

AG NEW MEXICO, FARM CREDIT SERVICES, ACA

**2018
Quarterly Report
Third Quarter**



For the Quarter Ended September 30, 2018

REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been prepared 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.



Brett Valentine, Chief Executive Officer

November 9, 2018



Randy Autrey, Chairman, Board of Directors

November 9, 2018



Will Fisher, Chief Financial Officer

November 9, 2018

**AG NEW MEXICO, FARM CREDIT SERVICES, ACA
MANAGEMENT’S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of Ag New Mexico, FCS, ACA, referred to as the association, for the quarter ended September 30, 2018. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2017 Annual Report to Stockholders.

The association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the association’s audit committee.

Significant Events:

For the quarter ended September 30, 2018 moisture and precipitation continued to be a concern as most of New Mexico is considered to be in a moderate to severe drought.

Loan Portfolio:

Total loans outstanding at September 30, 2018, including nonaccrual loans and sales contracts, were \$237,082,317 compared to \$220,352,945 at December 31, 2017, reflecting an increase of 7.6 percent. Nonaccrual loans as a percentage of total loans outstanding were 0.2 percent at September 30, 2018, compared to 0.9 percent at December 31, 2017.

The association recorded \$798 in recoveries and no charge-offs for the quarter ended September 30, 2018, and \$11,370 in recoveries and no charge-offs for the same period in 2017. The association’s allowance for loan losses was 0.2 percent and 0.2 percent of total loans outstanding as of September 30, 2018, and December 31, 2017, respectively.

Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the association’s components and trends of high-risk assets.

	September 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Nonaccrual	\$ 510,083	40.3%	\$ 1,968,203	83.3%
Other property owned, net	756,086	59.7%	394,200	16.7%
Total	\$ 1,266,169	100.0%	\$ 2,362,403	100.0%

Results of Operations:

The association had net income of \$724,103 and \$2,505,376 for the three and nine months ended September 30, 2018, as compared to net income of \$605,328 and \$2,265,114 for the same period in 2017, reflecting an increase of 19.6 and 10.6 percent. Net interest income was \$1,500,907 and \$4,426,542 for the three and nine months ended September 30, 2018, compared to \$1,403,219 and \$4,055,501 for the same period in 2017.

	nine months ended			
	September 30, 2018		September 30, 2017	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 225,886,448	\$ 8,211,534	\$ 209,065,450	\$ 6,759,437
Total interest-earning assets	225,886,448	8,211,534	209,065,450	6,759,437
Interest-bearing liabilities	196,262,835	3,784,992	181,389,843	2,703,936
Impact of capital	<u>\$ 29,623,613</u>		<u>\$ 27,675,607</u>	
Net interest income		<u>\$ 4,426,542</u>		<u>\$ 4,055,501</u>
	2018		2017	
	Average Yield		Average Yield	
Yield on loans	4.86%		4.32%	
Total yield on interest-earning assets	4.86%		4.32%	
Cost of interest-bearing liabilities	2.58%		1.99%	
Interest rate spread	2.28%		2.33%	
Net interest income as a percentage of average earning assets	2.62%		2.59%	

	Nine months ended:		
	September 30, 2018 vs. September 30, 2017		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 543,845	\$ 908,252	\$ 1,452,097
Interest expense	221,705	859,351	1,081,056
Net interest income	<u>\$ 322,140</u>	<u>\$ 48,901</u>	<u>\$ 371,041</u>

Interest income for the three and nine months ended September 30, 2018, increased by \$529,271 and \$1,452,097, or 22.1 and 21.5 percent respectively, from the same period of 2017, primarily due to increase in yields on earning assets and an increase in average loan volume. Interest expense for the three and nine months ended September 30, 2018, increased by \$431,583 and \$1,081,056, or 43.4 and 40.0 percent, from the same period of 2017 due to an increase in interest rates offset by an increase in average debt volume. Average loan volume for the third quarter of 2018 was \$225,886,448, compared to \$209,065,450 for the same period of 2017. The average net interest rate spread on the loan portfolio for the nine months ended September 30, 2018 was 2.28 percent, compared to 2.33 percent for the same period in 2017.

The association's return on average assets for the nine months ended September 30, 2018, was 1.40 percent compared to 1.37 percent for the same period in 2017. The association's return on average equity for the nine months ended September 30, 2018, was 8.38 percent, compared to 8.06 percent for the same period in 2017.

Liquidity and Funding Sources:

The association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the bank), which obtains its funds through the issuance of System-wide obligations and with lendable equity. The following schedule summarizes the association's borrowings.

