

# 2016

## ANNUAL REPORT



Photographed by Joni Adams Yates



LENDING SUPPORT FOR GENERATIONS

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# RIVER VALLEY AGCREDIT, ACA

## *2016 ANNUAL REPORT*

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### **Management**

Kyle Yancey.....	Chief Executive Officer
Kevin Brown .....	Chief Lending Officer
Beth Barkley.....	Chief Financial Officer

### **Board of Directors**

David L. Richesin .....	Chairman
Joe F. Campbell.....	Vice Chairman
Edsel Freels .....	Director
Darren Grogan.....	Director
Curtis Hancock.....	Director
Randall Heath.....	Director
Tiffany Myers .....	Outside Director
Dr. Buddy Ray .....	Outside Director
Jack Sanders .....	Director
David Singleton.....	Director
Brandon Strasser .....	Director
Aaron Wilson .....	Director
Eddie Workman .....	Director

## Message from the President

2016 was a year that forced most farmers to analyze their operations in great detail. Grain farmers in the western region were facing extreme financial uncertainty. After three consecutive years of declining grain prices, working capital was being depleted at an alarming rate and repayment margins that were once strong became negative for most farmers. Input efficiency became critical to the success of every crop. Managing the cost line instead of the revenue line became the daily plan. In the end, the farmer had no control over the weather. A summer that brought record rainfall to much of the area ended with a drought in the fall.

Our eastern region was not immune to the swings either. Much of the year was spent in a moderate to excessive drought that ended with disastrous wild fires over much of our territory destroying most of the hay crops. I recall the grand opening of the new Cleveland Office in late June; the grass looked more like late September and it never improved. During our annual meetings, what I thought was fog turned into smoke when I got out of the car. No one in the agricultural economy is immune to this uncertainty, especially a Farm Credit Association, and the effects of all these events impact our overall portfolio quality. Regardless, River Valley is honored to be an integral part of our agricultural markets, and we will continue to support your financing needs in the best of times and the worst of times. Overall I am very proud of our borrowers and employees that worked and managed through a very trying 2016.

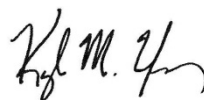
The Association's 2016 net volume grew to \$490.3 million with total assets of \$519.8 million. Both regions experienced significant growth in the poultry segment. Working capital shortfalls lead to greater usage of operating lines of credit. Our lenders added over \$100 million in new loan volume and the rural home loan originators contributed an additional \$466,000 in fee income. As you strive to be efficient in your operation, so do we in ours. Our expenses were \$1.1 million under budget in 2016. The less we spend the more money we can pay back in patronage.

Net earnings in 2016 were \$7.8 million which was \$1.3 million over budget thanks in part from a special patronage payment of \$2.5 million from our funding bank. This patronage helped increase our net income well above budget and given our cooperative status, our borrowers will receive a portion of that special patronage income in your pat refund. Return on assets (ROA) at year end was 1.60% which was well above the standard of 1.0% set in our general financing agreement with AgFirst. Year-end permanent capital improved to 19.38%.

Credit quality fell to 90.8% fully acceptable, down from 95.4% a year ago. Adversely classified volume makes up 5.8% of our portfolio compared to 1.37% last year. The downturn in our agriculture economy mentioned above plays a big role in the downgraded portfolio this year. We remain well positioned to handle an additional adversity as our allowance for loan losses is strong. Currently 1.20% of total loans, or \$5.9 million is set aside for troubled times. Delinquencies are down to .49% on a 12 month average.

This year your Board of Directors chose to downsize the number of directors over the course of the next four years. Through the process of attrition, we will now have 9 directors. In addition to downsizing, we also changed to regional representation. This will lead to more opportunities for stockholders to serve on the board, as you will no longer have to wait on your county seat to open. Your Board and Management constantly set goals that will add value to the Association. By choosing to downsize our board size, this aligns us with other associations our size.

Thank you for allowing me to serve as your CEO in 2016. As always, my door is open to all stockholders. Stop by or call anytime. May God bless you and your operations in 2017.



Kyle M. Yancey  
Chief Executive Officer  
River Valley AgCredit, ACA

March 13, 2017

## Report of Management

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

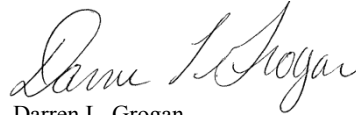
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the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

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

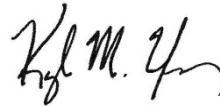
The Consolidated Financial Statements, in the opinion of management, fairly present the financial condition and results of operation of the Association. The undersigned certify that we have reviewed the 2016 Annual Report of River Valley AgCredit, ACA that the report has been prepared under the oversight 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.



David L. Richesin  
Chairman of the Board  
of River Valley AgCredit, ACA



Darren L. Grogan  
Member of Board of Directors  
Chairman of the Audit Committee  
of River Valley AgCredit, ACA



Kyle M. Yancey  
Chief Executive Officer  
of River Valley AgCredit, ACA



Beth Barkley  
Chief Financial Officer  
of River Valley AgCredit, ACA

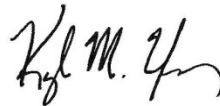
March 13, 2017

# Report on Internal Control Over Financial Reporting

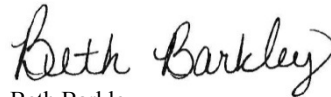
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal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

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2016. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of December 31, 2016, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2016. This annual report does not include an attestation report of the Association's external accounting firm regarding internal control over financial reporting.



Kyle M. Yancey  
Chief Executive Officer  
of River Valley AgCredit, ACA



Beth Barkley  
Chief Financial Officer  
of River Valley AgCredit, ACA

March 13, 2017

## Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	December 31,				
	2016	2015	2014	2013	2012 <sup>2</sup>
<b>Balance Sheet Data</b>					
Cash	\$ 675	\$ 2,358	\$ 2,933	\$ 3,064	\$ 3,664
Investment securities	8	22	97	155	1,218
Loans	496,247	491,025	492,869	456,327	449,025
Allowance for loan losses	(5,956)	(6,056)	(6,040)	(6,198)	(3,274)
Net loans	490,291	484,969	486,829	450,129	445,751
Investments in other Farm Credit institutions	6,671	6,957	7,390	8,378	9,713
Other property owned	569	892	919	3,272	4,508
Other assets	21,577	20,061	19,978	20,514	17,192
Total assets	\$ 519,791	\$ 515,259	\$ 518,146	\$ 485,512	\$ 482,046
Notes payable to AgFirst Farm Credit Bank <sup>1</sup>	\$ 411,707	\$ 409,486	\$ 411,161	\$ 389,062	\$ 385,296
Subordinated debt payable to other Farm Credit institutions	—	—	—	—	2,622
Accrued interest payable and other liabilities with maturities of less than one year	16,409	16,559	20,306	14,625	15,582
Total liabilities	428,116	426,045	431,467	403,687	403,500
Capital stock and participation certificates	4,404	4,541	4,872	4,989	5,176
Additional paid-in-capital	15,817	15,817	15,817	15,817	15,817
Retained earnings					
Allocated	39,816	39,882	38,301	36,490	33,945
Unallocated	31,638	28,974	27,689	24,529	23,608
Total members' equity	91,675	89,214	86,679	81,825	78,546
Total liabilities and members' equity	\$ 519,791	\$ 515,259	\$ 518,146	\$ 485,512	\$ 482,046
<b>Statement of Income Data</b>					
Net interest income	\$ 12,919	\$ 13,382	\$ 13,281	\$ 12,588	\$ 9,757
Provision for loan losses	237	450	136	3,977	975
Noninterest income (expense), net	(4,839)	(4,229)	(2,447)	(1,748)	(3,273)
Net income	\$ 7,843	\$ 8,703	\$ 10,698	\$ 6,863	\$ 5,509
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	1.60%	1.79%	2.27%	1.49%	1.50%
Total members' equity	8.62%	9.82%	12.74%	8.43%	8.69%
Net interest income as a percentage of					
average earning assets	2.73%	2.86%	2.93%	2.87%	2.79%
Net (chargeoffs) recoveries to average loans	(0.071)%	(0.093)%	(0.065)%	(0.241)%	(0.125)%
Total members' equity to total assets	17.64%	17.31%	16.73%	16.85%	16.29%
Debt to members' equity (:1)	4.67	4.78	4.98	4.93	5.14
Allowance for loan losses to loans	1.20%	1.23%	1.23%	1.36%	0.73%
Permanent capital ratio	19.38%	19.16%	18.20%	18.45%	17.41%
Total surplus ratio	18.61%	18.36%	17.33%	17.48%	16.28%
Core surplus ratio	17.37%	17.24%	16.20%	16.29%	14.32%
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash	\$ 2,906	\$ 3,172	\$ 2,449	\$ 1,990	\$ 1,758
Qualified allocated retained earnings	—	—	—	978	811
Nonqualified allocated retained earnings	—	—	2,099	728	695
Nonqualified retained earnings	2,870	3,301	2,449	1,990	1,758

<sup>1</sup> General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2017.

<sup>2</sup> Effective July 1, 2012, Chattanooga, ACA, merged with and into Jackson Purchase, ACA, which changed its name to River Valley AgCredit, ACA.

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

(dollars in thousands, except as noted)

## GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of River Valley AgCredit, ACA (Association) for the year ended December 31, 2016 with comparisons to the years ended December 31, 2015 and December 31, 2014. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

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

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

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, [www.rivervalleyagcredit.com](http://www.rivervalleyagcredit.com), or by calling 1-270-247-5613, extension 2020, or writing Beth Barkley, River Valley AgCredit, ACA, PO Box 309, Mayfield, KY 42066. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The

Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

## FORWARD LOOKING INFORMATION

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

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

## AGRICULTURAL OUTLOOK

The following United States Department of Agriculture (USDA) analysis provides a general understanding of the U.S. agricultural economic outlook. However, this outlook does not take into account all aspects of the Association's business. References to USDA information in this section refer to the U.S. agricultural market data and are not limited to information/data in the AgFirst District.

The February 2017 USDA forecast estimates 2016 farmers' net cash income, which is a measure of the cash income after

payment of business expenses, at \$91.9 billion, down \$12.8 billion from 2015 and down \$11.3 billion from its 10-year average of \$103.2 billion. The decline in net cash income in 2016 was primarily due to decreases in livestock receipts of \$21.7 billion and cash farm-related income of \$3.7 billion, partially offset by a decrease in cash expenses of \$8.3 billion.

The February 2017 USDA forecast for the farm economy, as a whole, forecasts 2017 farmers' net cash income to increase to \$93.5 billion, a \$1.6 billion increase from 2016, but \$9.7 billion below the 10-year average. The forecasted increase in farmers' net cash income for 2017 is primarily due to an expected increase in cash farm-related income of \$3.7 billion, partially offset by a decrease in crop receipts of \$1.0 billion and an increase in cash expenses of \$700 million.

The following table sets forth the commodity prices per bushel for certain crops, by hundredweight for hogs, milk, and beef cattle, and by pound for broilers and turkeys from December 31, 2013 to December 31, 2016:

Commodity	12/31/16	12/31/15	12/31/14	12/31/13
Hogs	\$43.10	\$42.80	\$64.30	\$61.50
Milk	\$18.80	\$17.30	\$20.40	\$22.00
Broilers	\$0.48	\$0.47	\$0.58	\$0.56
Turkeys	\$0.74	\$0.89	\$0.73	\$0.69
Corn	\$3.33	\$3.65	\$3.79	\$4.41
Soybeans	\$9.64	\$8.76	\$10.30	\$13.00
Wheat	\$3.91	\$4.75	\$6.14	\$6.73
Beef Cattle	\$111.00	\$122.00	\$164.00	\$130.00

The USDA's income outlook varies depending on farm size and commodity specialties. The USDA classifies all farms into four primary categories: small family farms (gross cash farm income (GCFI) less than \$350 thousand), midsize family farms (GCFI between \$350 thousand and under \$1 million), large-scale family farms (GCFI of \$1 million or more), and nonfamily farms (principal operator or individuals related to the operator do not own a majority of the business). Approximately 99 percent of U.S. farms are family farms and the remaining 1 percent are nonfamily farms. The family farms produce 89 percent of the value of agricultural output and the nonfamily farms produce the remaining 11 percent of agricultural output. The small family farms represent about 90 percent of all U.S. farms, hold 57 percent of farm assets and account for 24 percent of the value of production. Approximately 65 percent of production occurs on 9 percent of family farms classified as midsize or large-scale.

According to the USDA February 2017 forecast, farm sector equity (assets minus debt) is expected to decline 2.1 percent in 2017 to \$2.44 trillion, the third consecutive year of declining equity after a record \$2.60 trillion in 2014. Farm sector debt is expected to rise 5.2 percent to \$395 billion in 2017, while a 1.1 percent decline is anticipated in the market value of farm sector assets to \$2.84 trillion. Farm real estate accounts for about 84 percent of farm sector assets and the 2017 forecast anticipates a slight decline in real estate values. This reflects falling farm profit margins, increased interest rates, and more restrictive debt terms.

Two measures of the financial health of the agricultural sector used by the USDA are the farm sector's debt-to-asset and debt-to-equity ratios. As a result of the decline in farm assets and continued increase in farm debt, these ratios are forecast to rise in 2017 to 13.9 percent and 16.2 percent from 13.1 percent and 15.1 percent in 2016. The debt-to-asset ratio has increased for

the fifth straight year but is still well below the all-time highs of over 20 percent in the 1980s.

As estimated by the USDA in February 2017, the System's market share of farm business debt (defined as debt incurred by those involved in on-farm agricultural production) increased to 40.6 percent at December 31, 2015 (the latest available data), as compared with 39.6 percent at December 31, 2014.

