



## GreenStone Farm Credit Services, ACA

Quarterly Report  
March 31, 2019

### MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of GreenStone Farm Credit Services, ACA and its subsidiaries GreenStone Farm Credit Services, FLCA and GreenStone Farm Credit Services, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2018 (2018 Annual Report).

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

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### FORWARD-LOOKING INFORMATION

Any forward-looking statements in this Quarterly Report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2018 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

### AGRICULTURAL AND ECONOMIC CONDITIONS

Real gross domestic product (GDP) increased at an annual rate of 3.2% in the first quarter of 2019 according to the "advance" estimate released by the Bureau of Economic Analysis. The increase reflected positive contributions from personal consumption expenditures, private inventory investment, exports, state and local government spending, and nonresidential fixed investment. Imports, which are a subtraction from the calculation of GDP, decreased. These contributions were partially offset by a decrease in residential investment.

The U.S. economy remains generally strong with unemployment near record lows and average wages continuing to increase. Specifically, the U.S. unemployment rate stood at 3.8% at the end of February. Additionally, inflation remains near 2%, which is in line with the Federal Reserve's long-run target inflation rate. The Federal Reserve has indicated that it expects the U.S. economy to continue growing at a solid pace in 2019, although likely slower than the pace seen in recent years.

Despite this generally positive outlook, over the past few months some causes for concern have surfaced with regards to the macro-economy. Growth has slowed in some major foreign economies, particularly China and Europe. There is also elevated uncertainty around several unresolved government policy issues, including Brexit, ongoing trade negotiations, and the effects from the partial government shutdown in the U.S. Further, financial conditions tightened considerably in the fourth quarter of 2018 and remain somewhat less supportive of growth than they were earlier in 2018. While most of the recent domestic economic data remains solid, some surveys of business and consumer sentiment have moved lower.

Housing starts fell 0.3% in March 2019 from a month earlier, following a 12.0% decline in February. This is primarily being caused by persistent weakness in the single-family housing segment. Single-family homebuilding dropped 0.4% in March to 785,000 units, which is the lowest level since September 2016.

Oil prices have been especially volatile over the last several months as oversupply concerns have led to market uncertainty. Crude oil prices peaked at \$75 per barrel in early October 2018 before falling nearly 45% to \$43 per barrel during a fourth quarter rout that was driven by concerns over strong U.S. output and a buildup of inventory. In late 2018, the Organization of the Petroleum Exporting Countries and a separate group of 10 producer nations, led by Russia, agreed to collectively hold back crude production by 1.2 million barrels a day for the first half of 2019. Oil prices responded accordingly, with the futures price rebounding 30% from their December low. Much of the supply uncertainty affecting global oil markets is related to increased U.S. output. The U.S. Energy Information Administration (EIA) estimates that total U.S. crude oil production will average 12.4 million barrels per day in 2019 and 13.2 million barrels per day in 2020, up from approximately 11.3 million barrels per day in 2018. Most of this increase in production is expected to come from Texas and New Mexico. U.S. oil imports have been steadily falling over the last several years, with the EIA now forecasting that the U.S. will be a net exporter of crude oil and petroleum products beginning in the fourth quarter of 2020.

Some progress has been made over the past few months with regards to the U.S. ongoing trade negotiations with China. While a long-term deal has yet to be made, President Trump's decision to delay additional tariffs on Chinese exports was viewed with optimism by those hoping to find a resolution to the trade dispute between the two nations. As of now, China has agreed to purchase additional U.S. goods, particularly as it relates to agricultural products. Additionally, China has agreed to allow American businesses greater access to certain sectors such as financial services and autos. That being said, the prospects of a long-term deal are still clouded by differences over issues of technology transfers and intellectual property theft. Markets seem to be relatively optimistic for the prospects of a deal. However, despite the supposedly positive developments in the U.S./China trade negotiations, U.S. agricultural commodities continue to struggle, with corn, soybean, and wheat futures all declining during the first few months of 2019.

Hog prices, which are also highly dependent on export markets, have drifted generally lower during the first few months of 2019. This comes despite ongoing concern about an outbreak of African Swine Fever (ASF) in the Chinese hog herd. The Chinese hog herd has contracted by 13% and the number of breeding sows is down 15% when comparing January 2019 with a year earlier. Given this supply contraction, domestic Chinese hog prices hit 14-month highs in early March, with many industry observers expecting further price increases in the coming months. China is home to half of the world's hogs. Further, China's domestic annual pork consumption makes up roughly half of the total global pork consumption. Given these market dynamics, the Chinese government may have no choice but to start importing more U.S. pork products in order to meet consumer demand. Currently, U.S. pork exports to China are being hindered by a 62% duty.

