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*Central Kentucky Agricultural Credit Association*

**THIRD QUARTER 2017**

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**CERTIFICATION**

The undersigned certify that we have reviewed the September 30, 2017 quarterly 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 W. Caldwell  
Chief Executive Officer



Marcus G. Barnett  
Chief Financial Officer



James A. Lyons  
Chairman of the Board

November 8, 2017

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*Central Kentucky Agricultural Credit Association*

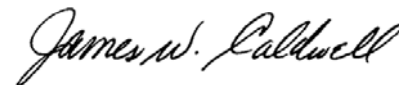
# Report on Internal Control Over Financial Reporting

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. This process provides 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.

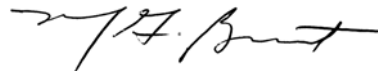
Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions 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 September 30, 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 September 30, 2017, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association's management determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2017.



James W. Caldwell  
Chief Executive Officer



Marcus G. Barnett  
Chief Financial Officer

November 8, 2017

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Central Kentucky Agricultural Credit Association (the Association) for the period ended September 30, 2017. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2016 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **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. The Association's loan portfolio is diversified over a range of agricultural commodities in our region. The predominate enterprises are beef cattle and thoroughbred horses. Overall, the outlook for the beef cattle industry is still uncertain due to increasing cattle numbers, but appears to be leveling off and finding stability. Industry uncertainties focus on economic factors impacting domestic demand and demand for exports, particularly overseas. The thoroughbred horse industry continues to show signs of improvement through recent sales. The outlook is more positive, mirroring the general economic outlook. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm employment in the area, significantly reduces the level of dependency on a given commodity.

The gross loan volume of the Association as of September 30, 2017 was \$466,627, an increase of \$40,532 as compared to \$426,095 at December 31, 2016. Net loans outstanding at September 30, 2017 were \$462,940 as compared to \$422,400 at December 31, 2016. Net loans accounted for 95.64 percent of total assets at September 30, 2017, as compared to 94.21 percent of total assets at December 31, 2016.

The increase in gross and net loan volume during the reporting period is primarily due to growth in both production loans and real estate loans.

There is an inherent risk in the extension of any type of credit. However, portfolio credit quality continues to be maintained at an acceptable level and credit administration remains

satisfactory. Nonaccrual loans decreased from \$2,045 at December 31, 2016, to \$1,949 at September 30, 2017. This decrease is primarily due to paydowns on a few loans in nonaccrual status.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The \$3,687 allowance for loan losses at September 30, 2017 reflected an \$8 decrease from December 31, 2016, and was considered by management to be adequate to cover possible losses.

## **RESULTS OF OPERATIONS**

### *For the three months ended September 30, 2017*

Net income for the three months ended September 30, 2017 totaled \$2,238, as compared to \$2,006 for the same period in 2016. Net interest income increased \$134 for the three months ended September 30, 2017 as compared to the same period in 2016. The Association recorded no provision for loan losses for the three months ended September 30, 2017, and no provision for loan losses for the same period in 2016.

At September 30, 2017, interest income on accruing loans increased \$602 compared to September 30, 2016. The Association recorded nonaccrual income of \$9 for the three months ended September 30, 2017, as compared to \$15 for the same period in 2016. Interest expense increased \$462 for the three months ended September 30, 2017 as compared to the comparable period of 2016. Movement in interest income and expense is primarily attributed to an increase in loan volume, a decrease in average interest rate margins, and an early-year reduction in the Association's direct note from receipt of patronage from the AgFirst Farm Credit Bank (Bank). Noninterest income for the three months ended September 30, 2017 totaled \$1,009 as compared to \$907 for the same period of 2016, an increase of \$102. The primary factors in the increase in Noninterest income were increased loan fee income, and increased income from equity in earnings from the Bank.

Noninterest expense for the three months ended September 30, 2017 decreased \$53 compared to the same period of 2016. The decrease is due primarily to decreased pension and retiree health insurance expense, as well as a decrease in Farm Credit System Insurance Corporation (FCSIC) premium rates. The Association recorded a provision for income taxes of \$1 for the three months

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ended September 30, 2017, as compared to a benefit for income taxes of \$55 for the same period in 2016.

***For the nine months ended September 30, 2017***

Net income for the nine months ended September 30, 2017 totaled \$6,125, as compared to \$5,646 for the same period in 2016. Net interest income increased \$280 for the nine months ended September 30, 2017 as compared to the same period in 2016. The Association recorded no provision for loan losses for the nine months ended September 30, 2017, and no provision for loan losses for the same period in 2016.

