
Yankee Farm Credit, ACA
THIRD QUARTER 2018

November 8, 2018

Dear Shareholder:

Enclosed are the Association's consolidated financial statements for the third quarter of 2018. These statements should be read in conjunction with the 2017 Annual Report to Shareholders.

The purpose of these consolidated financial statements is to provide timely financial information about your Association's financial condition and results of operations. Should you have any questions about these statements, please call us.

Copies of the Association's annual and quarterly reports are available to members at no charge from any of our local offices or by accessing the Association's website at www.yankeefarmcredit.com. The Association's annual reports are available 75 days after year end, and quarterly reports are available 40 days after the end of each calendar quarter. As a shareholder, your investment in the Association is materially affected by the financial condition and results of operations of CoBank, ACB. Yankee's, and CoBank's, annual and quarterly reports are available at no charge from any of our offices. Our office locations are listed at the end of this report.

The undersigned certify that they have reviewed this report and it has been prepared in accordance with all statutory and regulatory requirements and that the information contained herein is true, accurate, and complete to the best of his or her knowledge and belief. The consolidated financial statements, in the opinion of management, fairly present the financial condition of the institution except as noted.

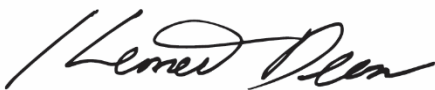
Sincerely,



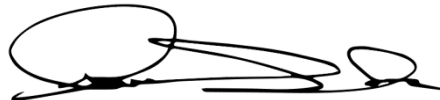
Paul B. Franklin
Chairperson, Board of Directors



Brenda K. Frank
President and Chief Executive Officer



Kenneth F. Deon
Chairperson, Audit Committee



Pamela A. Simek
Senior Vice President and Chief Financial Officer

Yankee Farm Credit, ACA
THIRD QUARTER 2018

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Yankee Farm Credit, ACA

Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

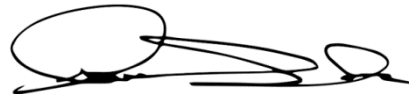
The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2018. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of September 30, 2018, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association's management determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2018.



Brenda K. Frank

President and Chief Executive Officer



Pamela A. Simek

Senior Vice President and Chief Financial Officer

November 8, 2018

Yankee Farm Credit, ACA

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

(dollars in thousands, except as noted)

(Unaudited)

RESULTS OF OPERATIONS: THIRD QUARTER

Net income for the third quarter of 2018 was \$3.376 million, up \$0.744 million (28%) from net income of \$2.632 million in the third quarter of 2017.

Net interest income before the provision for loan losses was up \$327 thousand (7%) in 2018 as compared to 2017. The following table shows the components of this increase:

Changes in net interest income due to:

Changes in volumes of accrual loans & debt	\$	233
Changes in interest rates on accrual loans & debt		96
Changes in interest income on nonaccrual loans		(1)
Other adjustments		(1)
Total change in net interest income	\$	<u>327</u>

Changes in accrual volumes and rates are shown in the following table:

	Three Months Ended September 30,	
	2018	2017
Average accrual loan volume	\$ 501,857	\$ 476,990
Average interest rate on loans	5.72%	5.05%
Average interest rate spread	3.32%	3.37%

Average loan volume was higher in 2018, and this contributed an increase of \$233 thousand in the total change in net interest income as shown in the first table above. Changes in interest rates contributed \$96 thousand to the total change in net interest income.

There was provision for loan losses of \$262 thousand in the third quarter of 2018, as compared to a provision for loan losses of \$117 thousand in the third quarter of 2017.

Noninterest income increased by \$540 thousand (46%) in 2018 as compared to 2017. This increase was due to an increase of \$575 thousand in patronage refunds from other Farm Credit institutions (predominately CoBank) as compared to the third quarter of 2017. Most of this increase in patronage was from a special cash patronage received from CoBank during the quarter.

Noninterest expense decreased by \$25 thousand (1%) in 2018 as compared to 2017. Salaries and employee benefits decreased by \$36 thousand (2%), while the Farm Credit Insurance Fund

(Insurance Fund) decreased \$45 thousand (6%). This was offset by operating expenses (which includes purchased services) increasing by \$52 thousand (6%).

RESULTS OF OPERATIONS: YEAR-TO-DATE

Net income through the third quarter of 2018 was \$10.444 million, \$2.581 million (33%) increased from net income of \$7.863 million through the third quarter of 2017.

Net interest income before the provision for loan losses was up \$1.243 million (10%) in 2018 as compared to 2017. The following table shows the components of this increase:

Changes in net interest income due to:

Changes in volumes of accrual loans & debt	\$	706
Changes in interest rates on accrual loans & debt		536
Changes in interest income on nonaccrual loans		3
Other adjustments		(2)
Total change in net interest income	\$	<u>1,243</u>

Changes in accrual volumes and rates are shown in the following table:

	Nine Months Ended September 30,	
	2018	2017
Average accrual loan volume	\$ 499,959	\$ 433,696
Average interest rate on loans	5.53%	4.80%
Average interest rate spread	3.33%	3.30%

Average loan volume was higher in 2018, and this contributed an increase of \$706 thousand in the total change in net interest income as shown in the first table above. Changes in interest rates contributed \$536 thousand to the total change in net interest income.