Construction of the new 8 million pounds per day cheese plant in Clinton County, Michigan is on track, with the facility expected to begin taking milk in October 2020. The processing complex is a joint venture between Glanbia, Select Milk Producers, and Dairy Farmers of America. The plant will help balance production within the Michigan milk shed (the facility will consume nearly 20% of Michigan's current milk production).

The Michigan dairy industry continues to see consolidation, with the total number of dairy producer permits down 12.2% over the last 12 months. That being said, total cow numbers were only down 1.4% over the same period, indicating that struggling producers were being absorbed by more efficient ones rather than simply taking cows out of production. Further to this point, daily milk production per cow increased 1.2% over the last 12 months, leading to total 2018 Michigan milk production being essentially flat compared to 2017. Nationally, milk production in the 23 major dairy producing states during December 2018 totaled 17.1 billion pounds, up 0.9% from December 2017. The daily production per cow in the 23 major states averaged 63.4 pounds for December 2018, up 0.7 pounds from December 2017. The 2019 forecast for the all-milk price is \$17.25-\$17.75 per hundredweight (cwt.) in 2019 compared to \$16.18 for 2018. The January 2019 mailbox price was \$14.83 per cwt. in Michigan and \$16.18 per cwt. in Wisconsin. For reference, the national average mailbox price was \$16.14, up \$0.13 for the month and up \$0.28 from a year ago.

## **LOAN PORTFOLIO**

### **Loan Portfolio**

Owned loan volume totaled \$8.7 billion at March 31, 2019, a \$65.2 million increase from December 31, 2018.

Total owned and managed loan volume, including serviced volume on the real estate loans sold to AgriBank, was \$8.8 billion at March 31, 2019, a \$57.6 million increase from December 31, 2018. Our combined mortgage portfolio increased \$136.2 million or 2.1% from December 31, 2018, while our short-term commercial loan portfolio decreased \$78.6 million or 3.6% from December 31, 2018. When compared to March 31, 2018, owned and managed mortgage volume is up 7.0% and commercial loan volume is up 2.7%. These increases were driven by growth in all market segments and led by our capital markets and country living segments that have increased 17.9% and 6.1% since March 31, 2018, respectively. Our current volume reflects an asset growth rate year over year that is running slightly above our 2019 Business Plan.

### **Portfolio Credit Quality**

The credit quality of our loan portfolio slowly declined throughout 2018 but remained relatively unchanged during the first three months of 2019. Acceptable credit quality, as measured under the Uniform Classification System, was 92.2% which was unchanged from December 31, 2018. Year over year, acceptable credit quality decreased 1.9% from 94.1% at March 31, 2018. Portfolio assets criticized as being less than acceptable are comprised of 4.2% other assets especially mentioned (OAEM) and 3.6% adversely classified. OAEM decreased 0.1% while adversely classified increased 0.1% from December 31, 2018.

Adversely classified loans are identified as having material credit weaknesses which, if left uncorrected, result in a greater than normal risk. Portfolio credit quality is considered when assessing the reasonableness of our allowance for loan losses. The credit quality of our core market of traditional production farm loans remains very sound. Weaker borrowers in our dairy and cash crop portfolios continued to be challenged financially during the first quarter of 2019.

The resulting level of credit quality, when combined with our earnings and addition to capital surplus, results in an adverse assets to regulatory capital ratio of 19.4%. This ratio has decreased 0.1% since December 31, 2018.

In certain circumstances, Federal Agricultural Mortgage Corporation and other government agency guarantee programs are used to reduce the risk of loss. At March 31, 2019, \$312.3 million of our loans were, to some level, guaranteed under these programs. The guaranteed loan volume increased from \$308.4 million at December 31, 2018.

## Risk Assets

### Components of Risk Assets

(dollars in thousands)	March 31	December 31
As of:	2019	2018
Loans:		
Nonaccrual	\$88,260	\$97,884
Accruing restructured	3,354	3,331
Accruing loans 90 days or more past due	54	79
Total risk loans	<u>91,668</u>	<u>101,294</u>
Acquired property	2,499	1,766
Total risk assets	<u>\$94,167</u>	<u>\$103,060</u>
Total risk loans as a percentage of total loans	1.1%	1.2%
Nonaccrual loans as a percentage of total loans	1.0%	1.1%
Current nonaccrual loans as a percentage of total nonaccrual loans	89.3%	91.2%
Total delinquencies as a percentage of total loans	0.3%	0.3%

Note: Accruing loans include accrued interest receivable.