At September 30, 2017, interest income on accruing loans increased \$1,146 compared to September 30, 2016. The Association recorded nonaccrual income of \$71 for the nine months ended September 30, 2017, as compared to \$52 for the same period in 2016. Interest expense increased \$885 for the nine months ended September 30, 2017 as compared to the comparable period of 2016. Movement in interest income and expense is primarily attributed to an increase in loan volume, a decrease in average interest rate margins, and an early-year reduction in the Association's direct note from receipt of Bank patronage. Noninterest income for the nine months ended September 30, 2017 totaled \$2,799 as compared to \$2,611 for the same period of 2016, an increase of \$188. The primary factors in the increase in Noninterest income were increased loan fee income, and increased income from equity in earnings of the Bank.

Noninterest expense for the nine months ended September 30, 2017 decreased \$65 compared to the same period of 2016. The decrease is due primarily to decreased pension and retiree health insurance expense, as well as a decrease in Farm Credit System Insurance Corporation (FCSIC) premium rates. The Association recorded a provision for income taxes of \$4 for the nine months ended September 30, 2017, as compared to a benefit for income taxes of \$50 for the same period in 2016.

The financial results of this interim report are not necessarily indicative of the results expected for the year.

**FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. 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. The total notes payable to

the Bank at September 30, 2017 was \$400,877 as compared to \$368,038 at December 31, 2016. The increase during the period is primarily attributed to an increase in loan volume, offset somewhat by the early year receipt of patronage from the Bank.

**CAPITAL RESOURCES**

Total members' equity at September 30, 2017 increased to \$79,060 from the December 31, 2016 total of \$73,029. The increase is primarily attributed to the Association's increase in retained earnings as a result of income recorded for the nine months ended September 30, 2017. Total capital stock and participation certificates were \$4,901 on September 30, 2017, compared to \$4,993 on December 31, 2016. This decrease is attributed to retirement of capital stock and participation certificates brought about by a reduction in the maximum member stock requirement that became effective on March 1, 2016.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum levels of several regulatory capital and leverage ratios. The capital ratios are calculated by dividing various levels of capital by a risk-adjusted asset base. The leverage ratios are calculated by dividing various types of capital by total regulatory assets. As of September 30, 2017, the Association's common equity tier 1 (CET1) ratio was 16.96 percent (regulatory minimum with conservation buffer is 5.125 percent), the tier 1 capital ratio was 16.96 percent (regulatory minimum with conservation buffer is 6.625 percent), the total capital ratio was 17.87 percent (regulatory minimum with conservation buffer is 8.625 percent), the permanent capital ratio was 17.23 percent (regulatory minimum is 7.00 percent), the tier 1 leverage ratio was 14.95 percent (regulatory minimum with conservation buffer is 5.00 percent), and the UREE leverage ratio was 14.61 percent (regulatory minimum is 1.5 percent).

**REGULATORY MATTERS**

**Capital**

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 existing core surplus and total surplus ratios with common equity tier 1 (CET1), tier 1 capital, and total capital risk-based capital ratios. The new regulations also replaced the existing net collateral ratio with a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The current permanent capital ratio (PCR) remains in effect.

Risk-adjusted assets have been defined by FCA Regulations as the Balance Sheet assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in

the various types of assets. The primary changes which generally have the effect of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

- Inclusion of off-balance-sheet commitments less than 14 months
- Increased risk-weighting of most loans 90 days past due or in nonaccrual status

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

- The CET1 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 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:

<b>Ratio</b>	<b>Minimum Requirement</b>	<b>Capital Conservation Buffer*</b>	<b>Minimum Requirement with Capital Conservation Buffer</b>	<b>Capital Ratios as of September 30, 2017</b>
<b>Risk-adjusted ratios:</b>				
CET1 Capital	4.5%	0.625%	5.125%	16.96%
Tier 1 Capital	6.0%	0.625%	6.625%	16.96%
Total Capital	8.0%	0.625%	8.625%	17.87%
Permanent Capital Ratio	7.0%	0.0%	7.0%	17.23%
<b>Non-risk-adjusted:</b>				
Tier 1 Leverage Ratio	4.0%	1.0%	5.0%	14.95%
UREE Leverage Ratio	1.5%	0.0%	1.5%	14.61%

\* - 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.

### Other 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.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 1, *Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*, in the Notes to the Financial Statements, and the 2016 Annual Report to Shareholders for recently issued accounting pronouncements. Additional information is provided in the table below.

