

ALABAMA FARM CREDIT, ACA

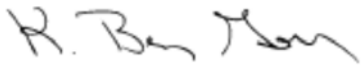
2018 Quarterly Report Second Quarter



For the Quarter Ended June 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.



K. Ben Gore, Chief Executive Officer/President
August 8, 2018



Matthew Christjohn, DVM, Chairman, Board of Directors
August 8, 2018



Karri H. Sumrall, Chief Financial Officer/Ex. Vice President
August 8, 2018



John R. Adams, CPA, Chairman, Audit Committee
August 8, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Alabama Farm Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter ended June 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:

In January 2018, the Association approved a patronage distribution to its stockholders. The Association was able to distribute \$9,000,701 to its members due to strong earnings during 2017. The distribution was made in March 2018.

Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate term loans, and farm-related business loans. These loans are available to eligible borrowers with competitive fixed, adjustable and indexed-based interest rates with loan maturities ranging up to 30 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with seasonal cash-flow capabilities of the borrower.

Total loans outstanding at June 30, 2018, including nonaccrual loans, were \$761,159,237 compared to \$729,419,322 at December 31, 2017, reflecting increase of 4.4 percent. A summary of credit quality at June 30, 2018, compared to December 31, 2017 is as follows:

	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Total loans		
Acceptable	98.5%	98.4%
OAEM	0.7	1.0
Substandard/doubtful	0.8	0.6
	<u>100.0%</u>	<u>100.0%</u>

The Association's largest commodity concentration in its loan portfolio continues to be poultry, which is approximately 44.4 percent or \$338,518,911. The industry is presently stable with market prices for poultry showing positive signs of increased demand for poultry products. Production thus far in 2018 has remained steady to increasing as markets both in the States and overseas continue to show signs of increased demand for poultry meat supplies. Some integrators are offering new grower contracts in order to meet their market demands, as well as, egg and chick placements in Alabama increasing slightly each week. The Association has 34.0 percent of its poultry portfolio guaranteed, which helps to reduce loss exposure in this commodity. The remaining poultry projections for 2018 are that markets will remain relatively stable to improving. This is due primarily to export markets (i.e. Cuba and India) improving, along with higher price meat from hogs and cattle, causing more demand for less expensive poultry. The Association continues to experience some isolated concerns in its portfolio, as evidenced by some due date changes to better match the individual growers' batch sales. Management feels that this loan servicing is due primarily to changes in poultry markets where integrators are adjusting their bird size, as the market dictates, and shifting to more antibiotic-free birds. Management anticipates these concerns will correct themselves with the increased demand for poultry.

Avian Influenza, or bird flu, continues to be a concern to the Association. In 2017, two cases of the highly pathogenic H7 Avian Influenza occurred in Tennessee just north of the Association's territory. Also, three cases of the low pathogenic Avian Influenza occurred in North Alabama within the Association's territory in 2017, including one farm of an Association borrower. In all cases, the birds were destroyed and farms were extensively cleaned and disinfected, along with weekly testing of farms within a 6.2 mile radius of the affected farms. The State Department of Agriculture and Industries, as well as all poultry integrators, enforce mandatory strict biosecurity measures on all farms. Also, the Association has bio security guidelines for poultry farm inspections during high risk conditions. The Association has not encountered any effects of the Avian Influenza thus far in 2018 and will continue to monitor any changes regarding outbreaks and any impact to the loan portfolio on an ongoing basis during the winter months.

Agricultural income has been stable to improving over the past few years, with fairly good growing conditions and commodity prices. Weather conditions thus far in 2018 have seen above average moisture over most of the Association's territory. Cattle producers saw prices decline slightly, but still remain above historical averages. Cattle operations are still profitable, which has resulted in a steady demand for livestock loans.

Poultry farm sales in 2018 indicate there is sufficient demand in the marketplace. Most integrators did very little expansion in 2017 due to an increase in supply and volatility in the export markets. However, as noted above, these expansions have increased in 2018. Feed costs to the integrators have remained at a normal or reasonable level in 2018, due to lower costs for corn and soybeans.

Timber markets for 2018 have improved with industry leaders projecting increasing demand for wood products during 2018. A new pine lumber mill announced for Demopolis, Alabama has commenced production, along with the announcement of Georgia-Pacific to build a new lumber production facility in Talladega, Alabama. These projects have increased demand and has helped prices for pine saw timber within Central and West Central Alabama, along with an increase in demand from overseas markets.

With a favorable lending package and steady demand, the Association has had steady loan growth thus far in 2018. The probability of higher input costs, questions about future commodity supplies and prices, volatility in export markets and unfolding world events, specifically the recent tariffs that President Trump has imposed on China goods, such as steel and aluminum, have caused China to retaliate against some US exports including pork, fruits, nuts, wine and ethanol. This has increased the level of financial risk in the farming sector and, likewise, the level of credit risk to those financial institutions providing credit to that sector. The Association currently does not have any significant concentrations in any of these sectors. Given the conditions outlined herein, and based on the Association's portfolio concentration, the quality of the loan portfolio is expected to remain constant throughout the remainder of 2018.

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.

	June 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Nonaccrual	\$ 4,284,728	60.9%	\$ 2,707,313	43.6%
90 days past due and still accruing interest	88,597	1.3%	-	0.0%
Formally restructured	985,096	14.0%	1,007,403	16.2%
Other property owned, net	1,675,448	23.8%	2,491,876	40.2%
Total	\$ 7,033,869	100.0%	\$ 6,206,592	100.0%

High-risk assets increased by \$827,277, or 13.3 percent, primarily due to the increase in nonaccrual loan volume and loans 90 days past due and still accruing interest offset by a decrease in other property owned, net. Nonaccrual loans as a percentage of total loans outstanding were 0.6 percent at June 30, 2018, compared to 0.4 percent at December 31, 2017. Since December 31, 2017, the Association moved 16 loans totaling \$2,464,952 to nonaccrual status due to delinquency and cash flow issues. Additionally, the Association acquired one property totaling \$171,297 and have written down the value of three properties totaling \$236,041 based on current appraisals or sales contracts executed. The Association had disposed of three properties during the six months ended June 30, 2018. At June 30, 2018, the Association held six properties totaling \$1,675,448, which consisted primarily of approximately 484.5 acres of land. Management continues to be alert to portfolio trends and has attempted to identify and report problem loans as quickly as possible. Management strives to implement proactive steps and allocate resources to work with distressed borrowers to either work through temporary repayment problems or to orderly liquidate collateral to repay the loan when the borrower's operation is no longer viable.

