



## Progressive Farm Credit Services, ACA

Quarterly Report  
March 31, 2017

### MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of Progressive Farm Credit Services, ACA and its subsidiaries Progressive Farm Credit Services, FLCA and Progressive Farm Credit Services, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2016 (2016 Annual Report).

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

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### FORWARD-LOOKING INFORMATION

Any forward-looking statements in this Quarterly Report are based on current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to a number of risks and uncertainties. More information about these risks and uncertainties is contained in our 2016 Annual Report. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

### AGRICULTURAL AND ECONOMIC CONDITIONS

**Land Values:** The average benchmark farm land value change in 2016 was 2.5%, compared to 0.8% and 12.0% in 2015 and 2014, respectively. The more moderate land value changes the past two years are indicative of lower commodity prices to more historical levels during the same period.

**Commodity Prices:** Farmers are entering the third year of lower prices and margins compared to the historic highs of the previous 4 years. 2017 is looking to be a repeat of 2016 and is now considered to be a "reset" back to historical norms of thinner margins. Many farmers have rebalanced their debt structure to match projected cash flows.

**Weather Conditions:** A late frost in March has raised some concerns regarding the wheat crop. Recent precipitation patterns has kept field work and corn planting to a minimum, however, a dry spell should enable farmers to catch up.

### LOAN PORTFOLIO

#### Loan Portfolio

Total loans were \$587.6 million at March 31, 2017, a decrease of \$26.6 million from December 31, 2016. The decrease was primarily due to normal seasonal loan repayments.

#### Portfolio Credit Quality

The credit quality of our portfolio declined slightly from December 31, 2016. Adversely classified loans increased to 1.4% of the portfolio at March 31, 2017, from 1.1% of the portfolio at December 31, 2016. Adversely classified loans are loans we have identified as showing some credit weakness outside our credit standards. We have considered portfolio credit quality in assessing the reasonableness of our allowance for loan losses.

In certain circumstances, government guarantee programs are used to reduce the risk of loss. At March 31, 2017, \$76.0 million of our loans were, to some level, guaranteed under these government programs.

## Risk Assets

### Components of Risk Assets

(dollars in thousands)	March 31	December 31
As of:	2017	2016
Loans:		
Nonaccrual	\$ 2,745	\$ 2,980
Accruing restructured	535	--
Accruing loans 90 days or more past due	918	143
Total risk loans	4,198	3,123
Other property owned	--	--
Total risk assets	\$ 4,198	\$ 3,123
Total risk loans as a percentage of total loans	0.7%	0.5%
Nonaccrual loans as a percentage of total loans	0.5%	0.5%
Current nonaccrual loans as a percentage of total nonaccrual loans	91.3%	95.8%
Total delinquencies as a percentage of total loans	1.7%	1.2%

Note: Accruing loans include accrued interest receivable.

Our risk assets have increased from December 31, 2016, but remained at acceptable levels. Despite the increase in risk assets, total risk loans as a percentage of total loans were well within our established risk management guidelines.

The increase in accruing restructured loans was primarily due to one restructured loan which was returned to accruing status during the first quarter of 2017.

The increase in accruing loans 90 days or more past due was primarily due to two mission related loans to a single borrower which became more than 90 days past due. These loans are fully guaranteed by the United States Department of Agriculture and therefore are adequately secured. Our accounting policy requires accruing loans past due 90 days to be transferred into nonaccrual status unless adequately secured and in the process of collection. Based on our analysis, all accruing loans 90 days or more past due were eligible to remain in accruing status.

### Allowance for Loan Losses

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

#### Allowance Coverage Ratios

As of:	March 31	December 31
	2017	2016
Allowance as a percentage of:		
Loans	0.1%	0.1%
Nonaccrual loans	19.2%	16.2%
Total risk loans	12.6%	15.4%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at March 31, 2017.

## RESULTS OF OPERATIONS

### Profitability Information

(dollars in thousands)	2017	2016
For the three months ended March 31		
Net income	\$ 2,878	\$ 2,574
Return on average assets	1.9%	1.8%
Return on average members' equity	8.4%	8.0%

Changes in the chart above relate directly to:

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

### Changes in Significant Components of Net Income

(in thousands)			Increase (decrease) in
For the three months ended March 31	2017	2016	net income
Net interest income	\$ 4,548	\$ 4,232	\$ 316
Provision for loan losses	44	28	(16)
Patronage income	384	415	(31)
Other income, net	99	84	15
Operating expenses	2,039	2,044	5
Provision for income taxes	70	85	15
Net income	<u>\$ 2,878</u>	<u>\$ 2,574</u>	<u>\$ 304</u>

### Changes in Net Interest Income

(in thousands)		
For the three months ended March 31	2017 vs 2016	
Changes in volume	\$	197
Changes in interest rates		69
Changes in nonaccrual income and other		50
Net change	<u>\$</u>	<u>316</u>

The decrease in patronage income was primarily due a reduction in patronage related to the wholesale spread on our note payable. The reduction was offset by a higher bank profit patronage rate compared to the prior year.

## FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on June 30, 2017, at which time the note will be renegotiated. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

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

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

We were not subject to a risk premium at March 31, 2017 or December 31, 2016.

Total members' equity increased \$1.6 million from December 31, 2016 primarily due to net income for the period partially offset by patronage distribution accruals.

Farm Credit Administration (FCA) 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 ratios. The permanent capital ratio continues to remain in effect, with some modifications to align with the new regulations.

The capital adequacy ratios are directly impacted by the changes in capital as more fully explained in this section and the changes in assets as discussed in the Loan Portfolio section. Refer to Note 5 of the accompanying Consolidated Financial Statements for additional detail regarding the capital ratios effective as of March 31, 2017. Refer to Note 7 in our 2016 Annual Report for a more complete description of the ratios effective as of December 31, 2016.

## RELATIONSHIP WITH AGRIBANK

### Purchased Services

During 2016, District Associations and AgriBank conducted research related to the creation of a separate service entity to provide many of the business services offered by AgriBank. A separate service entity may allow District Associations and AgriBank to develop and maintain long-term, cost effective technology and business services. If pursued, the service entity formation would require approval by the Farm Credit Administration (FCA) and would be owned by certain District Associations and AgriBank. An application to form the service entity is expected to be submitted to the FCA during the second quarter of 2017.

**CERTIFICATION**


The undersigned have reviewed the March 31, 2017 Quarterly Report of Progressive Farm Credit Services, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Markel D. Yarbro  
Chairperson of the Board  
Progressive Farm Credit Services, ACA



Robert E. Smith  
President and Chief Executive Officer  
Progressive Farm Credit Services, ACA



Vernon D. Griffith  
Chief Financial Officer  
Progressive Farm Credit Services, ACA

May 9, 2017

# CONSOLIDATED STATEMENTS OF CONDITION

Progressive Farm Credit Services, ACA

(in thousands)

(Unaudited)

As of:	March 31 2017	December 31 2016
<b>ASSETS</b>		
Loans	\$ 587,580	\$ 614,216
Allowance for loan losses	527	482
Net loans	587,053	613,734
Investment in AgriBank, FCB	11,709	11,709
Investment securities	2,254	2,483
Accrued interest receivable	7,317	10,083
Deferred tax assets, net	163	233
Other assets	4,023	4,451
Total assets	\$ 612,519	\$ 642,693
<b>LIABILITIES</b>		
Note payable to AgriBank, FCB	\$ 470,756	\$ 496,650
Accrued interest payable	2,141	2,289
Patronage distribution payable	1,250	5,500
Other liabilities	1,157	2,673
Total liabilities	475,304	507,112
Contingencies and commitments (Note 6)		
<b>MEMBERS' EQUITY</b>		
Capital stock and participation certificates	1,721	1,715
Unallocated surplus	135,494	133,866
Total members' equity	137,215	135,581
Total liabilities and members' equity	\$ 612,519	\$ 642,693

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

# CONSOLIDATED STATEMENTS OF INCOME

*Progressive Farm Credit Services, ACA*

*(in thousands)*

*(Unaudited)*

<i>For the period ended March 31</i>	<i>Three Months Ended</i>	
	<b>2017</b>	2016
<b>Interest income</b>	<b>\$ 6,689</b>	\$ 6,249
<b>Interest expense</b>	<b>2,141</b>	2,017
Net interest income	<b>4,548</b>	4,232
<b>Provision for loan losses</b>	<b>44</b>	28
Net interest income after provision for loan losses	<b>4,504</b>	4,204
<b>Other income</b>		
Patronage income	<b>384</b>	415
Financially related services income	<b>69</b>	65
Fee expense, net	<b>(16)</b>	(25)
Miscellaneous income, net	<b>46</b>	44
Total other income	<b>483</b>	499
<b>Operating expenses</b>		
Salaries and employee benefits	<b>1,271</b>	1,280
Other operating expenses	<b>768</b>	764
Total operating expenses	<b>2,039</b>	2,044
Income before income taxes	<b>2,948</b>	2,659
<b>Provision for income taxes</b>	<b>70</b>	85
Net income	<b>\$ 2,878</b>	\$ 2,574

