Equity
Balance at December 31, 2014	$ 6,744	$ 37,362	$ 17,287	$ 61,393
Comprehensive income			9,295	9,295
Capital stock/participation certificates issued/(retired), net	40			40
Patronage distribution				
Cash			(2,617)	(2,617)
Nonqualified retained earnings		5,561	(5,561)	—
Patronage distribution adjustment		(122)	120	(2)
Balance at December 31, 2015	$ 6,784	$ 42,801	$ 18,524	$ 68,109
Comprehensive income			9,837	9,837
Capital stock/participation certificates issued/(retired), net	(1,791)			(1,791)
Patronage distribution				
Cash			(3,105)	(3,105)
Nonqualified retained earnings		5,766	(5,766)	—
Patronage distribution adjustment		(223)	202	(21)
Balance at December 31, 2016	$ 4,993	$ 48,344	$ 19,692	$ 73,029
Comprehensive income			**10,893**	**10,893**
Capital stock/participation certificates issued/(retired), net	**(295)**			**(295)**
Patronage distribution				
Cash			**(3,590)**	**(3,590)**
Nonqualified retained earnings		**6,112**	**(6,112)**	**—**
Patronage distribution adjustment		**(3)**	**1**	**(2)**
Balance at December 31, 2017	**$ 4,698**	**$ 54,453**	**$ 20,884**	**$ 80,035**

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2017	2016	2015
Cash flows from operating activities:			
Net income	**$ 10,893**	$ 9,837	$ 9,295
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	**162**	143	140
Amortization (accretion) of net deferred loan costs (fees)	**(1)**	(4)	(1)
Provision for (reversal of allowance for) loan losses	**350**	(50)	(35)
(Gains) losses on other property owned	**—**	—	22
(Gains) losses on sales of premises and equipment, net	**(6)**	(5)	—
(Gains) losses on sales of rural home loans, net	**(11)**	(9)	(6)
Changes in operating assets and liabilities:			
Origination of loans held for sale	**(11,110)**	(10,058)	(5,656)
Proceeds from sales of loans held for sale, net	**12,416**	8,789	5,512
(Increase) decrease in accrued interest receivable	**(686)**	(644)	(648)
(Increase) decrease in accounts receivable	**(1,623)**	(205)	1,562
(Increase) decrease in other assets	**1,838**	237	(997)
Increase (decrease) in accrued interest payable	**192**	59	59
Increase (decrease) in accounts payable	**(173)**	208	(11)
Increase (decrease) in other liabilities	**(1,101)**	8	501
Total adjustments	**247**	(1,531)	442
Net cash provided by (used in) operating activities	**11,140**	8,306	9,737
Cash flows from investing activities:			
Net (increase) decrease in loans	**(45,642)**	(18,262)	(25,802)
(Increase) decrease in investment in other Farm Credit institutions	**(4)**	(34)	(34)
Purchases of premises and equipment	**(108)**	(232)	(25)
Proceeds from sales of premises and equipment	**6**	6	—
Proceeds from sales of other property owned	**—**	—	618
Net cash provided by (used in) investing activities	**(45,748)**	(18,522)	(25,243)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	**38,419**	15,004	18,287
Capital stock and participation certificates issued/(retired), net	**(295)**	(1,791)	40
Patronage refunds and dividends paid	**(3,093)**	(2,642)	(2,860)
Net cash provided by (used in) financing activities	**35,031**	10,571	15,467
Net increase (decrease) in cash	**423**	355	(39)
Cash, beginning of period	**1,605**	1,250	1,289
Cash, end of period	**$ 2,028**	$ 1,605	$ 1,250
Supplemental schedule of non-cash activities:			
Receipt of property in settlement of loans	**$ —**	$ 8	$ —
Estimated cash dividends or patronage distributions declared or payable	**3,590**	3,105	2,617
Supplemental information:			
Interest paid	**10,492**	9,188	8,220
Taxes (refunded) paid, net	**(69)**	—	108

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Central Kentucky Agricultural Credit Association (Association) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in the counties of Anderson, Bourbon, Boyle, Clark, Fayette, Franklin, Garrard, Harrison, Jessamine, Lincoln, Madison, Marion, Mercer, Montgomery, Scott, Washington and Woodford in the state of Kentucky.

The Association is a lending institution in the Farm Credit System (System), a nationwide network of cooperatively owned banks and associations. It was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

The nation is served by three Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), (collectively, the System Banks) each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities.

Each System Bank serves one or more Agricultural Credit Associations (ACAs) that originate long-term, short-term and intermediate-term loans, Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, and/or Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans. These associations borrow a majority of the funds for their lending activities from their related bank. System Banks are also responsible for supervising the activities of associations within their districts. AgFirst (Bank) and its related associations (Associations or District Associations) are collectively referred to as the AgFirst District. The District Associations jointly own substantially all of AgFirst's voting stock. As of year end, the District consisted of the Bank and nineteen District Associations. All nineteen were structured as ACA holding companies, with PCA and FLCA subsidiaries. FLCAs are tax-exempt while ACAs and PCAs are taxable.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation at its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure base amount to System institutions. However, it must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity and financial services that can be offered by the Association, and the persons eligible to borrow.

The Associations borrow from the Bank and in turn may originate and service short- and intermediate-term loans to their members, as well as long-term real estate mortgage loans.

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' earning assets. These lines of credit (or Direct Notes) are collateralized by a pledge of substantially all of each Association's assets. The terms of the Direct Notes are governed by a General Financing Agreement (GFA) between the Bank and Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized.

In addition to providing funding for earning assets, the Bank provides District Associations with banking and support services such as accounting, human resources, information systems, and marketing. The costs of these support services are included in cost of the Direct Note, or in some cases billed directly to certain Associations that use a specific service.