	September 30, 2018	December 31, 2017
Note payable to the bank	\$ 207,109,462	\$ 190,581,755
Accrued interest on note payable	470,370	352,731
Total	<u>\$ 207,579,832</u>	<u>\$ 190,934,486</u>

The association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2019. The primary source of liquidity and funding for the association is a direct loan from the bank. The outstanding balance of \$207,579,832 as of September 30, 2018, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 2.84 percent at September 30, 2018. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the bank and is governed by the general financing agreement. The increase in note payable to the bank and related accrued interest payable since December 31, 2017, is due to the association's increase in loan volume. The association's own funds, which represent the amount of the association's loan portfolio funded by the association's equity, were \$29,823,468 at September 30, 2018. The maximum amount the association may borrow from the bank as of September 30, 2018, was \$239,636,798 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, which is September 30, 2019, unless sooner terminated by the bank upon the occurrence of an event of default, or by the association, in the event of a breach of this agreement by the bank, upon giving the bank 30 calendar days' prior written notice, or in all other circumstances, upon giving the bank 120 days' prior written notice.

Capital Resources:

The association's capital position increased by \$2,558,070 at September 30, 2018, compared to December 31, 2017. The association's debt as a percentage of members' equity was 5.11:1 as of September 30, 2018, compared to 5.02:1 as of December 31, 2017.

Farm Credit Administration regulations require us to maintain minimums for various regulatory capital ratios. New regulations became effective January 1, 2017, which replaced the previously required core surplus and total surplus ratios with common equity tier 1, tier 1 capital, and total capital risk-based capital ratios. The new regulations also added tier 1 leverage and unallocated retained earnings and equivalents (UREE) ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations. As of September 30, 2018, the association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements:

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Cost." The guidance aligns 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 this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. The guidance also requires an entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. It further specifies where to present expense and payments in the financial statements. Early adoption is permitted. The guidance is to be applied on a retrospective or prospective basis to all implementation costs incurred after the date of adoption. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans." The guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance becomes effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The guidance is to be applied on a retrospective basis for all periods. The adoption of this guidance will not impact the Association's financial condition or its results of operations, but will impact the employee benefit plan disclosures.

In August 2018, the FASB issued guidance entitled "Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement." The guidance modifies the requirements on fair value measurements by removing, modifying or adding to the disclosures. This guidance becomes effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted and an entity is permitted to early adopt any removal or modified disclosures and delay adoption of the additional disclosures

until their effective date. The adoption of this guidance will not impact the Association's financial condition or its results of operations, but will impact the fair value measurements disclosures.

In February 2018, the FASB issued guidance entitled "Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35% to 21%. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In August 2017, the FASB issued guidance entitled "Targeted Improvements to Accounting for Hedging Activities." The guidance better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments in this guidance require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This guidance also addresses the timing of effectiveness testing, qualitative and quantitative effectiveness testing and components that can be excluded from effectiveness testing. This guidance becomes effective for interim and annual periods beginning after December 15, 2018. The Association is evaluating the impact of adoption on the Association's financial condition and its results of operations.

In March 2017, the FASB issued guidance entitled "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This guidance became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association's financial condition but did change the classification of certain items in the results of operations.

In August 2016, the FASB issued guidance entitled "Classification of Certain Cash Receipts and Cash Payments." The guidance 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 became effective for interim and annual periods beginning after December 15, 2017. The adoption of this guidance did not materially impact the Association's financial condition or its results of operations but did change the classification of certain items in the statement of cash flows.

In June 2016, the FASB issued guidance entitled "Measurement of Credit Losses on Financial Instruments." The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled "Leases." The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. In July 2018, the FASB issued an update entitled "Leases – Targeted Improvements," which provides entities with 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. An entity that elects this additional transition method must provide the required disclosures of the now current standard for all prior periods presented. The guidance and related amendments in this update become effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

In January 2016, the FASB issued guidance entitled "Recognition and Measurement of Financial Assets and Liabilities." The guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. 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 did impact the Association's fair value disclosures.

In May 2014, the FASB issued guidance entitled, "Revenue from Contracts with Customers." The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. The guidance sets forth the requirement for new and enhanced disclosures. The Association adopted the new standard-effective January 1, 2018, using the modified retrospective approach. As the majority of the Association's revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial position, results of operations, equity or cash flows.

Relationship with the Farm Credit Bank of Texas:

The association's financial condition may be impacted by factors that affect the bank. The financial condition and results of operations of the bank may materially affect the stockholder's investment in the association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the 2017 Annual Report of Ag New Mexico, FCS, ACA more fully describe the association's relationship with the bank.

The Texas Farm Credit District's (district) annual and quarterly stockholder reports, as well as those of the bank, are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. Copies of the district's quarterly and annual stockholder reports also can be requested by e-mail at fcf@farmcreditbank.com. The annual and quarterly stockholder reports for the bank and the district are also available on its website at www.farmcreditbank.com.

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Ag New Mexico, Farm Credit Services, ACA, 4501 N. Prince St., Clovis, New Mexico 88101 or calling (575) 762-3828. The annual and quarterly stockholder reports for the Association are also available on its website at www.agnewmexico.com. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing will.fisher@farmcreditbank.com.