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

## CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

*Progressive Farm Credit Services, ACA*

*(in thousands)*

*(Unaudited)*

		Capital Stock and Participation Certificates	Unallocated Surplus	Total Members' Equity
Balance at December 31, 2015	\$	1,742	\$ 125,926	\$ 127,668
Net income		--	2,574	2,574
Unallocated surplus designated for patronage distributions		--	(1,250)	(1,250)
Capital stock and participation certificates issued		32	--	32
Capital stock and participation certificates retired		(38)	--	(38)
<b>Balance at March 31, 2016</b>	<b>\$</b>	<b>1,736</b>	<b>\$ 127,250</b>	<b>\$ 128,986</b>
Balance at December 31, 2016	\$	1,715	\$ 133,866	\$ 135,581
Net income		--	<b>2,878</b>	<b>2,878</b>
Unallocated surplus designated for patronage distributions		--	(1,250)	(1,250)
Capital stock and participation certificates issued		27	--	27
Capital stock and participation certificates retired		(21)	--	(21)
<b>Balance at March 31, 2017</b>	<b>\$</b>	<b>1,721</b>	<b>\$ 135,494</b>	<b>\$ 137,215</b>

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

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. While our accounting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and the prevailing practices within the financial services industry, this interim Quarterly Report is prepared based upon statutory and regulatory requirements and, accordingly, does not include all disclosures required by U.S. GAAP. The results of the three months ended March 31, 2017 are not necessarily indicative of the results to be expected for the year ending December 31, 2017. The interim financial statements and the related notes in this Quarterly Report should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report for the year ended December 31, 2016 (2016 Annual Report).

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

#### Recently Issued or Adopted Accounting Pronouncements

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We have assessed the potential impact of accounting standards that have been issued by the Financial Accounting Standards Board (FASB) and have determined the following standards to be applicable to our business:

Standard	Description	Effective date and financial statement impact
In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13 "Financial Instruments – Credit Losses."	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.	The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2020 and interim periods within annual periods beginning after December 15, 2021. Early adoption is permitted as of annual reporting periods beginning after December 15, 2018, including interim periods within those annual periods. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.
In February 2016, the FASB issued ASU 2016-02 "Leases."	The guidance modifies the recognition and accounting for lessees and lessors and requires expanded disclosures regarding assumptions used to recognize revenue and expenses related to leases.	The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2019 and interim periods the subsequent year. Early adoption is permitted and modified retrospective adoption is required. We are currently evaluating the impact of the guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.
In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities."	The guidance is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial statements.	The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2018 and interim periods with annual periods beginning after December 15, 2019. Certain disclosure changes are permitted to be immediately adopted for annual reporting periods that have not yet been made available for issuance. Nonpublic entities are no longer required to include certain fair value of financial instruments disclosures as part of these disclosure changes. We have immediately adopted this guidance and have excluded such disclosures from our Notes to Consolidated Financial Statements. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2017 for other applicable sections of the guidance. We are currently evaluating the impact of the remaining guidance on our financial condition, results of operations, cash flows, and financial statement disclosures.

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Standard	Description	Effective date and financial statement impact
In May 2014, the FASB issued ASU 2014-09 "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. In this regard, a majority of our contracts would be excluded from the scope of this new guidance.	The guidance is effective for nonpublic entities for annual reporting periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018. In March 2016, the FASB issued ASUs 2016-08 and 2016-10 which provided further clarifying guidance on the previously issued standard. We are in the process of reviewing contracts to determine the effect, if any, on our financial condition and results of operations.

## NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

(dollars in thousands)

As of:	March 31, 2017		December 31, 2016	
	Amount	%	Amount	%
Real estate mortgage	\$ 331,863	56.5%	\$ 333,770	54.3%
Production and intermediate term	199,850	34.0%	225,894	36.8%
Agribusiness	4,983	0.8%	4,935	0.8%
Other	50,884	8.7%	49,617	8.1%
Total	\$ 587,580	100.0%	\$ 614,216	100.0%

The other category is primarily comprised of certain assets originated under the mission related investment authority, as well as rural residential real estate loans.