There was a provision for loan losses of \$100 thousand through the third quarter of 2018, as compared to a provision for loan losses of \$304 thousand through the third quarter of 2017.

Noninterest income increased by \$950 thousand (25%) in 2018 as compared to 2017. This increase resulted primarily from \$346 thousand in refunds from the Farm Credit System Insurance Corporation (Insurance Corp) related to Insurance Fund. The Insurance Fund is required by statute to maintain a secure base amount equal to 2% of the System's insured debt. When the

Insurance Fund exceeds that base (as it did in 2017) the Insurance Corp may refund excess amounts. See Note 1 *Organization and Operations* of the 2017 Annual Report for more information on the Insurance Corp and the Insurance Fund. Additionally, patronage refunds from other Farm Credit institutions (predominately CoBank) increased \$750 thousand (30%) as compared to the same period in 2017, partially due to the special cash patronage received from CoBank. These increases were partially offset by a \$144 thousand (12%) decrease in fees for financially related services.

Noninterest expense decreased by \$175 thousand (92%) in 2018 as compared to 2017. Other operating expenses (which includes purchased services) decreased by \$100 thousand (3%). Insurance Fund premiums decreased by \$132 thousand (30%). This was partially offset by occupancy and equipment expenses which increased by \$48 thousand (13%).

LOAN PORTFOLIO AND FINANCIAL CONDITION

Loans as of end of the third quarter totaled \$505.6 million, a decrease of \$6.4 million (1%) from year-end. Net loans outstanding (loans less allowance for loan losses) totaled \$499.5 million at the end of the third quarter, down \$6.5 million (1%) from year-end. These decreases primarily resulted from normal loan repayments and paydowns.

The loan portfolio continues to be concentrated in the dairy industry. Farm prices for dairy products decreased in the third quarter of 2018. Federal Order 1 prices for the third quarter of 2018 averaged \$16.35/cwt, up \$0.80/cwt (5%) from the second quarter of 2018, but down \$1.61/cwt (9%) from the third quarter of 2017. The change in prices received for dairy products has been accompanied by a slight decrease (as compared to the prior quarter) in the cost of farm inputs, particularly purchased feed. The composite Feed Index published by the USDA was 100 for the first two months (July and August) of the third quarter of 2018, up 6% from the second quarter of 2018 (adjusted), but down 2% from the third quarter of 2017 (adjusted). (Feed Index = 100 for 2011)

Loan quality worsened slightly but remained strong through the third quarter of 2018. Loans graded Substandard or lower were 4.5% of total loans at September 30, 2018, 1.1% worsened from year-end. High risk assets comprised 1.6% of loans and related assets at September 30, 2018, 0.3% worsened from year-end. (High risk assets include nonaccrual loans, accrual troubled debt restructured loans, loans delinquent 90 days or more but not yet classified as nonaccrual, and other property owned.) Repayment performance remained satisfactory. Loans (both accrual and nonaccrual) delinquent 30 days or more were 2.6% at September 30, 2018, up 1.1% from year-end. The 12-month rolling average for this statistic was 1.7% at September 30, 2018, up 9.2% from year-end. There were no charge-offs but \$1 thousand in recoveries in the first three quarters of 2018. There were charge-offs of \$5 thousand in the first three quarters of 2017, offset by \$5 thousand in recoveries for the same period.

As discussed in the 2017 Annual Report to Shareholders, the Association declared a patronage distribution of \$6.271 million based on 2017 earnings, 100% in cash. This was paid on March 22, 2018.

In August 2018, the Board of Directors authorized a special patronage distribution of \$1.848 million, to be paid during the fourth quarter of 2018. This distribution was due to higher than anticipated net income as a result of the receipts of significant non-recurring refunds from partner organizations (FCSIC and CoBank). This special patronage distribution is in addition to the standard patronage payment the Association typically makes in March of each year.

Members' equity as a percentage of assets was 20.3% at September 30, 2018, as compared to 19.2% at year-end.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain certain minimum regulatory capital ratios.

The regulations require common equity tier 1 (CET1), tier 1 and total regulatory capital (tier 1 plus tier 2) risk-based capital ratio requirements. The regulations also add a tier 1 leverage ratio for all System institutions.

The regulations establish a capital cushion (capital conservations buffer) for CET1, tier 1 and total capital requirements. In addition, the regulations establish a leverage capital cushion (leverage buffer) above the tier 1 leverage ratio requirement. The below regulatory minimums reflect the inclusion of these various buffers.

	Value At		Regulatory Minimum	Internal Minimum	2018 Goal Range
	September 30, 2018	December 31, 2017			
Permanent capital ratio	18.5%	18.8%	7.0%	15.0%	17.0% - 19.0%
CET 1	18.1%	18.5%	7.0%	14.5%	16.5% - 18.5%
Tier 1 capital	18.1%	18.5%	8.5%	14.5%	16.5% - 18.5%
Total regulatory capital	19.4%	19.8%	10.5%	16.0%	17.5% - 19.5%
Tier 1 leverage	17.5%	17.6%	5.0%	14.0%	15.5% - 17.5%

The ratios at September 30, 2018, as indicated above, are not indicative of the full year.

These consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

REGULATORY MATTERS

On May 10, 2018, the Farm Credit Administration adopted a final rule that amends the regulations governing investments of System banks and associations. The final rule strengthens eligibility criteria for the investments the banks may purchase and hold. It also implements Section 939A of the Dodd-Frank Act by removing references to and requirements for credit ratings and substitutes the eligibility requirement with other appropriate standards of credit worthiness. In addition, it grants associations greater flexibility regarding the risk management purposes for investments and limits the type and amount of investments that an association may hold. Only securities that are issued by, or are unconditionally guaranteed or insured as to the timely payment of principal and interest by, the U.S.

government or its agencies are eligible for association risk management purposes. An association may purchase and hold investments not to exceed 10 percent of its 90-day average daily balance of outstanding loans on the last business day of the quarter. The final rule will become effective January 1, 2019.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 1, *Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*, in the Notes to the Financial Statements, and the 2017 Annual Report to Shareholders for recently issued accounting pronouncements. Additional information is provided in the following table.

The following ASUs were issued by the Financial Accounting Standards Board (FASB):

Summary of Guidance	Adoption and Potential Financial Statement Impact
<i>ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments</i>	
<ul style="list-style-type: none"> • Replaces multiple existing impairment standards by establishing a single framework for financial assets to reflect management’s estimate of current expected credit losses (CECL) over the complete remaining life of the financial assets. • Changes the present incurred loss impairment guidance for loans to a CECL model. • The Update also modifies the other-than-temporary impairment model for debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit. • Eliminates existing guidance for purchased credit impaired (PCI) loans, and requires recognition of an allowance for expected credit losses on these financial assets. • Requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption. • Effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. 	<ul style="list-style-type: none"> • The Association has begun implementation efforts by establishing a cross-discipline governance structure. The Association is currently identifying key interpretive issues, and assessing existing credit loss forecasting models and processes against the new guidance to determine what modifications may be required. • The Association expects that the new guidance will result in an increase in its allowance for credit losses due to several factors, including: <ol style="list-style-type: none"> 1. The allowance related to loans and commitments will most likely increase to cover credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions, 2. An allowance will be established for estimated credit losses on any debt securities, 3. The nonaccretable difference on any PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans. • The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Association’s portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date. • The Association expects to adopt the guidance in first quarter 2021.

ASU 2016-02 – Leases (Topic 842)

<ul style="list-style-type: none">• Requires lessees to recognize leases on the balance sheet with lease liabilities and corresponding right-of-use assets based on the present value of lease payments.• Lessor accounting activities are largely unchanged from existing lease accounting.• The Update also eliminates leveraged lease accounting but allows existing leveraged leases to continue their current accounting until maturity, termination or modification.• Also, expands qualitative and quantitative disclosures of leasing arrangements.• Requires adoption using a modified cumulative effect approach wherein the guidance is applied to all periods presented. A recent amendment provides an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.• Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted.	<ul style="list-style-type: none">• The practical expedients allow entities to largely account for existing leases consistent with current guidance, except for the incremental balance sheet recognition for lessees.• The Association has started its implementation of the Update which has included an initial evaluation of leasing contracts and activities.• As a lessee the Association is developing its methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments but does not expect a material change to the timing of expense recognition.• Given the limited changes to lessor accounting, the Association does not expect material changes to recognition or measurement, but the implementation process and the impact will continue to be evaluated.• The Association is evaluating existing disclosures and may need to provide additional information as a result of adopting the Update.• The Association expects to adopt the guidance in first quarter 2019 using the optional modified retrospective method and practical expedients for transition.
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Yankee Farm Credit, ACA

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30, 2018 <i>(unaudited)</i>	December 31, 2017 <i>(audited)</i>
Assets		
Cash	\$ 11	\$ 13
Loans	505,552	511,930
Allowance for loan losses	(6,044)	(5,941)
Net loans	499,508	505,989
Other investments	475	369
Accrued interest receivable	2,705	2,013
Equity investments in other Farm Credit institutions	20,600	19,940
Premises and equipment, net	3,532	3,655
Accounts receivable	4,030	4,545
Other assets	676	729
Total assets	\$ 531,537	\$ 537,253
Liabilities		
Notes payable to CoBank, ACB	\$ 413,522	\$ 423,158
Accrued interest payable	816	647
Patronage refunds payable	6,139	6,271
Accounts payable	1,882	2,233
Other liabilities	1,524	1,575
Total liabilities	423,883	433,884
Commitments and contingencies (Note 5)		
Members' Equity		
Capital stock and participation certificates	1,106	1,126
Unallocated retained earnings	107,826	103,521
Accumulated other comprehensive income (loss)	(1,278)	(1,278)
Total members' equity	107,654	103,369
Total liabilities and members' equity	\$ 531,537	\$ 537,253

