Farm Credit Midsouth, ACA

Quarterly Report
June 30, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of Farm Credit Midsouth, ACA and its subsidiaries Farm Credit Midsouth, FLCA and Farm Credit Midsouth, 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

Northeast Arkansas received ample rain during the second quarter of 2017. Major flooding occurred throughout portions of our territory at the end of April, and another strong storm front followed at the end of May. Despite all of the rain and replanting that occurred, crops are in fairly good shape. Although, soybeans may be a little smaller than typically seen. According to the United States Department of Agriculture's Crop Progress Report issued July 5, 2017, corn, cotton, and soybeans were right at their 5-year average.

LOAN PORTFOLIO

Loan Portfolio

Total loans were $895.2 million at June 30, 2017, an increase of $45.6 million from December 31, 2016. The increase was primarily due to our commercial portfolio, which had normal operating disbursements offset by normal repayments, resulting in a net increase since year-end of $38.7 million. Our mortgage portfolio also had normal operating disbursements offset by normal repayments, resulting in a net increase of $6.9 million since year-end.

Portfolio Credit Quality

The overall credit quality of our portfolio declined slightly from December 31, 2016, due to a loss in working capital from lower crop prices. However, adversely classified loans decreased to 2.0% of the portfolio at June 30, 2017, from 2.6% 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 June 30, 2017, $9.4 million of our loans were, to some level, guaranteed under these government programs.

Risk Assets

Components of Risk Assets

(dollars in thousands) As of:		**June 30 2017**		December 31 2016
Loans:				
Nonaccrual	**$**	**6,576**	$	8,038
Accruing restructured		**12**		46
Accruing loans 90 days or more past due		**--**		--
Total risk loans		**6,588**		8,084
Other property owned		**--**		--
Total risk assets	**$**	**6,588**	$	8,084
Total risk loans as a percentage of total loans		**0.7%**		0.9%
Nonaccrual loans as a percentage of total loans		**0.7%**		0.9%
Current nonaccrual loans as a percentage of total nonaccrual loans		**39.3%**		36.7%
Total delinquencies as a percentage of total loans		**0.5%**		0.7%

Note: Accruing loans include accrued interest receivable.

Our risk assets decreased from December 31, 2016, and remained at acceptable levels. Total risk loans as a percentage of total loans were well within our established risk management guidelines.

The decrease in nonaccrual loans was primarily due to normal repayments and charge-offs. Nonaccrual loans remained at an acceptable level at June 30, 2017, and December 31, 2016.

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:	**June 30 2017**	December 31 2016
Allowance as a percentage of:		
Loans	**0.2%**	0.2%
Nonaccrual loans	**24.7%**	20.3%
Total risk loans	**24.6%**	20.2%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at June 30, 2017.

RESULTS OF OPERATIONS

Profitability Information

(dollars in thousands) For the six months ended June 30		**2017**		2016
Net income	**$**	**6,232**	$	6,063
Return on average assets		**1.5%**		1.5%
Return on average members' equity		**6.2%**		6.4%

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) For the six months ended June 30	2017	2016	Increase (decrease) in net income
Net interest income	$ 12,223	$ 11,912	$ 311
Provision for loan losses	729	395	(334)
Patronage income	1,264	1,163	101
Other income (loss), net	219	(17)	236
Operating expenses	6,509	6,349	(160)
Provision for income taxes	236	251	15
Net income	$ 6,232	$ 6,063	$ 169

Changes in Net Interest Income

(in thousands) For the six months ended June 30	2017 vs 2016
Changes in volume	$ 214
Changes in interest rates	(76)
Changes in nonaccrual income and other	173
Net change	$ 311

FUNDING, LIQUIDITY, AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matured on April 30, 2017, and was renewed for $950 million with a maturity date of April 30, 2020. The note payable will be renegotiated no later than the maturity date. 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 June 30, 2017, or December 31, 2016.