The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers.

Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

The accompanying consolidated financial statements include the accounts of the ACA, PCA and FLCA.

Certain amounts in the prior year financial statements have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or total members' equity of prior years.

A. **Cash:** Cash represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** The Association is authorized to make long-term real estate loans with maturities of 5 to 40 years and certain short- and intermediate-term loans for agricultural production or operating purposes with maturities of not more than 10 years.

   Loans are carried at their principal amount outstanding adjusted for charge-offs, premiums, discounts, deferred loan fees or costs, and derivative instruments and hedging valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the total investment in a loan and its principal amount may be deferred as part of the carrying amount of the loan and the net difference amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

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

   Loans are generally classified as nonaccrual when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

   When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

   Loans are charged off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

   In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

   The allowance for loan losses is maintained 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 individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

   The Association considers the following factors, among others, when determining the allowance for loan losses:

   - Changes in credit risk classifications
   - Changes in collateral values

- Changes in risk concentrations
- Changes in weather-related conditions
- Changes in economic conditions

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The Association uses a two-dimensional loan rating model based on internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

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

C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.

D. **Other Property Owned:** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) from Other Property Owned, Net in the Consolidated Statements of Comprehensive Income.

E. **Premises and Equipment:** Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or circumstances indicate that the carrying value of the asset may not be recoverable.

   From time to time, assets classified as premises and equipment are transferred to held for sale for various reasons. These assets are carried in Other Assets at the lower of the recorded investment in the asset or fair value less estimated cost to sell based upon the property's appraised value at the date of transfer. Any write-downs of property held for sale are recorded as other non-interest expense.

F. **Investments:** The Association may hold investments as described below.

   Investment in Other Farm Credit Institutions
   The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock, as presented on the Consolidated Balance Sheets as Investments in Other Farm Credit Institutions. Accounting for this investment is on the cost plus allocated equities basis.

G. **Voluntary Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as other liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

H. **Employee Benefit Plans:** The Association participates in District and multi-District sponsored benefit plans. These plans may include defined benefit final average pay retirement, defined benefit cash balance retirement, defined benefit other postretirement benefits, and defined contribution plans.

Defined Contribution Plans
Substantially all employees are eligible to participate in the defined contribution Farm Credit Benefit Alliance (FCBA) 401(k) Plan, subsequently referred to as the 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Company contributions to the 401(k) Plan are expensed as funded.

Additional information for the above may be found in Note 9 and the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report.

Multi-Employer Defined Benefit Plans
Substantially all employees hired before January 1, 2009 may participate in the Independent Associations Retirement Plan or the AgFirst Farm Credit Cash Balance Retirement Plan (Plan), which is a defined benefit plan and considered multi-employer under FASB accounting guidance. The Plan is noncontributory and includes eligible Association and District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes.

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-District sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents during the years the employee renders service necessary to become eligible for benefits.

Since the foregoing plans are multi-employer, the Association does not apply the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations for the pension plan and in the Annual Information Statement of the Farm Credit System for the other postretirement benefits plan.

Additional information for the above may be found in Note 9 and in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report and the Notes to the Annual Information Statement of the Farm Credit System.

I. **Income Taxes:** The Association evaluates tax positions taken in previous and current years according to FASB guidance. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to, an entity's status, including its status as a pass-through entity or tax-exempt entity.

The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the expected patronage program, which reduces taxable earnings.

J. **Due from AgFirst Farm Credit Bank:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

K. **Valuation Methodologies:** FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It prescribes three levels of inputs that may be used to measure fair value.

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology 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 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than a third-party valuation or internal model pricing.

The Association may use the Bank, internal resources or third parties to obtain fair value prices. Quoted market prices are generally used when estimating fair values of any assets or liabilities for which observable, active markets exist.

A number of methodologies may be employed to value items for which an observable active market does not exist. Examples of these items include: impaired loans, other property owned, and certain derivatives, investment securities and other financial instruments. Inputs to these valuations can involve estimates and assumptions that require a substantial degree of judgment. Some of the assumptions used include, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on results of operations.

Please see further discussion in Note 8.

L. **Off-Balance-Sheet Credit Exposures:** The credit risk associated with commitments to extend credit and letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party.

M. **Revenue Recognition:** The largest source of revenue for the Association is interest income. Interest income is recognized on an accrual basis driven by nondiscretionary formulas based on written contracts, such as loan agreements or securities contracts. Credit-related fees, including letter of credit fees, finance charges and other fees are recognized in non-interest income when earned. Other types of non-interest revenues, such as service charges, professional services and broker fees, are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

N. **Accounting Standards Updates (ASUs):** 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.

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 will be effective for reporting periods beginning after December 15, 2017 for public business entities. The Association does not expect these amendments to have a material effect on its financial statements.

In October 2016, the FASB issued ASU 2016-16 Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This Update requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. For public business entities, the amendments are effective, on a modified retrospective basis, for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. The Association does not expect these amendments to have a material effect on its financial statements.

In August 2016, the FASB issued ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). This Update eliminates diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The Update addresses eight specific cash flow issues with the objective of reducing existing diversity in practice. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments are to be applied using a retrospective transition method to each period presented. The Association elected retrospective early adoption of this guidance. The criteria of the standard were not significantly different from the Association's policy in place at adoption. Application of the guidance had no impact on the Association's Statements of Cash Flows.