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

Yankee Farm Credit, ACA
Consolidated Statements of
Comprehensive Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Interest Income				
Loans	\$ 7,239	\$ 6,071	\$ 21,042	\$ 17,389
Interest Expense				
Notes payable to CoBank, ACB	2,521	1,680	6,839	4,429
Net interest income	4,718	4,391	14,203	12,960
Provision for loan losses	262	117	100	304
Net interest income after provision for loan losses	4,456	4,274	14,103	12,656
Noninterest Income				
Loan fees	25	18	101	33
Fees for financially related services	224	231	1,090	1,234
Lease income	—	1	3	4
Patronage refunds from other Farm Credit institutions	1,459	884	3,226	2,476
Gains (losses) on sales of premises and equipment, net	13	27	18	34
Gains (losses) on other transactions	(20)	8	(48)	3
Insurance Fund refund	—	—	346	—
Other noninterest income	13	5	15	8
Total noninterest income	1,714	1,174	4,751	3,792
Noninterest Expense				
Salaries and employee benefits	1,619	1,655	4,942	4,933
Occupancy and equipment	138	134	419	371
Insurance Fund premiums	80	125	244	376
Other operating expenses	950	898	2,793	2,893
Total noninterest expense	2,787	2,812	8,398	8,573
Income before income taxes	3,383	2,636	10,456	7,875
Provision for income taxes	7	4	12	12
Net income	3,376	2,632	10,444	7,863
Other comprehensive income	—	—	—	—
Comprehensive income	\$ 3,376	\$ 2,632	\$ 10,444	\$ 7,863

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

Yankee Farm Credit, ACA

Consolidated Statements of Changes in Members' Equity

(unaudited)

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Unallocated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2016	\$ 1,092	\$ 99,887	\$ (1,561)	\$ 99,418
Comprehensive income		7,863		7,863
Capital stock/participation certificates issued/(retired), net	26			26
Patronage distribution Cash		(4,103)		(4,103)
Balance at September 30, 2017	\$ 1,118	\$ 103,647	\$ (1,561)	\$ 103,204
Balance at December 31, 2017	\$ 1,126	\$ 103,521	\$ (1,278)	\$ 103,369
Comprehensive income		10,444		10,444
Capital stock/participation certificates issued/(retired), net	(20)			(20)
Patronage distribution Cash		(6,139)		(6,139)
Balance at September 30, 2018	\$ 1,106	\$ 107,826	\$ (1,278)	\$ 107,654

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

Yankee Farm Credit, ACA

Notes to the Consolidated Financial Statements

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

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

Organization

The accompanying financial statements include the accounts of Yankee Farm Credit, ACA and its wholly owned subsidiaries, the Production Credit Association (PCA) and Federal Land Credit Association (FLCA) (collectively, the Association). A description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations for the Association as of and for the year ended December 31, 2017, are contained in the 2017 Annual Report to Shareholders. These unaudited interim consolidated financial statements should be read in conjunction with the latest Annual Report to Shareholders.

Basis of Presentation

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

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

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

Significant Accounting Policies

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

Management has made significant estimates in several areas, including loans and allowance for loan losses (Note 2, *Loans*

and *Allowance for Loan Losses*), and financial instruments (Note 4, *Fair Value Measurement*). Actual results could differ from those estimates.

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

Accounting Standards Updates (ASUs) Issued During the Period

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

- In August 2018, the FASB issued ASU 2018-15 *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update. The guidance is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for all entities. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption.
- In August 2018, the FASB issued ASU 2018-13 *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments are part of the FASB's disclosure framework project. The project's objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity's financial statements. The amendments remove, modify or add certain disclosures contained in the financial statement footnotes related to fair value. Additionally, the guidance is intended to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of

entities and their auditors when evaluating disclosure requirements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Entities may early adopt the provisions in whole upon issuance or may early adopt any removed or modified disclosures upon issuance and delay adoption of the additional disclosures until their effective date.

- In July 2018, the FASB issued ASU 2018-11 Leases (Topic 842): Targeted Improvements. The amendments are intended to reduce costs and ease implementation of the leases standard for financial statement preparers. It addresses certain areas identified as possible sources of unnecessary cost or complexity in the standard. Specifically, the amendments provide an option to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements and a practical expedient that permits lessors to not separate nonlease components from the associated lease component if certain conditions are met. For entities that have not adopted Topic 842 before the issuance of this Update, the effective date and transition requirements for the amendments related to separating components of a contract are the same as the effective date and transition requirements in ASU 2016-02.
- In July 2018, the FASB issued ASU 2018-10 Codification Improvements to Topic 842, Leases. The amendments affect narrow aspects of the guidance issued in ASU 2016-02. Specifically, the Update corrects, clarifies or changes inconsistent language to improve application of the guidance in ASU 2016-02. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in ASU 2016-02.
- In July 2018, the FASB issued ASU 2018-09 Codification Improvements. The amendments affect a wide variety of Topics in the Codification. They apply to all reporting entities within the scope of the affected accounting guidance. The Board has an ongoing project on its agenda about improvements to clarify the Codification or to correct unintended application of guidance. Those items generally are not expected to have a significant effect on current accounting practice. The transition and effective date guidance is based on the facts and circumstances of each amendment.
- In February 2018, the FASB issued ASU 2018-03 Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.