Our risk assets decreased from December 31, 2018, and remained at acceptable levels. Total risk loans as a percentage of total loans remained well within our established risk management guidelines.

Nonaccrual loans decreased from \$97.9 million at December 31, 2018, to \$88.3 million at March 31, 2019, and remained at acceptable levels. The decrease in nonaccrual loan volume was primarily due to a large commercial dairy that was sold during the first quarter of 2019. As of March 31, 2019, 57.6% of the nonaccrual loan portfolio was comprised of dairy loans.

Our accounting policy requires accruing loans past due 90 days to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, all loans 90 days or more past due and still accruing interest were eligible to remain in accruing status.

### Allowance for Loan Losses

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

#### Allowance Coverage Ratios

As of:	March 31	December 31
	2019	2018
Allowance as a percentage of:		
Loans	1.0%	1.0%
Nonaccrual loans	97.0%	85.9%
Total risk loans	93.4%	83.0%

The allowance for loan losses increased \$1.6 million from December 31, 2018, to \$85.6 million at March 31, 2019. During the first three months of 2019, a provision for loan losses of \$2.4 million was recorded. Included in our allowance is additional general industry reserves for our dairy and cash grain portfolios due to expected low commodity prices in the near future, primarily the milk price. The additional general industry reserve for the dairy portfolio increased from \$31.5 million at December 31, 2018, to \$38.2 million at March 31, 2019. The additional general industry reserve for the cash grain portfolio decreased from \$9.5 million at December 31, 2018, to \$9.2 million at March 31, 2019.

Under certain circumstances, credit losses may be recorded to establish a reserve on unfunded loan commitments. The "Provision for credit losses" in the Consolidated Statements of Comprehensive Income for the three months ended March 31, 2019, included a reversal of provision for credit losses on unfunded loan commitments of \$683 thousand. The accrued credit losses are recorded in "Other liabilities" in the Consolidated Statements of Condition. The accrued credit losses related to unfunded loan commitments were \$3.5 million and \$4.2 million as of March 31, 2019, and December 31, 2018, respectively. The decrease in accrued credit losses on unfunded loan commitments was primarily due to a paid off seasonal loan commitment of a large capital markets relationship.

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at March 31, 2019.

## RESULTS OF OPERATIONS

### Profitability Information

(dollars in thousands)

For the three months ended March 31	2019	2018
Net income	<b>\$47,278</b>	\$45,753
Return on average assets	<b>2.1%</b>	2.2%
Return on average members' equity	<b>11.2%</b>	11.6%

Changes in the chart above relate directly to:

- Changes in income discussed below
- Changes in assets discussed in the Loan Portfolio section
- Changes in capital discussed in the Funding, Liquidity, and Capital section

### Changes in Significant Components of Net Income

(in thousands)

For the three months ended March 31	2019	2018	Increase (decrease) in net income
Net interest income	<b>\$57,010</b>	\$53,535	<b>\$3,475</b>
Provision for credit losses	<b>(1,755)</b>	(2,094)	<b>339</b>
Patronage income	<b>8,701</b>	7,813	<b>888</b>
Financially related services income	<b>2,045</b>	1,970	<b>75</b>
Fee income	<b>3,432</b>	2,917	<b>515</b>
Allocated Insurance Reserve Accounts distribution	<b>1,997</b>	4,779	<b>(2,782)</b>
Acquired property income, net	<b>37</b>	95	<b>(58)</b>
Miscellaneous income, net	<b>374</b>	435	<b>(61)</b>
Operating expenses	<b>(23,765)</b>	(23,044)	<b>(721)</b>
Provision for income taxes	<b>(798)</b>	(653)	<b>(145)</b>
Net income	<b>\$47,278</b>	\$45,753	<b>\$1,525</b>

### Changes in Net Interest Income

(in thousands)

For the three months ended March 31	2019 vs 2018
Changes in volume	<b>\$2,729</b>
Changes in interest rates	<b>756</b>
Changes in nonaccrual income and other	<b>(10)</b>
Net change	<b>\$3,475</b>

### Patronage Income

(in thousands)