Impaired loans consist of all high-risk assets except other property owned. At June 30, 2018 and December 31, 2017, loans that were considered impaired were \$5,358,421 and \$3,714,716, respectively, representing 0.7 percent and 0.5 percent of total loan volume, respectively. The Association recorded \$1,015 in recoveries and no charge-offs for the quarter ended June 30, 2018, and \$952 in recoveries and no charge-offs for the same period in 2017. The Association recorded \$1,933 in recoveries and \$4,147 in charge-offs for the six months ended June 30, 2018, and \$1,916 in recoveries and no charge-offs for the same period in 2017. The Association's allowance for loan losses was 0.5 percent and 0.5 percent of total loans outstanding as of June 30, 2018, and December 31, 2017, respectively.

Counterparty risk is continually monitored by management of the Association. The Association's primary counterparty risk comes from participation loans and from the poultry integrators to which its borrowers are associated. The Association has participation loans with other Farm Credit Associations and Farm Credit Banks, all of which are currently performing. Additionally, because the Association's portfolio has approximately a 44.4 percent concentration in poultry, it mitigates its inherent risks with poultry and the integrators by heavy utilization of government guarantees. Also, the Association's lending territory has multiple integrators which would minimize the risk of

counterparty failure or lack of performance. Management analyzes the financial position and performance of these integrators by regularly gathering updated financials and other reports that are made available to the public.

As disclosed in the Association's 2017 Annual Report, it is management's assertion that the allowance coverage is adequate based on historical losses, portfolio stress testing, risk analysis, mitigation of losses due to having first lien real estate with minimal price appreciation and having approximately \$124.2 million, or 16.3 percent, of its portfolio government guaranteed at June 30, 2018. Management continuously monitors high-risk assets in an effort to reduce their impact on the Association and will continue to work with all of the Association's high-risk borrowers to receive full payment on the debt. Except for the relationship between installment due date and seasonal cash-flow capabilities of the borrower, the Association is not affected by any seasonal characteristics. The factors affecting the operations of the Association are the same factors that would affect any agricultural lender.

Results of Operations:

The Association had net income of \$3,915,602 and \$8,108,068 for the three and six months ended June 30, 2018, as compared to net income of \$3,460,050 and \$7,165,964 for the same period in 2017, reflecting an increase of 13.2 and 13.1 percent, respectively. Net interest income was \$5,410,407 and \$10,878,747 for the three and six months ended June 30, 2018, compared to \$5,240,878 and \$10,520,137 for the same period in 2017.

	June 30, 2018		Six months ended June 30, 2017	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 743,916,186	\$ 19,246,633	\$ 679,575,025	\$ 17,012,648
Interest-bearing liabilities	645,596,357	8,367,886	586,019,122	6,492,511
Impact of capital	<u>\$ 98,319,829</u>		<u>\$ 93,555,903</u>	
Net interest income		<u>\$ 10,878,747</u>		<u>\$ 10,520,137</u>

	2018 Average Yield	2017 Average Yield
	Yield on loans	5.2%
Total yield on interest-earning assets	5.2%	5.0%
Cost of interest-bearing liabilities	2.6%	2.2%
Interest rate spread	2.6%	2.8%
Net interest income as a percentage of average earning assets	3.0%	3.1%

	Six months ended: June 30, 2018 vs. June 30, 2017		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 1,610,719	\$ 623,266	\$ 2,233,985
Interest expense	660,067	1,215,308	1,875,375
Net interest income	<u>\$ 950,652</u>	<u>\$ (592,042)</u>	<u>\$ 358,610</u>

Net interest income for the three months and six months ended June 30, 2018, increased by \$169,529 and \$358,610, or 3.2 and 3.4 percent, respectively, from the same periods of 2017, primarily due to an increase in average loan volume and interest rates, offset by an increase in average outstanding debt and an increase in cost of funds on the Association's note with the Farm Credit Bank of Texas. Average loan volume for the first six months of 2018 was \$743,916,186, compared to \$679,575,025 for the same period of 2017. The average net interest rate spread on the loan portfolio for the first six months of 2018 was 2.6 percent, compared to 2.8 percent in the same period of 2017.

Noninterest income for the three months and six months ended June 30, 2018 increased by \$260,975 and \$619,831, or 45.9 and 51.8 percent, respectively, as compared to the same periods in 2017. This increase was due primarily to the Association's portion of a refund

from the Farm Credit System Insurance Corporation for the excess reserves held over that of the required two percent of insured obligations of the Farm Credit System secure base amount that was not received in 2017, increases in patronage income, gain on sale of premises and equipment, net, and a reversal of deferred gain due to a change in accounting principle as compared to the same periods in 2017.

Noninterest expenses for the three and six months ended June 30, 2018 increased by \$113,715 and \$220,142, or 5.1 and 5.0 percent, respectively, as compared to the same periods in 2017. The increase was due primarily to increases in salaries and employee benefits and other noninterest expenses. The increases were offset primarily due to decreases in travel, Insurance Fund premiums and loss on other property owned, net. The increase in salaries and employee benefits is due primarily to the additional of several new employees during 2018 to accommodate the growth of the Association. The increase in other noninterest expense is primarily due to timing of expenses incurred and increased costs of training and examination fees as compared to the same period in the prior year. The decrease in travel is primarily due to decrease in travel for Association employees and a decrease in overall costs compared to the prior year. The decrease in Insurance Fund premiums was due to a rate decrease by Farm Credit System Insurance Corporation. The decrease in loss on other property owned, net is due to the decrease in expenses and write-downs of properties due to updated appraisals or sales contracts as compared to the same periods in 2017.