In general, agriculture, during the past several years, experienced favorable economic conditions driven by high commodity and livestock prices and increased farmland values during this period. To date, the Association's financial results have remained favorable as a result of these favorable agricultural conditions. Production agriculture; however, remains a cyclical business that is heavily influenced by commodity prices and various other factors. In an environment of less favorable economic conditions in agriculture, including extensive and extended drought conditions, and without sufficient government support programs, including USDA-sponsored crop insurance programs, the Association's financial performance and credit quality measures would likely be negatively impacted. Conditions in the general economy remain more volatile given the state of the global economy. Certain agriculture sectors, as described more fully in this *Management's Discussion and Analysis*, recently have experienced significant financial stress and could experience additional financial stress in the near future, which could have a negative financial impact on the Association. Any negative impact from these less favorable conditions should be lessened by geographic and commodity diversification and the influence of off-farm income sources supporting agricultural-related debt. However, agricultural borrowers who are more reliant on off-farm income sources may be more adversely impacted by a weakened general economy.

## CRITICAL ACCOUNTING POLICIES

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

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



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

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

The Association uses a two-dimensional loan rating model that incorporates a 14-point risk rating model to identify and track the probability of default as well as a separate scale addressing the loss given default over a period of time. The probability of default scale provides for granularity in the ratings with 1 being the best score and 14 being a loss. Loss given default is measured by the codes of B, D, E, and F with B being well secured and F being under secured. In addition to the two-dimensional scale, management applies qualitative reserves to capture changes in loan concentrations, weather, and other events that impact the loan portfolio.

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

recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate for 2016 was selected by reference to analysis and yield curves of the plans' actuary and industry norms.

## ECONOMIC CONDITIONS

Overall unemployment conditions in the Purchase area of Kentucky has improved from a year ago. Unemployment is approximately 5.49% as compared to 6.24% in 2015. Unemployment in the counties served in Southeast Tennessee improved from 5.51% to 5.20% over the same period.

The Federal Reserve continues to forecast continued economic growth, discontinued the purchases of securities, and increased the Federal Funds rate. This indicates the Federal Reserve continues to believe the economy is improving and the effect should result in higher long term interest rates. It was reported that the US had growth in GDP in the last two quarters of 2016, although slower than previous year, with the expectation the economy will continue to improve. The economy will continue to be impacted by the fiscal deficit and the uncertainty created by Congress to bring the deficit under control. Interest rates are expected to increase during 2017.

Grain farmers were marginally profitable as a whole in 2016 with above normal yields. At current grain prices and average yields they should meet obligations in 2016 with lower input cost. Profitability will be impacted by the cost of inputs and whether or not input costs remain at current levels or decrease. Early indications are for decreased input costs year over year which will impact profitability positively. Livestock producers were profitable in 2016, but will see lower profitability due to lower prices. Poultry integrators improved their financial position during 2016 due to relatively high prices for their products and lower expenses due to lower cost of inputs primarily corn and soybeans. Poultry growers could see normalized placement of birds as integrators seek to expand production due to the continued low cost of feed. Our poultry growers as a whole in 2016 were sufficiently profitable to meet their obligations. Dairy farmers also were profitable during the year, but will have less opportunities for improvement in profitability with the forecast of lower milk prices.

Land prices are expected to be stable in the Kentucky region of the association. The pace of change is expected to be slow due to the continued forecast of lower grain prices. Land prices are expected to improve in the Tennessee region of the association as the general economy improves.

Land rents are also expected to be stable to lower, due to lower grain prices.

The housing market has improved in the territory served with sales actively occurring and values improving.

Your Association continues to be profitable and it is projected to be sustainable allowing your Cooperative to continue to pay a good patronage dividend. Losses are minimal and capital is adequate for moderate growth. Efficiencies deteriorated some due to cost increases and the Association holding a strong market position in the agricultural arena. Measures are being taken to improve these efficiencies and to improve the profitability of your Association.

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The diversification of the Association loan volume by type for each of the past three years is shown in the table below. Classifications of loan type information for 2014 has been updated for amounts that were previously reported in the 2014 Annual Report to correct errors. See Note 3, *Loans and Allowance for Loan Losses*, in the Notes to the Financial Statements for information on these classification revisions.

Loan Type	December 31,					
	2016		2015		2014	
Production and intermediate -term	\$ 222,689	44.87%	\$ 215,664	43.92%	\$ 214,779	43.58%
Real estate mortgage	220,738	44.48	215,002	43.79	221,047	44.85
Processing and marketing	2,003	0.40	5,695	1.16	8,475	1.72
Other	25,878	5.22	29,523	6.01	19,110	3.88
Rural residential real estate	15,123	3.05	17,222	3.51	20,008	4.06
Cooperatives	3,278	0.66	2,902	0.59	3,075	.62
Farm-related business	6,538	1.32	5,017	1.02	6,375	1.29
Total	\$ 496,247	100.00%	\$ 491,025	100.00%	\$ 492,869	100.00%

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

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

Branch	December 31,		
	2016	2015	2014
Bardwell, KY	5.87%	5.78%	6.64%
Clinton, KY	13.08	11.66	12.21
Hickman, KY	7.33	6.72	6.73
Kevil, KY	6.22	6.92	7.25
Murray, KY	13.41	12.83	11.81
Marshall County, KY	1.83	1.91	2.17
Mayfield, KY	11.46	10.73	11.18
Lone Oak, KY	1.46	1.53	1.69
Special Assets Unit-West	0.57	0.62	0.18
Capital Markets-Joint	7.37	9.07	5.51
Cleveland, TN	3.16	3.05	2.61
Pikeville, TN	3.56	4.02	4.19
Athens, TN	14.13	14.45	16.14
Dayton, TN	3.15	3.46	3.26
Loudon, TN	3.40	3.18	2.94
Chattanooga, TN	3.13	3.35	2.14
Special Assets Unit-East	0.60	0.72	1.04
Capital Markets-West	0.27	0.01	2.31
Capital Markets-East	-	-	-
	100.00%	100.00%	100.00%

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

The major commodities in the Association loan portfolio are shown below. The predominant commodities are cattle, corn, field crops, and poultry which constitute 69 percent of the entire portfolio.

Commodity Group *	December 31,					
	2016		2015		2014	
Cattle	\$ 53,768	11%	\$ 57,550	12%	\$ 54,897	11%
Corn	131,430	27	119,561	24	124,752	25
Cotton	93	-	72	-	118	-
Dairy	10,932	2	12,272	2	12,062	2
Ethanol	-	-	279	-	1,216	-
Field Crops	62,301	13	65,710	13	71,095	14
Forestry	21,106	4	22,804	5	26,538	5
Grain	34,960	7	44,210	9	36,765	8
Nursery/Greenhouse	1,398	-	1,510	-	1,138	-
Other	46,977	9	27,354	6	27,575	6
Other Real Estate	19,082	4	22,682	5	21,600	4
Poultry	85,788	18	89,682	18	83,322	17
Processing	7,318	1	7,684	2	7,471	2
Rural Home Loan	15,618	3	15,586	3	17,976	4
Swine	3,771	1	2,643	1	2,761	1
Tobacco	9	-	11	-	-	-
Tree Fruits and Nuts	1,696	-	1,415	-	3,583	1
Total	\$ 496,247	100%	\$ 491,025	100%	\$ 492,869	100%

\*Amounts have been revised in prior years to conform with the current period presentation.

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of corn and soybean producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase for period ending December 31, 2016 was primarily attributed to increased input costs of farm production, new loans in real estate, and equipment. The decrease in net loan volume for the twelve months ended December 31, 2015 is primarily due to higher than normal yields in 2015.

For the past few years, the Association has remained stable in long-term versus short-term loan volume. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans.

During 2016, the Association continued activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which is intended to strengthen our capital position.

Loan Participations:	December 31,		
	2016	2015	2014
Participations Purchased			
– FCS Institutions	\$ 9,372	\$ 9,906	\$ 13,336
Participations Purchased			
– Non-FCS Institutions	26,263	33,277	22,318
Participations Sold	(18,383)	(17,425)	(27,606)
Total	\$ 17,252	\$ 25,758	\$ 8,048

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2016.

The Association sells qualified long-term mortgage loans into the secondary market. For the year ended December 31, 2016, the Association originated loans for resale totaling \$16,273, which were sold into the secondary market as compared to \$15,510 for December 31, 2015 and \$11,052 for December 31, 2014.

The Association purchased portions of loans that are guaranteed by the United States Department of Agriculture and the Small Business Administration. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2016, the balance of these loans, including the unamortized premium, was \$25,219, compared to \$32,409 at December 31, 2015 and \$18,588 at December 31, 2014. These loans are included as participations purchased stated above.

## INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. The Association's investments consist primarily of asset-backed securities (ABS). The ABSs amounted to \$8, \$22, and \$97 at December 31, 2016, December 31, 2015, and December 31, 2014, respectively. These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government. In view of the recent economic conditions and

volatility related to these types of securities, the Association is actively monitoring the creditworthiness of these securities. These securities are supported by various forms of credit enhancements including insurance guarantees from AAA rated insurers, over-collateralization and favorable priority of payments. Based on our evaluations, we believe these securities do not pose a significant risk of loss given the credit enhancements and relatively short weighted average lives. However, in the event a security is downgraded, we may be required by our regulator to dispose of the security.

## CREDIT RISK MANAGEMENT

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

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

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

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

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.

- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

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

Credit Quality	2016	2015	2014
Acceptable & OAEM	94.28%	98.64%	98.76%
Substandard	5.72%	1.36%	1.24%
Doubtful	–%	–%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

### Nonperforming Assets

The Association’s loan portfolio is divided into performing and high-risk categories. The Credit Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

High-risk Assets	December 31,		
	2016	2015	2014
Nonaccrual loans	\$ 5,824	\$ 6,553	\$ 5,998
Restructured loans	2,345	2,160	3,081
Accruing loans 90 days past due	–	–	105
Total high-risk loans	8,169	8,713	9,184
Other property owned	569	892	919
Total high-risk assets	\$ 8,738	\$ 9,605	\$ 10,103
<b>Ratios</b>			
Nonaccrual loans to total loans	1.17%	1.33%	1.22%
High-risk assets to total assets	1.68%	1.87%	1.95%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans decreased \$729 or 11.12% in 2016. This decrease primarily resulted from amounts collected or accounts returned to accrual status. Of the \$5,824 in nonaccrual volume at December 31, 2016, \$2,957 or 5.07%, compared to 4.88% and 17.44% at December 31, 2015 and 2014, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

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

### Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio. The following table presents the activity in the allowance for loan losses for the most recent three years.

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2016	2015	2014
Balance at beginning of year	\$ 6,056	\$ 6,040	\$ 6,198
Charge-offs:			
Agribusiness	–	–	–
Production and intermediate-term	(82)	(210)	(86)
Rural Residential Real Estate	(73)	(82)	(67)
Real estate mortgage	(270)	(171)	(337)
Total charge-offs	(425)	(463)	(490)
Recoveries:			
Agribusiness	–	–	2
Production and intermediate-term	62	14	162
Rural Residential Real Estate	25	1	3
Real Estate Mortgage	1	14	29
Total recoveries	88	29	196
Net (charge-offs) recoveries	(337)	(434)	(294)
Provision for loan losses	237	450	136
Balance at end of year	\$ 5,956	\$ 6,056	\$ 6,040
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.071)%	(0.093)%	(0.065)%

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

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

Allowance for Loan Losses by Type	December 31,		
	2016	2015	2014
Real estate mortgage	\$ 2,175	\$ 2,400	\$ 2,441
Production and intermediate-term	3,581	3,394	2,587
Agribusiness	90	76	859
Rural residential real estate	110	186	149
Other	–	–	4
Total Allowance	\$ 5,956	\$ 6,056	\$ 6,040

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

Allowance for Loan Losses as a Percentage of:	December 31,		
	2016	2015	2014
Total loans	1.20%	1.23%	1.23%
Nonperforming loans	2.94%	2.39%	125.62%
Nonaccrual loans	102.27%	92.42%	100.70%

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

**RESULTS OF OPERATIONS***Net Interest Income*

Net interest income was \$12,919, \$13,382 and \$13,281 in 2016, 2015 and 2014, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

**Change in Net Interest Income:**

	<b>Volume*</b>	<b>Rate</b>	<b>Nonaccrual Income</b>	<b>Total</b>
<b>12/31/16 - 12/31/15</b>				
Interest income	\$ 235	\$ (262)	\$ (128)	\$ (27)
Interest expense	70	366	–	(436)
Change in net interest income	<u>\$ 165</u>	<u>\$ (628)</u>	<u>\$ (128)</u>	<u>\$ (463)</u>
<b>12/31/15 - 12/31/14</b>				
Interest income	\$ 744	\$ (268)	\$ (326)	\$ 476
Interest expense	198	177	–	(375)
Change in net interest income	<u>\$ 546</u>	<u>\$ (445)</u>	<u>\$ (326)</u>	<u>\$ 101</u>

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

*Noninterest Income*

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

<b>Noninterest Income</b>	<b>For the Year Ended</b>			<b>Percentage Increase/(Decrease)</b>	
	<b>December 31,</b>			<b>2016/</b>	<b>2015/</b>
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Loan fees	\$ 560	\$ 499	\$ 513	12.22%	(2.73)%
Fees for financially related services	311	491	526	(36.66)%	(9.32)%
Patronage refund from other Farm Credit Institutions	5,763	6,280	8,100	(8.23)%	(22.47)%
Gains (losses) on sales of rural home loans	255	332	224	(23.19)%	48.21%
Gains (losses) on sales of premises and equipment, net	32	(51)	–	37.25%	–%
Other noninterest income	2	63	57	(33.33)%	10.53%
Total noninterest income	<u>\$ 6,923</u>	<u>\$ 7,554</u>	<u>\$ 9,420</u>	<u>(8.35)%</u>	<u>(19.81)%</u>

AgFirst Board of Directors made a decision to declare a special cash distribution to the association based on the Bank's income and capital levels in 2016, 2015, and 2014. The amount of special distribution received was \$2,503, \$2,657, and \$4,758 respectively.