For the three months ended March 31	2019	2018
Wholesale patronage	<b>\$6,000</b>	\$5,662
Pool program patronage	<b>1,950</b>	1,388
AgDirect partnership distribution	<b>688</b>	708
Other Farm Credit Institutions	<b>63</b>	55
Total patronage income	<b>\$8,701</b>	\$7,813

The increase in patronage income from 2018 to 2019 was primarily due to patronage income of \$1.0 million that we received for our ownership interest in the ProPartners Financial loan pool. We did not receive patronage income for ProPartners loans during the first three months of 2018 since these were sold to AgriBank on December 1, 2018. The income and expenses associated with these loans during the first three months of 2018 were reported in their respective categories on the Consolidate Statement of Comprehensive Income.

The change in allocated insurance reserve accounts distribution was due to our share of distributions from Allocated Insurance Reserve Accounts (AIRA) of \$2.0 million in March of 2019, compared to \$4.8 million in March of 2018. The AIRA was established by the Farm Credit System Insurance Corporation (FCSIC) when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. Refer to our 2018 Annual Report for additional information about the FCSIC.

## FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on December 31, 2021, at which time the note will be renegotiated. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

The components of cost of funds associated with our note payable include:

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

We were not subject to a risk premium at March 31, 2019, or December 31, 2018.

Total members' equity increased \$27.0 million from December 31, 2018, primarily due to net income for the period partially offset by patronage distribution accruals. Accumulated other comprehensive loss is the impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan. Refer to Note 10 in our 2018 Annual Report for more information on the Pension Restoration Plan.

The Farm Credit Administration (FCA) Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total regulatory capital, and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents leverage. Refer to Note 8 in our 2018 Annual Report for a more complete description of these ratios.

### Regulatory Capital Requirements and Ratios

As of:	March 31 2019	December 31 2018	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:					
Common equity tier 1 ratio	16.2%	16.4%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	16.2%	16.4%	6.0%	2.5%*	8.5%
Total regulatory capital ratio	17.2%	17.3%	8.0%	2.5%*	10.5%
Permanent capital ratio	16.4%	16.6%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	17.2%	17.6%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	18.3%	18.6%	1.5%	N/A	1.5%

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

The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section.

**CERTIFICATION**

The undersigned have reviewed the March 31, 2019, Quarterly Report of GreenStone Farm Credit Services, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Edward L. Reed  
Chair of the Board  
GreenStone Farm Credit Services, ACA



David B. Armstrong  
Chief Executive Officer  
GreenStone Farm Credit Services, ACA



Travis D. Jones  
Executive Vice President – Chief Financial Officer  
GreenStone Farm Credit Services, ACA

May 8, 2019

# CONSOLIDATED STATEMENTS OF CONDITION

GreenStone Farm Credit Services, ACA

(in thousands)

(Unaudited)

As of:	March 31 2019	December 31 2018
<b>ASSETS</b>		
Loans	\$8,684,827	\$8,619,585
Allowance for loan losses	85,647	84,064
Net loans	8,599,180	8,535,521
Investment in AgriBank, FCB	196,566	196,566
Investment securities	12,060	7,715
Accrued interest receivable	62,353	65,449
Premises and equipment, net	47,858	46,579
Acquired property	2,499	1,766
Deferred tax assets, net	4,684	4,809
Other assets	47,385	60,905
Total assets	\$8,972,585	\$8,919,310
<b>LIABILITIES</b>		
Note payable to AgriBank, FCB	\$7,157,159	\$7,072,973
Accrued interest payable	50,301	48,402
Patronage distribution payable	20,350	82,000
Other liabilities	45,699	43,858
Total liabilities	7,273,509	7,247,233
Contingencies and commitments (Note 4)		
<b>MEMBERS' EQUITY</b>		
Protected members' equity	1	1
Capital stock and participation certificates	22,422	22,400
Unallocated surplus	1,678,456	1,651,528
Accumulated other comprehensive loss	(1,803)	(1,852)
Total members' equity	1,699,076	1,672,077
Total liabilities and members' equity	\$8,972,585	\$8,919,310

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

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

GreenStone Farm Credit Services, ACA

(in thousands)

(Unaudited)