The Association's annualized return on average assets for the six months ended June 30, 2018, was 2.1 percent compared to 2.1 percent for the same period in 2017. The Association's annualized return on average equity for the six months ended June 30, 2018, was 14.3 percent, compared to 13.4 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.

	June 30, 2018	December 31, 2017
Note payable to the bank	\$ 661,913,503	\$ 627,339,627
Accrued interest on note payable	1,486,402	1,299,309
Total	\$ 663,399,905	\$ 628,638,936

The Association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2020. The primary source of liquidity and funding for the Association is a direct loan from the bank. The outstanding balance of \$661,913,503 as of June 30, 2018, is recorded as a liability on the Association's balance sheet. The note carried a weighted average interest rate of 2.7 percent at June 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 loan portfolio as a result of increased loan demand in its 27 county territory and increase in capital market loans. The Association's own funds, which represent the amount of the Association's loan portfolio funded by the Association's equity, were \$99,893,308 at June 30, 2018. The maximum amount the Association may borrow from the bank as of June 30, 2018, was \$830,000,000 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, 2020, 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 \$8,178,836 at June 30, 2018, compared to December 31, 2017. The Association's debt as a percentage of members' equity was 5.7:1 as of June 30, 2018, compared to 5.8:1 as of December 31, 2017.

Risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of June 30, 2018
Common equity tier 1 ratio	4.5%	2.5%	7.0%	15.4%
Tier 1 capital ratio	6.0%	2.5%	8.5%	15.4%
Total capital ratio	8.0%	2.5%	10.5%	15.9%
Permanent capital ratio	7.0%	0.0%	7.0%	15.5%

Non-risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of June 30, 2018
Tier 1 leverage ratio	4.0%	1.0%	5.0%	13.7%
UREE leverage ratio	1.5%	0.0%	1.5%	14.9%

Risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of December 31, 2017
Common equity tier 1 ratio	4.5%	2.5%	7.0%	16.0%
Tier 1 capital ratio	6.0%	2.5%	8.5%	16.0%
Total capital ratio	8.0%	2.5%	10.5%	16.6%
Permanent capital ratio	7.0%	0.0%	7.0%	16.1%

Non-risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of December 31, 2017
Tier 1 leverage ratio	4.0%	1.0%	5.0%	14.2%
UREE leverage ratio	1.5%	0.0%	1.5%	15.4%

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 June 30, 2018, the Association exceeded all regulatory capital requirements.

Significant Recent Accounting Pronouncements:

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 percent to 21 percent. 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 adoption of this guidance did not impact the Association’s financial condition and 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 does not currently participate in hedging activities therefore there is no 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 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.

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 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 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. 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.” 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. The adoption of this guidance did not impact the Association’s financial condition or its results of operations.

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 Association New Model 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 fcdb@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 Alabama Farm Credit, ACA, P.O. Box 639, Cullman, Alabama 35056 or calling (256) 737-7128. Copies can also be requested by emailing karri.sumrall@alabamafarmcredit.com or can be obtained on its website at www.alabamafarmcredit.com 75 days after the fiscal year end. Copies of the Association’s annual stockholders report can also be requested 90 days after year end.

ALABAMA FARM CREDIT, ACA

CONSOLIDATED BALANCE SHEET

	June 30, 2018 (unaudited)	December 31, 2017
<u>ASSETS</u>		
Cash	\$ 8,945	\$ 339,393
Loans	761,159,237	729,419,322
Less: allowance for loan losses	<u>3,718,000</u>	<u>3,778,000</u>
Net loans	757,441,237	725,641,322
Accrued interest receivable	8,966,041	7,538,556
Investment in and receivable from the Farm Credit Bank of Texas:		
Capital stock	11,970,985	11,970,985
Other	1,348,153	547,617
Other property owned, net	1,675,448	2,491,876
Premises and equipment, net	4,194,719	4,081,885
Other assets	<u>1,304,306</u>	<u>949,182</u>
Total assets	<u><u>\$ 786,909,834</u></u>	<u><u>\$ 753,560,816</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 661,913,503	\$ 627,339,627
Accrued interest payable	1,486,402	1,299,309
Drafts outstanding	1,626,540	1,145,124
Patronage distributions payable	1,872	9,001,174
Other liabilities	<u>3,565,015</u>	<u>4,637,916</u>
Total liabilities	<u><u>668,593,332</u></u>	<u><u>643,423,150</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	2,752,635	2,687,255
Unallocated retained earnings	116,064,786	107,956,718
Accumulated other comprehensive loss	<u>(500,919)</u>	<u>(506,307)</u>
Total members' equity	<u>118,316,502</u>	<u>110,137,666</u>
Total liabilities and members' equity	<u><u>\$ 786,909,834</u></u>	<u><u>\$ 753,560,816</u></u>