*Noninterest Expense*

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

<b>Noninterest Expense</b>	<b>For the Year Ended</b>			<b>Percentage Increase/(Decrease)</b>	
	<b>December 31,</b>			<b>2016/</b>	<b>2015/</b>
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Salaries and employee benefits	\$ 7,921	\$ 8,104	\$ 8,356	(2.26)%	(3.02)%
Occupancy and equipment	565	562	610	0.53%	(7.87)%
Insurance Fund premiums	561	430	392	30.47%	9.69%
(Gains) losses on other property owned	71	1	65	70.00%	(98.46)%
Other operating expenses	2,644	2,686	2,452	(1.56)%	9.54%
Total noninterest expense	<u>\$11,762</u>	<u>\$11,783</u>	<u>\$11,875</u>	<u>(0.18)%</u>	<u>(0.77)%</u>

Salaries and employee benefits decreased in 2016, as compared with 2015, primarily due to Retirements and employee turnover.

Insurance Fund premiums increased 30.47 percent for the twelve months ended December 31, 2016, compared to the same period of 2015. The Farm Credit System Insurance Corporation (FCSIC) changed the methodology in assessing the insurance premiums as a result of the 2008 Farm Bill. Please refer to the "Regulatory Matters" section of this management's discussion and analysis for details concerning the 2008 Farm Bill. The FCSIC set premiums at 16 basis points on adjusted insured debt outstanding reduced by guaranteed investments for the first half of 2016 and 18 basis points in the second half of 2016 as

compared to 13 basis points for 2015. In addition, for 2016, 2015, and 2014, there was a 10 basis point premium on the average principal outstanding of nonaccrual loans and any other-than-temporarily impaired investments.

Noninterest expense decreased \$21 or (0.18) percent for December 31, 2016, as compared to the same period of 2015 and decreased \$92 or (0.77) percent compared to December 31, 2014. The primary reason for the decrease in total noninterest expense is attributable to a decrease in salaries and employee benefits and a decrease in other expense. The primary reason for the decrease in total noninterest expense for the period ended December 31, 2015 was attributable to a decrease in salaries.

*Income Taxes*

The Association recorded a benefit for income taxes of \$0 for the year ended December 31, 2016, as compared to a benefit of \$0 for 2015 and a provision of \$8 for 2014. Refer to Note 2, *Summary of Significant Accounting Policies*, and Note 12, *Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

*Key Results of Operations Comparisons*

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

<b>Key Results of Operations Comparisons</b>	<b>For the 12 Months Ended</b>		
	<b>12/31/16</b>	<b>12/31/15</b>	<b>12/31/14</b>
Return on average assets	1.60%	1.79%	2.27%
Return on average members' equity	8.62%	9.82%	12.74%
Net interest income as a percentage of average earning assets	2.73%	2.86%	2.93%
Net (charge-offs) recoveries to average loans	(0.071)%	(0.093)%	(0.065)%

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

## LIQUIDITY AND FUNDING SOURCES

### *Liquidity and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds".

Total notes payable to the Bank at December 31, 2016, were \$411,707 as compared to \$409,486 at December 31, 2015. The increase of 0.54 percent is attributable to an increase in loan volume. The average volume of outstanding notes payable to the Bank was \$389,907 and \$385,363 for the years ended December 31, 2016 and 2015, respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

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

The Association had no lines of credit from third party financial institutions as of December 31, 2016.

### *Funds Management*

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

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 30-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

### *Relationship with the Bank*

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

The Bank's ability to access capital of the Association is discussed in Note 4, *Investment in Other Farm Credit Institutions*, of the Notes to the Consolidated Financial Statements.

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

## CAPITAL RESOURCES

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

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2016 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2016, increased 2.76 percent to \$91,675 from the December 31, 2015, total of \$89,214. At December 31, 2015, total members' equity increased 2.92 percent from the December 31, 2014 total of

\$86,679. The increase was primarily attributed to association earnings.

Total capital stock and participation certificates were \$4,404 on December 31, 2016, compared to \$4,541 on December 31, 2015 and \$4,872 on December 31, 2014.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2016	2015	2014	Regulatory Minimum
Permanent capital ratio	19.38%	19.16%	18.20%	7.00%
Total surplus ratio	18.61%	18.36%	17.33%	7.00%
Core surplus ratio	17.37%	17.24%	16.20%	3.50%

The increase in the Association's permanent capital, total surplus, and core surplus for December 31, 2016 is attributed primarily to an increase in retained earnings. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

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

### PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$5,776 in 2016, \$6,473 in 2015, and \$6,997 in 2014.

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

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to Young\*, Beginning\*\* and Small\*\*\* farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. As a result, 2016 goals were established and met.

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

	As of December 31, 2016	
	Number of Loans	Amount of Loans
	<i>(dollars in thousands)</i>	
Young	673	\$70,416
Beginning	1,198	\$117,194
Small	2,844	\$198,821

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

The 2012 USDA Ag census data is the latest data available. It has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 11,155 reported farmers of which by definition 449 or 4.00 percent were Young, 1,980 or 17.70 percent were Beginning and 10,310 or 92.40 percent were Small. Comparatively, as of December, 2016, the demographics of the Association's agricultural portfolio contained 2,934 farmers, of which by definition 468 or 16 percent were Young, 866 or 29.50 percent were Beginning and 2,006 or 68.40 percent were Small.

ACA's goals are to maintain our YBS percentages at the 2016 level, but in no case slip below the goals set in the Business Plan of 15% for Young, 15% for Beginning and 42% for Small farmers. The differences in the census data and the Association data are primarily in the definition differences in Young, Beginning and Small farmers. The Association assigns Young, Beginning and Small based on the age, years of experience and income of the youngest individual involved in the operation. Our numbers also include farmers that do not own farmland but rent all of their land.

The Association addresses the specific credit programs and partnerships that have been developed to help small farmers, young farmers, and farmers just starting out. It comprises programs offered by:

1. The Farm Service Agency (FSA), which includes guaranteed and direct loans to qualifying borrowers. The Association is a Preferred Lender, a status designated by the FSA.
2. KAFB Beginning Farmer Program – the state of Kentucky has special interest rates for loans up to \$100 for YBS in combination with ACA direct loans, with ACA as servicer of the account.

3. Agricultural Infrastructure Loan Program – the state of Kentucky has developed this program for past Tobacco Producers. The program gives a low interest rate on loans up to \$100 in combination with ACA direct loans on any infrastructure on their farms. ACA is the servicer of the account.

The Association sponsors local events (such as 4-H, FFA fairs, and Cattle Producers Association) or events where the Association is an exhibitor (such as industry or trade shows).

The Association is committed to the future success of Young, Beginning and Small farmers.

- \* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- \*\* Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- \*\*\* Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

## REGULATORY MATTERS

New regulatory capital requirements for System banks and associations became effective January 1, 2017 and were adopted to:

- modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- 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, but also to ensure that the rules recognize the cooperative structure and the organization of the System,
- make System regulatory capital requirements more transparent, and
- meet the requirements of Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

These new requirements replace the core surplus and total surplus requirements with Common Equity Tier 1 (CET1), Tier 1 and Total Capital risk-based capital ratio requirements. The new requirements also replace the existing net collateral ratio with a Tier 1 Leverage ratio which is applicable to all banks and associations. The Permanent Capital Ratio remains in effect.

The following sets forth the new regulatory capital ratios:

Ratio	Primary Components of Numerator	Denominator	Minimum Requirement	Minimum Requirement with Conservation Buffer
CET1 Capital	Unallocated retained earnings/surplus (URE), Common Stock (subject to certain conditions)	Risk-weighted assets	4.5%	7.0%
Tier 1 Capital	CET1 Capital, Non-cumulative perpetual preferred stock	Risk-weighted assets	6.0%	8.5%
Total Capital	Tier 1 Capital, Allowance for Loan Losses, other equity securities not included in Tier 1 Capital	Risk-weighted assets	8.0%	10.5%
Tier 1 Leverage	Tier 1 Capital (1.5% must be URE or URE equivalents)	Total assets	4.0%	5.0%

The new capital requirements have a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. Based on analysis, all District entities are positioned to be in compliance with the new requirements.

On November 30, 2015, the FCA, along with four other federal agencies, published in the Federal Register a final rule to establish capital and margin requirements for covered swap entities as required by the Dodd-Frank Act. See below for further information regarding the Dodd-Frank Act. This rule is not expected to have a material impact for District institutions.

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 2017. The proposed investment regulations are expected to have a minimal impact for District institutions. The stated objectives of the proposed rule are as follows:

- To strengthen the safety and soundness of System banks and associations,
- To ensure that System banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption,

- To enhance the ability of the System banks to supply credit to agricultural and aquatic producers,
- To comply with the requirements of section 939A of the Dodd-Frank Act,
- To modernize the investment eligibility criteria for System banks, and
- To revise the investment regulation for System associations to improve their investment management practices so they are more resilient to risk.

## FINANCIAL REGULATORY REFORM

The Dodd-Frank Act was signed into law on July 21, 2010. While the Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, many of the statutory provisions of the Dodd-Frank Act are not applicable to the Farm Credit System.

The provisions of the Dodd-Frank Act pertaining to the regulation of derivatives transactions require, among other things, more of these transactions to be cleared through a third-party central clearinghouse and traded on regulated exchanges or other multilateral platforms. Margin is required for these transactions. Derivative transactions that are not subject to



mandatory trading and clearing requirements may be subject to minimum margin and capital requirements. The Commodity Futures Trading Commission and other federal banking regulators have exempted System institutions from certain, but not all, of these new requirements, including, for swaps with members, mandatory clearing and minimum margin for noncleared swaps.

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

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

In light of the foregoing, it is difficult to predict at this time the extent to which the Dodd-Frank Act or the forthcoming implementing rules and regulations will have an impact on the System. However, it is possible they could affect funding and hedging strategies and increase funding and hedging costs.

#### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

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

# *Disclosure Required by Farm Credit Administration Regulations*

## Description of Business

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

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

## Unincorporated Business Entity (UBE)

River Valley AgCredit, ACA holds an equity investment at December 31, 2016 in the following Unincorporated Business Entities (UBEs) as an equity interest holder of the limited liability company (LLC). The LLCs were organized for the stated purpose of holding and managing unusual or complex collateral associated with former loans, until such time as the assets may be sold or otherwise disposed of pursuant to the terms of Operating Agreements of the respective LLCs.

Entity Name	Entity Type	Entity Purpose
Ethanol Holding Company, LLC	LLC	Manage Acquired Property
A1 Ledges Wilder LLC	LLC	Manage Acquired Property
A1 Sequatchie Point, LLC	LLC	Manage Acquired Property

## Description of Property

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

Location	Description	Form of Ownership
328 E. Broadway Mayfield, KY	Administrative	Owned
408 E. Broadway Mayfield, KY	Administrative	Owned
196 US Hwy 51 North Bardwell, KY	Branch	Leased*
102 N Washington St. Clinton, KY	Branch	Owned
1514 Union City Hwy. Hickman, KY	Branch	Owned
12350 U.S. Highway 60 West Kevil, KY	Branch	Owned
1401 N. 12th St. Murray, KY	Branch	Owned
2730 U S Hwy. 641 N Benton, KY	Branch	Owned
545 Dick Castleman Bypass Mayfield, KY	Branch	Owned
3565 Lone Oak Rd, Suite 1 Paducah, KY	Branch	Leased**
2620 APD 40 Cleveland, TN	Branch	Owned
2596 Keith St. Cleveland, TN	Branch	Owned
3270 Main St Pikeville, TN	Branch	Owned
1117 S Congress Parkway Athens, TN	Branch	Owned
230 Main Street Dayton, TN	Branch	Owned
2052 Hwy 72 Loudon, TN	Branch	Owned
601 Morrison Springs Rd Chattanooga, TN	Branch	Owned

\*Five year lease expiring 3/31/19. Monthly payment \$1,620.00.

\*\*Five-year lease beginning 12/1/12 & terminating 11/30/17. Monthly payment \$2,000.00. Addendum done 6/1/16 to increase payment by \$825.55, to expire 5/31/19.

**Legal Proceedings**

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

**Description of Capital Structure**

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

**Description of Liabilities**

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

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

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

**Senior Officers**

The following represents certain information regarding the senior officers of the Association and their business experience for the past five years:

Name and Title	Term of Office	Prior Experience
Kyle Yancey, Chief Executive Officer	1/1/2016 - Present	CEO Elect-Aug 2014-Dec 2015 Chief Credit Officer, 2013-Aug 2014/Regional Lending Manager, 2011-2013
Gary Keith, Chief Operating Officer	7/1/2012 - present	President/Chief Executive Officer of Chattanooga AgCredit from August 1991-June 2012
Kevin Brown, Chief Lending Officer	2/1/2012 – present	Assistant Vice President April 2008 – January 2012/Branch Manager 1993 - 2008.
Beth Barkley, Chief Financial Officer	1/1/2014 – present	Senior Accountant, 2013 Accountant II, 2012 Accountant I, 2009-2011

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2016, 2015 and 2014, is as follows:

Name of Individual or Number in	Year	Annual					Total
		Salary	Bonus	Perq/ Other*	Pension Change***		
Kyle Yancey	2016	\$ 250,017	25,563	\$ 2,665	\$ 90,815	\$ 369,061	
Stan Brunston	2015	\$ 277,196	25,000	\$ 51,709**	\$ 114,335	\$ 468,239	
Stan Brunston	2014	\$ 271,095	\$ 44,797	\$ 5,744	\$ 458,728	\$ 780,364	
6	2016	\$ 811,047	\$ 59,711	\$ 9,843	\$ 681,062	\$ 1,561,663	
6	2015	\$ 839,147	\$ -	\$ 8,739	\$ 293,106	\$ 1,140,991	
5	2014	\$ 733,175	\$ 118,971	\$ 23,521**	\$ 938,211(a)	\$ 1,813,878	

\*Amounts in the above table classified as Perquisites include group life insurance and automobile compensation.

\*\*Amount includes severance pay at retirement for one officer.