## Delinquency

### Aging Analysis of Loans

(in thousands) As of March 31, 2017	30-89	90 Days	Total	Not Past Due	90 Days or	
	Days	or More	Past Due	or Less than 30	More Past Due	
	Past Due	Past Due	Past Due	Days Past Due	Total	and Accruing
Real estate mortgage	\$ 803	\$ 238	\$ 1,041	\$ 335,026	\$ 336,067	\$ --
Production and intermediate term	1,977	--	1,977	200,688	202,665	--
Agribusiness	--	--	--	5,025	5,025	--
Other	6,149	918	7,067	44,059	51,126	918
Total	\$ 8,929	\$ 1,156	\$ 10,085	\$ 584,798	\$ 594,883	\$ 918

As of December 31, 2016	30-89	90 Days	Total	Not Past Due	90 Days or	
	Days	or More	Past Due	or Less than 30	More Past Due	
	Past Due	Past Due	Past Due	Days Past Due	Total	and Accruing
Real estate mortgage	\$ 922	\$ 268	\$ 1,190	\$ 337,741	\$ 338,931	\$ 143
Production and intermediate term	790	--	790	229,739	230,529	--
Agribusiness	--	--	--	5,013	5,013	--
Other	5,407	--	5,407	44,404	49,811	--
Total	\$ 7,119	\$ 268	\$ 7,387	\$ 616,897	\$ 624,284	\$ 143

Note: Accruing loans include accrued interest receivable.

## Risk Loans

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

<b>Risk Loan Information</b>		
(in thousands)	March 31	December 31
As of:	2017	2016
Volume with specific allowance	\$ --	\$ 473
Volume without specific allowance	4,198	2,650
Total risk loans	<u>\$ 4,198</u>	<u>\$ 3,123</u>
Total specific allowance	\$ --	\$ 35
For the three months ended March 31	2017	2016
Income on accrual risk loans	\$ 9	\$ --
Income on nonaccrual loans	72	22
Total income on risk loans	<u>\$ 81</u>	<u>\$ 22</u>
Average risk loans	\$ 3,616	\$ 676

Note: Accruing loans include accrued interest receivable.

We had \$729 thousand of commitments to lend additional money to borrowers whose loans were at risk at March 31, 2017.

## Troubled Debt Restructurings (TDRs)

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

There were no TDRs that occurred during the three months ended March 31, 2017 or 2016.

There were no TDRs that defaulted during the three months ended March 31, 2017 or 2016 in which the modification was within twelve months of the respective reporting period.

<b>TDRs Outstanding in the Real Estate Mortgage Loan Category</b>		
(in thousands)	March 31	December 31
As of:	2017	2016
TDRs in accrual status	\$ 535	\$ --
TDRs in nonaccrual status	--	473
Total TDRs	<u>\$ 535</u>	<u>\$ 473</u>

There were no commitments to lend to borrowers whose loans have been modified in a TDR at March 31, 2017.

## Allowance for Loan Losses

### Changes for Allowance for Loan Losses

(in thousands)	2017	2016
Three months ended March 31		
Balance at beginning of period	\$ 482	\$ 452
Provision for loan losses	44	28
Loan recoveries	1	2
Loan charge-offs	--	--
Balance at end of period	<u>\$ 527</u>	<u>\$ 482</u>

**NOTE 3: INVESTMENT IN AGRIBANK, FCB**

Effective January 1, 2017, we were required by AgriBank to maintain an investment equal to 2.25% of the average quarterly balance of our note payable, with an additional amount required on growth in excess of a sustainable growth rate. Previously, the required investment was equal to 2.25% of the average quarterly balance of our note payable to AgriBank plus an additional 1.0% on growth that exceeded a targeted rate.

<b>Investment in AgriBank</b>		
(in thousands)	<b>March 31</b>	December 31
As of:	<b>2017</b>	2016
Required stock investment	<b>\$ 10,465</b>	\$ 11,709
Allocated excess stock investment	<b>625</b>	--
Purchased excess stock investment	<b>619</b>	--
Total investment	<b>\$ 11,709</b>	\$ 11,709

**NOTE 4: INVESTMENT SECURITIES**

We held investment securities of \$2.3 million at March 31, 2017 and \$3.1 million at December 31, 2016. Our investment securities consisted of securities containing loans fully guaranteed by the Small Business Administration (SBA).

The investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. To date, we have not recognized any impairment on our investment portfolio.