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

ALABAMA FARM CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
<u>INTEREST INCOME</u>				
Loans	\$ 9,804,842	\$ 8,609,610	\$ 19,246,633	\$ 17,012,648
<u>INTEREST EXPENSE</u>				
Note payable to the Farm Credit Bank of Texas	4,394,435	3,368,732	8,367,886	6,492,511
Net interest income	5,410,407	5,240,878	10,878,747	10,520,137
<u>(REVERSAL OF) PROVISION FOR LOAN LOSSES</u>				
Net interest income after provision for loan losses	5,441,422	5,133,130	10,942,668	10,400,253
<u>NONINTEREST INCOME</u>				
Income from the Farm Credit Bank of Texas:				
Patronage income	575,108	515,406	1,118,110	1,000,517
Loan fees	80,533	49,138	151,498	106,374
Financially related services income	2,905	3,906	6,639	8,350
Gain on other property owned, net	152,515	-	149,541	-
Gain on sale of premises and equipment, net	18,564	150	51,007	225
Other noninterest income	-	50	339,050	80,548
Total noninterest income	829,625	568,650	1,815,845	1,196,014
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	1,339,377	1,136,468	2,729,378	2,374,861
Directors' expense	84,405	104,373	178,106	180,997
Purchased services	119,288	103,556	215,008	218,304
Travel	127,134	193,695	215,962	268,645
Occupancy and equipment	129,864	113,564	241,537	231,924
Communications	73,753	44,514	121,424	84,979
Advertising	91,707	103,642	150,829	172,694
Public and member relations	51,669	71,236	118,775	147,212
Supervisory and exam expense	49,854	46,670	110,375	103,567
Insurance Fund premiums	113,034	167,789	222,749	331,813
Business insurance	18,674	11,947	105,773	89,972
Loss on other property owned, net	-	57,698	-	85,569
Other components of net periodic postretirement benefit cost	24,109	14,813	48,217	29,627
Other noninterest expense	132,577	71,765	192,312	110,139
Total noninterest expenses	2,355,445	2,241,730	4,650,445	4,430,303
NET INCOME	3,915,602	3,460,050	8,108,068	7,165,964
Other comprehensive income (loss):				
Change in postretirement benefit plans	2,694	(5,502)	5,388	(11,004)
COMPREHENSIVE INCOME	\$ 3,918,296	\$ 3,454,548	\$ 8,113,456	\$ 7,154,960

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

ALABAMA FARM CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY
(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2016	\$ 2,518,190	\$ 101,909,008	\$ (164,098)	\$ 104,263,100
Comprehensive income	-	7,165,964	(11,004)	\$ 7,154,960
Capital stock/participation certificates issued	208,440	-	-	208,440
Capital stock/participation certificates retired	(137,040)	-	-	(137,040)
Balance at June 30, 2017	<u>\$ 2,589,590</u>	<u>\$ 109,074,972</u>	<u>\$ (175,102)</u>	<u>\$ 111,489,460</u>
Balance at December 31, 2017	\$ 2,687,255	\$ 107,956,718	\$ (506,307)	\$ 110,137,666
Comprehensive income	-	8,108,068	5,388	8,113,456
Capital stock/participation certificates issued	228,795	-	-	228,795
Capital stock/participation certificates retired	(163,415)	-	-	(163,415)
Balance at June 30, 2018	<u>\$ 2,752,635</u>	<u>\$ 116,064,786</u>	<u>\$ (500,919)</u>	<u>\$ 118,316,502</u>

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

ASSOCIATION NEW MODEL
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Alabama Farm Credit, 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 the counties of Blount, Calhoun, Cherokee, Clay, Cleburne, Colbert, Cullman, DeKalb, Etowah, Fayette, Franklin, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Limestone, Madison, Marion, Marshall, Morgan, Randolph, Shelby, St. Clair, Talladega, Walker and Winston in the state of Alabama. 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 percent to 21 percent. 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 adoption of this guidance did not impact the Association’s financial condition and results of operations.

In August 2017, the Financial Accounting Standards Board (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 does not currently participate in hedging activities therefore there is no 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 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.

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued):

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 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 change the classification of certain items in the statement of cash flows.

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 six months ended June 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	June 30, 2018	December 31, 2017
	Amount	Amount
Production agriculture:		
Real estate mortgage	\$ 631,774,214	\$ 619,995,606
Production and intermediate term	80,382,177	70,227,903
Agribusiness:		
Processing and marketing	31,416,840	25,616,273
Farm-related business	1,389,323	949,469
Rural residential real estate	13,939,172	12,630,071
Communication	2,072,188	-
Energy	185,323	-
Total	\$ 761,159,237	\$ 729,419,322

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):

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 June 30, 2018:

	<u>Other Farm Credit Institutions</u>		<u>Non-Farm Credit Institutions</u>		<u>Total</u>	
	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>	<u>Participations</u>
	<u>Purchased</u>	<u>Sold</u>	<u>Purchased</u>	<u>Sold</u>	<u>Purchased</u>	<u>Sold</u>
Agribusiness	\$ 31,256,729	\$ -	\$ -	\$ -	\$ 31,256,729	\$ -
Production and intermediate term	5,053,846	-	-	-	5,053,846	-
Communication	2,072,188	-	-	-	2,072,188	-
Energy	185,323	-	-	-	185,323	-
Total	<u>\$ 38,568,086</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 38,568,086</u>	<u>\$ -</u>

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 is generally paid by the Association on such balances. Balances of ACPs were \$32,935,139 and \$23,831,046 at June 30, 2018, and December 31, 2017, respectively.

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

	<u>June 30,</u> <u>2018</u>	<u>December 31,</u> <u>2017</u>
Nonaccrual loans:		
Real estate mortgage	\$ 4,005,577	\$ 2,675,292
Production and intermediate term	279,151	32,021
Total nonaccrual loans	<u>4,284,728</u>	<u>2,707,313</u>
Accruing restructured loans:		
Real estate mortgage	985,096	1,007,403
Total accruing restructured loans	<u>985,096</u>	<u>1,007,403</u>
Accruing loans 90 days or more past due:		
Production and intermediate term	88,597	-
Total accruing loans 90 days or more past due	<u>88,597</u>	<u>-</u>
Total nonperforming loans	<u>5,358,421</u>	<u>3,714,716</u>
Other property owned	<u>1,675,448</u>	<u>2,491,876</u>
Total nonperforming assets	<u>\$ 7,033,869</u>	<u>\$ 6,206,592</u>

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.