\*\*\*Required disclosure effective beginning in 2013. On February 4, 2015, the FCA Board approved the final rule, "Disclosure to Shareholders; Pension Benefit Disclosures." The rule amends FCA regulations to exclude employee compensation from being reported in the Summary Compensation Table if the employee would be considered a "highly compensated employee" solely because of payments related to or change(s) in value of the employee's qualified pension plan provided that the plan was available to all similarly situated employees on the same basis at the time the employees joined the plan. The rule will be effective 30 days after publication in the Federal Register during which time either one or both Houses of Congress are in session. System banks and associations must comply with the rule for compensation reported in the table for the fiscal year ending 2015, and may implement the rule retroactively for the fiscal years ended 2014 and 2013. The Association applied the rule to 2014 and retroactively to 2013. This application had an effect on the 2013 amounts as previously reported in the 2013 Annual Report and changes were made accordingly.

(a)The changes in pension values in 2014 as reflected in the table above resulted primarily from changes in the actuarial assumptions for mortality and discount rate. See further discussion in Note 9, Employee Benefit Plans, of the Financial Statements.

The disclosure of information on the total compensation paid during 2016 to any senior officer or to any other employee included in the aggregate group total as reported in the table above is available and will be disclosed to the shareholders of the institution upon request.

The Association participates in multi-association, District and multi-District sponsored benefit plans. Change in pension value is considered a part of compensation. The following Pension Benefits table reflects number of years credited service, actuarial present value of accumulated benefits, along

with any payments made during 2016 for the CEO and senior officers and other highly compensated employees as a group.

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits	Payments During 2016
Kyle Yancey	2016	IARP	11	\$209,473	\$-
6 Officers, excluding the CEO	2016	IARP	27*	\$4,967,979	\$-

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

In addition to a base salary, senior officers earn additional compensation under an incentive plan which is tied to the overall business performance and the individual's performance appraisal rating. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals typically include return on assets, credit quality, credit administration, loan volume, nonaccrual loan volume, permanent capital and other key ratios. Those covered by the plan include all employees. Also all employees except Administrative staff participate in insurance and lease incentive plans designed to motivate employees to increase insurance sales and leasing fee income to benefit the member as well as the Association. Additional incentive plans available to all employees include member referral incentives designed to encourage employees to promote new business through personal contacts. Bonuses are shown in the year earned, which may be different than the year of payment. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request. Disclosure of information on the total compensation paid during 2016 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

On October 3, 2012, FCA adopted a regulation that requires all System institutions to hold advisory votes on the compensation for all senior officers and/or the CEO when the compensation of either the CEO or the senior officer group increases by 15 percent or more from the previous reporting period. In addition, the regulation requires associations to hold an advisory vote on CEO and/or senior officer compensation when 5 percent of the voting stockholders petition for the vote and to disclose the petition authority in the annual report to shareholders. The regulation became effective December 17, 2012, and the base year for determining whether there is a 15 percent or greater increase was 2014. River Valley AgCredit, ACA did not hold an advisory vote based on a stockholder petition in 2013.

On January 17, 2014, the President signed into law the Consolidated Appropriations Act which includes language prohibiting the FCA from using any funds available to "implement or enforce" the regulation. In addition, on February 7, 2014, the President signed into law the Agricultural Act of 2014. Section 5404 of the law directs FCA to within 60 days of enactment of the law "review its rules to reflect the Congressional intent that a primary responsibility of boards of directors of Farm Credit System institutions, as elected representatives of their stockholders, is to oversee compensation practices." FCA has not yet taken any action with respect to their regulation in response to these actions.

On March 31, 2014, the FCA published an interim final rule rescinding all requirements for nonbinding advisory votes on senior officer compensation at System banks and associations. The comment period for the interim rule ended on April 30, 2014, and the final rule became effective on June 18, 2014.

## Directors

The following chart details the year the director began serving on the board, the current term of expiration, and total cash compensation paid:

DIRECTOR	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION	TOTAL COMP. PAID DURING 2016
David Richesin, <i>Chairman</i>	2008*	2017	\$ 21,540
Joe Campbell, <i>Vice Chairman</i>	2000	2019	13,540
Jack Sanders	2008*	2017	14,405
Edsel Freels	2010*	2016	12,905
Darren Grogan	2008	2017	12,810
Randall Heath	2006	2019	11,405
Buddy D. Ray, <i>Outside Dir</i>	2003	2019	12,270
Curtis Hancock, Jr	1991	2018	10,675
David Singleton	1996*	2018	12,270
Aaron Wilson	2009	2018	13,405
Eddie Workman	2005	2017	12,040
Tiffany Myers, <i>Outside Dir</i>	2015	2018	13,405
Brandon Strasser	2015	2018	12,175
			<u>\$ 172,845</u>

\*Original year of election or appointment to the Board of Directors of Chattanooga, ACA.

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years. Unless specifically listed, the principal occupation of the board member for the past five years has been as a self-employed farmer.

**Mr. David Richesin, Chairman, is** a row crop operator headquartered in Loudon County, TN. He is President of the Board of Directors of Loudon County Farm Bureau and State Board Director of Tennessee Farm Bureau. He is also a member of the Ag Central Farmers Coop. Mr. Richesin received his BS degree in Agricultural Business from University of Tennessee.

**Mr. Joe F. Campbell, Vice Chairman,** operates a row crop farming operation in Fulton County, KY and is the owner and operator of Campbell Appraisal Services. He is a member of the Kentucky and Tennessee Society of Farm Managers and Rural Appraisers. Mr. Campbell has a BS degree in Administrative Management from Murray State University.

**Mr. Curtis Hancock, Jr.,** operates a row crop program in Hickman County, KY. He serves as State Treasurer for Kentucky Farm Business Analysis Group, serves on the AgFirst District Farm Credit Council, serves on the National Farm Credit Council Board in Washington, DC, serves on the Farm Credit Council Services Board in Denver, and serves on the AgFirst FCB Board of Directors. Mr. Hancock received his BS in agriculture from University of Tennessee at Martin and his MS in Ag Economics from the University of Tennessee at Knoxville.

**Mr. Jack Sanders,** operates a beef cattle and row crop farm in Bradley County, TN. He is a member of the Board of Directors of Bradley County Farm Bureau, a director of the Farm Bureau State Insurance Board, a member of the Bradley County Agricultural Board, and a member of Southeastern Farmers' Cooperative. Mr. Sanders received his BS degree from Mars Hill College.

**Mr. Edsel Freels** owns and operates a farm in Rhea County, TN including beef, cattle, hogs, corn, wheat, soybeans, tobacco, and hay. He is President of the Rhea County Farm Bureau, Chairman of Rhea County FSA Committee, and a member of the Rhea County Fair Board. He is also a member of the Southeastern Farmers' Cooperative.

**Mr. Darren Grogan** serves as Chairman of the Audit Committee. He operates a row crop operation headquartered in Carlisle County, KY. Mr. Grogan is a graduate of Ashford University with a BS degree in Economics with specialization in Finance and a minor in Accounting.

**Mr. Randall Heath** operates a row crop farming operation in Graves County, KY. Mr. Heath serves as President of Graves County Farm Bureau.

**Mrs. Tiffany Myers, Outside Director**, is a licensed Certified Public Accountant for the state of Kentucky and is employed as the Director of Internal Audit for NES Rentals out of Chicago. She serves as Treasurer for Bethel Cumberland Presbyterian Church and is a Luminaria Chair for the Ballard County Relay for Life. Mrs. Myers received her degree in accounting from Murray State University.

**Dr. Buddy D. Ray, DVM, Outside Director**, serves as the Chairman of the Compensation Committee. He is a veterinarian at the Bovine Consulting Associates, LLC. He also serves on the Bayer Large Animal Advisory Board. Dr. Ray received his BS degree in Agriculture from Murray State University and received his DVM from Auburn University.

**Mr. David Singleton** operates 134 acres in Bledsoe County, TN on which he raises beef cattle, hay, and poultry. He is former President and Director of Bledsoe Cattlemen's Association and a former director and current member of the Southeastern Farmers' Cooperative and of the TN Poultry Association.

**Mr. Brandon Strasser** owns a farming partnership with his parents consisting of approximately 225 milk cows. He received his Bachelor's degree in Animal Science from the University of TN, Knoxville, and completed Agricultural Economics graduate course work from Texas A&M University.

**Mr. Aaron Wilson** serves as Chairman of the Credit Risk Committee. He operates a row crop and cow/calf farming program in Ballard County, KY. He serves as Chairman of the Ballard County Soil Conservation Department and is a member of the UST/MSU Ag Leadership Development Class. Mr. Wilson received his BS degree in Biology from Transylvania University.

**Mr. Eddie Workman** operates a row crop and tobacco program, with his son Greg Workman, in Calloway County, KY. Mr. Workman serves on the Calloway County Farm Bureau Board and also serves as the Soil Conservation Supervisor.

Subject to approval by the board, the Association may allow directors honoraria of \$500 for attendance at meetings, committee meetings, or special assignments. The Chairman of the Board and all other directors are paid a quarterly retainer fee of \$1,000 and \$500 respectively. Total compensation paid to directors as a group was \$137,345.

The following chart details the number of meetings, other activities and additional compensation paid for other activities (if applicable), and current committee assignments for each director:

Name of Director	Days Served		Committee Assignments	Comp. Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
David Richesin, <b>Chairman</b>	6	28	Compensation, Governance	\$ 18,540
Joe Campbell, <b>Vice Chairman</b>	4	18	Governance	11,540
Jack Sanders	5	19	Credit Risk	11,905
Brandon Strasser	6	13	Audit	9,175
Edsel Freels	6	15	Compensation	9,905
Tiffany Myers, <i>Outside Dir</i>	5	17	Audit	10,905
Darren Grogan	5	15	Governance, Audit	10,310
Randall Heath	6	12	Credit Risk	8,405
Buddy D Ray, <i>Outside Dir</i>	6	14	Compensation, Governance	9,270
Curtis Hancock, Jr.	5	11	Audit	8,175
David Singleton	5	15	Compensation	9,770
Aaron Wilson	6	16	Governance, Credit Risk	10,405
Eddie Workman	6	13	Credit Risk	9,040
				<u>\$ 137,345</u>

\*Includes board committee meetings and other board activities other than regular board meetings and quarterly retainer fees.

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$28,213 for 2016, \$24,078 for 2015 and \$19,726 for 2014.

#### Transactions with Senior Officers and Directors

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

#### Involvement in Certain Legal Proceedings

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

**Relationship with Independent Auditor**

Dixon Hughes Goodman LLP has been the Association’s principal auditor since 2011. There were no changes in or material disagreements with our independent auditor on any matter of accounting principles or financial statement disclosure during this period.

Aggregate fees paid by the Association for services rendered by its independent auditor for the year ended December 31, 2016 were as follows:

	2016
<b>Independent Auditor</b>	
Dixon Hughes Goodman LLP	
Audit services	\$ 66,500
Total	\$ 66,500

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

**Consolidated Financial Statements**

The Consolidated Financial Statements, together with the report thereon of Dixon Hughes Goodman LLP dated March 13, 2017 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s quarterly reports are available upon request free of charge by calling 1-270-247-5613 or writing Beth Barkley, River Valley AgCredit, ACA, P. O. Box 309, Mayfield, KY 42066 or accessing the website, [www.rivervalleyagcredit.com](http://www.rivervalleyagcredit.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

**Borrower Information Regulations**

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

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

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

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the

Management’s Discussion and Analysis of Financial Condition and Results of Operations section included in this Annual Report to the shareholders.

**Shareholder Investment**

Shareholder investment in the Association may be materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst’s web site at [www.agfirst.com](http://www.agfirst.com). The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

## *Report of the Audit Committee*

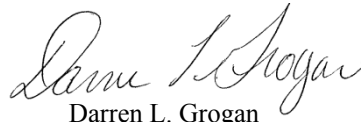
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee are employees of River Valley AgCredit, ACA (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

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

Dixon Hughes Goodman LLP (DHG), the Association's independent auditor for 2016, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with DHG the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). The Committee discussed with DHG its independence from River Valley AgCredit, ACA.

The Committee has also reviewed the non-audit services provided by DHG, if any, and concluded that these services were not incompatible with maintaining DHG's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2016. The foregoing report is provided by the following independent directors, who constitute the Committee:



Darren L. Grogan

Chairman of the Audit Committee

**Members of Audit Committee**

Tiffany Myers

Curtis Hancock

Brandon Strasser

March 13, 2017



**INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Members  
River Valley AgCredit, ACA  
Mayfield, KY

We have audited the accompanying consolidated financial statements of River Valley AgCredit, ACA (the "Association") which comprise the consolidated balance sheets as of December 31, 2016, 2015, and 2014, and the related consolidated statements of comprehensive income, changes in members' equity and cash flows for the years then ended and the related notes to the financial statements.