Total members' equity increased $4.1 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 4 of the accompanying Consolidated Financial Statements for additional detail regarding the capital ratios effective as of June 30, 2017. Refer to Note 6 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 allows District Associations and AgriBank to develop and maintain long-term, cost effective technology and business services. The service entity would be owned by certain District Associations and AgriBank. An application to form the service entity was submitted to the FCA for approval in May 2017.

Patronage

AgriBank has amended its capital plan effective July 1, 2017, to provide for adequate capital at AgriBank under the new capital regulations as well as to create a path to long-term capital optimization within the AgriBank District. The plan optimizes capital at AgriBank; distributing available AgriBank earnings in the form of patronage, either cash or stock. A key part of these changes involves maintaining capital adequacy such that sufficient earnings will be retained in the form of unallocated retained earnings and allocated stock to meet the leverage ratio target and other regulatory or policy constraints prior to any cash patronage distributions.

CERTIFICATION

The undersigned have reviewed the June 30, 2017, Quarterly Report of Farm Credit Midsouth, 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.

Chris Roberts
Chairperson of the Board
Farm Credit Midsouth, ACA

James McJunkins
President and Chief Executive Officer
Farm Credit Midsouth, ACA

Shari J. Wilson
Senior Vice President of Finance, Chief Financial Officer
Farm Credit Midsouth, ACA

August 9, 2017

CONSOLIDATED STATEMENTS OF CONDITION

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

As of:		June 30 2017		December 31 2016
ASSETS				
Loans	**$**	**895,185**	$	849,609
Allowance for loan losses		**1,623**		1,634
Net loans		**893,562**		847,975
Investment in AgriBank, FCB		**17,669**		17,669
Accrued interest receivable		**12,948**		17,398
Deferred tax assets, net		**613**		840
Other assets		**7,034**		7,533
Total assets	**$**	**931,826**	$	891,415
LIABILITIES				
Note payable to AgriBank, FCB	**$**	**719,817**	$	680,502
Accrued interest payable		**3,496**		3,308
Patronage distribution payable		**2,150**		4,200
Other liabilities		**4,371**		5,468
Total liabilities		**729,834**		693,478
Contingencies and commitments (Note 5)				
MEMBERS' EQUITY				
Protected members' equity		**2**		2
Capital stock and participation certificates		**1,966**		1,994
Unallocated surplus		**200,024**		195,941
Total members' equity		**201,992**		197,937
Total liabilities and members' equity	**$**	**931,826**	$	891,415

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

CONSOLIDATED STATEMENTS OF INCOME

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
For the period ended June 30	**2017**	2016	**2017**	2016
Interest income	**$ 9,708**	$ 9,230	**$ 18,844**	$ 17,836
Interest expense	**3,496**	3,051	**6,621**	5,924
Net interest income	**6,212**	6,179	**12,223**	11,912
Provision for loan losses	**623**	395	**729**	395
Net interest income after provision for loan losses	**5,589**	5,784	**11,494**	11,517
Other income				
Patronage income	**646**	592	**1,264**	1,163
Financially related services income	**29**	32	**52**	71
Fee income	**160**	114	**268**	290
Miscellaneous (loss) income, net	**(165)**	29	**(101)**	(378)
Total other income	**670**	767	**1,483**	1,146
Operating expenses				
Salaries and employee benefits	**2,119**	2,060	**4,286**	4,137
Other operating expenses	**1,110**	1,044	**2,223**	2,212
Total operating expenses	**3,229**	3,104	**6,509**	6,349
Income before income taxes	**3,030**	3,447	**6,468**	6,314
(Benefit from) provision for income taxes	**(63)**	146	**236**	251
Net income	**$ 3,093**	$ 3,301	**$ 6,232**	$ 6,063

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

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

Farm Credit Midsouth, ACA
(in thousands)
(Unaudited)