In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The Update improves 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 Association 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 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 Association is in the process of evaluating what effects the guidance may have 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 is intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP. The ASU will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years for public business entities. The Association does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance changes the recognition of revenue from contracts with customers. The core principle of the new 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. This guidance also includes 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 has issued several additional Updates that generally provide clarifying guidance where there was the potential for diversity in practice, or address the cost and complexity of applying Topic 606. The guidance and all related updates will be effective for reporting periods beginning after December 15, 2017 for public business entities. The amendments are to be applied retrospectively. The Association has identified ancillary revenues that will be affected by this Update. However, because financial instruments are not within the scope of the guidance, it is expected that adoption will not have a material impact on the Association's financial condition or results of operations. The Association expects to adopt the guidance in first quarter 2018 using the modified retrospective method and that adoption will result in additional disclosures.

Note 3 — Loans and Allowance for Loan Losses

For a description of the Association's accounting for loans, including impaired loans, and the allowance for loan losses, see Note 2 subsection B above.

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

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate collateral. As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional structure, incorporating a 14-point probability of default scale (see further discussion in Note 2 subsection B above) and a separate scale addressing estimated percentage loss in the event of default. The loan rating structure incorporates borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, and collateral).

The Association's loan portfolio, which includes purchased interests in loans, has been segmented by the following loan types as defined by the FCA:

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.

- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.
- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.
- Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.
- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.
- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.
- Communication loans — loans primarily to finance rural communication providers.
- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.
- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.
- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.
- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.
- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans outstanding at period end follows:

	December 31, 2017	December 31, 2016	December 31, 2015
Real estate mortgage	$ 300,833	$ 268,880	$ 250,887
Production and intermediate-term	156,798	147,903	147,341
Loans to cooperatives	–	–	26
Processing and marketing	1,168	1,053	1,430
Farm-related business	4,820	421	500
Rural residential real estate	8,111	7,838	7,679
Total loans	$ 471,730	$ 426,095	$ 407,863

A substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly.

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

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. The following tables present the principal balance of participation loans at periods ended:

December 31, 2017	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ –	$ 13,789	$ –	$ –	$ –	$ 5,934	$ –	$ 19,723
Production and intermediate-term	–	4,897	–	–	–	1,439	–	6,336
Processing and marketing	1,010	–	–	–	–	16	1,010	16
Farm-related business	–	6,187	–	–	–	249	–	6,436
Total	$ 1,010	$ 24,873	$ –	$ –	$ –	$ 7,638	$ 1,010	$ 32,511

December 31, 2016	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ –	$ 24,595	$ –	$ –	$ –	$ 4,526	$ –	$ 29,121
Production and intermediate-term	–	3,757	–	–	–	1,315	–	5,072
Processing and marketing	860	–	–	–	–	25	860	25
Total	$ 860	$ 28,352	$ –	$ –	$ –	$ 5,866	$ 860	$ 34,218

December 31, 2015	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ –	$ 17,502	$ –	$ –	$ –	$ 2,699	$ –	$ 20,201
Production and intermediate-term	–	8,647	–	–	–	1,060	–	9,707
Processing and marketing	1,433	–	–	–	–	–	1,433	–
Farm-related business	–	–	–	–	–	38	–	38
Total	$ 1,433	$ 26,149	$ –	$ –	$ –	$ 3,797	$ 1,433	$ 29,946

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

December 31, 2017	Due less than 1 year	Due 1 through 5 years	Due after 5 years	Total
Real estate mortgage	$ 5,311	$ 29,510	$ 266,012	$ 300,833
Production and intermediate-term	56,223	79,115	21,460	156,798
Processing and marketing	–	148	1,020	1,168
Farm-related business	301	1,675	2,844	4,820
Rural residential real estate	1,547	1,233	5,331	8,111
Total loans	$ 63,382	$ 111,681	$ 296,667	$ 471,730
Percentage	13.44%	23.67%	62.89%	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 loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

	December 31, 2017	2016	2015
Real estate mortgage:			
Acceptable	95.58%	95.79%	96.06%
OAEM	1.94	2.25	1.77
Substandard/doubtful/loss	2.48	1.96	2.17
	100.00%	100.00%	100.00%
Production and intermediate-term:			
Acceptable	95.42%	96.73%	96.73%
OAEM	1.64	1.50	2.52
Substandard/doubtful/loss	2.94	1.77	0.75
	100.00%	100.00%	100.00%
Loans to cooperatives:			
Acceptable	–%	–%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	–%	–%	100.00%
Processing and marketing:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%

	December 31, 2017	2016	2015
Farm-related business:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%
Rural residential real estate:			
Acceptable	89.91%	91.83%	93.98%
OAEM	2.94	–	3.24
Substandard/doubtful/loss	7.15	8.17	2.78
	100.00%	100.00%	100.00%
Total Loans:			
Acceptable	95.48%	96.06%	96.28%
OAEM	1.84	1.94	2.06
Substandard/doubtful/loss	2.68	2.00	1.66
	100.00%	100.00%	100.00%

The following tables provide an aging analysis of past due loans and related accrued interest as of:

December 31, 2017

	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	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	$ 453	$ 292	$ 745	$ 303,746	$ 304,491	$ –
Production and intermediate-term	965	439	1,404	158,159	159,563	20
Processing and marketing	–	–	–	1,171	1,171	–
Farm-related business	7	–	7	4,832	4,839	–
Rural residential real estate	110	–	110	8,023	8,133	–
Total	$ 1,535	$ 731	$ 2,266	$ 475,931	$ 478,197	$ 20

December 31, 2016

	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	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	$ 842	$ 242	$ 1,084	$ 271,106	$ 272,190	$ –
Production and intermediate-term	841	290	1,131	149,220	150,351	–
Processing and marketing	–	–	–	1,056	1,056	–
Farm-related business	–	–	–	423	423	–
Rural residential real estate	–	288	288	7,568	7,856	–
Total	$ 1,683	$ 820	$ 2,503	$ 429,373	$ 431,876	$ –