***Management's Responsibility for the Financial Statements***

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

***Auditors' Responsibility***

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of River Valley AgCredit, ACA as of December 31, 2016, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Dixon Hughes Goodman LLP*

Atlanta, Georgia  
March 13, 2017



# Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31,		
	2016	2015	2014
<b>Assets</b>			
Cash	\$ 675	\$ 2,358	\$ 2,933
Investment securities:			
Held to maturity (fair value of \$8, \$21, and \$96, respectively)	8	22	97
Loans	496,247	491,025	492,869
Allowance for loan losses	(5,956)	(6,056)	(6,040)
Net loans	490,291	484,969	486,829
Loans held for sale	643	214	—
Accrued interest receivable	6,025	5,214	5,056
Investments in other Farm Credit institutions	6,671	6,957	7,390
Premises and equipment, net	5,942	5,637	5,698
Other property owned	569	892	919
Accounts receivable	6,991	6,251	8,283
Other assets	1,976	2,745	941
Total assets	<b>\$ 519,791</b>	<b>\$ 515,259</b>	<b>\$ 518,146</b>
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 411,707	\$ 409,486	\$ 411,161
Accrued interest payable	836	807	806
Patronage refunds payable	3,202	3,478	2,683
Accounts payable	963	475	483
Advanced conditional payments	2,788	4,624	5,936
Other liabilities	8,620	7,175	10,398
Total liabilities	<b>428,116</b>	<b>426,045</b>	<b>431,467</b>
Commitments and contingencies (Note 11)			
<b>Members' Equity</b>			
Capital stock and participation certificates	4,404	4,541	4,872
Additional paid-in-capital	15,817	15,817	15,817
Retained earnings			
Allocated	39,816	39,882	38,301
Unallocated	31,638	28,974	27,689
Total members' equity	<b>91,675</b>	<b>89,214</b>	<b>86,679</b>
Total liabilities and members' equity	<b>\$ 519,791</b>	<b>\$ 515,259</b>	<b>\$ 518,146</b>

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

# Consolidated Statements of Comprehensive Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2016	2015	2014
<b>Interest Income</b>			
Loans	\$ 22,457	\$ 22,484	\$ 22,005
Investments	—	—	3
Total interest income	<b>22,457</b>	22,484	22,008
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	9,500	9,048	8,654
Other	38	54	73
Total interest expense	<b>9,538</b>	9,102	8,727
Net interest income	<b>12,919</b>	13,382	13,281
Provision for loan losses	237	450	136
Net interest income after provision for loan losses	<b>12,682</b>	12,932	13,145
<b>Noninterest Income</b>			
Loan fees	560	499	513
Fees for financially related services	311	491	526
Patronage refunds from other Farm Credit institutions	5,763	6,280	8,100
Gains (losses) on sales of rural home loans, net	255	332	224
Gains (losses) on sales of premises and equipment, net	32	(51)	—
Other noninterest income	2	3	57
Total noninterest income	<b>6,923</b>	7,554	9,420
<b>Noninterest Expense</b>			
Salaries and employee benefits	7,921	8,104	8,356
Occupancy and equipment	565	562	610
Insurance Fund premiums	561	430	392
(Gains) losses on other property owned, net	71	1	65
Other operating expenses	2,644	2,686	2,452
Total noninterest expense	<b>11,762</b>	11,783	11,875
Income before income taxes	<b>7,843</b>	8,703	10,690
Provision (benefit) for income taxes	—	—	(8)
Net income	<b>7,843</b>	8,703	10,698
Other comprehensive income	—	—	—
Comprehensive income	<b>\$ 7,843</b>	\$ 8,703	\$ 10,698

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

# Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Additional Paid-in-Capital	Retained Earnings		Total Members' Equity
			Allocated	Unallocated	
Balance at December 31, 2013	\$ 4,989	\$ 15,817	\$ 36,490	\$ 24,529	\$ 81,825
Comprehensive income				10,698	10,698
Capital stock/participation certificates issued/(retired), net	(117)				(117)
Patronage distribution					
Cash				(2,449)	(2,449)
Nonqualified allocated retained earnings			2,099	(2,099)	—
Nonqualified retained earnings			2,449	(2,449)	—
Retained earnings retired			(2,441)		(2,441)
Patronage distribution adjustment			(296)	(541)	(837)
<b>Balance at December 31, 2014</b>	<b>\$ 4,872</b>	<b>\$ 15,817</b>	<b>\$ 38,301</b>	<b>\$ 27,689</b>	<b>\$ 86,679</b>
Comprehensive income				8,703	8,703
Capital stock/participation certificates issued/(retired), net	(331)				(331)
Patronage distribution					
Cash				(3,172)	(3,172)
Nonqualified retained earnings			3,301	(3,301)	—
Retained earnings retired			(2,331)		(2,331)
Patronage distribution adjustment			611	(945)	(334)
<b>Balance at December 31, 2015</b>	<b>\$ 4,541</b>	<b>\$ 15,817</b>	<b>\$ 39,882</b>	<b>\$ 28,974</b>	<b>\$ 89,214</b>
<b>Comprehensive income</b>				<b>7,843</b>	<b>7,843</b>
<b>Capital stock/participation certificates issued/(retired), net</b>	<b>(137)</b>				<b>(137)</b>
<b>Patronage distribution</b>					
<b>Cash</b>				<b>(2,906)</b>	<b>(2,906)</b>
<b>Nonqualified retained earnings</b>			<b>2,870</b>	<b>(2,870)</b>	<b>—</b>
<b>Retained earnings retired</b>			<b>(2,450)</b>		<b>(2,450)</b>
<b>Patronage distribution adjustment</b>			<b>(486)</b>	<b>597</b>	<b>111</b>
<b>Balance at December 31, 2016</b>	<b>\$ 4,404</b>	<b>\$ 15,817</b>	<b>\$ 39,816</b>	<b>\$ 31,638</b>	<b>\$ 91,675</b>

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

# Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2016	2015	2014
<b>Cash flows from operating activities:</b>			
Net income	\$ 7,843	\$ 8,703	\$ 10,698
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	272	301	312
Amortization (accretion) of net deferred loan costs (fees)	466	275	238
Premium amortization (discount accretion) on investments	—	1	—
Amortization (accretion) of yield mark resulting from merger	(45)	(118)	(123)
Provision for loan losses	237	450	136
(Gains) losses on other property owned	7	(51)	(8)
(Gains) losses on sales of premises and equipment, net	(32)	51	—
(Gains) losses on sales of rural home loans, net	(255)	(332)	(224)
Changes in operating assets and liabilities:			
Origination of loans held for sale	(16,273)	(15,510)	(11,052)
Proceeds from sales of loans held for sale, net	16,099	15,628	11,276
(Increase) decrease in accrued interest receivable	(811)	(158)	(436)
(Increase) decrease in accounts receivable	(740)	2,032	597
(Increase) decrease in other assets	769	(1,804)	234
Increase (decrease) in accrued interest payable	29	1	49
Increase (decrease) in accounts payable	488	(8)	88
Increase (decrease) in other liabilities	1,445	(3,223)	5,164
Total adjustments	1,656	(2,465)	6,251
Net cash provided by (used in) operating activities	9,499	6,238	16,949
<b>Cash flows from investing activities:</b>			
Proceeds from maturities of or principal payments received on investment securities, held to maturity	14	74	57
Net (increase) decrease in loans	(6,270)	626	(37,507)
(Increase) decrease in investment in other Farm Credit institutions	286	433	988
Proceeds from payments received on other investments	—	—	643
Purchases of premises and equipment	(577)	(295)	(814)
Proceeds from sales of premises and equipment	32	4	1
Proceeds from sales of other property owned	537	558	2,782
Net cash provided by (used in) investing activities	(5,978)	1,400	(33,850)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	2,290	(1,528)	22,234
Net increase (decrease) in advanced conditional payments	(1,836)	(1,312)	(209)
Capital stock and participation certificates issued/(retired), net	(137)	(331)	(117)
Patronage refunds and dividends paid	(3,071)	(2,711)	(2,697)
Retained earnings retired	(2,450)	(2,331)	(2,441)
Net cash provided by (used in) financing activities	(5,204)	(8,213)	16,770
Net increase (decrease) in cash	(1,683)	(575)	(131)
Cash, beginning of period	2,358	2,933	3,064
Cash, end of period	\$ 675	\$ 2,358	\$ 2,933
<b>Supplemental schedule of non-cash activities:</b>			
Financed sales of other property owned	\$ 50	\$ 73	\$ 36
Receipt of property in settlement of loans	271	552	457
Estimated cash dividends or patronage distributions declared or payable	2,906	3,172	2,449
<b>Supplemental information:</b>			
Interest paid	9,578	9,247	8,813
Taxes (refunded) paid, net	17	17	9

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

# Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

## Note 1 — Organization and Operations

A. **Organization:** River Valley AgCredit, ACA (Association) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in the counties of Ballard, Calloway, Carlisle, Fulton, Graves, Hickman, Marshall and McCracken in the state of Kentucky and in the counties of Hamilton, Marion, Bradley, Polk, Bledsoe, Sequatchie, Monroe, Meigs, McMinn, Rhea, Loudon and Roane in the state of Tennessee.

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

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

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

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

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance

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

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

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

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

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

The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

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

**Note 2 — Summary of Significant Accounting Policies**

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

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

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

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

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

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

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

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

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

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

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

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

- Changes in credit risk classifications
- Changes in collateral values
- Changes in risk concentrations
- Changes in weather related conditions
- Changes in economic conditions

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the

present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

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

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

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

Acquired loans are recorded at estimated fair value on their purchase date with no carryover of any related allowance for loan losses. Acquired loans were segregated between those considered to be credit impaired and those deemed performing. To make this determination, management considered such factors as past due status, nonaccrual status and credit risk ratings. The fair value of acquired performing loans was determined by discounting expected cash flows, both principal and interest, for each loan at prevailing market interest rates. The difference between the fair value and principal balances due at acquisition date, the fair value discount, is accreted into income over the estimated life of each loan.

For certain acquired loans that experienced deterioration in credit quality between origination and acquisition, the amount paid for the loan will reflect this fact. At acquisition,

each loan is reviewed to determine whether there is evidence of deterioration of credit quality since origination and if it is probable that the Association would be unable to collect all amounts due according to the loan's contractual terms. If both conditions exist, the purchaser determines whether each such loan is to be accounted for individually or whether such loans would be assembled into pools of loans based on common risk characteristics (credit score, loan type, and date of origination, for example). Considerations of value should include expected prepayments, the estimated amount and timing of undiscounted expected principal, interest, and other cash flows (expected at acquisition) for each loan and the subsequently aggregated pool of loans. Any excess of the loan's or pool's scheduled principal and contractual interest payments over all of the cash flows expected at acquisition is an amount that should not be accreted to income (nonaccretable difference). The remaining amount, representing the excess of the loan's cash flows expected to be collected over the amount paid, is accreted into interest income over the remaining life of the loan or pool (accretable yield).

Accounting guidance requires that the purchaser continue to estimate cash flows expected to be collected over the life of the loan or pool. It then evaluates at the balance sheet date whether the present value of its loans, determined using the effective interest rate, has decreased and if so, recognizes a loss. For loans or pools that are not accounted for as debt securities, the present value of any subsequent significant increase in the loan's or pool's actual cash flows or cash flows expected to be collected is used first to reverse any existing valuation allowance for that loan or pool. For any remaining increases in cash flows expected to be collected, or for loans or pools accounted for as debt securities, a purchaser adjusts the amount of accretable yield recognized on a prospective basis over the loan's or pool's remaining life.

Valuation allowances for all purchased impaired loans reflect only those losses incurred after acquisition, that is, the present value of cash flows expected at acquisition that are not expected to be collected. Valuation allowances are established only subsequent to acquisition of the loans.

In addition to the probability of default methodology, management applies an additional qualitative reserve that captures changes in loan concentrations, weather, local economy, and other events that impact the loan portfolio.

- C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.
- D. **Other Property Owned:** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) from Other Property Owned,

Net in the Consolidated Statements of Comprehensive Income.

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

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

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

**Investment Securities**

The Association holds certain investment securities, as permitted under the FCA regulations. These investments are classified based on management's intention on the date of purchase and are generally recorded in the Consolidated Balance Sheets as securities on the trade date.

Securities for which the Association has the intent and ability to hold to maturity are classified as held-to-maturity (HTM) and carried at amortized cost. Investment securities classified as available-for-sale (AFS) are carried at fair value with net unrealized gains and losses included as a component of Other Comprehensive Income (OCI). Purchase premiums and discounts are amortized or accreted ratably over the term of the respective security using the interest method.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. As mentioned above, changes in the fair value of AFS investments are reflected in OCI, unless the investment is deemed to be other-than-temporarily impaired (OTTI). Impairment is considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If the Association intends to sell an impaired debt security or is more likely than not to be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but the Association does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and is separated into (i) the estimated amount relating to credit loss, and (ii) the amount relating to all other factors. Only the estimated credit loss amount is charged to current earnings, with the

remainder of the loss amount recognized in other comprehensive income.

In subsequent periods, if the present value of cash flows expected to be collected is less than the amortized cost basis, the Association will record additional OTTI and adjust the yield of the security prospectively. The amount of total OTTI for an AFS security that previously was impaired is determined as the difference between its carrying amount prior to the determination of OTTI and its fair value.

Interest on investment securities, including amortization of premiums and accretion of discounts, is included in Interest Income. Realized gains and losses from the sales of investment securities are recognized in current earnings using the specific identification method.

**Investment in Other Farm Credit Institutions**

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

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

- H. **Employee Benefit Plans:** The Association participates in District and multi-District sponsored benefit plans. These plans include a defined benefit final average pay retirement plan, a defined benefit cash balance retirement plan, a defined benefit other postretirement benefits plan, and a defined contribution 401(k) plan.

**Defined Contribution Plans**

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

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

**Multi-Employer Defined Benefit Plans**

Substantially all employees hired before November 4, 2014 may participate in either the AgFirst Farm Credit Retirement Plan or the AgFirst Farm Credit Cash Balance Retirement Plan (collectively referred to as the "Plans"), which are defined benefit plans and considered multi-employer under FASB accounting guidance. The Plans are noncontributory and include eligible Association and District employees.



The “Projected Unit Credit” actuarial method is used for financial reporting purposes. The actuarially-determined costs of the Plans are allocated to each participating entity by multiplying the Plans’ net pension expense by each institution’s eligible service cost and accumulated benefit obligation as a percentage of the total eligible service cost and total accumulated benefit obligation for all Plan participants. The cumulative excess of amounts funded by the Association over the cost allocated to the Association is reflected as prepaid retirement expense, a component of Other Assets in the Association’s Consolidated Balance Sheets.

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-District sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Certain charges related to this plan are an allocation of District charges based on the Association’s proportional share of the plan liability. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents during the years the employee renders service necessary to become eligible for benefits. The cumulative excess of cost allocated to the Association over the amounts funded by the Association is reflected as postretirement benefits other than pensions, a component of Other Liabilities in the Association’s Consolidated Balance Sheets.

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

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

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

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

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the

Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

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

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

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

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

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

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

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

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

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

Please see further discussion in Note 8.