AG NEW MEXICO, FARM CREDIT SERVICES, ACA

BALANCE SHEET

	September 30, 2018 (unaudited)	December 31, 2017
<u>ASSETS</u>		
Loans	\$ 237,082,317	\$ 220,352,945
Less: allowance for loan losses	508,186	456,645
Net loans	<u>236,574,131</u>	<u>219,896,300</u>
Accrued interest receivable	3,346,955	2,605,952
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	5,139,035	5,139,035
Other	1,450,668	526,369
Deferred taxes, net	333,254	355,449
Other property owned, net	756,086	394,200
Premises and equipment, net	3,068,083	3,043,915
Other assets	545,820	358,164
Total assets	<u><u>\$ 251,214,032</u></u>	<u><u>\$ 232,319,384</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 207,109,462	\$ 190,581,755
Advance conditional payments	451,758	19,470
Accrued interest payable	470,370	352,731
Drafts outstanding	54,141	3,659
Patronage distributions payable	-	532,004
Other liabilities	2,004,891	2,264,425
Total liabilities	<u>210,090,622</u>	<u>193,754,044</u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	464,410	435,635
Unallocated retained earnings	41,001,040	38,495,664
Accumulated other comprehensive income (loss)	<u>(342,040)</u>	<u>(365,959)</u>
Total members' equity	<u>41,123,410</u>	<u>38,565,340</u>
Total liabilities and members' equity	<u><u>\$ 251,214,032</u></u>	<u><u>\$ 232,319,384</u></u>

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

AG NEW MEXICO, FARM CREDIT SERVICES, ACA

STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Quarter Ended September 30,		nine months ended September 30,	
	2018	2017	2018	2017
<u>INTEREST INCOME</u>				
Loans	\$ 2,927,884	\$ 2,398,613	\$ 8,211,534	\$ 6,759,437
Total interest income	<u>2,927,884</u>	<u>2,398,613</u>	<u>8,211,534</u>	<u>6,759,437</u>
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	<u>1,426,977</u>	<u>995,394</u>	<u>3,784,992</u>	<u>2,703,936</u>
Total interest expense	<u>1,426,977</u>	<u>995,394</u>	<u>3,784,992</u>	<u>2,703,936</u>
Net interest income	<u>1,500,907</u>	<u>1,403,219</u>	<u>4,426,542</u>	<u>4,055,501</u>
<u>PROVISION FOR LOAN LOSSES</u>				
	<u>3,623</u>	<u>(68,246)</u>	<u>50,919</u>	<u>(2,828)</u>
Net interest income after provision for loan losses	<u>1,497,284</u>	<u>1,471,465</u>	<u>4,375,623</u>	<u>4,058,329</u>
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	485,126	335,569	1,455,587	1,010,464
Loan fees	49,858	61,391	209,137	204,575
Refunds from Farm Credit System				
Insurance Corporation	-	-	319,682	-
Financially related services income	525	475	1,086	1,474
Gain (loss) on other property owned, net	-	(1,163)	-	14,954
Gain (loss) on sale of premises and equipment, net	18,253	-	18,253	(2,650)
Other noninterest income	31,576	16,208	92,117	1,096,867
Total noninterest income	<u>585,338</u>	<u>412,480</u>	<u>2,095,862</u>	<u>2,325,684</u>
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	794,294	829,048	2,383,830	2,366,130
Directors' expense	44,374	32,379	135,324	124,735
Purchased services	119,982	64,630	349,190	566,111
Travel	81,253	66,083	225,503	192,002
Occupancy and equipment	91,757	75,324	234,113	238,850
Communications	10,540	7,936	35,181	27,210
Advertising	12,290	7,793	28,967	23,255
Public and member relations	45,940	31,216	59,411	52,062
Supervisory and exam expense	18,046	36,199	83,508	127,176
Insurance Fund premiums	39,540	60,046	113,494	175,489
Other noninterest expense	77,402	67,963	294,487	225,879
Total noninterest expenses	<u>1,335,418</u>	<u>1,278,617</u>	<u>3,943,008</u>	<u>4,118,899</u>
Income before income taxes	<u>747,204</u>	<u>605,328</u>	<u>2,528,477</u>	<u>2,265,114</u>
Provision for (benefit from) income taxes	<u>23,101</u>	<u>-</u>	<u>23,101</u>	<u>-</u>
NET INCOME	<u>724,103</u>	<u>605,328</u>	<u>2,505,376</u>	<u>2,265,114</u>
Other comprehensive income:				
Change in postretirement benefit plans	<u>8,577</u>	<u>3,789</u>	<u>23,919</u>	<u>24,161</u>
COMPREHENSIVE INCOME	<u>\$ 732,680</u>	<u>\$ 609,117</u>	<u>\$ 2,529,295</u>	<u>\$ 2,289,275</u>