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):

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:

	June 30, 2018	December 31, 2017
Real estate mortgage		
Acceptable	98.2%	98.3%
OAEM	0.8	1.0
Substandard/doubtful	1.0	0.7
	100.0	100.0
Production and intermediate term		
Acceptable	99.5	99.1
OAEM	0.2	0.8
Substandard/doubtful	0.3	0.1
	100.0	100.0
Agribusiness		
Acceptable	100.0	-
OAEM	-	-
Substandard/doubtful	-	-
	100.0	-
Energy and water/waste water		
Acceptable	100.0	-
OAEM	-	-
Substandard/doubtful	-	-
	100.0	-
Communication		
Acceptable	100.0	-
OAEM	-	-
Substandard/doubtful	-	-
	100.0	-
Rural residential real estate		
Acceptable	98.8	100.0
OAEM	1.2	-
Substandard/doubtful	-	-
	100.0	100.0
Total loans		
Acceptable	98.5	98.4
OAEM	0.7	1.0
Substandard/doubtful	0.8	0.6
	100.0%	100.0%

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):

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

June 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	\$ 4,937,576	\$ 1,123,774	\$ 6,061,350	\$ 633,317,450	\$ 639,378,800	\$ -
Production and intermediate term	488,495	321,280	809,775	80,850,884	81,660,659	88,597
Processing and marketing	-	-	-	31,453,856	31,453,856	-
Farm-related business	-	-	-	1,392,950	1,392,950	-
Communication	-	-	-	2,072,661	2,072,661	-
Energy	-	-	-	185,804	185,804	-
Rural residential real estate	547,815	-	547,815	13,441,557	13,989,372	-
Total	\$ 5,973,886	\$ 1,445,054	\$ 7,418,940	\$ 762,715,162	\$ 770,134,102	\$ 88,597

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	\$ 5,314,383	\$ 842,421	\$ 6,156,804	\$ 620,417,696	\$ 626,574,500	\$ -
Production and intermediate term	154,573	4,147	158,720	70,966,247	71,124,967	-
Processing and marketing	-	-	-	25,640,420	25,640,420	-
Farm-related business	-	-	-	950,911	950,911	-
Communication	-	-	-	-	-	-
Energy	-	-	-	-	-	-
Rural residential real estate	-	-	-	12,667,080	12,667,080	-
Total	\$ 5,468,956	\$ 846,568	\$ 6,315,524	\$ 730,642,354	\$ 736,957,878	\$ -

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 June 30, 2018, the total recorded investment of troubled debt restructured loans was \$977,022, all of which is classified as accrual. Troubled debt restructurings are analyzed for allowance for loan losses using the specific analysis method. No specific allowance for loan losses were recorded for troubled debt restructurings as of June 30, 2018. There were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring at June 30, 2018 or December 31, 2017.

In restructurings where principal is forgiven, the amount of the forgiveness is immediately charged off. In restructurings where accrued interest is forgiven, the interest is reversed (if current year interest) or charged off (if prior year interest). There were no troubled debt restructurings during the six months ended June 30, 2018.

The predominant form of concession granted for troubled debt restructuring includes the extension of terms due to cash flow constrictions enabling the borrower to fund the original payment amount. At times, these terms might be offset with incremental payments, collateral or new borrower guarantees, in which case we assess all of the modified terms to determine if the overall modification qualifies as a troubled debt restructuring.

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	
	June 30, 2018	December 31, 2017
Real estate mortgage	\$ 985,096	\$ 1,007,403
Total	\$ 985,096	\$ 1,007,403

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):

Additional impaired loan information is as follows:

	June 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:						
Real estate mortgage	\$ 714,084	\$ 721,155	\$ 53,660	\$ 506,268	\$ 506,268	\$ 18,903
Production and intermediate term	40,180	40,279	40,134	32,021	32,136	31,037
Total	\$ 754,264	\$ 761,434	\$ 93,794	\$ 538,289	\$ 538,404	\$ 49,940
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$ 4,268,515	\$ 4,278,641	\$ -	\$ 3,168,044	\$ 3,178,177	\$ -
Production and intermediate term	325,355	325,355	-	-	-	-
Total	\$ 4,593,870	\$ 4,603,996	\$ -	\$ 3,168,044	\$ 3,178,177	\$ -
Total impaired loans:						
Real estate mortgage	\$ 4,982,599	\$ 4,999,796	\$ 53,660	\$ 3,674,312	\$ 3,684,445	\$ 18,903
Production and intermediate term	365,535	365,634	40,134	32,021	32,136	31,037
Total	\$ 5,348,134	\$ 5,365,430	\$ 93,794	\$ 3,706,333	\$ 3,716,581	\$ 49,940

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

	For the Three Months Ended			
	June 30, 2018		June 30, 2017	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$ 508,815	\$ -	\$ 296,809	\$ -
Production and intermediate term	27,873	-	4,147	-
Total	\$ 536,688	\$ -	\$ 300,956	\$ -
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$4,087,968	\$ 19,424	\$ 3,502,577	\$ 8,217
Production and intermediate term	280,468	2,005	-	-
Rural residential real estate	-	-	-	-
Total	\$4,368,436	\$ 21,429	\$ 3,502,577	\$ 8,217
Total impaired loans:				
Real estate mortgage	\$4,596,783	\$ 19,424	\$ 3,799,386	\$ 8,217
Production and intermediate term	308,341	2,005	4,147	-
Rural residential real estate	-	-	-	-
Total	\$4,905,124	\$ 21,429	\$ 3,803,533	\$ 8,217

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):