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Total Members' Equity
Balance at December 31, 2015	$ 3	$ 2,033	$ 185,119	$ 187,155
Net income	--	--	6,063	6,063
Unallocated surplus designated for patronage distributions	--	--	(2,100)	(2,100)
Capital stock and participation certificates issued	--	66	--	66
Capital stock and participation certificates retired	(1)	(93)	--	(94)
Balance at June 30, 2016	$ 2	$ 2,006	$ 189,082	$ 191,090
Balance at December 31, 2016	$ 2	$ 1,994	$ 195,941	$ 197,937
Net income	**--**	**--**	**6,232**	**6,232**
Unallocated surplus designated for patronage distributions	**--**	**--**	**(2,149)**	**(2,149)**
Capital stock and participation certificates issued	**--**	**77**	**--**	**77**
Capital stock and participation certificates retired	**--**	**(105)**	**--**	**(105)**
Balance at June 30, 2017	**$ 2**	**$ 1,966**	**$ 200,024**	**$ 201,992**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements contain all adjustments necessary for a fair presentation of the interim consolidated financial condition and consolidated results of operations. Our accounting policies conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the financial services industry. This interim Quarterly Report is prepared based upon statutory and regulatory requirements and in accordance with GAAP. However, certain disclosures required by GAAP are omitted. The results of the six months ended June 30, 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 Farm Credit Midsouth, ACA and its subsidiaries Farm Credit Midsouth, FLCA and Farm Credit Midsouth, PCA. All material intercompany transactions and balances have been eliminated in consolidation.

Recently Issued or Adopted Accounting Pronouncements

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.

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

Loans by Type

(dollars in thousands)

As of:	**June 30, 2017**		December 31, 2016	
	Amount	%	Amount	%
Real estate mortgage	**$ 468,977**	**52.4%**	$ 470,148	55.3%
Production and intermediate term	**374,937**	**41.9%**	345,097	40.6%
Agribusiness	**49,944**	**5.6%**	33,817	4.0%
Other	**1,327**	**0.1%**	547	0.1%
Total	**$ 895,185**	**100.0%**	$ 849,609	100.0%

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

Delinquency

Aging Analysis of Loans

(in thousands) **As of June 30, 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
Real estate mortgage	**$ 105**	**$ 460**	**$ 565**	**$ 475,211**	**$ 475,776**
Production and intermediate term	**119**	**1,653**	**1,772**	**378,411**	**380,183**
Agribusiness	**--**	**1,805**	**1,805**	**49,035**	**50,840**
Other	**--**	**--**	**--**	**1,334**	**1,334**
Total	**$ 224**	**$ 3,918**	**$ 4,142**	**$ 903,991**	**$ 908,133**

As of December 31, 2016	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
Real estate mortgage	$ --	$ 367	$ 367	$ 479,249	$ 479,616
Production and intermediate term	1,987	2,892	4,879	347,655	352,534
Agribusiness	--	705	705	33,603	34,308
Other	--	--	--	549	549
Total	$ 1,987	$ 3,964	$ 5,951	$ 861,056	$ 867,007

Note: Accruing loans include accrued interest receivable.

There were no loans 90 days or more past due and still accruing interest at June 30, 2017, and December 31, 2016.

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.

Risk Loan Information

(in thousands) As of:		**June 30** **2017**		December 31 2016
Volume with specific allowance	**$**	**30**	$	1,691
Volume without specific allowance		**6,558**		6,393
Total risk loans	**$**	**6,588**	$	8,084
Total specific allowance	**$**	**--**	$	27
For the six months ended June 30		**2017**		2016
Income on accrual risk loans	**$**	**4**	$	37
Income on nonaccrual loans		**359**		186
Total income on risk loans	**$**	**363**	$	223
Average risk loans	**$**	**6,955**	$	6,093

Note: Accruing loans include accrued interest receivable.

We did not have any commitments to lend additional money to borrowers whose loans were at risk at June 30, 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 completed during the six months ended June 30, 2017. We completed TDRs of certain production and intermediate term loans during the six months ended June 30, 2016. Our recorded investment in these loans just prior to and immediately following restructuring was $3.0 million. The recorded investment of the loan is the unpaid principal amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off. The primary type of modification was extension of maturity.