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

AG NEW MEXICO, FARM CREDIT SERVICES, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY
(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2016	\$ 396,005	\$ 36,401,498	\$ (334,981)	\$ 36,462,522
Comprehensive income	-	2,265,114	24,161	2,289,275
Capital stock/participation certificates and allocated retained earnings issued	73,340	-	-	73,340
Capital stock/participation certificates and allocated retained earnings retired	(42,120)	-	-	(42,120)
Patronage refunds:				
Cash		(45,115)	-	(45,115)
Balance at September 30, 2017	<u>\$ 427,225</u>	<u>\$ 38,621,497</u>	<u>\$ (310,820)</u>	<u>\$ 38,737,902</u>
Balance at December 31, 2017	\$ 435,635	\$ 38,495,664	\$ (365,959)	\$ 38,565,340
Comprehensive income	-	2,505,376	23,919	2,529,295
Capital stock/participation certificates and allocated retained earnings issued	69,345	-	-	69,345
Capital stock/participation certificates and allocated retained earnings retired	(40,570)	-	-	(40,570)
Balance at September 30, 2018	<u>\$ 464,410</u>	<u>\$ 41,001,040</u>	<u>\$ (342,040)</u>	<u>\$ 41,123,410</u>

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

AG NEW MEXICO, FARM CREDIT SERVICES, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

Ag New Mexico, Farm Credit Services, ACA (Agricultural Credit Association), referred to as the association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves all counties in the state of New Mexico with the exception of San Juan County and that portion of Rio Arriba County lying west of the Continental Divide. In addition, the Association and Farm Credit Services of New Mexico, ACA have entered into an agreement that allows the Association to make mortgage loans in New Mexico, on a statewide basis, without obtaining territorial approval. The association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements and should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2017, as contained in the 2017 Annual Report to Stockholders.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP), except for the inclusion of a statement of cash flows. GAAP require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the association has elected not to include a statement of cash flows in these consolidated financial statements. These interim financial statements should be read in conjunction with the audited financial statements as of and for the year ended December 31, 2017, as contained in the 2017 Annual Report to Stockholders. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. Descriptions of the significant accounting policies are included in the 2017 Annual Report to Stockholders. In the opinion of management, these policies and the presentation of the interim financial condition and results of operations conform with GAAP and prevailing practices within the banking industry.

In February 2018, the Financial Accounting Standards Board (FASB) issued guidance entitled “Income Statement — Reporting Comprehensive Income — Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This guidance allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the recently issued tax legislation, Tax Cuts and Jobs Act (TCJA) that lowered the federal corporate tax rate from 35% to 21%. The amount of the reclassification shall include the effect of the change in the tax rate on gross deferred tax amounts and related valuation allowances at the date of enactment of the TCJA related to items remaining in accumulated other comprehensive income. The guidance becomes effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Association is evaluating the impact of adoption on the Association’s financial condition and its results of operations.

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In March 2017, the FASB issued guidance entitled “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost.” The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. Other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. 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 but did change the classification of certain items in the results of operations.

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In June 2016, FASB issued guidance entitled “Measurement of Credit Losses on Financial Instruments.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses. For public business entities that are not U.S. Securities and Exchange Commission filers this guidance becomes effective for interim and annual periods beginning after December 15, 2020, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

In February 2016, the FASB issued guidance entitled “Leases.” The guidance requires the recognition by lessees of lease assets and lease liabilities on the balance sheet for the rights and obligations created by those leases. Leases with lease terms of more than 12 months are impacted by this guidance. This guidance becomes effective for interim and annual periods beginning after December 15, 2018, with early application permitted. The Association is evaluating the impact of adoption on its financial condition and results of operations.

In January 2016, the FASB issued guidance entitled “Recognition and Measurement of Financial Assets and Liabilities.” This guidance affects, among other things, the presentation and disclosure requirements for financial instruments. For public entities, the guidance eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments carried at amortized cost. 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 did impact the Association’s fair value disclosures.

In May 2014, the FASB issued guidance entitled, “Revenue from Contracts with Customers.” The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Financial instruments and other contractual rights within the scope of other guidance issued by the FASB are excluded from the scope of this new revenue recognition guidance. The guidance sets forth the requirement for new and enhanced disclosures. The Association has determined that the effect of the adoption is not material to its financial condition or results of operations and will not change its current recognition practices.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended September 30, 2018, are not necessarily indicative of the results to be expected for the year ended December 31, 2017. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	September 30, 2018 Amount	December 31, 2017 Amount
Production agriculture:		
Real estate mortgage	\$ 96,326,151	\$ 84,314,263
Production and intermediate term	59,315,758	57,164,758
Agribusiness:		
Loans to cooperatives	7,646,749	4,686,861
Processing and marketing	45,746,182	45,896,052
Farm-related business	5,131,548	6,187,405
Communication	2,941,255	2,652,129
Energy	6,227,461	7,531,374
Water and waste water	1,995,031	1,994,398
Rural residential real estate	9,350,342	7,933,931
Lease receivables	2,401,840	1,991,774
Total	\$ 237,082,317	\$ 220,352,945

The association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at September 30, 2018:

	Other Farm Credit Institutions	
	Participations Purchased	Participations Sold
Real estate mortgage	\$ 10,892,194	\$ 19,953,005
Production and intermediate term	9,299,873	13,234,120
Agribusiness	39,672,761	11,033,323
Communication	2,541,255	-
Energy	6,227,461	-
Water and waste water	1,995,031	-
Lease receivables	1,902,683	-
Total	\$ 72,531,258	\$ 44,220,448

The association is authorized under the Farm Credit Act to accept “advance conditional payments” (ACPs) from borrowers. To the extent the borrower’s access to such ACPs is restricted and the legal right of setoff exists, the ACPs are netted against the borrower’s related loan balance. Unrestricted advance conditional payments are included in other liabilities. ACPs are not insured, and interest may be paid by the association on such balances. Balances of ACPs were \$1,669,005 and \$385,324 at September 30, 2018, and December 31, 2017, respectively.