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

Standard	Summary of Guidance	Effective Date and Potential Financial Statement Impact
ASU 2017-08 – Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): <i>Premium Amortization on Purchased Callable Debt Securities</i>	<ul style="list-style-type: none"> <li>• Requires amortization of premiums to the earliest call date on debt securities with call features that are explicit, noncontingent and callable at fixed prices and on preset dates.</li> <li>• Does not impact securities held at a discount; the discount continues to be amortized to the contractual maturity.</li> <li>• Requires adoption on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.</li> </ul>	<ul style="list-style-type: none"> <li>• The investment securities portfolio may include holdings of callable debt securities. The Association is currently evaluating the impact of the Update on the financial statements, which will be affected by any investments in callable debt securities carried at a premium at the time of adoption.</li> <li>• The Association expects to adopt the guidance in first quarter 2019 using the modified retrospective method with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption.</li> </ul>
ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): <i>Measurement of Credit Losses on Financial Instruments</i>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Changes the present incurred loss impairment guidance for loans to a current expected credit loss (CECL) model.</li> <li>• 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.</li> <li>• Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on financial assets purchased with more than insignificant credit deterioration since origination.</li> <li>• Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption.</li> </ul>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• The Association expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including:             <ol style="list-style-type: none"> <li>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,</li> <li>2. An allowance will be established for estimated credit losses on debt securities,</li> <li>3. The nonaccretible difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans.</li> </ol> </li> <li>• 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.</li> <li>• The Association expects to adopt the guidance in first quarter 2021 using the modified retrospective method with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption.</li> </ul>

<p>ASU 2016-02 – Leases (Topic 842)</p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Lessor accounting activities are largely unchanged from existing lease accounting.</li> <li>• The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification.</li> <li>• Expands qualitative and quantitative disclosures of leasing arrangements.</li> <li>• Requires adoption using a modified cumulative-effect approach wherein the guidance is applied to all periods presented.</li> </ul>	<ul style="list-style-type: none"> <li>• The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees.</li> <li>• The Association has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities.</li> <li>• 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.</li> <li>• 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.</li> <li>• The Association is evaluating existing disclosures and may need to provide additional information as a result of adoption of the Update.</li> <li>• The Association expects to adopt the guidance in first quarter 2019 using the modified retrospective method and practical expedients for transition.</li> </ul>
<p>ASU 2016-01 – Financial Instruments – Overall (Subtopic 825-10): <i>Recognition and Measurement of Financial Assets and Financial Liabilities</i></p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Requires certain equity instruments be measured at fair value, with changes in fair value recognized in earnings.</li> <li>• The guidance also updates fair value presentation and disclosure requirements for financial instruments measured at amortized cost.</li> </ul>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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 evaluating which method will be applied to these nonmarketable equity investments.</li> <li>• 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.</li> <li>• 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.</li> </ul>

<p>ASU 2014-09 – Revenue from Contracts With Customers (Topic 606) and subsequent related Updates</p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Changes the accounting for certain contract costs, including whether they may be offset against revenue in the Statements of Income, and requires additional disclosures about revenue and contract costs.</li> <li>• 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.</li> </ul>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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 practices. The Association has not identified material changes to the timing or amount of revenue recognition.</li> <li>• 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.</li> <li>• The Association expects to adopt the guidance in first quarter 2018 using the modified retrospective method with a cumulative-effect adjustment to opening retained earnings.</li> </ul>
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**NOTE:** Shareholder investment in the Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst’s annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2764, or by writing Matthew Miller, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association’s annual and quarterly reports are also available upon request free of charge by calling 1-859-253-3249, or writing Marcus Barnett, Chief Financial Officer, Central Kentucky Agricultural Credit Association, P.O. Box 1290, Lexington, KY 40588-1290, or accessing the website [www.agcreditonline.com](http://www.agcreditonline.com). The Association prepares a 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.



# Central Kentucky Agricultural Credit Association

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30, 2017 <i>(unaudited)</i>	December 31, 2016 <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 793	\$ 1,605
Loans	466,627	426,095
Allowance for loan losses	(3,687)	(3,695)
Net loans	462,940	422,400
Loans held for sale	—	1,428
Accrued interest receivable	6,554	5,781
Investments in other Farm Credit institutions	7,117	7,113
Premises and equipment, net	2,965	3,014
Other property owned	8	8
Accounts receivable	2,276	5,135
Other assets	1,405	1,861
Total assets	\$ 484,058	\$ 448,345
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 400,877	\$ 368,038
Accrued interest payable	934	815
Patronage refunds payable	99	3,195
Accounts payable	413	709
Other liabilities	2,675	2,559
Total liabilities	404,998	375,316
Commitments and contingencies (Note 7)		
<b>Members' Equity</b>		
Capital stock and participation certificates	4,901	4,993
Retained earnings		
Allocated	48,341	48,344
Unallocated	25,818	19,692
Total members' equity	79,060	73,029
Total liabilities and members' equity	\$ 484,058	\$ 448,345