There were no TDRs that defaulted during the six months ended June 30, 2017, or 2016 in which the modification was within twelve months of the respective reporting period.

TDRs Outstanding in the Production and Intermediate Term Loan Category

(in thousands) As of:		**June 30** **2017**		December 31 2016
TDRs in accrual status	**$**	**12**	$	46
TDRs in nonaccrual status		**1,367**		1,893
Total TDRs	**$**	**1,379**	$	1,939

The decrease in TDRs in nonaccrual status was primarily due to normal repayments.

There were no commitments to lend to borrowers whose loans have been modified in a TDR at June 30, 2017.

Allowance for Loan Losses

Changes for Allowance for Loan Losses

(in thousands) Six months ended June 30		**2017**		2016
Balance at beginning of period	**$**	**1,634**	$	1,832
Provision for loan losses		**729**		395
Loan recoveries		**24**		--
Loan charge-offs		**(764)**		(378)
Balance at end of period	**$**	**1,623**	$	1,849

NOTE 3: INVESTMENT IN AGRIBANK, FCB

Effective July 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 Association growth in excess of a targeted growth rate, if the District is also growing above a targeted growth rate. From January 1 to June 30, 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.

Investment in AgriBank

(in thousands) As of:	**June 30 2017**	December 31 2016
Required stock investment	**$ 16,380**	$ 17,669
Purchased excess stock investment	**1,289**	--
Total investment	**$ 17,669**	$ 17,669

NOTE 4: MEMBERS' EQUITY

Regulatory Capitalization Requirements

Select Capital Ratios

	As of June 30, 2017	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:				
Common equity tier 1 ratio	**20.0%**	4.5%	2.5%*	7.0%
Tier 1 capital ratio	**20.0%**	6.0%	2.5%*	8.5%
Total capital ratio	**20.1%**	8.0%	2.5%*	10.5%
Permanent capital ratio	**20.0%**	7.0%	0.0%	7.0%
Non-risk-adjusted:				
Tier 1 leverage ratio	**21.7%**	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	**21.7%**	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, with some modifications, to align with the new regulations.

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 (not all items below may be applicable to our Association):

- 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 had no allocated excess stock at June 30, 2017, or December 31, 2016.

Refer to Note 6 in our 2016 Annual Report for a more complete description of the ratios effective as of December 31, 2016.

NOTE 5: 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. In 2009, we were named as a counter-defendant in an on-going lawsuit. On October 26, 2015, the case was heard by a jury, and on November 3, 2015, a verdict was issued against the Association. We are currently in the process of appealing the verdict and plan to pursue all other available avenues of relief. We recorded $1.6 million of loss contingency related to this litigation matter in 2015, $506 thousand in 2016, and $192 thousand thus far in 2017. These amounts are included in “Other liabilities” in the Consolidated Statements of Condition and “Miscellaneous income (loss), net” in the Consolidated Statements of Income. As additional information becomes available, the potential liability related to pending litigation will be assessed and estimates will be revised as necessary. 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 6: 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 June 30, 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 June 30, 2017**				**Six months ended June 30, 2017**
	Fair Value Measurement Using			Total Fair	
	Level 1	Level 2	Level 3	Value	Total Losses
Impaired loans	**$ --**	**$ 31**	**$ --**	**$ 31**	**$ (737)**
	As of December 31, 2016				Six months ended June 30, 2016
	Fair Value Measurement Using			Total Fair	
	Level 1	Level 2	Level 3	Value	Total Losses
Impaired loans	$ --	$ 1,748	$ --	$ 1,748	$ (120)

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 7: SUBSEQUENT EVENTS

We have evaluated subsequent events through August 9, 2017, which is the date the Consolidated Financial Statements were available to be issued. There have been no material subsequent events that would require recognition in our Quarterly Report or disclosure in the Notes to Consolidated Financial Statements.