<b>Additional Investment Securities Information</b>		
(dollars in thousands)	<b>March 31</b>	December 31
As of:	<b>2017</b>	2016
Amortized cost	<b>\$ 2,254</b>	\$ 2,483
Unrealized gains	<b>79</b>	92
Unrealized losses	<b>(3)</b>	(25)
Fair value	<b>\$ 2,330</b>	\$ 2,550
Weighted average yield	<b>3.6%</b>	3.4%

Investment income is recorded in "Interest income" in the Consolidated Statements of Income and totaled \$21 thousand and \$28 thousand for the three months ended March 31, 2017 and 2016, respectively.

**NOTE 5: MEMBERS' EQUITY****Regulatory Capitalization Requirements****Select Capital Ratios**

	<b>As of</b>	Regulatory	Capital	
	<b>March 31, 2017</b>	Minimums	Conservation	Total
			Buffer	
Risk-adjusted:				
Common equity tier 1 ratio	<b>20.8%</b>	4.5%	2.5%*	7.0%
Tier 1 capital ratio	<b>20.8%</b>	6.0%	2.5%*	8.5%
Total capital ratio	<b>20.9%</b>	8.0%	2.5%*	10.5%
Permanent capital ratio	<b>20.9%</b>	7.0%	0.0%	7.0%
Non-risk-adjusted:				
Tier 1 leverage ratio	<b>21.0%</b>	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	<b>20.8%</b>	1.5%	0.0%	1.5%

\*The 2.5% capital conservation buffer over risk-adjusted ratio minimums will be phased in over three years under the FCA capital requirements.

Effective January 1, 2017, the regulatory capital requirements for Farm Credit System Banks and associations were modified. The new regulations replaced existing 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 a tier 1 leverage ratio and an unallocated retained earnings equivalents (UREE) leverage ratio. The permanent capital ratio continues to remain in effect.

Risk-adjusted assets have been defined by Farm Credit Administration (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 with terms at origination of less than 14 months
- Increased risk-weighting of most loans 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 inclusion of the allowance for loan losses as a deduction to risk-adjusted assets for the permanent capital ratio.

These 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 member stock, other required member stock held for a minimum of 7 years, allocated equities held for a minimum of 7 years or not subject to retirement, 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 member stock held for a minimum of 5 years, allocated equities held for a minimum of 5 years, subordinated debt, and limited-life preferred stock greater than 5 years to maturity at issuance subject to certain limitations, allowance for loan losses and reserve for credit losses subject to certain limitations, less certain investments in other System institutions under the corresponding deduction approach, divided by average risk-adjusted assets.
- Permanent capital ratio is all at-risk borrower stock, any allocated excess stock, unallocated retained earnings, paid-in capital, subordinated debt, and preferred stock 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 retirement 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 total requirements, including the buffer amounts, capital distributions (equity redemptions, dividends, and patronage) and discretionary senior executive bonuses are restricted or prohibited without prior FCA approval.

Effective January 1, 2017, the regulatory capital requirements allow for allotment agreements for only the permanent capital ratio and, as such, any stock in excess of our AgriBank required investment was not included in the common equity tier 1, tier 1 capital, total capital, or leverage ratios. We included 5.3% of our investment in AgriBank as permanent capital at March 31, 2017, respectively. These changes did not have a material impact on our permanent capital ratio. We had no allocated excess stock at December 31, 2016.

#### **NOTE 6: CONTINGENCIES AND COMMITMENTS**

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

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

#### **NOTE 7: FAIR VALUE MEASUREMENTS**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market for the asset or liability. Accounting guidance also establishes a fair value hierarchy, with three levels of inputs that may be used to measure fair value. Refer to Note 2 in our 2016 Annual Report for a more complete description of the three input levels.

We did not have any assets or liabilities measured at fair value on a recurring basis at March 31, 2017 or December 31, 2016.

## Non-Recurring

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

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

(in thousands)

	As of March 31, 2017				Three months ended March 31, 2017	
	Fair Value Measurement Using			Total Fair	Total Gains	
	Level 1	Level 2	Level 3	Value		
Impaired loans	\$ --	\$ --	\$ --	\$ --	\$ 35	
	As of December 31, 2016				Three months ended March 31, 2016	
	Fair Value Measurement Using			Total Fair	Total Gains	
	Level 1	Level 2	Level 3	Value		
Impaired loans	\$ --	\$ --	\$ 460	\$ 460	\$ --	

### Valuation Techniques

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

### NOTE 8: SUBSEQUENT EVENTS

We have evaluated subsequent events through May 9, 2017, which is the date the Consolidated Financial Statements were available to be issued. Subsequent to March 31, 2017 loans to one borrower totaling \$1.0 million were transferred to nonaccrual status in the normal course of loan servicing. There have been no material subsequent events, other than the matter described above, that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.