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

**Central Kentucky Agricultural Credit Association**  
**Consolidated Statements of**  
**Comprehensive Income**

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2017	2016	2017	2016
<b>Interest Income</b>				
Loans	\$ 5,730	\$ 5,134	\$ 16,278	\$ 15,113
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	2,791	2,329	7,732	6,847
Net interest income	2,939	2,805	8,546	8,266
Provision for loan losses	—	—	—	—
Net interest income after provision for loan losses	2,939	2,805	8,546	8,266
<b>Noninterest Income</b>				
Loan fees	198	158	495	413
Lease income	12	4	24	15
Patronage refunds from other Farm Credit institutions	786	730	2,254	2,166
Gains (losses) on sales of rural home loans, net	13	9	19	12
Gains (losses) on sales of premises and equipment, net	—	6	6	5
Other noninterest income	—	—	1	—
Total noninterest income	1,009	907	2,799	2,611
<b>Noninterest Expense</b>				
Salaries and employee benefits	1,148	1,202	3,519	3,590
Occupancy and equipment	79	72	230	201
Insurance Fund premiums	125	138	354	374
(Gains) losses on other property owned, net	—	—	—	1
Other operating expenses	357	349	1,113	1,115
Total noninterest expense	1,709	1,761	5,216	5,281
Income before income taxes	2,239	1,951	6,129	5,596
Provision (benefit) for income taxes	1	(55)	4	(50)
Net income	2,238	2,006	6,125	5,646
Other comprehensive income	—	—	—	—
Comprehensive income	\$ 2,238	\$ 2,006	\$ 6,125	\$ 5,646

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

**Central Kentucky Agricultural Credit Association**  
**Consolidated Statements of Changes in**  
**Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
		Allocated	Unallocated	
Balance at December 31, 2015	\$ 6,784	\$ 42,801	\$ 18,524	\$ 68,109
Comprehensive income			5,646	5,646
Capital stock/participation certificates issued/(retired), net	(1,405)			(1,405)
Patronage distribution adjustment		(223)	202	(21)
Balance at September 30, 2016	\$ 5,379	\$ 42,578	\$ 24,372	\$ 72,329
<b>Balance at December 31, 2016</b>	<b>\$ 4,993</b>	<b>\$ 48,344</b>	<b>\$ 19,692</b>	<b>\$ 73,029</b>
<b>Comprehensive income</b>			<b>6,125</b>	<b>6,125</b>
<b>Capital stock/participation certificates issued/(retired), net</b>	<b>(92)</b>			<b>(92)</b>
<b>Patronage distribution adjustment</b>		<b>(3)</b>	<b>1</b>	<b>(2)</b>
<b>Balance at September 30, 2017</b>	<b>\$ 4,901</b>	<b>\$ 48,341</b>	<b>\$ 25,818</b>	<b>\$ 79,060</b>

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

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*Central Kentucky Agricultural Credit Association*

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

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

### ***Organization***

The accompanying financial statements include the accounts of Central Kentucky Agricultural Credit Association, ACA and its Production Credit Association (PCA) and Federal Land Credit Association (FLCA) subsidiaries (collectively, the Association). A description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations for the Association as of and for the year ended December 31, 2016, are contained in the 2016 Annual Report to Shareholders. These unaudited interim consolidated financial statements should be read in conjunction with the latest Annual Report to Shareholders.

### ***Basis of Presentation***

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

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

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

### ***Significant Accounting Policies***

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

Management has made significant estimates in several areas, including loans and allowance for loan losses (Note 2, *Loans and Allowance for Loan Losses*), investment securities and

other-than-temporary impairment (Note 3, *Investments*), and financial instruments (Note 5, *Fair Value Measurement*). Actual results could differ from those estimates.