The amendments in this Update include items brought to the Board's attention by stakeholders. The amendments clarify certain aspects of the guidance issued in ASU 2016-01. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted ASU 2016-01.

- In February 2018, the FASB issued ASU 2018-02 Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and are intended to improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The Update also requires certain disclosures about stranded tax effects. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted.

ASUs Pending Effective Date

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

Potential effects of ASUs issued in previous periods:

- In June 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

- In February 2016, the FASB issued ASU 2016-02 Leases (Topic 842). This update, and subsequent clarifying guidance issued, requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Leases will be classified as either finance leases or operating leases. This distinction will be relevant for the pattern of expense recognition in the income statement. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Early adoption is permitted. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

Accounting Standards Effective During the Period

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

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

- In March 2017, the FASB issued ASU 2017-07 Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost related to the income statement presentation of the components of net periodic benefit cost for an entity’s sponsored defined benefit pension and other postretirement plans. The amendments were effective January 1, 2018 for the Association. Adoption in 2018 did not have a material effect on the Association’s financial statements, but did require reclassification of certain periodic pension costs to Other Operating Expenses.
- In August 2016, the FASB issued ASU 2016-15—Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The Update addresses specific cash flow issues with the objective of reducing the diversity in the classification of these cash flows. Included in the cash flow issues are debt prepayment or debt extinguishment costs and settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing. This guidance becomes effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not impact the Association’s financial condition or its results of operations but may change the classification of certain items in the statement of cash flows.
- In January 2016, the FASB issued ASU 2016-01 Financial Instruments—Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities.

The Update was intended to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to existing GAAP.

Transition Information

- Adoption did not have an impact on the Association's financial condition or results of operations.
 - The new standard did result in changes to certain disclosures.
- In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). This guidance changed the recognition of revenue from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance also included expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity’s contracts with customers. Based on input received from stakeholders, the FASB issued several additional updates that generally provided clarifying guidance where there was the potential for diversity in practice, or address the cost and complexity of applying Topic 606.

Transition Information

- The Association identified ancillary revenues affected by this Update and noted that there were no contracts in scope as of January 1, 2018.

Note 2 — Loans and Allowance for Loan Losses

The Association maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. See Note 3, *Loans and Allowance for Loan Losses*, from the latest Annual Report for further discussion.

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

A summary of loans outstanding at period end follows:

	September 30, 2018	December 31, 2017
Real estate mortgage	\$ 227,820	\$ 217,434
Production and intermediate-term	194,040	221,398
Loans to cooperatives	5,852	5,902
Processing and marketing	39,023	31,830
Farm-related business	36,535	32,884
Power and water/waste disposal	670	707
Rural residential real estate	1,612	1,775
Total loans	\$ 505,552	\$ 511,930

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

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

	September 30, 2018							
	Within 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	\$ 8,682	\$ 27,127	\$ 43	\$ -	\$ -	\$ -	\$ 8,725	\$ 27,127
Production and intermediate-term	1,406	206,857	-	-	-	-	1,406	206,857
Loans to cooperatives	5,859	-	-	-	-	-	5,859	-
Processing and marketing	13,725	51,681	-	-	-	-	13,725	51,681
Farm-related business	11,027	-	-	-	-	-	11,027	-
Power and water/waste disposal	670	-	-	-	-	-	670	-
Total	\$ 41,369	\$ 285,665	\$ 43	\$ -	\$ -	\$ -	\$ 41,412	\$ 285,665

	December 31, 2017							
	Within 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	\$ 5,743	\$ 13,714	\$ -	\$ -	\$ -	\$ -	\$ 5,743	\$ 13,714
Production and intermediate-term	772	290,458	-	-	-	-	772	290,458
Loans to cooperatives	5,902	-	-	-	-	-	5,902	-
Processing and marketing	14,526	26,370	-	-	-	-	14,526	26,370
Farm-related business	7,814	1,178	-	-	-	-	7,814	1,178
Power and water/waste disposal	707	-	-	-	-	-	707	-
Total	\$ 35,464	\$ 331,720	\$ -	\$ -	\$ -	\$ -	\$ 35,464	\$ 331,720

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

	September 30, 2018	December 31, 2017		September 30, 2018	December 31, 2017
Real estate mortgage:			Farm-related business:		
Acceptable	81.51%	87.55%	Acceptable	99.11%	97.16%
OAEM	13.16	8.43	OAEM	0.21	0.26
Substandard/doubtful/loss	5.33	4.02	Substandard/doubtful/loss	0.68	2.58
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
Production and intermediate-term:			Power and water/waste disposal:		
Acceptable	85.96%	89.24%	Acceptable	100.00%	100.00%
OAEM	8.88	7.17	OAEM	-	-
Substandard/doubtful/loss	5.16	3.59	Substandard/doubtful/loss	-	-
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
Loans to cooperatives:			Rural residential real estate:		
Acceptable	100.00%	100.00%	Acceptable	86.64%	87.47%
OAEM	-	-	OAEM	13.36	12.53
Substandard/doubtful/loss	-	-	Substandard/doubtful/loss	-	-
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
Processing and marketing:			Total loans:		
Acceptable	98.97%	98.88%	Acceptable	86.08%	89.76%
OAEM	-	1.12	OAEM	9.40	6.81
Substandard/doubtful/loss	1.03	-	Substandard/doubtful/loss	4.52	3.43
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>