December 31, 2015

	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	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	$ 1,160	$ 1,346	$ 2,506	$ 251,262	$ 253,768	$ 7
Production and intermediate-term	925	654	1,579	147,998	149,577	–
Loans to cooperatives	–	–	–	26	26	–
Processing and marketing	–	–	–	1,430	1,430	–
Farm-related business	–	–	–	501	501	–
Rural residential real estate	–	85	85	7,613	7,698	–
Total	$ 2,085	$ 2,085	$ 4,170	$ 408,830	$ 413,000	$ 7

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

	December 31, 2017	2016	2015
Nonaccrual loans:			
Real estate mortgage	$ 794	$ 1,058	$ 1,937
Production and intermediate-term	609	569	998
Rural residential real estate	300	418	228
Total	$ 1,703	$ 2,045	$ 3,163
Accruing restructured loans:			
Real estate mortgage	$ 1,242	$ 1,280	$ 198
Production and intermediate-term	–	–	100
Total	$ 1,242	$ 1,280	$ 298
Accruing loans 90 days or more past due:			
Real estate mortgage	$ –	$ –	$ 7
Production and intermediate-term	20	–	–
Total	$ 20	$ –	$ 7
Total nonperforming loans	$ 2,965	$ 3,325	$ 3,468
Other property owned	8	8	–
Total nonperforming assets	$ 2,973	$ 3,333	$ 3,468
Nonaccrual loans as a percentage of total loans	0.36%	0.48%	0.78%
Nonperforming assets as a percentage of total loans and other property owned	0.63%	0.78%	0.85%
Nonperforming assets as a percentage of capital	3.71%	4.56%	5.09%

The following table presents information relating to impaired loans (including accrued interest) as defined in Note 2:

	December 31, 2017	2016	2015
Impaired nonaccrual loans:			
Current as to principal and interest	$ 701	$ 935	$ 493
Past due	1,002	1,110	2,670
Total	1,703	2,045	3,163
Impaired accrual loans:			
Restructured	1,242	1,280	298
90 days or more past due	20	–	7
Total	1,262	1,280	305
Total impaired loans	$ 2,965	$ 3,325	$ 3,468
Additional commitments to lend	$ 193	$ –	$ –

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

	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	$ 131	$ 151	$ 6	$ 156	$ 4
Production and intermediate-term	376	376	199	449	12
Rural residential real estate	–	–	–	–	–
Total	$ 507	$ 527	$ 205	$ 605	$ 16
With no related allowance for credit losses:					
Real estate mortgage	$ 1,905	$ 2,147	$ –	$ 2,272	$ 62
Production and intermediate-term	253	334	–	301	8
Rural residential real estate	300	360	–	358	10
Total	$ 2,458	$ 2,841	$ –	$ 2,931	$ 80
Total impaired loans:					
Real estate mortgage	$ 2,036	$ 2,298	$ 6	$ 2,428	$ 66
Production and intermediate-term	629	710	199	750	20
Rural residential real estate	300	360	–	358	10
Total	$ 2,965	$ 3,368	$ 205	$ 3,536	$ 96

Impaired loans:	December 31, 2016 Recorded Investment	Unpaid Principal Balance	Related Allowance	Year Ended December 31, 2016 Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	$ 358	$ 364	$ 3	$ 401	$ 14
Production and intermediate-term	272	277	24	305	11
Rural residential real estate	15	14	15	16	1
Total	$ 645	$ 655	$ 42	$ 722	$ 26
With no related allowance for credit losses:					
Real estate mortgage	$ 1,980	$ 2,226	$ –	$ 2,215	$ 80
Production and intermediate-term	297	414	–	332	12
Rural residential real estate	403	441	–	452	16
Total	$ 2,680	$ 3,081	$ –	$ 2,999	$ 108
Total impaired loans:					
Real estate mortgage	$ 2,338	$ 2,590	$ 3	$ 2,616	$ 94
Production and intermediate-term	569	691	24	637	23
Rural residential real estate	418	455	15	468	17
Total	$ 3,325	$ 3,736	$ 42	$ 3,721	$ 134

Impaired loans:	December 31, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance	Year Ended December 31, 2015 Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	$ 787	$ 709	$ –	$ 725	$ 13
Production and intermediate-term	812	878	154	748	13
Total	$ 1,599	$ 1,587	$ 154	$ 1,473	$ 26
With no related allowance for credit losses:					
Real estate mortgage	$ 1,355	$ 1,448	$ –	$ 1,249	$ 22
Production and intermediate-term	286	308	–	263	5
Rural residential real estate	228	253	–	210	4
Total	$ 1,869	$ 2,009	$ –	$ 1,722	$ 31
Total impaired loans:					
Real estate mortgage	$ 2,142	$ 2,157	$ –	$ 1,974	$ 35
Production and intermediate-term	1,098	1,186	154	1,011	18
Rural residential real estate	228	253	–	210	4
Total	$ 3,468	$ 3,596	$ 154	$ 3,195	$ 57

Interest income on nonaccrual and accruing restructured loans was $94, $132, and $42 for 2017, 2016, and 2015, respectively.