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

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

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

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

- N. Accounting Standards Updates (ASUs):** In January, 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also support more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. 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. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In November, 2016, the FASB issued ASU 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash. The Update clarifies 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. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In October, 2016, the FASB issued ASU 2016-17 Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control. If a reporting entity satisfies the first characteristic of a primary beneficiary of a variable interest entity (VIE), the amendments in this Update require that reporting entity, in determining whether it satisfies the second characteristic of a primary beneficiary, to include all of its direct variable interests in a VIE and, on a proportionate basis, its indirect variable interests in a VIE held through related parties, including related parties that are under common control with the reporting entity. That is, a single decision maker is not required to consider indirect interests held through related parties that are under common control with the single decision maker to be the equivalent of direct interests in their entirety. Instead, a single decision maker is required to include those interests on a proportionate basis consistent with indirect interests held through other related parties. 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 this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In October, 2016, the FASB issued ASU 2016-16 Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. The Update requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory. The amendments in this Update align the recognition of income tax consequences for intra-entity transfers of assets other than inventory with International Financial Reporting Standards (IFRS). 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. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In August, 2016, the FASB issued ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). Stakeholders had indicated there was 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 the 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. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In June, 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The Update improves financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The Update will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. For public business entities that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. For all other organizations, the ASU will take effect for fiscal years beginning after December 15, 2020, and for interim periods within fiscal years beginning after December 15, 2021. 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 will apply the ASU guidance as a public business entity that is not a SEC filer. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In February, 2016, the FASB issued ASU 2016-02 Leases (Topic 842). The Update is intended to improve financial reporting about leasing transactions. The ASU affects all companies and other organizations that lease assets such as real estate, airplanes, and manufacturing equipment. The ASU will require organizations that lease assets—referred to as “lessees”—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. A lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current guidance, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, the new ASU will require both types of leases to be recognized on the balance sheet. The Update also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the

financial statements. The accounting by organizations that own the assets leased by the lessee—also known as lessor accounting—will remain largely unchanged from current guidance. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014. The amendments are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early application will be permitted for all organizations. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In January, 2016, the FASB issued Accounting Standards Update (ASU) 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments are intended to improve the recognition and measurement of financial instruments. The Update affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. The new guidance makes targeted improvements to existing GAAP by requiring equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements, eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities, eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The ASU is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. 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 September, 2015, the FASB issued ASU 2015-16 Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this Update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined and to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been

recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the amendments were effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. Adoption of this guidance was applied prospectively and did not have an impact on the Association's financial condition or results of operations.

In May, 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). Topic 820 permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. Investments valued using the practical expedient were categorized within the fair value hierarchy on the basis of whether the investment was redeemable with the investee at net asset value on the measurement date, never redeemable with the investee at net asset value, or redeemable with the investee at net asset value at a future date. To address diversity in practice related to how certain investments measured at net asset value with future redemption dates were categorized, the amendments in this Update removed the requirement to categorize investments for which fair values are measured using the net asset value per share practical expedient. It also limited disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. For public business entities, the guidance was effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Adoption of this guidance was applied retrospectively to all periods presented and did not have an impact on the Association's financial condition or results of operations.

In February, 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are VIEs or voting interest entities, eliminate the presumption that a general partner should consolidate a limited partnership, affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, and provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update were effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Adoption of this guidance was applied on a modified retrospective basis and did not have an impact on the Association's financial condition or results of operations.

In August, 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The

Update is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. The Update provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments in this Update apply to all companies and not-for-profit organizations and became effective in the annual period ended after December 15, 2016, with early application permitted. Adoption of this guidance was applied prospectively and did not have a material impact on the Association's financial condition or results of operations.

In May 2014, the FASB, responsible for U.S. Generally Accepted Accounting Principles (U.S. GAAP), and the International Accounting Standards Board (IASB), responsible for International Financial Reporting Standards (IFRS), jointly issued converged standards on the recognition of revenue from contracts with customers. ASU 2014-09, Revenue from Contracts with Customers (Topic 606) and IFRS 15 "Revenue from Contracts with Customers" are intended to improve the financial reporting of revenue and comparability of the top line in financial statements globally and supersede substantially all previous revenue recognition guidance. The core principle of the new standards is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standards also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. Because of the pervasive nature of the new guidance, the boards have established a joint transition resource group (TRG) in order to aid transition to the new standard. Based on input received from its stakeholders and Revenue Recognition TRG, the FASB has issued five Updates related to this ASU. The Updates generally provided clarifying guidance where there was the potential for diversity in practice, or to address the cost and complexity of applying Topic 606. Collectively, the Updates are not expected to have a significant effect on implementation of the guidance. For public business entities, the amendments in the Update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. 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.

### Note 3 — Loans and Allowance for Loan Losses

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

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

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

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

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

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.
- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.

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

A summary of loans outstanding at period end follows:

	December 31,		
	2016	2015	2014
Real estate mortgage	\$ 220,738	\$ 215,002	\$ 221,047
Production and intermediate-term	222,689	215,664	214,779
Loans to cooperatives	3,278	2,902	3,075
Processing and marketing	2,003	5,695	8,475
Farm-related business	6,538	5,017	6,375
Rural residential real estate	15,123	17,222	20,008
Other (including Mission Related)	25,878	29,523	19,110
Total Loans	\$ 496,247	\$ 491,025	\$ 492,869

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

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

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

December 31, 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	\$ -	\$ 7,022	\$ -	\$ -	\$ -	\$ 1,504	\$ -
Production and intermediate-term	4,959	8,924	-	-	-	729	4,959	9,653
Loans to cooperatives	1,941	-	-	-	1,341	-	3,282	-
Processing and marketing	2,010	-	-	-	-	-	2,010	-
Farm-related business	462	-	-	-	-	-	462	-
Rural residential real estate	-	204	-	-	-	-	-	204
Other (including Mission Related)	-	-	-	-	24,922	-	24,922	-
Total	\$ 9,372	\$ 16,150	\$ -	\$ -	\$ 26,263	\$ 2,233	\$ 35,635	\$ 18,383

December 31, 2015

	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ -	\$ 9,315	\$ -	\$ -	\$ 1,567	\$ 714	\$ 1,567
Production and intermediate-term	2,396	5,661	-	-	135	1,217	2,531	6,878
Loans to cooperatives	-	-	-	-	2,902	-	2,902	-
Processing and marketing	4,972	-	278	-	419	-	5,669	-
Farm-related business	2,260	296	-	-	-	-	2,260	296
Rural residential real estate	-	222	-	-	-	-	-	222
Other (including Mission Related)	-	-	-	-	28,254	-	28,254	-
Total	\$ 9,628	\$ 15,494	\$ 278	\$ -	\$ 33,277	\$ 1,931	\$ 43,183	\$ 17,425

December 31, 2014

	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	\$ -	\$ 14,336	\$ -	\$ -	\$ -	\$ 759	\$ -
Production and intermediate-term	3,341	10,208	-	-	-	1,253	3,341	11,461
Loans to cooperatives	-	-	-	-	3,075	-	3,075	-
Processing and marketing	7,514	-	501	-	419	-	8,434	-
Farm-related business	1,980	811	-	-	-	-	1,980	811
Rural residential real estate	-	239	-	-	-	-	-	239
Other (including Mission Related)	-	-	-	-	18,824	-	18,824	-
Total	\$ 12,835	\$ 25,594	\$ 501	\$ -	\$ 22,318	\$ 2,012	\$ 35,654	\$ 27,606

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

	December 31, 2016			
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 409	\$ 17,991	\$ 202,338	\$ 220,738
Production and intermediate-term	93,834	82,755	46,100	222,689
Loans to cooperatives	–	3,278	–	3,278
Processing and marketing	–	1,154	849	2,003
Farm-related business	4,757	299	1,482	6,538
Rural residential real estate	1,387	1,625	12,111	15,123
Other (including Mission Related)	149	4,263	21,466	25,878
Total Loans	\$ 100,536	\$ 111,365	\$ 284,346	\$ 496,247
Percentage	20.26%	22.44%	57.30%	100.00%

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

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

	December 31,				December 31,		
	2016	2015	2014		2016	2015	2014
<b>Real estate mortgage:</b>				<b>Farm-related business:</b>			
Acceptable	91.81%	95.46%	97.83%	Acceptable	82.41%	72.64%	74.66%
OAEM	4.37	3.13	0.80	OAEM	–	–	25.34
Substandard/doubtful/loss	3.82	1.41	1.37	Substandard/doubtful/loss	17.59	27.36	–
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Production and intermediate-term:</b>				<b>Rural residential real estate:</b>			
Acceptable	88.73%	95.04%	97.50%	Acceptable	96.65%	96.19%	96.63%
OAEM	3.05	4.17	1.36	OAEM	0.19	0.40	0.16
Substandard/doubtful/loss	8.22	0.79	1.14	Substandard/doubtful/loss	3.16	3.41	3.21
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Loans to cooperatives:</b>				<b>Other (including Mission Related):</b>			
Acceptable	100.00%	100.00%	100.00%	Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–	OAEM	–	–	–
Substandard/doubtful/loss	–	–	–	Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%
<b>Processing and marketing:</b>				<b>Total Loans:</b>			
Acceptable	79.36%	100.00%	100.00%	Acceptable	90.88%	95.42%	97.48%
OAEM	20.64	–	–	OAEM	3.40	3.22	1.28
Substandard/doubtful/loss	–	–	–	Substandard/doubtful/loss	5.72	1.36	1.24
	100.00%	100.00%	100.00%		100.00%	100.00%	100.00%

The following tables provide an age analysis of past due loans with related accrued interest and premiums as of periods ended:

	December 31, 2016						Recorded Investment 90 Days or More Past Due and Accruing Interest
	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		
Real estate mortgage	\$ 1,113	\$ 853	\$ 1,966	\$ 221,457	\$ 223,423	\$ –	
Production and intermediate-term	479	1,168	1,647	224,060	225,707	–	
Loans to cooperatives	–	–	–	3,297	3,297	–	
Processing and marketing	–	–	–	2,006	2,006	–	
Farm-related business	44	–	44	6,516	6,560	–	
Rural residential real estate	257	7	264	14,908	15,172	–	
Other (including Mission Related)	103	–	103	26,004	26,107	–	
Total	1,996	2,028	4,024	498,248	502,272	–	

December 31, 2015						
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	\$ 779	\$ 1,182	\$ 1,961	\$ 215,206	\$ 217,167	\$ -
Production and intermediate-term	813	1,287	2,100	216,276	218,376	-
Loans to cooperatives	-	-	-	2,937	2,937	-
Processing and marketing	-	-	-	5,734	5,734	-
Farm-related business	-	-	-	5,024	5,024	-
Rural residential real estate	340	68	408	16,869	17,277	-
Other (including Mission Related)	-	-	-	29,724	29,724	-
Total	1,932	2,537	4,469	491,770	496,239	-

December 31, 2014						
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment 90 Days or More Past Due and Accruing Interest
Real estate mortgage	\$ 1,152	\$ 3,083	\$ 4,235	\$ 219,068	\$ 223,303	\$ 36
Production and intermediate-term	121	1,665	1,786	215,552	217,338	69
Loans to cooperatives	-	-	-	3,102	3,102	-
Processing and marketing	-	-	-	8,490	8,490	-
Farm-related business	-	-	-	6,381	6,381	-
Rural residential real estate	216	60	276	19,795	20,071	-
Other (including Mission Related)	-	-	-	19,240	19,240	-
Total	\$ 1,489	4,808	6,297	491,628	497,925	105

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

	December 31,		
	2016	2015	2014
<b>Nonaccrual loans:</b>			
Real estate mortgage	\$ 3,058	\$ 2,828	\$ 4,017
Production and intermediate-term	1,407	2,086	1,802
Farm-related business	1,154	1,374	-
Rural residential real estate	205	265	179
Total	\$ 5,824	\$ 6,553	\$ 5,998
<b>Accruing restructured loans:</b>			
Real estate mortgage	\$ 2,323	\$ 2,136	\$ 2,081
Production and intermediate-term	-	-	974
Rural residential real estate	22	24	26
Total	\$ 2,345	\$ 2,160	\$ 3,081
<b>Accruing loans 90 days or more past due:</b>			
Real estate mortgage	\$ -	\$ -	\$ 36
Production and intermediate-term	-	-	69
Total	\$ -	\$ -	\$ 105
Total nonperforming loans	\$ 8,169	\$ 8,713	\$ 9,184
Other property owned	569	892	919
Total nonperforming assets	\$ 8,738	\$ 9,605	\$ 10,103
Nonaccrual loans as a percentage of total loans	1.17%	1.33%	1.22%
Nonperforming assets as a percentage of total loans and other property owned	1.76%	1.95%	2.05%
Nonperforming assets as a percentage of capital	9.53%	10.77%	11.66%



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

	December 31,		
	2016	2015	2014
<b>Impaired nonaccrual loans:</b>			
Current as to principal and interest	\$ 2,956	\$ 3,200	\$ 1,046
Past due	2,868	3,353	4,952
Total	<u>5,824</u>	<u>6,553</u>	<u>5,998</u>
<b>Impaired accrual loans:</b>			
Restructured	2,345	2,160	3,081
90 days or more past due	-	-	105
Total	<u>2,345</u>	<u>2,160</u>	<u>3,186</u>
Total impaired loans	<u>\$ 8,169</u>	<u>\$ 8,713</u>	<u>\$ 9,184</u>
Additional commitments to lend	<u>\$ 9</u>	<u>\$ 7</u>	<u>\$ 7</u>

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

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	\$ 28	\$ 49	\$ 29	\$ 31	\$ -
Production and intermediate-term	787	806	407	878	3
Rural residential real estate	56	93	14	63	-
Total	<u>\$ 871</u>	<u>\$ 948</u>	<u>\$ 450</u>	<u>\$ 972</u>	<u>\$ 3</u>
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 5,353	\$ 5,553	\$ -	\$ 5,971	\$ 21
Production and intermediate-term	620	718	-	691	2
Farm-related business	1,154	1,252	-	1,287	4
Rural residential real estate	171	214	-	191	1
Total	<u>\$ 7,298</u>	<u>\$ 7,737</u>	<u>\$ -</u>	<u>\$ 8,140</u>	<u>\$ 28</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 5,381	\$ 5,602	\$ 29	\$ 6,002	\$ 21
Production and intermediate-term	1,407	1,524	407	1,569	5
Farm-related business	1,154	1,252	-	1,287	4
Rural residential real estate	227	307	14	254	1
Total	<u>\$ 8,169</u>	<u>\$ 8,685</u>	<u>\$ 450</u>	<u>\$ 9,112</u>	<u>\$ 31</u>