	For the Six Months Ended			
	June 30, 2018		June 30, 2017	
	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$ 212,743	\$ -	\$ 148,405	\$ -
Production and intermediate term	11,149	-	4,147	-
Total	<u>\$ 223,892</u>	<u>\$ -</u>	<u>\$ 152,552</u>	<u>\$ 152,552</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$2,823,673	\$ 49,610	\$ 3,376,275	\$ 32,891
Production and intermediate term	57,080	3,509	-	-
Rural residential real estate	-	-	738	-
Total	<u>\$2,880,753</u>	<u>\$ 53,119</u>	<u>\$ 3,377,013</u>	<u>\$ 32,891</u>
Total impaired loans:				
Real estate mortgage	\$3,036,416	\$ 49,610	\$ 3,524,680	\$ 32,891
Production and intermediate term	68,229	3,509	4,147	-
Rural residential real estate	-	-	738	-
Total	<u>\$3,104,645</u>	<u>\$ 53,119</u>	<u>\$ 3,529,565</u>	<u>\$ 32,891</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	Total
Allowance for Credit Losses:							
Balance at March 31, 2018	\$ 3,554,461	\$ 123,900	\$ 50,881	\$ 1,833	\$ -	\$ 10,925	\$ 3,742,000
Charge-offs	-	-	-	-	-	-	-
Recoveries	1,015	-	-	-	-	-	1,015
Provision for loan losses	(42,086)	23,695	(12,952)	(5)	(80)	413	(31,015)
Other	1,339	(5,754)	10,269	-	113	33	6,000
Balance at June 30, 2018	<u>\$ 3,514,729</u>	<u>\$ 141,841</u>	<u>\$ 48,198</u>	<u>\$ 1,828</u>	<u>\$ 33</u>	<u>\$ 11,371</u>	<u>\$ 3,718,000</u>
Balance at December 31, 2017	\$ 3,581,175	\$ 145,525	\$ 37,427	\$ 2,226	\$ -	\$ 11,647	\$ 3,778,000
Charge-offs	(4,012)	-	-	-	-	-	(4,012)
Recoveries	1,933	-	-	-	-	-	1,933
Provision for loan losses	(65,706)	2,070	502	(398)	(80)	(309)	(63,921)
Other	1,339	(5,754)	10,269	-	113	33	6,000
Balance at June 30, 2018	<u>\$ 3,514,729</u>	<u>\$ 141,841</u>	<u>\$ 48,198</u>	<u>\$ 1,828</u>	<u>\$ 33</u>	<u>\$ 11,371</u>	<u>\$ 3,718,000</u>
Ending Balance:							
Individually evaluated for impairment	\$ 53,660	\$ 40,134	\$ -	\$ -	\$ -	\$ -	\$ 93,794
Collectively evaluated for impairment	3,461,069	101,707	48,198	1,828	33	11,371	3,624,206
Balance at June 30, 2018	<u>\$ 3,514,729</u>	<u>\$ 141,841</u>	<u>\$ 48,198</u>	<u>\$ 1,828</u>	<u>\$ 33</u>	<u>\$ 11,371</u>	<u>\$ 3,718,000</u>

NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES (continued):

Balance at								
March 31, 2017	\$ 3,589,912	\$ 81,225	\$ 29,049	\$ 2,441	\$ -	\$ 8,873	\$ 3,711,500	
Recoveries	952	-	-	-	-	-	952	
Provision for loan losses	67,898	39,179	1,414	(6)	(1,663)	926	107,748	
Other	(1,590)	(24,451)	(2,908)	-	1,679	270	(27,000)	
Balance at								
June 30, 2017	<u>\$ 3,657,172</u>	<u>\$ 95,953</u>	<u>\$ 27,555</u>	<u>\$ 2,435</u>	<u>\$ 16</u>	<u>\$ 10,069</u>	<u>\$ 3,793,200</u>	
Balance at								
December 31, 2016	\$ 3,602,704	\$ 56,603	\$ 27,088	\$ 2,450	\$ 313	\$ 9,241	\$ 3,698,399	
Recoveries	1,916	-	-	-	-	-	1,916	
Provision for loan losses	54,142	63,801	3,375	(15)	(1,976)	558	119,885	
Other	(1,590)	(24,451)	(2,908)	-	1,679	270	(27,000)	
Balance at								
June 30, 2017	<u>\$ 3,657,172</u>	<u>\$ 95,953</u>	<u>\$ 27,555</u>	<u>\$ 2,435</u>	<u>\$ 16</u>	<u>\$ 10,069</u>	<u>\$ 3,793,200</u>	
Ending Balance:								
Individually evaluated for impairment	\$ 1,850	\$ 4,147	\$ -	\$ -	\$ -	\$ -	\$ 5,997	
Collectively evaluated for impairment	<u>3,655,322</u>	<u>91,806</u>	<u>27,555</u>	<u>2,435</u>	<u>16</u>	<u>10,069</u>	<u>3,787,203</u>	
Balance at								
June 30, 2017	<u>\$ 3,657,172</u>	<u>\$ 95,953</u>	<u>\$ 27,555</u>	<u>\$ 2,435</u>	<u>\$ 16</u>	<u>\$ 10,069</u>	<u>\$ 3,793,200</u>	
	Real Estate	Production and			Energy and	Rural		
	Mortgage	Intermediate	Agribusiness	Communications	Water/Waste	Residential	Total	
		Term			Water	Real Estate		
Recorded Investments								
in Loans Outstanding:								
Ending Balance at								
June 30, 2018	<u>\$ 639,369,976</u>	<u>\$ 81,660,659</u>	<u>\$ 32,846,806</u>	<u>\$ 2,072,661</u>	<u>\$ 185,804</u>	<u>\$ 13,989,372</u>	<u>\$ 770,125,278</u>	
Individually evaluated for impairment	<u>\$ 4,990,673</u>	<u>\$ 367,748</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,358,421</u>	
Collectively evaluated for impairment	<u>\$ 634,379,303</u>	<u>\$ 81,292,911</u>	<u>\$ 32,846,806</u>	<u>\$ 2,072,661</u>	<u>\$ 185,804</u>	<u>\$ 13,989,372</u>	<u>\$ 764,766,857</u>	
Ending Balance at								
June 30, 2017	<u>\$ 608,408,628</u>	<u>\$ 63,526,393</u>	<u>\$ 23,309,033</u>	<u>\$ 1,974,692</u>	<u>\$ 62,195</u>	<u>\$ 11,774,449</u>	<u>\$ 709,055,390</u>	
Individually evaluated for impairment	<u>\$ 332,673</u>	<u>\$ 4,147</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 336,820</u>	
Collectively evaluated for impairment	<u>\$ 608,075,953</u>	<u>\$ 63,522,246</u>	<u>\$ 23,309,034</u>	<u>\$ 1,974,692</u>	<u>\$ 62,195</u>	<u>\$ 11,774,449</u>	<u>\$ 708,718,569</u>	

NOTE 3 — 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.