For the period ended March 31	Three Months Ended	
	2019	2018
<b>Interest income</b>	<b>\$107,296</b>	<b>\$92,081</b>
<b>Interest expense</b>	<b>50,286</b>	<b>38,546</b>
Net interest income	57,010	53,535
<b>Provision for credit losses</b>	<b>1,755</b>	<b>2,094</b>
Net interest income after provision for credit losses	55,255	51,441
<b>Non-interest income</b>		
Patronage income	8,701	7,813
Financially related services income	2,045	1,970
Fee income	3,432	2,917
Allocated Insurance Reserve Accounts distribution	1,997	4,779
Acquired property income, net	37	95
Miscellaneous income, net	374	435
Total non-interest income	16,586	18,009
<b>Operating expenses</b>		
Salaries and employee benefits	16,581	15,565
Other operating expenses	7,184	7,479
Total operating expenses	23,765	23,044
Income before income taxes	48,076	46,406
<b>Provision for income taxes</b>	<b>798</b>	<b>653</b>
<b>Net income</b>	<b>\$47,278</b>	<b>\$45,753</b>
<b>Other comprehensive income</b>		
Employee benefit plans activity	\$49	\$58
Total other comprehensive income	49	58
<b>Comprehensive income</b>	<b>\$47,327</b>	<b>\$45,811</b>

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



## CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

GreenStone Farm Credit Services, ACA

(in thousands)

(Unaudited)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2017	\$1	\$22,141	\$1,548,350	(\$1,846)	\$1,568,646
Net income	--	--	45,753	--	45,753
Other comprehensive income	--	--	--	58	58
Unallocated surplus designated for patronage distributions	--	--	(12,615)	--	(12,615)
Capital stock and participation certificates issued	--	421	--	--	421
Capital stock and participation certificates retired	--	(432)	--	--	(432)
<b>Balance at March 31, 2018</b>	<b>\$1</b>	<b>\$22,130</b>	<b>\$1,581,488</b>	<b>(\$1,788)</b>	<b>\$1,601,831</b>
Balance at December 31, 2018	\$1	\$22,400	\$1,651,528	(\$1,852)	\$1,672,077
<b>Net income</b>	--	--	<b>47,278</b>	--	<b>47,278</b>
<b>Other comprehensive income</b>	--	--	--	<b>49</b>	<b>49</b>
<b>Unallocated surplus designated for patronage distributions</b>	--	--	<b>(20,344)</b>	--	<b>(20,344)</b>
<b>Cumulative effect of change in accounting principle</b>	--	--	<b>(6)</b>	--	<b>(6)</b>
<b>Capital stock and participation certificates issued</b>	--	<b>363</b>	--	--	<b>363</b>
<b>Capital stock and participation certificates retired</b>	--	<b>(341)</b>	--	--	<b>(341)</b>
<b>Balance at March 31, 2019</b>	<b>\$1</b>	<b>\$22,422</b>	<b>\$1,678,456</b>	<b>(\$1,803)</b>	<b>\$1,699,076</b>

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

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim Consolidated Statements of Condition and Consolidated Statements of Comprehensive Income. Our accounting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. This interim Quarterly Report is prepared based upon statutory and regulatory requirements and in accordance with GAAP. However, certain disclosures required by GAAP are omitted. The results of the three months ended March 31, 2019, are not necessarily indicative of the results to be expected for the year ending December 31, 2019. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report for the year ended December 31, 2018 (2018 Annual Report).

The Consolidated Financial Statements present the consolidated financial results of GreenStone Farm Credit Services, ACA (the Association) and its subsidiaries GreenStone Farm Credit Services, FLCA and GreenStone Farm Credit Services, PCA (the subsidiaries). All material intercompany transactions and balances have been eliminated in consolidation.

#### Significant Accounting Policies

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**Leases:** We are the lessee in operating leases. We evaluate arrangements at inception to determine if it is a lease. Leases with an initial term of 12 months or less are not recorded on the balance sheet with lease expense recognized on a straight-line basis over the lease term. For leases with terms greater than 12 months the right-of-use (ROU) assets are included in "Other assets" in the Consolidated Statements of Condition and the lease liabilities are included in "Other liabilities" in the Consolidated Statements of Condition.

The ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate when readily determinable. Our lease terms may include options to extend or terminate the lease. The length of the lease term is modified to include the option when it is reasonably certain that we will exercise that option. Operating lease expense for lease payments is recognized on a straight-line basis over the lease term.