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

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

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

- In March 2017, the FASB issued ASU 2017-08 *Receivables—Nonrefundable Fees and Other Costs* (Subtopic 310-20): *Premium Amortization on Purchased Callable Debt Securities*. The guidance relates to certain callable debt securities and shortens the amortization period for any premium to the earliest call date. The Update will be effective for interim and annual periods beginning after December 15, 2018 for public business entities. Early adoption is permitted. The 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 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 recognition standard. The amendments will be effective for reporting periods beginning after December 15, 2017 for public business entities. 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 2017, the FASB issued ASU 2017-04 *Intangibles—Goodwill and Other* (Topic 350): *Simplifying the Test for Goodwill Impairment*. The Update simplifies the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private

company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for reporting periods beginning after December 15, 2020 for public business entities that are not SEC filers. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. 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 2017, the FASB issued ASU 2017-03 Accounting Changes and Error Corrections (Topic 250) and Investments—Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings (SEC Update). The ASU incorporates recent SEC guidance about disclosing, under SEC SAB Topic 11.M, the effect on financial statements of adopting the revenue, leases, and credit losses standards. The Update was effective upon issuance. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

#### ***ASUs Pending Effective Date***

For a detailed description of the ASUs below, see the latest Annual Report.

Potential effects of ASUs issued in previous periods:

- 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. In January, 2017, the FASB issued this update to provide a more robust framework to use in determining when a set of assets and activities is a business. It supports more consistency in applying the guidance, reduces the costs of application, and makes the definition of a business more operable. For public business entities, the ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The amendments should be applied prospectively. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- 2016-16 Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory: In October, 2016, the FASB issued this Update that 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 is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

- 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments: In June, 2016, the FASB issued this Update to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- 2016-02 Leases (Topic 842): In February, 2016, the FASB issued this Update which 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.
- 2016-01 Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities: In January, 2016, the FASB issued this Update which 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 is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.
- 2014-09 Revenue from Contracts with Customers (Topic 606): In May 2014, the FASB issued this guidance to change 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. Early application is not permitted. 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, but may result in additional disclosures.

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

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

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

- 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash. In November, 2016, the FASB issued this Update to clarify that amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. 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 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.
- 2016-17 Consolidation (Topic 810) - Interests Held through Related Parties That Are under Common Control: In October, 2016, the FASB issued this Update to amend the consolidation guidance on how a reporting entity that is the single decision maker of a variable interest entity (VIE) should treat indirect interests in the entity held through

related parties that are under common control with the reporting entity when determining whether it is the primary beneficiary of that VIE. The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Application of the guidance had no impact on the Association's financial statements.

- 2016-15 Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force): In August, 2016, the FASB issued this Update to eliminate 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.

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

The Association maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of 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. See Note 3, *Loans and Allowance for Loan Losses*, from the latest Annual Report for further discussion.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. The 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.

A summary of loans outstanding at period end follows:

	September 30, 2017	December 31, 2016
Real estate mortgage	\$ 295,202	\$ 268,880
Production and intermediate-term	157,421	147,903
Processing and marketing	1,121	1,053
Farm-related business	4,594	421
Rural residential real estate	8,276	7,838
Other (including Mission Related)	13	-
<b>Total Loans</b>	<b>\$ 466,627</b>	<b>\$ 426,095</b>

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

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

	September 30, 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	\$ -	\$ 18,736	\$ -	\$ -	\$ -	\$ 5,811	\$ -	\$ 24,547
Production and intermediate-term	-	5,200	-	-	-	1,292	-	6,492
Processing and marketing	950	-	-	-	-	22	950	22
Farm-related business	-	6,280	-	-	-	-	-	6,280
<b>Total</b>	<b>\$ 950</b>	<b>\$ 30,216</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 7,125</b>	<b>\$ 950</b>	<b>\$ 37,341</b>

	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
<b>Total</b>	<b>\$ 860</b>	<b>\$ 28,352</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 5,866</b>	<b>\$ 860</b>	<b>\$ 34,218</b>

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:

	September 30, 2017			
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 4,875	\$ 26,894	\$ 263,433	\$ 295,202
Production and intermediate-term	56,783	79,050	21,588	157,421
Processing and marketing	-	89	1,032	1,121
Farm-related business	319	1,752	2,523	4,594
Rural residential real estate	1,179	1,439	5,658	8,276
Other (including Mission Related)	-	13	-	13
<b>Total Loans</b>	<b>\$ 63,156</b>	<b>\$ 109,237</b>	<b>\$ 294,234</b>	<b>\$ 466,627</b>
Percentages	13.53%	23.41%	63.06%	100.00%