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

	September 30, 2018	December 31, 2017
Nonaccrual loans:		
Real estate mortgage	\$ 402,523	\$ 1,524,216
Production and intermediate term	107,560	443,987
Total nonaccrual loans	510,083	1,968,203
Other property owned	756,086	394,200
Total nonperforming assets	\$ 1,266,169	\$ 2,362,403

One credit quality indicator utilized by the association is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- 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 factors, conditions and values that make collection in full highly questionable; and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	September 30, 2018	December 31, 2017
Real estate mortgage		
Acceptable	94 %	93 %
OAEM	3	4
Substandard/doubtful	3	3
	100	100
Production and intermediate term		
Acceptable	93	93
OAEM	5	5
Substandard/doubtful	2	2
	100	100
Agribusiness		
Acceptable	99	99
OAEM	1	1
	100	100
Energy and water/waste water		
Acceptable	100	100
	100	100
Communication		
Acceptable	100	100
	100	100
Rural residential real estate		
Acceptable	100	100
	100	100
Lease receivables		
Acceptable	100	100
	100	100
Total loans		
Acceptable	96	95
OAEM	3	3
Substandard/doubtful	1	2
	100 %	100 %

The following tables provide an age analysis of past due loans (including accrued interest) as of:

September 30, 2018	30-89 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 and Accruing
Real estate mortgage	\$ 958,417	\$ 402,523	\$ 1,360,940	\$ 96,879,927	\$ 98,240,867	\$ -
Production and intermediate term	1,023,702	107,560	1,131,262	59,199,835	60,331,097	-
Loans to cooperatives	-	-	-	7,660,863	7,660,863	-
Processing and marketing	-	-	-	46,017,537	46,017,537	-
Farm-related business	-	-	-	5,186,954	5,186,954	-
Communication	-	-	-	2,942,475	2,942,475	-
Energy	-	-	-	6,240,501	6,240,501	-
Water and waste water	-	-	-	2,005,253	2,005,253	-
Rural residential real estate	-	-	-	9,386,087	9,386,087	-
Lease receivables	-	-	-	2,417,638	2,417,638	-
Total	\$ 1,982,119	\$ 510,083	\$ 2,492,202	\$ 237,937,070	\$ 240,429,272	\$ -

December 31, 2017	30-89 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 and Accruing
Real estate mortgage	\$ 353,291	\$ 1,524,216	\$ 1,877,507	\$ 83,718,031	\$ 85,595,538	\$ -
Production and intermediate term	489,345	443,987	933,332	57,030,572	57,963,904	-
Loans to cooperatives	-	-	-	4,692,654	4,692,654	-
Processing and marketing	-	-	-	46,263,365	46,263,365	-
Farm-related business	-	-	-	6,243,489	6,243,489	-
Communication	-	-	-	2,653,126	2,653,126	-
Energy	-	-	-	7,563,688	7,563,688	-
Water and waste water	-	-	-	2,024,620	2,024,620	-
Rural residential real estate	108,656	-	108,656	7,849,370	7,958,026	-
Lease receivables	-	-	-	2,000,487	2,000,487	-
Total	\$ 951,292	\$ 1,968,203	\$ 2,919,495	\$ 220,039,402	\$ 222,958,897	\$ -

Note: The recorded investment in the 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.

A restructuring of a debt constitutes a troubled debt restructuring 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. Troubled debt restructurings are undertaken in order to improve the likelihood of recovery on the loan and may include, but are not limited to, forgiveness of principal or interest, interest rate reductions that are lower than the current market rate for new debt with similar risk, or significant term or payment extensions.

As of September 30, 2018, the total recorded investment of troubled debt restructured loans was \$328,873, including \$328,873 classified as nonaccrual and \$0 classified as accrual, with specific allowance for loan losses of \$0. As of September 30, 2018, commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring were \$442,016 at period end and \$93,333 at December 31, 2017.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Real estate mortgage	\$ 317,311	\$ 514,875	\$ 317,311	\$ 514,875
Production and intermediate term	11,562	347,989	11,562	347,989
Total	\$ 328,873	\$ 862,864	\$ 328,873	\$ 862,864

*represents the portion of loans modified as TDRs that are in nonaccrual status

Additional impaired loan information is as follows:

	September 30, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance	Recorded Investment	Unpaid Principal Balance ^a	Related Allowance
Impaired loans with a related allowance for credit losses:						
Production and intermediate term	\$ -	\$ -	\$ -	\$ 94,998	\$ 137,395	\$ 9,400
Total	\$ -	\$ -	\$ -	\$ 94,998	\$ 137,395	\$ 9,400
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 402,523	\$ 402,719	\$ -	\$ 1,524,216	\$ 1,524,412	\$ -
Production and intermediate term	107,560	189,617	-	347,989	398,255	-
Total	\$ 510,083	\$ 592,336	\$ -	\$ 1,872,205	\$ 1,922,667	\$ -
Total impaired loans:						
Real estate mortgage	\$ 402,523	\$ 402,719	\$ -	\$ 1,524,216	\$ 1,524,412	\$ -
Production and intermediate term	107,560	189,617	-	442,987	535,650	9,400
Total	\$ 510,083	\$ 592,336	\$ -	\$ 1,968,203	\$ 2,060,062	\$ 9,400

^a Unpaid principal balance represents the recorded principal balance of the loan.

	For the Three Months Ended				For the Nine Months Ended			
	September 30, 2018		September 30, 2017		September 30, 2018		September 30, 2017	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:								
Production and intermediate term	\$ -	\$ -	\$ 289,017	\$ -	\$ -	\$ -	\$ 665,103	\$ -
Total	\$ -	\$ -	\$ 289,017	\$ -	\$ -	\$ -	\$ 665,103	\$ -
Impaired loans with no related allowance for credit losses:								
Real estate mortgage	\$ 404,668	\$ -	\$1,445,783	\$ 6,521	\$ 492,111	\$ -	\$1,457,026	\$ 18,975
Production and intermediate term	107,560	-	458,134	5,571	218,077	-	449,242	15,424
Total	\$ 512,228	\$ -	\$1,903,917	\$ 12,092	\$ 710,188	\$ -	\$1,906,268	\$ 34,399
Total impaired loans:								
Real estate mortgage	\$ 404,668	\$ -	\$1,445,783	\$ 6,521	\$ 492,111	\$ -	\$1,457,026	\$ 18,975
Production and intermediate term	107,560	-	747,151	5,571	218,077	-	1,114,345	15,424
Total	\$ 512,228	\$ -	\$2,192,934	\$ 12,092	\$ 710,188	\$ -	\$2,571,371	\$ 34,399

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Lease Receivables	Total
Allowance for Credit Losses:								
Balance at June 30, 2018	\$ 126,574	\$ 249,467	\$ 84,002	\$ 6,215	\$ 26,985	\$ 8,470	\$ -	\$ 501,713
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provision for loan losses	910	4,659	604	45	194	61	-	6,473
Other	-	-	-	-	-	-	-	-
Balance at September 30, 2018	<u>\$ 127,484</u>	<u>\$ 254,126</u>	<u>\$ 84,606</u>	<u>\$ 6,260</u>	<u>\$ 27,179</u>	<u>\$ 8,531</u>	<u>\$ -</u>	<u>\$ 508,186</u>
Balance at December 31, 2017	\$ 114,695	\$ 228,073	\$ 76,118	\$ 5,632	\$ 24,452	\$ 7,675	\$ -	\$ 456,645
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	798	-	-	-	-	-	798
Provision for loan losses	12,789	25,431	8,488	628	2,727	856	-	50,919
Other	-	(176)	-	-	-	-	-	(176)
Balance at September 30, 2018	<u>\$ 127,484</u>	<u>\$ 254,126</u>	<u>\$ 84,606</u>	<u>\$ 6,260</u>	<u>\$ 27,179</u>	<u>\$ 8,531</u>	<u>\$ -</u>	<u>\$ 508,186</u>
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	127,484	254,126	84,606	6,260	27,179	8,531	-	508,186
Balance at September 30, 2018	<u>\$ 127,484</u>	<u>\$ 254,126</u>	<u>\$ 84,606</u>	<u>\$ 6,260</u>	<u>\$ 27,179</u>	<u>\$ 8,531</u>	<u>\$ -</u>	<u>\$ 508,186</u>
Balance at June 30, 2017	\$ 181,057	\$ 273,551	\$ 176,673	\$ 13,072	\$ 56,752	\$ 17,814	\$ -	\$ 718,919
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	-	11,370	-	-	-	-	-	11,370
Provision for loan losses	(9,139)	(38,389)	(13,848)	(1,025)	(4,449)	(1,396)	-	(68,246)
Other	-	743	-	-	-	-	-	743
Balance at September 30, 2017	<u>\$ 171,918</u>	<u>\$ 247,275</u>	<u>\$ 162,825</u>	<u>\$ 12,047</u>	<u>\$ 52,303</u>	<u>\$ 16,418</u>	<u>\$ -</u>	<u>\$ 662,786</u>
Balance at December 31, 2016	\$ 107,983	\$ 228,799	\$ 163,621	\$ 12,106	\$ 52,559	\$ 16,498	\$ -	\$ 581,566
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	64,460	11,369	-	-	-	-	-	75,829
Provision for loan losses	(525)	(1,112)	(796)	(59)	(256)	(80)	-	(2,828)
Other	-	8,219	-	-	-	-	-	8,219
Balance at September 30, 2017	<u>\$ 171,918</u>	<u>\$ 247,275</u>	<u>\$ 162,825</u>	<u>\$ 12,047</u>	<u>\$ 52,303</u>	<u>\$ 16,418</u>	<u>\$ -</u>	<u>\$ 662,786</u>
Ending Balance:								
Individually evaluated for impairment	\$ -	\$ 215,704	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 215,704
Collectively evaluated for impairment	171,918	31,571	162,825	12,047	52,303	16,418	-	447,082
Balance at September 30, 2017	<u>\$ 171,918</u>	<u>\$ 247,275</u>	<u>\$ 162,825</u>	<u>\$ 12,047</u>	<u>\$ 52,303</u>	<u>\$ 16,418</u>	<u>\$ -</u>	<u>\$ 662,786</u>