#### Recently Issued or Adopted Accounting Pronouncements

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

Standard and effective date	Description	Adoption status and financial statement impact
In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02 "Leases." In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements." The guidance is effective for public business entities in its first quarter of 2019 and early adoption is permitted.	The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases. When this guidance is adopted, a liability for lease obligations and a corresponding right-of-use asset will be recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months. The guidance includes an optional transition method where an entity is permitted to apply the guidance as of the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings.	We adopted this guidance on January 1, 2019. The adoption of this guidance did not have a material impact on our financial condition, results of operations, and financial statement disclosures, and had no impact on cash flows.
In June 2016, the FASB issued ASU 2016-13 "Financial Instruments – Credit Losses." This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted.	The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses.	We have no plans to early adopt this guidance. We have reviewed the accounting standard and are in the process of drafting disclosures. Significant implementation matters yet to be addressed include system selection, system development and testing, drafting of accounting policies, and designing processes and controls. We are currently unable to estimate the impact on the financial statements.

**NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES**
**Loans by Type**

(dollars in thousands)

As of:	March 31, 2019		December 31, 2018	
	Amount	Percentage	Amount	Percentage
Real estate mortgage	\$5,288,829	60.9%	\$5,265,017	61.1%
Production and intermediate-term	1,900,410	21.9	2,035,886	23.6
Agribusiness	1,050,305	12.1	907,425	10.5
Other	445,283	5.1	411,257	4.8
Total	<b>\$8,684,827</b>	<b>100.0%</b>	<b>\$8,619,585</b>	<b>100.0%</b>

The other category is primarily comprised of rural infrastructure and rural residential real estate related loans.

**Delinquency**
**Aging Analysis of Loans**

(in thousands)	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less than 30 Days Past Due	Accruing Loans 90 Days or More Past Due
<b>As of March 31, 2019</b>					
Real estate mortgage	\$15,919	\$3,146	\$19,065	\$5,306,313	\$ --
Production and intermediate-term	6,055	1,835	7,890	1,912,631	54
Agribusiness	--	282	282	1,054,265	--
Other	1,611	569	2,180	444,136	--
<b>Total</b>	<b>\$23,585</b>	<b>\$5,832</b>	<b>\$29,417</b>	<b>\$8,717,345</b>	<b>\$54</b>
<b>As of December 31, 2018</b>					
Real estate mortgage	\$15,678	\$2,992	\$18,670	\$5,287,020	\$79
Production and intermediate-term	4,381	2,351	6,732	2,049,625	--
Agribusiness	--	332	332	910,298	--
Other	2,649	588	3,237	408,754	--
<b>Total</b>	<b>\$22,708</b>	<b>\$6,263</b>	<b>\$28,971</b>	<b>\$8,655,697</b>	<b>\$79</b>

Note: Accruing loans include accrued interest receivable.

**Risk Loans**

Risk loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms.

**Risk Loan Information**

(in thousands)	March 31 2019	December 31 2018
As of:		
Volume with specific allowance	\$68,057	\$76,625
Volume without specific allowance	23,611	24,669
Total risk loans	<b>\$91,668</b>	<b>\$101,294</b>
Total specific allowance	<b>\$23,685</b>	\$25,248
For the three months ended March 31		
Income on accrual risk loans	\$52	\$67
Income on nonaccrual loans	556	463
Total income on risk loans	<b>\$608</b>	<b>\$530</b>
Average risk loans	<b>\$95,964</b>	\$53,477

Note: Accruing loans include accrued interest receivable.

We had \$3.4 million of commitments to lend additional money to borrowers whose loans were classified as risk loans at March 31, 2019.

## Troubled Debt Restructurings (TDRs)

In situations where, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession for other than an insignificant period of time to the borrower that we would not otherwise consider, the related loan is classified as a troubled debt restructuring, also known as a restructured loan. A concession is generally granted in order to minimize economic loss and avoid foreclosure. Concessions vary by program and borrower and may include interest rate reductions, term extensions, payment deferrals, or an acceptance of additional collateral in lieu of payments. In limited circumstances, principal may be forgiven. Loans classified as TDRs are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.

### TDR Activity

(in thousands)

Three months ended March 31

	2019		2018	
	Pre-modification	Post-modification	Pre-modification	Post-modification
Production and intermediate-term	\$ --	\$ --	\$49	\$49
Other	10	10	--	--
Total	<b>\$10</b>	<b>\$10</b>	\$49	\$49

Pre-modification represents the outstanding recorded investment of the loan just prior to restructuring and post-modification represents the outstanding recorded investment of the loan immediately following the restructuring. The recorded investment in the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off.