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

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

	September 30, 2017	December 31, 2016		September 30, 2017	December 31, 2016
<b>Real estate mortgage:</b>			<b>Farm-related business:</b>		
Acceptable	96.22%	95.79%	Acceptable	100.00%	100.00%
OAEM	1.43	2.25	OAEM	-	-
Substandard/doubtful/loss	2.35	1.96	Substandard/doubtful/loss	-	-
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>			<b>Rural residential real estate:</b>		
Acceptable	96.04%	96.73%	Acceptable	91.49%	91.83%
OAEM	0.96	1.50	OAEM	2.36	-
Substandard/doubtful/loss	3.00	1.77	Substandard/doubtful/loss	6.15	8.17
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Processing and marketing:</b>			<b>Other (including Mission Related)</b>		
Acceptable	100.00%	100.00%	Acceptable	100.00%	-%
OAEM	-	-	OAEM	-	-
Substandard/doubtful/loss	-	-	Substandard/doubtful/loss	-	-
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>-%</u>
			<b>Total Loans:</b>		
			Acceptable	96.13%	96.06%
			OAEM	1.27	1.94
			Substandard/doubtful/loss	2.60	2.00
				<u>100.00%</u>	<u>100.00%</u>

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

September 30, 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	\$ 225	\$ 191	\$ 416	\$ 298,673	\$ 299,089	\$ -
Production and intermediate-term	424	464	888	159,157	160,045	-
Processing and marketing	-	-	-	1,123	1,123	-
Farm-related business	-	-	-	4,615	4,615	-
Rural residential real estate	379	41	420	7,876	8,296	-
Other (including Mission Related)	-	-	-	13	13	-
Total	\$ 1,028	\$ 696	\$ 1,724	\$ 471,457	\$ 473,181	\$ -

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	\$ -



Nonperforming assets (including accrued interest receivable as applicable) and related credit quality statistics at period end were as follows:

	September 30, 2017	December 31, 2016
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 851	\$ 1,058
Production and intermediate-term	749	569
Rural residential real estate	349	418
Total	<u>\$ 1,949</u>	<u>\$ 2,045</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	\$ 1,226	\$ 1,280
Total	<u>\$ 1,226</u>	<u>\$ 1,280</u>
<b>Accruing loans 90 days or more past due:</b>		
Total	\$ -	\$ -
Total nonperforming loans	\$ 3,175	\$ 3,325
Other property owned	8	8
Total nonperforming assets	<u>\$ 3,183</u>	<u>\$ 3,333</u>
Nonaccrual loans as a percentage of total loans	0.42%	0.48%
Nonperforming assets as a percentage of total loans and other property owned	0.68%	0.78%
Nonperforming assets as a percentage of capital	<u>4.03%</u>	<u>4.56%</u>

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

	September 30, 2017	December 31, 2016
<b>Impaired nonaccrual loans:</b>		
Current as to principal and interest	\$ 1,121	\$ 935
Past due	828	1,110
Total	<u>\$ 1,949</u>	<u>\$ 2,045</u>
<b>Impaired accrual loans:</b>		
Restructured	\$ 1,226	\$ 1,280
90 days or more past due	-	-
Total	<u>\$ 1,226</u>	<u>\$ 1,280</u>
Total impaired loans	<u>\$ 3,175</u>	<u>\$ 3,325</u>
Additional commitments to lend	\$ -	\$ -

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

	September 30, 2017			Quarter Ended September 30, 2017		Nine Months Ended September 30, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans:</b>							
<b>With a related allowance for credit losses:</b>							
Real estate mortgage	\$ 131	\$ 151	\$ 6	\$ 140	\$ -	\$ 149	\$ 3
Production and intermediate-term	554	569	203	591	2	632	14
Rural residential real estate	-	-	-	-	-	-	-
Total	<u>\$ 685</u>	<u>\$ 720</u>	<u>\$ 209</u>	<u>\$ 731</u>	<u>\$ 2</u>	<u>\$ 781</u>	<u>\$ 17</u>
<b>With no related allowance for credit losses:</b>							
Real estate mortgage	\$ 1,946	\$ 2,211	\$ -	\$ 2,079	\$ 6	\$ 2,221	\$ 48
Production and intermediate-term	195	262	-	209	-	223	4
Rural residential real estate	349	403	-	373	1	398	9
Total	<u>\$ 2,490</u>	<u>\$ 2,876</u>	<u>\$ -</u>	<u>\$ 2,661</u>	<u>\$ 7</u>	<u>\$ 2,842</u>	<u>\$ 61</u>
<b>Total:</b>							
Real estate mortgage	\$ 2,077	\$ 2,362	\$ 6	\$ 2,219	\$ 6	\$ 2,370	\$ 51
Production and intermediate-term	749	831	203	800	2	855	18
Rural residential real estate	349	403	-	373	1	398	9
Total	<u>\$ 3,175</u>	<u>\$ 3,596</u>	<u>\$ 209</u>	<u>\$ 3,392</u>	<u>\$ 9</u>	<u>\$ 3,623</u>	<u>\$ 78</u>