The following tables provide an aging analysis of the recorded investment (principal balance plus accrued interest) of past due loans as of:

September 30, 2018					
	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	\$ 5,723	\$ 398	\$ 6,121	\$ 223,122	\$ 229,243
Production and intermediate-term	2,246	4,088	6,334	188,727	195,061
Loans to cooperatives	-	-	-	5,862	5,862
Processing and marketing	-	-	-	39,142	39,142
Farm-related business	243	181	424	36,236	36,660
Power and water/waste disposal	-	-	-	670	670
Rural residential real estate	-	-	-	1,619	1,619
Total	\$ 8,212	\$ 4,667	\$ 12,879	\$ 495,378	\$ 508,257

December 31, 2017					
	30 Through 89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans
Real estate mortgage	\$ 1,810	\$ 939	\$ 2,749	\$ 215,559	\$ 218,308
Production and intermediate-term	630	3,728	4,358	217,976	222,334
Loans to cooperatives	-	-	-	5,920	5,920
Processing and marketing	-	-	-	31,906	31,906
Farm-related business	526	141	667	32,315	32,982
Power and water/waste disposal	-	-	-	712	712
Rural residential real estate	-	-	-	1,781	1,781
Total	\$ 2,966	\$ 4,808	\$ 7,774	\$ 506,169	\$ 513,943

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

	September 30, 2018	December 31, 2017
Nonaccrual loans:		
Real estate mortgage	\$ 961	\$ 915
Production and intermediate-term	4,042	3,460
Farm-related business	228	202
Total	\$ 5,231	\$ 4,577
Accruing restructured loans:		
Real estate mortgage	\$ 1,869	\$ 77
Production and intermediate-term	1,139	-
Total	\$ 3,008	\$ 77
Accruing loans 90 days or more past due:		
Production and intermediate-term	\$ 27	\$ -
Total	\$ 27	\$ -
Total nonperforming loans	\$ 8,266	\$ 4,654
Other property owned	-	-
Total nonperforming assets	\$ 8,266	\$ 4,654
Nonaccrual loans as a percentage of total loans	1.03%	0.89%
Nonperforming assets as a percentage of total loans and other property owned	1.63%	0.91%
Nonperforming assets as a percentage of capital	7.68%	4.50%

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

	September 30, 2018	December 31, 2017
Impaired nonaccrual loans:		
Current as to principal and interest	\$ 465	\$ 559
Past due	4,766	4,018
Total	\$ 5,231	\$ 4,577
Impaired accrual loans:		
Restructured	\$ 3,008	\$ 77
90 days or more past due	27	-
Total	\$ 3,035	\$ 77
Total impaired loans	\$ 8,266	\$ 4,654
Additional commitments to lend	\$ 4	-

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

Impaired loans:	September 30, 2018			Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans	Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:							
Real estate mortgage	\$ 961	\$ 1,774	\$ 73	\$ 733	\$ —	\$ 729	\$ 43
Production and intermediate-term	4,042	4,437	208	3,082	1	3,066	183
Farm-related business	228	253	89	174	—	173	10
Total	\$ 5,231	\$ 6,464	\$ 370	\$ 3,989	\$ 1	\$ 3,968	\$ 236
With no related allowance for credit losses:							
Real estate mortgage	\$ 1,869	\$ 1,886	\$ —	\$ 1,425	\$ 1	\$ 1,417	\$ 85
Production and intermediate-term	1,166	1,224	—	890	—	885	52
Farm-related business	—	—	—	—	—	—	—
Total	\$ 3,035	\$ 3,110	\$ —	\$ 2,315	\$ 1	\$ 2,302	\$ 137
Total:							
Real estate mortgage	\$ 2,830	\$ 3,660	\$ 73	\$ 2,158	\$ 1	\$ 2,146	\$ 128
Production and intermediate-term	5,208	5,661	208	3,972	1	3,951	235
Farm-related business	228	253	89	174	—	173	10
Total	\$ 8,266	\$ 9,574	\$ 370	\$ 6,304	\$ 2	\$ 6,270	\$ 373

Impaired loans:	December 31, 2017			Year Ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	\$ 992	\$ 1,718	\$ 118	\$ 1,086	\$ 25
Production and intermediate-term	3,460	3,869	186	4,196	—
Farm-related business	202	258	109	201	1
Total	\$ 4,654	\$ 5,845	\$ 413	\$ 5,483	\$ 26
With no related allowance for credit losses:					
Real estate mortgage	\$ —	\$ 48	\$ —	\$ 26	\$ 4
Production and intermediate-term	—	206	—	137	17
Farm-related business	—	—	—	8	354
Total	\$ —	\$ 254	\$ —	\$ 171	\$ 375
Total:					
Real estate mortgage	\$ 992	\$ 1,766	\$ 118	\$ 1,112	\$ 29
Production and intermediate-term	3,460	4,075	186	4,333	17
Farm-related business	202	258	109	209	355
Total	\$ 4,654	\$ 6,099	\$ 413	\$ 5,654	\$ 401