Impaired loans:	December 31, 2015			Year Ended December 31, 2015	
	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	\$ 35	\$ 56	\$ 35	\$ 32	\$ 1
Production and intermediate-term	850	854	409	786	15
Rural residential real estate	64	101	24	60	1
Total	<u>\$ 949</u>	<u>\$ 1,011</u>	<u>\$ 468</u>	<u>\$ 878</u>	<u>\$ 17</u>
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 4,929	\$ 4,873	\$ -	\$ 4,563	\$ 88
Production and intermediate-term	1,236	1,357	-	1,145	22
Farm-related business	1,374	1,390	-	1,272	24
Rural residential real estate	225	320	-	208	4
Total	<u>\$ 7,764</u>	<u>\$ 7,940</u>	<u>\$ -</u>	<u>\$ 7,188</u>	<u>\$ 138</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 4,964	\$ 4,929	\$ 35	\$ 4,595	\$ 89
Production and intermediate-term	2,086	2,211	409	1,931	37
Farm-related business	1,374	1,390	-	1,272	24
Rural residential real estate	289	421	24	268	5
Total	<u>\$ 8,713</u>	<u>\$ 8,951</u>	<u>\$ 468</u>	<u>\$ 8,066</u>	<u>\$ 155</u>

	December 31, 2014			Year Ended December 31, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	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	\$ 126	\$ 150	\$ 44	\$ 147	\$ 7
Production and intermediate-term	460	475	152	536	25
Rural residential real estate	71	108	24	83	4
Total	<u>\$ 657</u>	<u>\$ 733</u>	<u>\$ 220</u>	<u>\$ 766</u>	<u>\$ 36</u>
<b>With no related allowance for credit losses:</b>					
Real estate mortgage	\$ 6,009	\$ 6,214	\$ –	\$ 7,003	\$ 328
Production and intermediate-term	2,385	2,390	–	2,780	130
Rural residential real estate	133	145	–	156	7
Total	<u>\$ 8,527</u>	<u>\$ 8,749</u>	<u>\$ –</u>	<u>\$ 9,939</u>	<u>\$ 465</u>
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 6,135	\$ 6,364	\$ 44	\$ 7,150	\$ 335
Production and intermediate-term	2,845	2,865	152	3,316	155
Rural residential real estate	204	253	24	239	11
Total	<u>\$ 9,184</u>	<u>\$ 9,482</u>	<u>\$ 220</u>	<u>\$ 10,705</u>	<u>\$ 501</u>

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31,		
	2016	2015	2014
Interest income which would have been recognized under the original loan terms	\$ 352	\$ 430	\$ 842
Less: interest income recognized	29	154	501
Foregone interest income	<u>\$ 323</u>	<u>\$ 276</u>	<u>\$ 341</u>

During the year ended December 31, 2015, management recognized additional risks within the loan portfolio on loans with a loss given default rating of B which needed to be addressed in the allowance for loan loss methodology. A five percent allowance factor was added to those loans with a B rating which resulted in an additional quantitative allowance of \$513 as of December 31, 2015. The allowance for loan loss methodology was not changed in 2016.

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

	Real Estate Mortgage	Production and Intermediate-term	Agribusiness*	Rural Residential Real Estate	Other (including Mission Related)	Total
<b>Activity related to the allowance for credit losses:</b>						
Balance at December 31, 2015	\$ 2,400	\$ 3,394	\$ 76	\$ 186	\$ -	\$ 6,056
Charge-offs	(270)	(82)	-	(73)	-	(425)
Recoveries	1	62	-	25	-	88
Provision for loan losses	44	207	14	(28)	-	237
Balance at December 31, 2016	\$ 2,175	\$ 3,581	\$ 90	\$ 110	\$ -	\$ 5,956
Balance at December 31, 2014	\$ 2,441	\$ 2,587	\$ 859	\$ 149	\$ 4	\$ 6,040
Charge-offs	(171)	(210)	-	(82)	-	(463)
Recoveries	14	14	-	1	-	29
Provision for loan losses	116	1,003	(783)	118	(4)	450
Balance at December 31, 2015	\$ 2,400	\$ 3,394	\$ 76	\$ 186	\$ -	\$ 6,056
Balance at December 31, 2013	\$ 2,187	\$ 3,045	\$ 460	\$ 130	\$ 376	\$ 6,198
Charge-offs	(337)	(86)	-	(67)	-	(490)
Recoveries	29	162	2	3	-	196
Provision for loan losses	562	(534)	397	83	(372)	136
Balance at December 31, 2014	\$ 2,441	\$ 2,587	\$ 859	\$ 149	\$ 4	\$ 6,040
<b>Allowance on loans evaluated for impairment:</b>						
Individually	\$ 29	\$ 407	\$ -	\$ 14	\$ -	\$ 450
Collectively	2,146	3,174	90	96	-	5,506
PCI**	-	-	-	-	-	-
Balance at December 31, 2016	\$ 2,175	\$ 3,581	\$ 90	\$ 110	\$ -	\$ 5,956
Individually	\$ 35	\$ 409	\$ -	\$ 24	\$ -	\$ 468
Collectively	2,365	2,985	76	162	-	5,588
PCI**	-	-	-	-	-	-
Balance at December 31, 2015	\$ 2,400	\$ 3,394	\$ 76	\$ 186	\$ -	\$ 6,056
Individually	\$ 44	\$ 152	\$ -	\$ 24	\$ -	\$ 220
Collectively	2,397	2,435	859	125	4	5,820
PCI**	-	-	-	-	-	-
Balance at December 31, 2014	\$ 2,441	\$ 2,587	\$ 859	\$ 149	\$ 4	\$ 6,040
<b>Recorded investment in loans evaluated for impairment:</b>						
Individually	\$ 5,228	\$ 1,407	\$ 1,154	\$ 195	\$ -	\$ 7,984
Collectively	217,908	224,300	10,709	14,936	26,107	493,960
PCI**	287	-	-	41	-	328
Balance at December 31, 2016	\$ 223,423	\$ 225,707	\$ 11,863	\$ 15,172	\$ 26,107	\$ 502,272
Individually	\$ 4,807	\$ 2,086	\$ 1,374	\$ 243	\$ -	\$ 8,510
Collectively	212,013	216,290	12,321	16,977	29,724	487,325
PCI**	347	-	-	57	-	404
Balance at December 31, 2015	\$ 217,167	\$ 218,376	\$ 13,695	\$ 17,277	\$ 29,724	\$ 496,239
Individually	\$ 4,851	\$ 2,304	\$ -	\$ 145	\$ -	\$ 7,300
Collectively	216,957	214,493	17,973	19,854	19,240	488,517
PCI**	1,495	541	-	72	-	2,108
Ending balance at December 31, 2014	\$ 223,303	\$ 217,338	\$ 17,973	\$ 20,071	\$ 19,240	\$ 497,925

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

\*\*Purchased credit impaired (PCI) loans. This table includes PCI loans currently classified as performing and not individually evaluated for impairment.

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

Outstanding Recorded Investment	Year Ended December 31, 2016				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification:</b>					
Rural residential real estate	\$ -	\$ 8	\$ -	\$ 8	
Total	\$ -	\$ 8	\$ -	\$ 8	
<b>Post-modification:</b>					
Rural residential real estate	\$ -	\$ 8	\$ -	\$ 8	\$ -
Total	\$ -	\$ 8	\$ -	\$ 8	\$ -

Outstanding Recorded Investment	Year Ended December 31, 2015				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification:</b>					
Real estate mortgage	\$ -	\$ 1,315	\$ -	\$ 1,315	
Total	\$ -	\$ 1,315	\$ -	\$ 1,315	
<b>Post-modification:</b>					
Real estate mortgage	\$ -	\$ 1,315	\$ -	\$ 1,315	\$ -
Total	\$ -	\$ 1,315	\$ -	\$ 1,315	\$ -

Outstanding Recorded Investment	Year Ended December 31, 2014				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
<b>Pre-modification:</b>					
Real estate mortgage	\$ -	\$ 849	\$ -	\$ 849	
Production and intermediate-term	-	1,000	-	1,000	
Total	\$ -	\$ 1,849	\$ -	\$ 1,849	
<b>Post-modification:</b>					
Real estate mortgage	\$ -	\$ 849	\$ -	\$ 849	\$ -
Production and intermediate-term	-	1,000	-	1,000	-
Total	\$ -	\$ 1,849	\$ -	\$ 1,849	\$ -

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

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

Defaulted troubled debt restructurings	Year Ended December 31,		
	2016	2015	2014
Production and intermediate-term	\$ -	\$ -	\$ 718
Total	\$ -	\$ -	\$ 718

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

	Total TDRs			Nonaccrual TDRs		
	December 31,			December 31,		
	2016	2015	2014	2016	2015	2014
Real estate mortgage	\$ 3,634	\$ 4,377	\$ 4,132	\$ 1,311	\$ 2,241	\$ 2,051
Production and intermediate-term	27	592	1,480	27	592	506
Rural residential real estate	55	71	86	33	47	60
Total Loans	\$ 3,716	\$ 5,040	\$ 5,698	\$ 1,371	\$ 2,880	\$ 2,617
Additional commitments to lend	\$ -	\$ -	\$ -			

The following table presents information as of period end:

	December 31, 2016	
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	\$	295
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	\$	42

### Purchased Credit Impaired (PCI) Loans

River Valley acquires loans individually and in groups or portfolios.

In connection with a 2012 business combination, River Valley purchased impaired loans that are accounted for under the Cost Recovery Method. The carrying amounts of those loans included in the balance sheet amounts of loans receivable at December 31, were as follows.

	2016		2015		2014	
Real estate mortgage	\$	287	\$	347	\$	1,495
Production and intermediate-term		-		-		541
Rural residential real estate		41		57		72
Total Loans	\$	328	\$	404	\$	2,108

There was no allowance for loan losses related to these loans at December 31, 2016, 2015, or 2014. During the years ended December 31, 2016, 2015, and 2014, net provision expense on these loans was a net provision reversal of \$3, net provision expense of \$0, and a net provision reversal of \$368, respectively. See above for a summary of changes in the total allowance for loan losses for the period ended December 31, 2016. There were no other loans acquired during the year ended December 31, 2016 for which it was probable at acquisition that all contractually required payments would not be collected. The total of loans acquired in the 2012 business combination for which it was probable at acquisition that all contractually required payments would not be collected were as follows:

	Acquired in 2012	
Real estate mortgage	\$	3,488
Production and intermediate-term		4,105
Rural residential real estate		236
Total Loans	\$	7,829

The loans acquired by the Association in the business combination that were within the scope of purchased impaired loan guidance are accounted for using a cash basis method of income recognition because the Association cannot reasonably estimate cash flows expected to be collected. Substantially all of the loans acquired were real estate collateral dependent loans. As discussed previously, the real estate market is unpredictable, making the estimation of the amount and timing of a sale of loan collateral in essentially the same condition as received upon foreclosure indeterminate. As such, the Association does not have the information necessary to reasonably estimate cash flows expected to be collected to compute its yield. Management determined a nonaccrual classification would be the most appropriate and that no income would be recognized on these loans as is allowed under accounting guidance. The carrying values of PCI loans are net

of nonaccretable discounts which totaled \$576 at acquisition and a premium of \$8 at December 31, 2016.

### Note 4 — Investments

#### Investment Securities

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are issued through the Small Business Administration and are guaranteed by the full faith and credit of the United States government. They are held for managing short-term surplus funds and reducing interest rate risk. These securities meet the applicable Farm Credit Administration (FCA) regulatory guidelines related to government agency guaranteed investments.

A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

	December 31, 2016				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
ABSs	\$ 8	\$ -	\$ -	\$ 8	1.49%

	December 31, 2015				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
ABSs	\$ 22	\$ -	\$ (1)	\$ 21	1.34%

	December 31, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
ABSs	\$ 97	\$ -	\$ (1)	\$ 96	1.39%

A summary of the contractual maturity, amortized cost and estimated fair value of investment securities held-to-maturity follows:

	December 31, 2016		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 5	\$ 5	1.49%
After one year through five years	3	3	1.49
After five years through ten years	-	-	-
After ten years	-	-	-
Total	\$ 8	\$ 8	1.49%

Expected maturities for these types of securities can differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

An investment is considered impaired if its fair value is less than its cost. The following tables show the fair value and gross unrealized losses for investments that were in a continuous unrealized loss position aggregated by investment category at each reporting period. A continuous unrealized loss position for an investment is measured from the date the impairment was first identified. There were no securities in a continuous unrealized loss position at December 31, 2016.

December 31, 2015			
Less than 12 Months		12 Months or Greater	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
ABSs	\$ -	\$ 21	\$ (1)

December 31, 2014			
Less than 12 Months		12 Months or Greater	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
ABSs	\$ -	\$ 96	\$ (1)

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

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

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

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

The Association has not recognized any credit losses as any impairments were deemed temporary and resulted from non-credit related factors. The Association has the ability and intent to hold these temporarily impaired investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements.

A substantial portion of these investments was in U. S. government agency securities and the Association expects these securities would not be settled at a price less than their amortized cost. All securities continue to perform at period end.

**Investments in Other Farm Credit Institutions**

Investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. Accounting for this investment is on the cost plus allocated equities basis.

The Association owns 2.47 percent of the issued stock of the Bank as of December 31, 2016 net of any reciprocal investment. As of that date, the Bank's assets totaled \$32.1 billion and shareholders' equity totaled \$2.2 billion. The Bank's earnings were \$342 million for 2016. The Bank's information is audited by another external auditor. In addition, the Association had an investment of \$416 related to other Farm Credit institutions at December 31, 2016.