Impaired loans:	December 31, 2016			Year Ended December 31, 2016	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>With a related allowance for credit losses:</b>					
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
<b>With no related allowance for credit losses:</b>					
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
<b>Total:</b>					
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

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

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Rural Residential Real Estate	Other (including Mission Related)	Total
<b>Activity related to the allowance for credit losses:</b>						
Balance at June 30, 2017	\$ 2,207	\$ 1,397	\$ 21	\$ 62	\$ –	\$ 3,687
Charge-offs	–	–	–	–	–	–
Recoveries	–	–	–	–	–	–
Provision for loan losses	16	(33)	21	(4)	–	–
Balance at September 30, 2017	\$ 2,223	\$ 1,364	\$ 42	\$ 58	\$ –	\$ 3,687
Balance at December 31, 2016	\$ 2,308	\$ 1,296	\$ 13	\$ 78	\$ –	\$ 3,695
Charge-offs	–	–	–	(14)	–	(14)
Recoveries	–	6	–	–	–	6
Provision for loan losses	(85)	62	29	(6)	–	–
Balance at September 30, 2017	\$ 2,223	\$ 1,364	\$ 42	\$ 58	\$ –	\$ 3,687
Balance at June 30, 2016	\$ 2,205	\$ 1,485	\$ 14	\$ 64	\$ –	\$ 3,768
Charge-offs	–	(23)	–	–	–	(23)
Recoveries	–	–	–	–	–	–
Provision for loan losses	113	(133)	3	17	–	–
Balance at September 30, 2016	\$ 2,318	\$ 1,329	\$ 17	\$ 81	\$ –	\$ 3,745
Balance at December 31, 2015	\$ 2,204	\$ 1,486	\$ 18	\$ 63	\$ –	\$ 3,771
Charge-offs	–	(26)	–	–	–	(26)
Recoveries	–	–	–	–	–	–
Provision for loan losses	114	(131)	(1)	18	–	–
Balance at September 30, 2016	\$ 2,318	\$ 1,329	\$ 17	\$ 81	\$ –	\$ 3,745
<b>Allowance on loans evaluated for impairment:</b>						
Individually	\$ 6	\$ 203	\$ –	\$ –	\$ –	\$ 209
Collectively	2,217	1,161	42	58	–	3,478
Balance at September 30, 2017	\$ 2,223	\$ 1,364	\$ 42	\$ 58	\$ –	\$ 3,687
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
<b>Recorded investment in loans evaluated for impairment:</b>						
Individually	\$ 851	\$ 749	\$ –	\$ 349	\$ –	\$ 1,949
Collectively	298,238	159,296	5,738	7,947	13	471,232
Balance at September 30, 2017	\$ 299,089	\$ 160,045	\$ 5,738	\$ 8,296	\$ 13	\$ 473,181
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

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

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 table presents 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 TDRs that occurred for the three and nine month periods ended September 30, 2017 or the three months ended September 30, 2016.

Outstanding Recorded Investment	Nine months ended September 30, 2016				Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total	
<b>Pre-modification:</b>					
Real estate mortgage	\$ -	\$ 1,219	\$ -	\$ 1,219	
Total	\$ -	\$ 1,219	\$ -	\$ 1,219	
<b>Post-modification:</b>					
Real estate mortgage	\$ -	\$ 1,219	\$ -	\$ 1,219	\$ -
Total	\$ -	\$ 1,219	\$ -	\$ 1,219	\$ -

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 the periods presented. Payment default is defined as a payment that was thirty days or more past due.

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

	Total TDRs		Nonaccrual TDRs	
	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
Real estate mortgage	\$ 1,226	\$ 1,320	\$ -	\$ 40
Total Loans	\$ 1,226	\$ 1,320	\$ -	\$ 40
Additional commitments to lend	\$ -	\$ -		

The following table presents information as of period end:

	September 30, 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	\$ 186

### Note 3 — Investments

#### Investments in Other Farm Credit Institutions

The Association is required to maintain ownership in AgFirst Farm Credit Bank (AgFirst or the Bank) of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. The Association owned 1.94 percent of the issued stock of the Bank as of September 30, 2017 net of any reciprocal investment. As of that date, the Bank's assets totaled \$32.1 billion and shareholders' equity totaled \$2.5 billion. The Bank's earnings were \$247 million for the first nine months of 2017. In addition, the Association held investments of \$210 related to other Farm Credit institutions.