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

	Real Estate Mortgage	Production and Intermediate- term	Agribusiness*	Power and water/waste disposal	Rural Residential Real Estate	Total
Activity related to the allowance for credit losses:						
Balance at June 30, 2018	\$ 2,831	\$ 2,625	\$ 317	\$ 1	\$ 7	\$ 5,781
Charge-offs	—	—	—	—	—	—
Recoveries	—	1	—	—	—	1
Provision for loan losses	354	(93)	(3)	—	4	262
Balance at September 30, 2018	\$ 3,185	\$ 2,533	\$ 314	\$ 1	\$ 11	\$ 6,044
Balance at December 31, 2017	\$ 2,902	\$ 2,705	\$ 326	\$ —	\$ 8	\$ 5,941
Charge-offs	—	—	—	—	—	—
Recoveries	—	3	—	—	—	3
Provision for loan losses	283	(175)	(12)	1	3	100
Balance at September 30, 2018	\$ 3,185	\$ 2,533	\$ 314	\$ 1	\$ 11	\$ 6,044
Balance at June 30, 2017	\$ 2,827	\$ 2,922	\$ 228	\$ —	\$ 9	\$ 5,986
Charge-offs	—	(5)	—	—	—	(5)
Recoveries	—	—	—	—	—	—
Provision for loan losses	116	(24)	25	—	—	117
Balance at September 30, 2017	\$ 2,943	\$ 2,893	\$ 253	\$ —	\$ 9	\$ 6,098
Balance at December 31, 2016	\$ 2,691	\$ 2,824	\$ 269	\$ —	\$ 9	\$ 5,793
Charge-offs	—	(5)	—	—	—	(5)
Recoveries	—	—	6	—	—	6
Provision for loan losses	252	74	(22)	—	—	304
Balance at September 30, 2017	\$ 2,943	\$ 2,893	\$ 253	\$ —	\$ 9	\$ 6,098
Allowance on loans evaluated for impairment:						
Individually	\$ 73	\$ 208	\$ 89	\$ —	\$ —	\$ 370
Collectively	3,112	2,325	225	1	11	5,674
Balance at September 30, 2018	\$ 3,185	\$ 2,533	\$ 314	\$ 1	\$ 11	\$ 6,044
Individually	\$ 118	\$ 186	\$ 109	\$ —	\$ —	\$ 413
Collectively	2,784	2,519	217	—	8	5,528
Balance at December 31, 2017	\$ 2,902	\$ 2,705	\$ 326	\$ —	\$ 8	\$ 5,941
Recorded investment in loans evaluated for impairment:						
Individually	\$ 3,112	\$ 2,328	\$ 225	\$ 2	\$ 7	\$ 5,674
Collectively	226,131	192,733	81,439	668	1,612	502,583
Balance at September 30, 2018	\$ 229,243	\$ 195,061	\$ 81,664	\$ 670	\$ 1,619	\$ 508,257
Individually	\$ 992	\$ 3,437	\$ 225	\$ —	\$ —	\$ 4,654
Collectively	217,316	218,897	70,583	712	1,781	509,289
Balance at December 31, 2017	\$ 218,308	\$ 222,334	\$ 70,808	\$ 712	\$ 1,781	\$ 513,943

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

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

Outstanding Recorded Investment	Three Months Ended September 30, 2018				
	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ —	\$ 1,064	\$ 239	\$ 1,303	
Production and intermediate-term	136	762	239	1,137	
Farm-related business	47	—	—	47	
Total	\$ 183	\$ 1,826	\$ 478	\$ 2,487	
Post-modification:					
Real estate mortgage	\$ —	\$ 1,064	\$ 239	\$ 1,303	\$ —
Production and intermediate-term	136	762	239	1,137	—
Farm-related business	47	—	—	47	—
Total	\$ 183	\$ 1,826	\$ 478	\$ 2,487	\$ —

Nine Months Ended September 30, 2018					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ –	\$ 1,673	\$ 239	\$ 1,912	
Production and intermediate-term	136	768	239	1,143	
Farm-related business	47	–	–	47	
Total	\$ 183	\$ 2,441	\$ 478	\$ 3,102	
Post-modification:					
Real estate mortgage	\$ –	\$ 1,673	\$ 239	\$ 1,912	\$ –
Production and intermediate-term	136	768	239	1,143	–
Farm-related business	47	–	–	47	–
Total	\$ 183	\$ 2,441	\$ 478	\$ 3,102	\$ –

Three Months Ended September 30, 2017					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ 566	\$ –	\$ –	\$ 566	
Production and intermediate-term	–	41	–	41	
Farm-related business	–	–	–	–	
Total	\$ 566	\$ 41	\$ –	\$ 607	
Post-modification:					
Real estate mortgage	\$ 566	\$ –	\$ –	\$ 566	\$ –
Production and intermediate-term	–	41	–	41	–
Farm-related business	–	–	–	–	–
Total	\$ 566	\$ 41	\$ –	\$ 607	\$ –