NOTE 3 — CAPITAL (continued):**Regulatory Capitalization Requirements**

Below are the capital ratios as of June 30, 2018 and December 31, 2017, respectively:

Risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of June 30, 2018
Common equity tier 1 ratio	4.5%	2.5%	7.0%	15.4%
Tier 1 capital ratio	6.0%	2.5%	8.5%	15.4%
Total capital ratio	8.0%	2.5%	10.5%	15.9%
Permanent capital ratio	7.0%	0.0%	7.0%	15.5%
Non-risk-adjusted:				
Tier 1 leverage ratio	4.0%	1.0%	5.0%	13.7%
UREE leverage ratio	1.5%	0.0%	1.5%	14.9%
Risk-adjusted:	Regulatory Minimums	Conservation Buffer	Total	As of December 31, 2017
Common equity tier 1 ratio	4.5%	2.5%	7.0%	16.0%
Tier 1 capital ratio	6.0%	2.5%	8.5%	16.0%
Total capital ratio	8.0%	2.5%	10.5%	16.6%
Permanent capital ratio	7.0%	0.0%	7.0%	16.1%
Non-risk-adjusted:				
Tier 1 leverage ratio	4.0%	1.0%	5.0%	14.2%
UREE leverage ratio	1.5%	0.0%	1.5%	15.4%

Risk-adjusted assets have been defined by FCA regulations as the Statement of Condition assets and off-balance-sheet commitments adjusted by various percentages, depending on the level of risk inherent in the various types of assets. The primary changes which generally have the impact of increasing risk-adjusted assets (decreasing risk-based regulatory capital ratios) were as follows:

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

Risk-adjusted assets is calculated differently for the permanent capital ratio (referred herein as PCR risk-adjusted assets) compared to the other risk-based capital ratios. The primary difference is the deduction of the allowance for loan losses from risk-adjusted assets for the permanent capital ratio.

The ratios are based on a three-month average daily balance in accordance with FCA regulations and are calculated as follows:

- Common equity tier 1 ratio is statutory minimum purchased borrower stock, other required borrower stock held for a minimum of seven years, allocated equities held for a minimum of seven years or not subject to revolving, unallocated retained earnings, paid-in capital, less certain regulatory required deductions including the amount of allocated investments in other System institutions, and the amount of purchased investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Tier 1 capital ratio is common equity tier 1 plus non-cumulative perpetual preferred stock, divided by average risk-adjusted assets.
- Total capital is tier 1 capital plus other required borrower stock held for a minimum of five years, allocated equities held for a minimum of five years, subordinated debt and limited-life preferred stock greater than five years to maturity at issuance subject to certain limitations, allowance and reserve for credit losses under certain limitations less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.

NOTE 3 — CAPITAL (continued):

- Permanent capital ratio (PCR) is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt and preferred subject to certain limitations, less certain allocated and purchased investments in other System institutions, divided by PCR risk-adjusted assets.
- Tier 1 leverage ratio is tier 1 capital, including regulatory deductions, divided by average assets less regulatory deductions subject to tier 1 capital.
- UREE leverage ratio is unallocated retained earnings, paid-in capital, allocated surplus not subject to revolvement less certain regulatory required deductions including the amount of allocated investments in other System institutions divided by average assets less regulatory deductions subject to tier 1 capital.

If the capital ratios fall below the minimum regulatory requirements, including the capital conservation and leverage buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary bonus payments to senior officers are restricted or prohibited without prior FCA approval.

Calculations of the June 30, 2018 and December 31, 2017, respectively, risk-adjusted capital ratios are included in the following table:

June 30, 2018:

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 113,689	\$ 113,689	\$ 113,689	\$ 113,689
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,724	2,724	2,724	2,724
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	3,796	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(11,971)	(11,971)	(11,971)	(11,971)
	<u>\$ 104,442</u>	<u>\$ 104,442</u>	<u>\$ 108,238</u>	<u>\$ 104,442</u>
Denominator:				
Risk-adjusted assets excluding allowance	\$ 691,374	\$ 691,374	\$ 691,374	\$ 691,374
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(11,971)	(11,971)	(11,971)	(11,971)
Allowance for loan losses	-	-	-	(3,742)
	<u>\$ 679,403</u>	<u>\$ 679,403</u>	<u>\$ 679,403</u>	<u>\$ 675,661</u>

December 31, 2017:

(dollars in thousands)	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	\$ 113,352	\$ 113,352	\$ 113,352	\$ 113,352
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	2,666	2,666	2,666	2,666
Allowance for loan losses and reserve for credit losses subject to certain limitations	-	-	3,879	-
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(11,177)	(11,177)	(11,177)	(11,177)
	<u>\$ 104,841</u>	<u>\$ 104,841</u>	<u>\$ 108,720</u>	<u>\$ 104,841</u>
Denominator:				
Risk-adjusted assets excluding allowance	\$ 665,598	\$ 665,598	\$ 665,598	\$ 665,598
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(11,177)	(11,177)	(11,177)	(11,177)
Allowance for loan losses	-	-	-	(3,820)
	<u>\$ 654,421</u>	<u>\$ 654,421</u>	<u>\$ 654,421</u>	<u>\$ 650,601</u>