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	Communications	Energy and Water/Waste Water	Rural Residential Real Estate	Lease Receivables	Total
Recorded Investments in Loans Outstanding:								
Ending Balance at								
September 30, 2018	\$98,240,865	\$ 60,331,098	\$ 58,865,355	\$ 2,942,475	\$ 8,245,754	\$9,386,087	\$2,417,638	\$240,429,272
Individually evaluated for impairment	\$ 402,523	\$ 107,560	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 510,083
Collectively evaluated for impairment	\$97,838,342	\$ 60,223,538	\$ 58,865,355	\$ 2,942,475	\$ 8,245,754	\$9,386,087	\$2,417,638	\$239,919,189
Ending Balance at								
September 30, 2017	\$84,767,524	\$ 53,980,100	\$ 55,721,405	\$ 2,674,147	\$ 9,749,524	\$7,520,159	\$2,029,575	\$216,442,434
Individually evaluated for impairment	\$ 1,439,004	\$ 547,820	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,986,824
Collectively evaluated for impairment	\$83,362,316	\$ 53,432,280	\$ 55,721,405	\$ 2,674,147	\$ 9,749,524	\$7,520,159	\$2,029,575	\$214,489,406

NOTE 4 — CAPITAL:

The association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the association's goals and objectives with the board.

Regulatory Capitalization Requirements

Risk-adjusted:	Regulatory Conservation			As of September 30, 2018
	Minimums	Buffer	Total	
Common equity tier 1 ratio	4.50%	2.50%	7.00%	14.59%
Tier 1 capital ratio	6.00%	2.50%	8.50%	14.59%
Total capital ratio	8.00%	2.50%	10.50%	14.82%
Permanent capital ratio	7.00%	0.00%	7.00%	14.62%
Non-risk-adjusted:				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	14.36%
UREE leverage ratio	1.50%	0.00%	1.50%	15.31%

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	39,591,951	39,591,951	39,591,951	39,591,951
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	461,211	461,211	461,211	461,211
Allowance for loan losses and reserve for credit losses subject to certain limitations			536,244	
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	<u>(5,139,035)</u>	<u>(5,139,035)</u>	<u>(5,139,035)</u>	<u>(5,139,035)</u>
	34,914,127	34,914,127	35,450,371	34,914,127
Denominator:				
Risk-adjusted assets excluding allowance	244,381,751	244,381,751	244,381,751	244,381,751
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(5,139,035)	(5,139,035)	(5,139,035)	(5,139,035)
Allowance for loan losses				(501,929)
	<u>239,242,716</u>	<u>239,242,716</u>	<u>239,242,716</u>	<u>238,740,787</u>

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	39,591,951	39,591,951
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	461,211	-
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	<u>(5,139,035)</u>	<u>(2,379,200)</u>
	<u>34,914,127</u>	<u>37,212,751</u>
Denominator:		
Total Assets	249,274,935	249,274,935
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	<u>(6,201,753)</u>	<u>(6,201,753)</u>
	<u>243,073,182</u>	<u>243,073,182</u>

An additional component of equity is accumulated other comprehensive income, which is reported net of taxes, is as follows:

Accum Other Comp Income (Loss)	Before Tax	Deferred Tax	Net of Tax
September 30, 2018			
Nonpension postretirement benefits	\$ (342,946)	\$ 906	\$ (342,040)
Total	<u>\$ (342,946)</u>	<u>\$ 906</u>	<u>\$ (342,040)</u>
September 30, 2017			
Nonpension postretirement benefits	\$ (314,923)	\$ 4,103	\$ (310,820)
Total	<u>\$ (314,923)</u>	<u>\$ 4,103</u>	<u>\$ (310,820)</u>

The association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Consolidated Statement of Comprehensive Income. The following table summarizes the changes in accumulated other comprehensive income (loss) for the nine months ended September 30:

	<u>2018</u>	<u>2017</u>
Accumulated other comprehensive income (loss) at January 1	\$(365,959)	\$(334,981)
Amortization of prior service (credit) costs included in salaries and employee benefits	(8,349)	(11,130)
Amortization of actuarial (gain) loss included in salaries and employee benefits	31,362	31,188
Income tax expense related to items of other comprehensive income	906	4,103
Other comprehensive income (loss), net of tax	<u>23,919</u>	<u>24,161</u>
Accumulated other comprehensive income at September 30	<u>\$(342,040)</u>	<u>\$(310,820)</u>

NOTE 5 — INCOME TAXES:

Ag New Mexico, Farm Credit Services, ACA conducts its business activities through two wholly-owned subsidiaries. Long-term mortgage lending activities are conducted through a wholly-owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are conducted through a wholly-owned PCA subsidiary. The PCA subsidiary and the ACA holding company are subject to income tax. Ag New Mexico, Farm Credit Services, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Ag New Mexico, Farm Credit Services, ACA can exclude from taxable income amounts distributed as qualified patronage dividends in the form of cash, stock or allocated retained earnings. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage dividends. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized.

NOTE 6 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 13 to the 2017 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

<u>September 30, 2018</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>	<u>Total Gains (Losses)</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Assets:					
Loans*	\$ -	\$ -	\$510,083	\$ 510,083	\$ -
Other property owned	-	-	840,096	840,096	-
<u>December 31, 2017</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>	<u>Total Gains (Losses)</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Assets:					
Loans*	\$ -	\$ -	\$ 86,598	\$ 86,598	\$ -
Other property owned	-	-	438,000	438,000	-

*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

Valuation Techniques

As more fully discussed in Note 13 to the 2017 Annual Report to Stockholders, authoritative guidance 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. The following represent a brief summary of the valuation techniques used for the association's assets and liabilities. For a more complete description, see Notes to the 2017 Annual Report to Stockholders.

Assets Held in Nonqualified Benefits Trusts

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

Standby Letters of Credit

The fair value of letters of credit approximate the fees currently charged for similar agreements or the estimated cost to terminate or otherwise settle similar obligations.

Loans Evaluated for Impairment

For certain loans evaluated for impairment under FASB impairment guidance, the fair value is based upon the underlying collateral since the loans are collateral-dependent for which real estate is the collateral. 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. As a result, a majority of these loans have fair value measurements that fall within Level 3 of the fair value hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. The fair value of these loans would fall under Level 2 of the hierarchy if the process uses independent appraisals and other market-based information.

Other Property Owned

Other property owned is generally classified as Level 3 of the fair value hierarchy. The process for measuring the fair value of the other property owned involves the use of independent appraisals and other market-based information. Costs to sell represent transaction costs and are not included as a component of the asset's fair value. As a result, these fair value measurements fall within Level 3 of the hierarchy.

Cash

For cash, the carrying amount is a reasonable estimate of fair value.

Loans

Fair value is estimated by discounting the expected future cash flows using the associations' current interest rates at which similar loans would be made to borrowers with similar credit risk. The discount rates are based on the associations' current loan origination rates as well as management's estimates of credit risk. Management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale and could be less.

For purposes of estimating fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics. Expected future cash flows, primarily based on contractual terms, and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

The fair value of loans in nonaccrual status that are current as to principal and interest is estimated as described above, with appropriately higher interest rates which reflect the uncertainty of continued cash flows. For collateral-dependent impaired loans, it is assumed that collection will result only from the disposition of the underlying collateral.

Commitments to Extend Credit

The fair value of commitments is estimated using the fees currently charged for similar agreements, taking into account the remaining terms of the agreements and the creditworthiness of the counterparties. For fixed-rate loan commitments, estimated fair value also considers the difference between current levels of interest rates and the committed rates.

NOTE 7 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the nine months ended September 30:

	Other Benefits	
	2018	2017
Service cost	\$ 10,758	\$ 8,048
Interest cost	42,156	29,914
Expected return on plan assets	-	-
Amortization of prior service (credits) costs	(8,349)	(7,420)
Amortization of net actuarial (gain) loss	31,362	14,992
Net periodic benefit cost	\$ 75,927	\$ 45,534

The association's liability for the unfunded accumulated obligation for these benefits at September 30, 2018, was \$1,442,726 and is included in "Other Liabilities" in the balance sheet.

The components of net periodic benefit cost other than the service cost component are included in the line item "other components of net periodic postretirement benefit cost" in the income statement.

The structure of the district's defined benefit pension plan is characterized as multiemployer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations). The association recognizes its amortized annual contributions to the plan as an expense. The association previously disclosed in its financial statements for the year ended December 31, 2017, that it expected to contribute \$54,932 to the district's defined benefit pension plan in 2018. As of September 30, 2018, the full annual contribution has been made. The association presently does not anticipate contributing any additional contributions to fund the defined benefit pension plan in 2018.

NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:

The association is involved in various legal proceedings in the normal course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the association.

NOTE 9 — SUBSEQUENT EVENTS:

The association has evaluated subsequent events through November 9, 2018, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of November 9, 2018.