Nine Months Ended September 30, 2017					
Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
Pre-modification:					
Real estate mortgage	\$ 566	\$ –	\$ –	\$ 566	
Production and intermediate-term	–	41	–	41	
Farm-related business	–	–	–	–	
Total	\$ 566	\$ 41	\$ –	\$ 607	
Post-modification:					
Real estate mortgage	\$ 566	\$ –	\$ –	\$ 566	\$ –
Production and intermediate-term	–	41	–	41	–
Farm-related business	–	–	–	–	–
Total	\$ 566	\$ 41	\$ –	\$ 607	\$ –

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:	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Real estate mortgage	\$ 241	\$ –	\$ 241	\$ –
Production and intermediate-term	161	–	161	–
Total	\$ 402	\$ –	\$ 402	\$ –

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

	Total TDRs		Nonaccrual TDRs	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Real estate mortgage	\$ 2,422	\$ 703	\$ 553	\$ 626
Production and intermediate-term	1,139	–	–	–
Farm-related business	46	–	46	–
Total loans	\$ 3,607	\$ 703	\$ 599	\$ 626
Additional commitments to lend	\$ 4	\$ –		

The following table presents information as of period end:

	<u>September 30, 2018</u>
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	\$ —
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	\$ —

Note 3 — Capital

Please see the 2017 Annual Report to Shareholders, particularly Note 7 *Members' Equity*, for a description of the Association's capitalization policies. The Association's requirement for purchased equities (stock and participation certificates) is presently the legal minimum of 2.0 percent of the loan not to exceed \$1 thousand.

The patronage distribution for 2017 was \$6.271 million and was distributed 100 percent in cash on March 22, 2018. A special mid-year patronage of \$1.848 million was declared in August 2018. A year-end patronage distribution program is also in effect for 2018. The amount of the year-end patronage distribution for 2018 will depend on financial results for the year as a whole and is therefore not known with certainty at this time. However, management estimates that the patronage distribution attributable to the first nine months of 2018 is approximately \$4.291 million.

Management believes it is probable that the 2018 patronage distribution will be paid 100 percent in cash. Therefore, the accompanying consolidated financial statements show an interim accrual at the end of the third quarter of 2018 for patronage refunds payable of \$6.139 million, which includes already declared amounts in 2018. The corresponding interim accrual at the end of the third quarter of 2017 for patronage refunds payable was \$4.103 million (also 100 percent cash).

Note 4 — Fair Value Measurement

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

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

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

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

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

For a complete discussion of the inputs and other assumptions considered in assigning various assets and liabilities to the fair value hierarchy levels, see Note 14, *Disclosures About Fair Value of Financial Instruments* in the 2017 Annual Report to Shareholders.

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

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. 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.

		September 30, 2018				
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements						
Assets:						
Recurring Assets	\$	-	\$	-	\$	-
Liabilities:						
Recurring Liabilities	\$	-	\$	-	\$	-
Nonrecurring Measurements						
Assets:						
Impaired loans	\$	4,861	\$	-	\$	4,861
Other property owned		-		-		-
Nonrecurring Assets	\$	4,861	\$	-	\$	4,861
Other Financial Instruments						
Assets:						
Cash	\$	11	\$	11	\$	-
Loans		494,647		-		505,732
Other Financial Assets	\$	494,658	\$	11	\$	505,743
Liabilities:						
Notes payable to CoBank	\$	413,522	\$	-	\$	410,202
Other Financial Liabilities	\$	413,522	\$	-	\$	410,202
		December 31, 2017				
		Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
Recurring Measurements						
Assets:						
Recurring Assets	\$	-	\$	-	\$	-
Liabilities:						
Recurring Liabilities	\$	-	\$	-	\$	-
Nonrecurring Measurements						
Assets:						
Impaired loans	\$	4,241	\$	-	\$	4,241
Other property owned		-		-		-
Nonrecurring Assets	\$	4,241	\$	-	\$	4,241
Other Financial Instruments						
Assets:						
Cash	\$	13	\$	13	\$	-
Loans		501,748		-		508,349
Other Financial Assets	\$	501,761	\$	13	\$	508,362
Liabilities:						
Notes payable to CoBank	\$	423,158	\$	-	\$	422,552
Other Financial Liabilities	\$	423,158	\$	-	\$	422,552

SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

Inputs to Valuation Techniques

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations. 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	\$ 4,861	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement cost	*
			Comparability adjustments	*

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

Information about Other Financial Instrument Fair Value Measurements

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

Note 5 — Commitments and Contingent Liabilities

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

Note 6 — Subsequent Events

Subsequent to the period ended September 30, 2018, the Association disbursed the special mid-year patronage to eligible members in the amount of \$1.848 million during October 2018.

The Association evaluated all other events and determined there were none requiring additional disclosure through November 8, 2018, which was the date the consolidated financial statements were issued.

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