**Note 5 — Real Estate and Other Property**

**Premises and Equipment**

Premises and equipment consists of the following:

	December 31,		
	2016	2015	2014
Land	\$ 2,114	\$ 2,114	\$ 1,676
Buildings and improvements	4,871	4,436	4,762
Furniture and equipment	1,501	1,532	1,471
	8,486	8,082	7,909
Less: accumulated depreciation	2,544	2,445	2,211
Total	\$ 5,942	\$ 5,637	\$ 5,698

**Other Property Owned**

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

	December 31,		
	2016	2015	2014
(Gains) losses on sale, net	\$ (5)	\$ (126)	\$ (272)
Carrying value unrealized (gains) losses	12	75	264
Operating (income) expense, net	64	52	73
(Gains) losses on other property owned, net	\$ 71	\$ 1	\$ 65

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2016, 2015, and 2014.

**Note 6 — Debt**

**Notes Payable to AgFirst Farm Credit Bank**

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a GFA. The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2016, the Association's notes payable were within the specified limitations.

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

The weighted average interest rates on the variable rate advances were 1.86 percent for LIBOR-based loans and 1.98 percent for Prime-based loans, and the weighted average remaining maturities were 3.2 years and 1.5 years, respectively, at December 31, 2016. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 2.67 percent, and the weighted average remaining maturity was 10.4 years at December 31, 2016. The weighted-average interest rate on all interest-bearing notes payable was 2.46 percent and the weighted-average remaining maturity was 7.9 years at December 31, 2016. Variable rate and fixed rate notes payable represent approximately 12.54 percent and 87.46 percent, respectively, of total notes payable at December 31, 2016. The

weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

**Note 7 — Members' Equity**

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

**A. Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Common stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lesser of \$1 thousand or two percent of the loan amount. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

**B. Regulatory Capitalization Requirements and Restrictions:** FCA regulations require that certain minimum standards for capital be achieved and maintained. These standards are measured based on capital as a percentage of risk-adjusted assets and off-balance-sheet commitments and surplus levels as a percentage of risk-adjusted assets.

Failure to meet the capital requirements can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2016	2015	2014	Regulatory Minimum
Permanent capital ratio	19.38%	19.16%	18.20%	7.00%
Total surplus ratio	18.61%	18.36%	17.33%	7.00%
Core surplus ratio	17.37%	17.24%	16.20%	3.50%

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

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

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

The Association had the following shares outstanding at December 31, 2016:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	No	218,512	\$ 1,093
C Common/Voting	No	579,303	2,896
C Participation Certificates/Nonvoting	No	82,911	415
Total Capital Stock and Participation Certificates		880,726	\$ 4,404

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

*Retained Earnings*

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

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

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

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

At December 31, 2016, allocated members’ equity consisted of \$4,074 of qualified surplus, \$8,896 of nonqualified allocated surplus and \$26,846 of nonqualified retained surplus. The Association retired \$1,804 of nonqualified allocated surplus and \$646 of qualified allocated surplus in 2016.

*Patronage Distributions*

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower’s interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

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

*Dividends*

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 8 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid on all classes of stock and participation certificates.

The rate of dividends on Classes B or C Common Stock and participation certificates shall be at the same rate per share.



Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these Consolidated Financial Statements.

*Transfer*

Classes B and C Common Stocks and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such Stock or Participation Certificates as provided in Section 830 of the Association's bylaws.

*Impairment*

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

1. Classes B and C Common Stock and Participation Certificates

*Liquidation*

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

1. Holders of Classes B and C Common Stock and Participation Certificates
2. Holders of allocated surplus evidenced by qualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed
3. Holders of nonqualified allocated surplus evidenced by written notices of allocation in the order of the year of issuance, until the total amount of such account has been distributed
4. Any remaining assets after such distribution shall be distributed to present and former Patrons, to the extent practicable.

**Note 8 — Fair Value Measurement**

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

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

hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

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

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

**Level 1**

For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

**Level 2**

The Association had no Level 2 assets and liabilities measured at fair value on a recurring basis.

**Level 3**

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

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

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

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

FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for

commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

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

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. 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 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	\$ 7,719	\$ -	\$ -	\$ 7,719	\$ 7,719	\$ (319)
Other property owned	569	-	-	639	639	(7)
Nonrecurring Assets	\$ 8,288	\$ -	\$ -	\$ 8,358	\$ 8,358	\$ (326)
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 675	\$ 675	\$ -	\$ -	\$ 675	
Investment securities, held-to-maturity	8	-	-	8	8	
Loans	483,215	-	-	475,075	475,075	
Accrued Interest Receivable	6,025	-	6,025	-	6,025	
Other Financial Assets	\$ 489,923	\$ 675	\$ 6,025	\$ 475,083	\$ 481,783	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 411,707	\$ -	\$ -	\$ 404,539	\$ 404,539	
Accrued Interest Payable	836	-	836	-	836	
Other Financial Liabilities	\$ 412,543	\$ -	\$ 836	\$ 404,539	\$ 405,375	

At or for the Year ended December 31, 2015						
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	\$ 8,245	\$ -	\$ -	\$ 8,245	\$ 8,245	\$ (681)
Other property owned	892	-	-	1,004	1,004	51
Nonrecurring Assets	\$ 9,137	\$ -	\$ -	\$ 9,249	\$ 9,249	\$ (630)
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 2,358	\$ 2,358	\$ -	\$ -	\$ 2,358	
Investment securities, held-to-maturity	22	-	-	21	21	
Loans	476,938	-	-	474,642	474,642	
Accrued Interest Receivable	5,214	-	5,214	-	5,214	
Other Financial Assets	\$ 484,532	\$ 2,358	\$ 5,214	\$ 474,663	\$ 482,235	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 409,486	\$ -	\$ -	\$ 407,081	\$ 407,081	
Accrued Interest Payable	807	-	807	-	807	
Other Financial Liabilities	\$ 410,293	\$ -	\$ 807	\$ 407,081	\$ 407,888	

At or for the Year ended December 31, 2014

	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	\$ 8,964	\$ -	\$ -	\$ 8,964	\$ 8,964	\$ 588
Other property owned	919	-	-	1,012	1,012	8
Nonrecurring Assets	\$ 9,883	\$ -	\$ -	\$ 9,976	\$ 9,976	\$ 596
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 2,933	\$ 2,933	\$ -	\$ -	\$ 2,933	
Investment securities, held-to-maturity	97	-	-	96	96	
Loans	477,865	-	-	472,417	472,417	
Accrued Interest Receivable	5,056	-	5,056	-	5,056	
Other Financial Assets	\$ 485,951	\$ 2,933	\$ 5,056	\$ 472,513	\$ 480,502	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 411,161	\$ -	\$ -	\$ 405,727	\$ 405,727	
Accrued Interest Payable	806	-	806	-	806	
Other Financial Liabilities	\$ 411,967	\$ -	\$ 806	\$ 405,727	\$ 406,533	

**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.

**Investment Securities**

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

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

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

**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	\$ 8,358	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
Investment securities, held-to-maturity	Vendor priced	**
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts
		Probability of default
		Loss severity

\*\* The significant unobservable inputs used to estimate fair value for assets and liabilities that are obtained from third party vendors are not included in the table as the specific inputs applied are not provided by the vendor.

**Note 9 — Employee Benefit Plans**

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

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

In November 2014, the AgFirst Plan Sponsor Committee approved and executed amendments to the CB Plan that included the following changes:

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

A favorable determination letter was received from the Internal Revenue Service, and as a result of the termination of the CB Plan, vested benefits will be distributed to participants in 2017. Participants will continue to receive interest credits to their hypothetical cash balance accounts following the termination of the plan through the month immediately preceding the month in which the vested benefits are distributed from the plan.

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

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

The Association's participation in the multiemployer defined benefit plans for the annual periods ended December 31, is outlined in the table below. The "Percentage Funded to Projected Benefit Obligation" or "Percentage Funded to Accumulated Postretirement Benefit Obligation" represents the funded amount for the entire plan and the "Contributions" and "Percentage of Total Contributions" columns represent the Association's respective amounts.

Pension Plan	Percentage Funded to Projected Benefit Obligation			Contributions			Percentage of Total Contributions		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Independent Associations' Retirement Plan	83.70%	83.07%	77.50%	\$764	\$3,058	\$934	26.40%	35.32%	30.35%
AgFirst Farm Credit Cash Balance Retirement Plan	100.21%	102.72%	100.07%	\$-	\$-	\$36	0.00%	0.00%	0.71%

Other Postretirement Benefit Plan	Percentage Funded to Accumulated Postretirement Benefit Obligation			Contributions			Percentage of Total Contribution		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plans	0.00%	0.00%	0.00%	\$119	\$91	\$106	1.65%	1.34%	1.37%

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

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

Substantially all employees of the Association hired before November 4, 2014 are eligible to participate in either the defined benefit IAR Plan with two other District associations or the CB Plan. These two plans are noncontributory and include eligible District employees. For participants hired prior to January 1, 2009, benefits are provided under the IAR Plan and are based on eligible compensation and years of service. For participants hired on or after January 1, 2009 through November 3, 2014, benefits are provided under the CB Plan and are determined using a percent of eligible compensation formula. Prior to January 1, 2015, when employer contributions were discontinued as discussed above, the employer contribution under the CB Plan was based on a formula of 3.00 - 5.00 percent of eligible compensation (depending on years of service) and interest credits as allocated to an employee's theoretical account balance. The actuarially-determined costs of these plans are allocated to each participating entity, including the Association, by multiplying the plans' net pension expense by each institution's eligible service cost and accumulated benefit obligation as a percentage of the total eligible service cost and total accumulated benefit obligation for all plan participants. Plan expenses included in employee benefit costs were \$1,252 for 2016, \$1,265 for 2015, and \$1,193 for 2014. The cumulative excess of amounts funded by the Association over the cost allocated to the Association is reflected as prepaid retirement expense, a component of Other Assets in the Consolidated Balance Sheets.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. This plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs were \$414 for 2016, \$487 for 2015, and \$348 for 2014. The cumulative excess of cost allocated to the Association over the amounts funded by the Association is reflected as postretirement benefits other than pensions, a component of Other Liabilities in the Association's Consolidated Balance Sheets.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. The 401(k) Plan requires the Association to match 100 percent of employee optional contributions up to a maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were \$286, \$312, and \$295 for the years ended December 31, 2016, 2015, and 2014, respectively. Beginning in 2015, contributions include additional amounts related to the discontinuation of the CB Plan as discussed above.

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

**Note 10 — Related Party Transactions**

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

Total loans to such persons at December 31, 2016 amounted to \$29,914. During 2016, \$32,424 of new loans were made and repayments totaled \$24,300. In the opinion of management, none of these loans outstanding at December 31, 2016 involved more than a normal risk of collectibility.

**Note 11 — Commitments and Contingencies**

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

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

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

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2016, \$103,634 of commitments to extend credit and no commercial letters of credit were outstanding with no related reserve for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2016, standby letters of credit outstanding totaled \$88 with expiration dates ranging from January 1, 2017 to May 17, 2018. The maximum

potential amount of future payments that may be required under these guarantees was \$88.

**Note 12 — Income Taxes**

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2016	2015	2014
Current:			
Federal	\$ —	\$ —	\$ (8)
	—	—	(8)
Deferred:	—	—	—
Total provision (benefit) for income taxes	\$ —	\$ —	\$ (8)

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

	December 31,		
	2016	2015	2014
Federal tax at statutory rate	\$ 2,745	\$ 3,046	\$ 3,742
Patronage distributions	(1,017)	(1,110)	(857)
Tax-exempt FLCA earnings	(1,809)	(1,837)	(2,837)
Change in deferred tax asset valuation allowance	216	14	(632)
Other	(135)	(113)	576
Provision (benefit) for income taxes	\$ —	\$ —	\$ (8)

Deferred tax assets and liabilities are comprised of the following at:

	December 31,		
	2016	2015	2014
Deferred income tax assets:			
Allowance for loan losses	\$ 1,274	\$ 1,249	\$ 1,007
Nonaccrual Interest	125	74	86
Annual leave	119	141	130
Other postretirement benefits	645	569	436
Other Property Owned write-downs	10	14	15
Loss Carryforward	4	40	37
Depreciation	—	—	—
Pension	—	—	—
Gross deferred tax assets	2,177	2,087	1,711
Less: valuation allowance	(1,516)	(1,300)	(1,286)
Gross deferred tax assets, net of valuation allowance	661	787	425
Deferred income tax liabilities:			
Pensions and other postretirement benefits	(543)	(657)	(221)
FAS 91	(1)	—	—
Depreciation	(117)	(130)	(204)
Gross deferred tax liability	(661)	(787)	(425)
Net deferred tax asset (liability)	\$ —	\$ —	\$ —

At December 31, 2016, deferred income taxes have not been provided by the Association on approximately \$5.3 million of its investment in the Bank. Management expects that these earnings will not be converted to cash.

The Association recorded a valuation allowance of \$1,516, \$1,300 and \$1,286 as of December 31, 2016, 2015 and 2014, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and no unrecognized tax benefits at December 31, 2016 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to

unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2013 and forward.

**Note 13 — Additional Financial Information**

**Quarterly Financial Information (Unaudited)**

	2016				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,201	\$ 3,167	\$ 3,220	\$ 3,331	\$ 12,919
Provision for (reversal of allowance for) loan losses	283	(25)	94	(115)	237
Noninterest income (expense), net	(1,837)	(1,613)	(1,658)	269	(4,839)
Net income	\$ 1,081	\$ 1,579	\$ 1,468	\$ 3,715	\$ 7,843

	2015				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,340	\$ 3,300	\$ 3,352	\$ 3,390	\$ 13,382
Provision for (reversal of allowance for) loan losses	10	62	68	310	450
Noninterest income (expense), net	(1,990)	(1,740)	(1,437)	938	(4,229)
Net income	\$ 1,340	\$ 1,498	\$ 1,847	\$ 4,018	\$ 8,703

	2014				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,287	\$ 3,200	\$ 3,408	\$ 3,386	\$ 13,281
Provision for (reversal of allowance for) loan losses	35	(132)	252	(19)	136
Noninterest income (expense), net	(1,509)	(1,889)	(1,248)	2,199	(2,447)
Net income	\$ 1,743	\$ 1,443	\$ 1,908	\$ 5,604	\$ 10,698

**Note 14 — Subsequent Events**

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 13, 2017, which was the date the financial statements were issued.



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