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

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Rural Residential Real Estate	Total
Activity related to the allowance for credit losses:					
Balance at December 31, 2016	$ 2,308	$ 1,296	$ 13	$ 78	$ 3,695
Charge-offs	–	–	–	(14)	(14)
Recoveries	–	6	–	–	6
Provision for loan losses	158	158	35	(1)	350
Balance at December 31, 2017	$ 2,466	$ 1,460	$ 48	$ 63	$ 4,037
Balance at December 31, 2015	$ 2,204	$ 1,486	$ 18	$ 63	$ 3,771
Charge-offs	–	(26)	–	–	(26)
Recoveries	–	–	–	–	–
Provision for loan losses	104	(164)	(5)	15	(50)
Balance at December 31, 2016	$ 2,308	$ 1,296	$ 13	$ 78	$ 3,695
Balance at December 31, 2014	$ 2,184	$ 1,629	$ 7	$ 72	$ 3,892
Charge-offs	–	(86)	–	–	(86)
Recoveries	–	–	–	–	–
Provision for loan losses	20	(57)	11	(9)	(35)
Balance at December 31, 2015	$ 2,204	$ 1,486	$ 18	$ 63	$ 3,771
Allowance on loans evaluated for impairment:					
Individually	$ 6	$ 199	$ –	$ –	$ 205
Collectively	2,460	1,261	48	63	3,832
Balance at December 31, 2017	$ 2,466	$ 1,460	$ 48	$ 63	$ 4,037
Individually	$ 3	$ 24	$ –	$ 15	$ 42
Collectively	2,305	1,272	13	63	3,653
Balance at December 31, 2016	$ 2,308	$ 1,296	$ 13	$ 78	$ 3,695
Individually	$ –	$ 154	$ –	$ –	$ 154
Collectively	2,204	1,332	18	63	3,617
Balance at December 31, 2015	$ 2,204	$ 1,486	$ 18	$ 63	$ 3,771
Recorded investment in loans evaluated for impairment:					
Individually	$ 2,036	$ 734	$ –	$ 195	$ 2,965
Collectively	302,455	158,829	6,010	7,938	475,232
Balance at December 31, 2017	$ 304,491	$ 159,563	$ 6,010	$ 8,133	$ 478,197
Individually	$ 1,058	$ 569	$ –	$ 418	$ 2,045
Collectively	271,132	149,782	1,479	7,438	429,831
Balance at December 31, 2016	$ 272,190	$ 150,351	$ 1,479	$ 7,856	$ 431,876
Individually	$ 2,227	$ 463	$ –	$ 225	$ 2,915
Collectively	251,541	149,114	1,957	7,473	410,085
Balance at December 31, 2015	$ 253,768	$ 149,577	$ 1,957	$ 7,698	$ 413,000

**Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.*

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. The guaranteed balance of designated loans under these agreements was $78,263, $70,999, and $76,349 at December 31, 2017, 2016, and 2015, respectively. Fees paid for such guarantee commitments totaled $140, $145, and $168 for 2017, 2016, and 2015, respectively. These amounts are classified as noninterest expense.

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. There were no new TDRs that occurred during 2017.

	Year Ended December 31, 2016				
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	$ –	$ 1,219	$ –	$ 1,219	
Total	$ –	$ 1,219	$ –	$ 1,219	
Post-modification:					
Real estate mortgage	$ –	$ 1,219	$ –	$ 1,219	$ –
Total	$ –	$ 1,219	$ –	$ 1,219	$ –

Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
	Year Ended December 31, 2015				
Pre-modification:					
Real estate mortgage	$ –	$ 202	$ –	$ 202	
Production and intermediate-term	–	100	–	100	
Total	$ –	$ 302	$ –	$ 302	
Post-modification:					
Real estate mortgage	$ –	$ 202	$ –	$ 202	$ –
Production and intermediate-term	–	100	–	100	–
Total	$ –	$ 302	$ –	$ 302	$ –

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.

There were no TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during periods presented. Payment default is defined as a payment that was thirty days or more past due.

The following table provides information at each 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		
	December 31,			December 31,		
	2017	2016	2015	2017	2016	2015
Real estate mortgage	$ 1,242	$ 1,320	$ 198	$ –	$ 40	$ –
Production and intermediate-term	–	–	100	–	–	–
Total loans	$ 1,242	$ 1,320	$ 298	$ –	$ 40	$ –
Additional commitments to lend	$ –	$ –	$ –			

The following table presents information as of period end:

	December 31, 2017
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	$ –
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	$ 76

Note 4 — Investments

Investments in Other Farm Credit Institutions

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. The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as required by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. Accounting for this investment is on the cost plus allocated equities basis.

The Association's investment in the Bank totaled $6,908 for 2016. In addition, the Bank had a reciprocal investment in the Association of $1,749 at December 31, 2017. The Association's resulting net investment in the Bank was $5,159 for 2017, $4,933 for 2016 and $4,625 for 2015. The Association owns 1.93 percent of the issued stock of the Bank as of December 31, 2017 net of any reciprocal investment. As of that date, the Bank's assets totaled $32.5 billion and shareholders' equity totaled $2.2 billion. The Bank's earnings were $345 million for 2017. In addition, the Association had an investment of $209 related to other Farm Credit institutions at December 31, 2017.

Note 5 — Real Estate and Other Property

Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2017	2016	2015
Land	$ 753	$ 725	$ 725
Buildings and improvements	3,440	3,440	3,425
Furniture and equipment	1,432	1,435	1,270
	5,625	5,600	5,420
Less: accumulated depreciation	2,665	2,586	2,494
Total	$ 2,960	$ 3,014	$ 2,926

Other Property Owned
Net (gains) losses on other property owned consist of the following:

	December 31,		
	2017	2016	2015
(Gains) losses on sale, net	$ –	$ –	$ –
Carrying value unrealized (gains) losses	–	–	22
Operating (income) expense, net	–	1	37
(Gains) losses on other property owned, net	$ –	$ 1	$ 59

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2017, 2016, and 2015.

Note 6 — Debt

Notes Payable to AgFirst Farm Credit Bank
Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2017, the Association's notes payable were within the specified limitations.

The Association's indebtedness to the Bank represents borrowings by the Association to fund its earning assets. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by the GFA. Interest rates on both variable and fixed rate advances are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA, which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon an agreement between the Bank and the Association.