The primary type of modification was interest rate reduction below market.

We had no TDRs that defaulted during the three months ended March 31, 2019, in which the modifications were within twelve months of the respective reporting period. We had TDRs in the production and intermediate-term loan category of \$135 thousand that defaulted during the three months ended March 31, 2018, in which the modifications were within twelve months of the respective reporting period.

### TDRs Outstanding

(in thousands)	March 31	December 31
As of:	2019	2018
Accrual status:		
Real estate mortgage	\$2,676	\$2,650
Production and intermediate-term	419	419
Agribusiness	--	--
Other	259	262
Total TDRs in accrual status	<b>\$3,354</b>	\$3,331
Nonaccrual status:		
Real estate mortgage	\$2,278	\$2,289
Production and intermediate-term	1,041	1,337
Agribusiness	10,668	10,535
Other	186	184
Total TDRs in nonaccrual status	<b>\$14,173</b>	\$14,345
Total TDRs:		
Real estate mortgage	\$4,954	\$4,939
Production and intermediate-term	1,460	1,756
Agribusiness	10,668	10,535
Other	445	446
Total TDRs	<b>\$17,527</b>	\$17,676

Additional commitments to lend to borrowers whose loans have been modified in a TDR were \$2.2 million at March 31, 2019.

## Allowance for Loan Losses

### Changes in Allowance for Loan Losses

(in thousands)	2019	2018
Three months ended March 31		
Balance at beginning of period	\$84,064	\$72,640
Provision for loan losses	2,438	334
Loan recoveries	83	220
Loan charge-offs	(938)	(56)
Balance at end of period	<u>\$85,647</u>	<u>\$73,138</u>

The "Provision for credit losses" in the Consolidated Statements of Comprehensive Income includes a provision for loan losses as presented in the previous chart, as well as a (reversal of) provision for credit losses on unfunded commitments as presented in the chart below. The accrued credit losses on unfunded commitments are recorded in "Other liabilities" in the Consolidated Statements of Condition.

### Credit Loss Information on Unfunded Commitments

(in thousands)	2019	2018
For the three months ended March 31		
(Reversal of) provision for credit losses	(\$683)	\$1,760
	March 31	December 31
As of:	2019	2018
Accrued credit losses	\$3,486	\$4,169

## NOTE 3: INVESTMENT SECURITIES

We held investment securities of \$12.1 million at March 31, 2019, and \$7.7 million at December 31, 2018. Our investment securities consisted of securities backed by pools of loans guaranteed by the Small Business Administration. The investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. No investments within the portfolio were impaired as of March 31, 2019, or December 31, 2018.

### Additional Investment Securities Information

(dollars in thousands)	March 31	December 31
As of:	2019	2018
Amortized cost	\$12,060	\$7,715
Unrealized gains	260	278
Fair value	<u>\$12,320</u>	<u>\$7,993</u>
Weighted average yield	5.1%	4.9%

Investment income is recorded in "Interest income" in the Consolidated Statements of Comprehensive Income and totaled \$150 thousand and \$114 thousand for the three months ended March 31, 2019, and 2018, respectively.

## NOTE 4: CONTINGENCIES AND COMMITMENTS

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

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

## NOTE 5: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three input levels that may be used to measure fair value. Refer to Note 2 in our 2018 Annual Report for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at March 31, 2019, or December 31, 2018.

## Non-Recurring Basis

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis.

### Assets Measured at Fair Value on a Non-recurring Basis

(in thousands)

	As of March 31, 2019			Total Fair Value
	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	
<b>Impaired loans</b>	\$ --	\$ --	\$46,590	\$46,590
<b>Acquired property</b>	--	--	6,019	6,019

  

	As of December 31, 2018			Total Fair Value
	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	
Impaired loans	\$ --	\$ --	\$53,946	\$53,946
Acquired property	--	--	4,891	4,891

## Valuation Techniques

**Impaired loans:** Represents the carrying amount and related write-downs of loans which were evaluated for individual impairment based on the appraised value of the underlying collateral. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses observable market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters, they are classified as Level 3.

**Acquired property:** Represents the fair value and related losses of foreclosed assets that were measured at fair value based on the collateral value, which is generally determined using appraisals, or other indications based on sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. If the process uses observable market-based information, they are classified as Level 2. If the process requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the property and other matters, they are classified as Level 3.

### NOTE 6: SUBSEQUENT EVENTS

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