### Note 4 — Debt

#### Notes Payable to AgFirst Farm Credit Bank

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. The contractual terms of the revolving line of credit are contained in the General Financing Agreement (GFA). The GFA also defines Association performance criteria for borrowing from the Bank, which includes borrowing base margin, earnings and capital covenants, among others.

## Note 5 — Fair Value Measurement

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

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

The classifications within the fair value hierarchy are as follows:

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

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

Level 3 inputs 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 the third-party valuation or internal model pricing.

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

There were no Level 3 assets or 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. Fair values are estimated at least annually, or when information suggests a significant change in value, for assets measured at fair value on a nonrecurring 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.

At or for the Nine Months Ended September 30, 2017						
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value	Fair Value Effects On Earnings
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Recurring Assets	\$ —	\$ —	\$ —	\$ —	\$ —	
<b>Liabilities:</b>						
Recurring Liabilities	\$ —	\$ —	\$ —	\$ —	\$ —	
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$ 476	\$ —	\$ —	\$ 476	\$ 476	\$ (175)
Other property owned	8	—	—	9	9	—
Nonrecurring Assets	\$ 484	\$ —	\$ —	\$ 485	\$ 485	\$ (175)
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 793	\$ 793	\$ —	\$ —	\$ 793	
Loans	462,465	—	—	453,055	453,055	
Other Financial Assets	\$ 463,258	\$ 793	\$ —	\$ 453,055	\$ 453,848	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 400,877	\$ —	\$ —	\$ 396,033	\$ 396,033	
Other Financial Liabilities	\$ 400,877	\$ —	\$ —	\$ 396,033	\$ 396,033	

At or for the Year Ended December 31, 2016

	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value	Fair Value Effects On Earnings
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Recurring Assets	\$ -	\$ -	\$ -	\$ -	\$ -	
<b>Liabilities:</b>						
Recurring Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans*	\$ 603	\$ -	\$ -	\$ 603	\$ 603	\$ 86
Other property owned	8	-	-	9	9	-
Nonrecurring Assets	\$ 611	\$ -	\$ -	\$ 612	\$ 612	\$ 86
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 1,605	\$ 1,605	\$ -	\$ -	\$ 1,605	
Loan*s	423,225	-	-	412,214	412,214	
Other Financial Assets	\$ 424,830	\$ 1,605	\$ -	\$ 412,214	\$ 413,819	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 368,038	\$ -	\$ -	\$ 360,085	\$ 360,085	
Other Financial Liabilities	\$ 368,038	\$ -	\$ -	\$ 360,085	\$ 360,085	

\*Subsequent to the issuance of the 2016 Annual Report, management identified errors in the reporting of certain loans measured at fair value on a non-recurring basis using Level 3. Management has evaluated the impact of the errors on the disclosure in this note and concluded that individually and in the aggregate, the errors do not result in a material misstatement of the previously issued financial statements. The Level 3 fair values of impaired loans and loans reported for December 31, 2016 have been revised from the previously reported amounts of \$3,283 and \$409,534 to \$603 and \$412,214, respectively.

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

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

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	\$ 484	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 6 — Employee Benefit Plans**

The following is a table of retirement and other postretirement benefit expenses for the Association:

	Three Months Ended September 30 ,		Nine Months Ended September 30 ,	
	2017	2016	2017	2016
Pension	\$ 146	\$ 205	\$ 439	\$ 616
401(k)	51	45	151	136
Other postretirement benefits	16	38	56	115
Total	\$ 213	\$ 288	\$ 646	\$ 867

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 9/30/17	Projected Contributions For Remainder of 2017	Projected Total Contributions 2017
	Pension	\$ —	\$ 585
Other postretirement benefits	56	21	77
Total	\$ 56	\$ 606	\$ 662

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan's Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2017.

Further details regarding employee benefit plans are contained in the 2016 Annual Report to Shareholders. As of March 31, 2017, the AgFirst Farm Credit Cash Balance Retirement Plan had been terminated and all vested benefits had been distributed to participants.

**Note 7 — Commitments and Contingent Liabilities**

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.

**Note 8 — Subsequent Events**

The Association evaluated subsequent events and determined that, except as described below, there were none requiring disclosure through November 8, 2017, which was the date the financial statements were issued.

On October 16, 2017, AgFirst's Board of Directors indicated an intention to declare, in December 2017, a special patronage distribution. The Association will receive between \$2,820 and \$3,384 which will be recorded as patronage refunds from other Farm Credit institutions.