The weighted average interest rates on the variable rate advances were 2.61 percent for LIBOR-based loans and 2.67 percent for Prime-based loans, and the weighted average remaining maturities were 1.4 years and 1.4 years, respectively, at December 31, 2017. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 3.00 percent, and the weighted average remaining maturity was 12.5 years at December 31, 2017. The weighted-average interest rate on all interest-bearing notes payable was 2.93 percent and the weighted-average remaining maturity was 10.6 years at December 31, 2017. Variable rate and fixed rate notes payable represent approximately 3.74 percent and 96.26 percent, respectively, of total notes payable at December 31, 2017. The weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

Note 7 — Members' Equity

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

A. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Common stock for agricultural loans, or participation certificates in the case of rural home and farm-related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to two percent of the loan amount or $1 thousand, whichever is less. The Association bylaws permit the Board of Directors, at their discretion, to establish an investment range between a minimum of two percent of the loan amount or $1 thousand, whichever is less, and a maximum not to exceed ten percent of the loan amount. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

   The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

B. **Regulatory Capitalization Requirements and Restrictions:** An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

   There are currently no prohibitions in place that would prevent the Association from retiring stock, distributing earnings, or paying dividends per the statutory and regulatory restrictions, and the Association has no reason to believe any such restrictions may apply in the future.

   Effective January 1, 2017, the regulatory capital requirements for System Banks and associations were modified. The new regulations ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted. New regulations replaced core surplus and total surplus ratios with common equity tier 1 (CET1) capital, tier 1 capital, and total capital risk-based capital ratios. The new regulations also include a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio (PCR) remains in effect.

The ratios are calculated using three-month average daily balances, in accordance with FCA regulations, as follows:

- The CET1 capital ratio is the sum of statutory minimum purchased borrower stock, other required borrower stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to revolvement, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of investments in other System institutions, divided by average risk-adjusted assets.
- The tier 1 capital ratio is CET1 capital plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- The total capital ratio is tier 1 capital plus other required borrower stock held for a minimum of 5 years, subordinated debt and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance for loan losses and reserve for unfunded commitments under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- The permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred stock subject to certain limitations, less certain investments in other System institutions, divided by PCR risk-adjusted assets.
- The tier 1 leverage ratio is tier 1 capital, divided by average assets less regulatory deductions to tier 1 capital.
- The UREE leverage ratio is unallocated retained earnings, paid-in capital, and allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions to tier 1 capital.

The following sets forth the regulatory capital ratios which were effective January 1, 2017:

Ratio	Minimum Requirement	Capital Conservation Buffer*	Minimum Requirement with Capital Conservation Buffer	Capital Ratios as of December 31, 2017
Risk-adjusted ratios:				
CET1 Capital Ratio	4.5%	0.625%	5.125%	16.66%
Tier 1 Capital Ratio	6.0%	0.625%	6.625%	16.66%
Total Capital Ratio	8.0%	0.625%	8.625%	17.54%
Permanent Capital Ratio	7.0%	0.0%	7.0%	16.91%
Non-risk-adjusted:				
Tier 1 Leverage Ratio	4.0%	1.0%	5.0%	14.63%
UREE Leverage Ratio	1.5%	0.0%	1.5%	14.29%

** The capital conservation buffers 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.*

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.

C. **Description of Equities:** The Association is authorized to issue or have outstanding nonvoting Class A Preferred Stock, nonvoting Class B Common Stock, voting Class C Common Stock, nonvoting Class C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The Board, at its sole discretion, may declare dividends on either the Class A Preferred Stock alone, or on all classes of Stock and Participation certificates during any fiscal year. However, dividends shall not be paid on common stock or participation certificates in any year with respect to which the Association has obligated itself to distribute patronage refunds.

The Association had the following shares outstanding at December 31, 2017:

		Shares Outstanding	
Class	Protected	Number	Aggregate Par Value
A Common/Nonvoting	No	218	$ 1
C Common/Voting	No	567,866	2,839
Common Issued to Bank/Nonvoting	No	349,730	1,749
C Participation Certificates/Nonvoting	No	21,855	109
Total Capital Stock and Participation Certificates		939,669	$ 4,698

At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board, provided that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2017, allocated members' equity consisted of $54,453 of nonqualified retained surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to Patrons, on a patronage basis, all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patrons are defined as Members, Equity holders, and other customers, borrowers and financial institutions with which the Association shall conduct business as identified by the Board in the obligation resolution. Patronage distributions are based on the proportion of the Patron's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash. Amounts not distributed are retained as unallocated members' equity.

Transfer

Classes B and C Common Stock and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities as provided in the Association's bylaws. Class A Preferred Stock may be transferred in the manner set forth in the resolution authorizing the issuance of such Stock.

Impairment

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order: Class B Common Stock, Class C Common Stock and unit of Participation Certificates.

1. Class B Common Stock, Class C Common Stock and unit of Participation Certificates
2. Class A Preferred Stock

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Class A Preferred Stock
2. Classes B and C Common Stock and Participation Certificates
3. Allocated retained earnings evidenced by qualified written notices of allocation, in the order of the year of issuance and pro-rata by year of issuance
4 Allocated retained earnings evidenced by nonqualified written notices of allocation, in the year of issuance and pro-rata by year of issuance
5 All unallocated retained earnings earned after April 1, 1995, shall be distributed to all Patrons from April 1, 1995, through the date of liquidation on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to their ownership

Note 8 — 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.

Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities.

The classifications within the fair value hierarchy (See Note 2) are as follows:

Level 1
The Association has no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 2017. For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

Level 2
The Association had no Level 2 assets or liabilities measured at fair value on a recurring basis at December 31, 2017.

Level 3
Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. Certain loans evaluated for impairment under FASB guidance have fair values based upon the underlying collateral, as the loans were collateral-dependent. Specific reserves were established for these loans when the value of the collateral, less estimated cost to sell, was less than the principal balance of the loan. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters.

Notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

There were no Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

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.

	December 31, 2017				
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Recurring Assets	$ –	$ –	$ –	$ –	$ –
Liabilities:					
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –
Nonrecurring Measurements					
Assets:					
Impaired loans	$ 302	$ –	$ –	$ 302	$ 302
Other property owned	8	–	–	9	9
Nonrecurring Assets	$ 310	$ –	$ –	$ 311	$ 311
Other Financial Instruments					
Assets:					
Cash	$ 2,028	$ 2,028	$ –	$ –	$ 2,028
Loans	467,524	–	–	455,704	455,704
Other Financial Assets	$ 469,552	$ 2,028	$ –	$ 455,704	$ 457,732
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	$ 406,457	$ –	$ –	$ 399,924	$ 399,924
Other Financial Liabilities	$ 406,457	$ –	$ –	$ 399,924	$ 399,924

	December 31, 2016				
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements					
Assets:					
Recurring Assets	$ –	$ –	$ –	$ –	$ –
Liabilities:					
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –
Nonrecurring Measurements					
Assets:					
Impaired loans	$ 603	$ –	$ –	$ 603	$ 603
Other property owned	8	–	–	9	9
Nonrecurring Assets	$ 611	$ –	$ –	$ 612	$ 612
Other Financial Instruments					
Assets:					
Cash	$ 1,605	$ 1,605	$ –	$ –	$ 1,605
Loans	423,225	–	–	412,214	412,214
Other Financial Assets	$ 424,830	$ 1,605	$ –	$ 412,214	$ 413,819
Liabilities:					
Notes payable to AgFirst Farm Credit Bank	$ 368,038	$ –	$ –	$ 360,085	$ 360,085
Other Financial Liabilities	$ 368,038	$ –	$ –	$ 360,085	$ 360,085

	December 31, 2015									
		Total Carrying Amount		Level 1		Level 2		Level 3		Total Fair Value
Recurring Measurements										
Assets:										
Recurring Assets	$	–	$	–	$	–	$	–	$	–
Liabilities:										
Recurring Liabilities	$	–	$	–	$	–	$	–	$	–
Nonrecurring Measurements										
Assets:										
Impaired loans	$	1,445	$	–	$	–	$	1,445	$	1,445
Other property owned		–		–		–		–		–
Nonrecurring Assets	$	1,445	$	–	$	–	$	1,445	$	1,445
Other Financial Instruments										
Assets:										
Cash	$	1,250	$	1,250	$	–	$	–	$	1,250
Loans		402,797		–		–		401,175		401,175
Other Financial Assets	$	404,047	$	1,250	$	–	$	401,175	$	402,425
Liabilities:										
Notes payable to AgFirst Farm Credit Bank	$	353,034	$	–	$	–	$	351,294	$	351,294
Other Financial Liabilities	$	353,034	$	–	$	–	$	351,294	$	351,294

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.

Inputs to Valuation Techniques

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

Quoted market prices are generally not available for certain System financial instruments, as described 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

		Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	$	311	Appraisal	Income and expense	*
				Comparable sales	*
				Replacement costs	*
				Comparability adjustments	*

** Ranges for this type of input are not useful because each collateral property is unique.*

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying Value	Par/Principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity

Note 9 — Employee Benefit Plans

The Association participates in three District sponsored benefit plans. These plans include a multi-employer defined benefit pension plan, the Independent Associations Retirement Plan, which is a final average pay plan (IAR Plan). In addition, the Association participates in a multi-employer defined benefit other postretirement benefits plan (OPEB Plan), the Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plan, and a defined contribution 401(k) plan. The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

1. Assets contributed to multi-employer plans by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If the Association chooses to stop participating in some of its multi-employer plans, the Association may be required to contribute to eliminate the underfunded status of the plan.

The Association previously participated in a separate multi-employer plan, the AgFirst Farm Credit Cash Balance Retirement Plan which is a cash balance plan (CB Plan). In November 2014, the AgFirst Plan Sponsor Committee approved and executed amendments to the CB Plan that included the following changes:

1. The CB Plan was closed to new participants effective as of December 31, 2014. Based on the plan's eligibility provisions, this change affected employees hired on or after November 4, 2014.
2. Employer contributions were discontinued effective as of January 1, 2015.
3. All participants who were not already fully vested in the CB Plan became fully vested as of December 31, 2014.
4. The CB Plan was terminated effective as of December 31, 2015.

Curtailment accounting, as prescribed in ASC 715 "Compensation – Retirement Benefits", was initiated upon execution of the plan amendments and did not have a material impact on the Association's financial condition or results of operations.

A favorable determination letter was received from the Internal Revenue Service, and as a result of the termination of the CB Plan, vested benefits were distributed to participants in 2017.

Beginning on January 1, 2015, for participants in the CB Plan and eligible employees hired on or after November 4, 2014, additional employer contributions are made to the 401(k) Plan equal to 3.00 percent of the participants' eligible compensation.

The District's multi-employer plans are not subject to ERISA and no Form 5500 is required. As such, the following information is neither available for nor applicable to the plans:

1. The Employee Identification Number (EIN) and three-digit Pension Plan Number
2. The most recent Pension Protection Act (PPA) zone status. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.
3. The "FIP/RP Status" indicating whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.
4. The expiration date(s) of collective-bargaining agreement(s).

During 2017, the method of recording expenses at participating District entities for the IAR and OPEB Plans was modified. 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 Consolidated Balance Sheets. For 2017 and future years, participating entities will record employee benefit costs based on the actual contributions to the Plans. This change caused the Association 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 the reduction of Other Assets by $1,762 and the reduction of Other Liabilities by $1,467 on the Association's Balance Sheets, and a total addition of employee benefit costs on the Association's Statements of Income of $295 during 2017.