NOTE 3 — CAPITAL (continued):

Calculations of the June 30, 2018 and December 31, 2017, respectively, non-risk adjusted capital ratios are included in the following table:

June 30, 2018:

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 113,689	\$ 113,689
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,734	-
Allowance for loan losses and reserve for credit losses subject to certain limitations		
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(11,971)	-
	<u>\$ 104,452</u>	<u>\$ 113,689</u>
Denominator:		
Total Assets	\$ 778,400	\$ 778,400
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(15,056)	(15,056)
	<u>\$ 763,344</u>	<u>\$ 763,344</u>

December 31, 2017:

(dollars in thousands)	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	\$ 113,352	\$ 113,352
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	2,666	-
Allowance for loan losses and reserve for credit losses subject to certain limitations		
Regulatory Adjustments and Deductions:		
Amount of allocated investments in other System institutions	(11,177)	-
	<u>\$ 104,841</u>	<u>\$ 113,352</u>
Denominator:		
Total Assets	\$ 751,594	\$ 751,594
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(15,084)	(15,084)
	<u>\$ 736,510</u>	<u>\$ 736,510</u>

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

Accumulated Other Comp Loss			
June 30, 2018	<u>Before Tax</u>	<u>Deferred Tax</u>	<u>Net of Tax</u>
Nonpension other postretirement benefits	\$ (500,919)	\$ -	\$ (500,919)
Total	<u>\$ (500,919)</u>	<u>\$ -</u>	<u>\$ (500,919)</u>
June 30, 2017	<u>Before Tax</u>	<u>Deferred Tax</u>	<u>Net of Tax</u>
Nonpension other postretirement benefits	\$ (175,102)	\$ -	\$ (175,102)
Total	<u>\$ (175,102)</u>	<u>\$ -</u>	<u>\$ (175,102)</u>

NOTE 3 — CAPITAL (continued):

The Association's accumulated other comprehensive loss relates entirely to its nonpension other postretirement benefits. Amortization of prior service credits and of actuarial 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 loss for the six months ended June 30:

	<u>2018</u>	<u>2017</u>
Accumulated other comprehensive loss at January 1	\$(506,307)	\$(164,098)
Amortization of prior service credits included in salaries and employee benefits	(9,306)	(12,406)
Amortization of actuarial loss included in salaries and employee benefits	14,694	1,402
Other comprehensive income (loss), net of tax	5,388	(11,004)
Accumulated other comprehensive loss at June 30	<u>\$(500,919)</u>	<u>\$(175,102)</u>

In January 2018, the Association approved a patronage distribution to its stockholders. The Association was able to distribute \$9,000,701 to its members due to strong earnings during 2017. The distribution was made in March 2018.

NOTE 4 — INCOME TAXES:

Alabama Farm Credit, 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. Alabama Farm Credit, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Alabama Farm Credit, 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. The Association's valuation allowance was \$1,177,758 as of the quarter ended June 30, 2018 for no available tax benefit is expected as of that point in time.

NOTE 5 — 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>June 30, 2018</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	<u>\$ 72,401</u>	-	-	<u>\$ 72,401</u>
Total assets	<u>\$ 72,401</u>	-	-	<u>\$ 72,401</u>
 <u>December 31, 2017</u>				
	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Assets held in nonqualified benefit trusts	<u>\$ 64,142</u>	-	-	<u>\$ 64,142</u>
Total assets	<u>\$ 64,142</u>	-	-	<u>\$ 64,142</u>

NOTE 5 — FAIR VALUE MEASUREMENTS (continued):

Assets and liabilities measured at fair value on a nonrecurring basis for each of the fair value hierarchy values are summarized below:

<u>June 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*	\$ -	\$ -	\$ 667,670	\$ 667,640	\$ -
Other property owned	-	-	1,699,055	1,699,055	152,515
<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*	\$ -	\$ -	\$ 488,350	\$ 488,350	\$ -
Other property owned	-	-	2,576,808	2,576,808	(94,907)

*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.

With regard to nonrecurring measurements for impaired loans and other property owned, it is not practicable to provide specific information on inputs, as each collateral property is unique. System institutions utilize appraisals to value these loans and other property owned and take into account unobservable inputs, such as income and expense, comparable sales, replacement cost and comparability adjustments.

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.

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.

NOTE 6 — EMPLOYEE BENEFIT PLANS:

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

	Other Benefits	
	2018	2017
Service cost	\$ 20,318	\$ 14,034
Interest cost	42,828	40,631
Amortization of prior service credits	(9,306)	(12,406)
Amortization of net actuarial loss	14,695	1,402
Net periodic benefit cost	<u>\$ 68,535</u>	<u>\$ 43,661</u>

The Association previously disclosed in its financial statements for the year ended December 31, 2017, that it expected to contribute \$69,147 to the district's nonpension other post-retirement benefit in 2018. As of June 30, 2018, \$26,976 of contributions have been made. The Association presently anticipates contributing an additional \$38,370 to fund the district's non-pension other post-retirement benefit pension plan in 2018 for a total of \$65,346. The Association's liability for the unfunded accumulated obligation for these benefits at June 30, 2018, was \$2,206,772 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.

Contributions to District Defined Benefit Pension Plan

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 \$381,833 to the district's defined benefit pension plan in 2018. The Association contributed the entire amount in January 2018 and as of June 30, 2018, has amortized \$190,916 of expense to salaries and benefits. The Association does not presently anticipate additional contributions to fund the defined benefit pension plan in 2018.

NOTE 7 — 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 8 — SUBSEQUENT EVENTS:

The Association has evaluated subsequent events through August 8, 2018, which is the date the financial statements were issued. There are no other significant events requiring disclosure as of August 8, 2018.