The IAR Plan includes other District employees that are not employees of the Association and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association's Balance Sheets but are included in the Combined Balance Sheets for the AgFirst District. IAR Plan expenses included in employee benefit costs on the Association's Statements of Income were $848 for 2017, $821 for 2016, and $837 for 2015. At December 31, 2017, 2016, and 2015, the total liability balance for the IAR Plan presented in the District Combined Balance Sheets is $15,078, $11,528, and $11,062, respectively. The IAR Plan is 81.82%, 83.70%, and 83.07% percent funded to the projected benefit obligation as of December 31, 2017, 2016, and 2015, respectively.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. 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 Association or District and is accounted for as a multiemployer plan. The related net benefit plan obligations are not included in the Association'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 employee benefit costs on the Association's Statements of Income were $72 for 2017, $154 for 2016, and $194 for 2015. At December 31, 2017, the total AgFirst District liability balance for the OPEB Plan presented in the Farm Credit System Combined Statement of Condition is $216,259.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. This 401(k) plan requires the Association to match 100 percent of employee optional contributions up to a maximum employee contribution of 6.00 percent of total compensation. 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 $217, $194, and $174 for the years ended December 31, 2017, 2016, and 2015, respectively. Beginning in 2015, contributions include additional amounts related to the discontinuation of the CB Plan as discussed above.

Additional information for the above may be found in Note 9 in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report and the Notes to the Annual Information Statement of the Farm Credit System.

Note 10 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2017 amounted to $3,408. During 2017, $2,700 of new loans were made and repayments totaled $2,289. In the opinion of management, none of these loans outstanding at December 31, 2017 involved more than a normal risk of collectibility.

Note 11 — Commitments and Contingencies

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association 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, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

In the normal course of business, the Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers. These financial instruments may include commitments to extend credit or letters of credit.

The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2017, $52,214 of commitments to extend credit and no commercial letters of credit were outstanding with no related reserve for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets at December 31, 2017.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2017, standby letters of credit outstanding totaled $8 with expiration dates ranging from January 2, 2018 to June 30, 2018. The maximum potential amount of future payments that may be required under these guarantees was $8.

Note 12 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2017	2016	2015
Current:			
Federal	$ 12	$ (53)	$ 2
State	–	–	–
	$ 12	$ (53)	$ 2
Deferred:			
Federal	–	–	–
State	–	–	–
Total provision (benefit) for income taxes	$ 12	$ (53)	$ 2

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

	December 31, 2017	2016	2015
Federal tax at statutory rate	$ 3,817	$ 3,424	$ 3,254
Patronage distributions	(1,257)	(1,086)	(916)
Tax-exempt FLCA earnings	(2,685)	(2,388)	(1,981)
Change in deferred tax asset valuation allowance	(121)	61	(338)
Deferred tax rate change	260	–	–
Other	(2)	(64)	(17)
Provision (benefit) for income taxes	$ 12	$ (53)	$ 2

In late December 2017, federal tax legislation was enacted which, among other things, lowered the federal corporate tax rate from 35% to 21% beginning on January 1, 2018. The change to the lower corporate tax rate led to an insignificant remeasurement of the deferred tax liabilities and deferred tax assets in 2017, the period of enactment. Deferred tax assets and liabilities are comprised of the following at:

	December 31, 2017	2016	2015
Deferred income tax assets:			
Allowance for loan losses	$ 301	$ 467	$ 520
Annual leave	65	101	98
Nonaccrual loan interest	45	71	64
Pensions and other postretirement benefits	–	514	487
Other	–	–	–
Gross deferred tax assets	411	1,153	1,169
Less: valuation allowance	(390)	(511)	(449)
Gross deferred tax assets, net of valuation allowance	21	642	720
Deferred income tax liabilities:			
Pensions and other postretirement benefits	–	(617)	(701)
Depreciation	(21)	(25)	(19)
Other	–	–	–
Gross deferred tax liability	(21)	(642)	(720)
Net deferred tax asset (liability)	$ –	$ –	$ –

At December 31, 2017, deferred income taxes have not been provided by the Association on approximately $6 million of its investment in the Bank. Management expects that these earnings will not be converted to cash.

The Association recorded a valuation allowance of $390, $511 and $449 as of December 31, 2017, 2016 and 2015, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2017 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2014 and forward.

Note 13 — Additional Financial Information

Quarterly Financial Information (Unaudited)

2017	First	Second	Third	Fourth	Total
Net interest income	$ 2,807	$ 2,800	$ 2,939	$ 3,014	$ 11,560
Provision for (reversal of allowance for) loan losses	–	–	–	350	350
Noninterest income (expense), net	(886)	(834)	(701)	2,104	(317)
Net income	$ 1,921	$ 1,966	$ 2,238	$ 4,768	$ 10,893

2016	First	Second	Third	Fourth	Total
Net interest income	$ 2,717	$ 2,744	$ 2,805	$ 2,830	$ 11,096
Provision for (reversal of allowance for) loan losses	–	–	–	(50)	(50)
Noninterest income (expense), net	(910)	(911)	(799)	1,311	(1,309)
Net income	$ 1,807	$ 1,833	$ 2,006	$ 4,191	$ 9,837

2015	First	Second	Third	Fourth	Total
Net interest income	$ 2,593	$ 2,582	$ 2,667	$ 2,713	$ 10,555
Provision for (reversal of allowance for) loan losses	–	–	–	(35)	(35)
Noninterest income (expense), net	(867)	(875)	(769)	1,216	(1,295)
Net income	$ 1,726	$ 1,707	$ 1,898	$ 3,964	$ 9,295

Note 14 — Subsequent Events

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 13, 2018, which was the date the financial statements were issued.

AgCredit

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You'll like the way we do business!