

LEGACY AG CREDIT, ACA

**2017
Quarterly Report
First Quarter**



For the Quarter Ended March 31, 2017

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.



Al Conner, Interim Chief Executive Officer
May 9, 2017



Terry Milligan, Chairman, Board of Directors
May 9, 2017



Daryl D. Belt, Chief Financial Officer
May 9, 2017



John Shinn, CPA, Chairman, Audit Committee
May 9, 2017

LEGACY AG CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Legacy Ag Credit, ACA (Agricultural Credit Association), referred to as the association, for the quarter ended March 31, 2017. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2016 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:

As previously communicated by a letter to stockholders dated November 22, 2016, the merger with Texas Farm Credit Services was terminated by a vote of the Legacy Ag Credit board at the November 2016 board meeting. See Terminated Merger Discussion section in 2016 Annual Report for more information.

On December 1, 2016, the CEO's (Joseph Crouch) resignation was accepted by the board effective December 31, 2016 and on December 1, 2016 the CCO (Al Conner) was named Interim CEO by the board.

Effective January 10, 2017 the association was placed under Special Supervision by the Farm Credit Administration (FCA) related to the manner in which the decision was made to terminate the merger with Texas Farm Credit Services. The FCA also established a number of supervisory requirements including: (1) the engagement of a board consultant approved by the FCA, and (2) FCA notification prior to any material board decisions, or any actions related to the composition and structure of the board, bylaw changes, or association management.

In response to the supervisory requirements the board has engaged a consultant with many years of direct Farm Credit related experience who will also serve as an independent administrative resource for the association director nominating committee. The board has also added an additional outside director who brings many years of Farm Credit experience to the association. A search for a CEO is in process. See Terminated Merger Discussion in the 2016 Annual Report for more information.

In January 2017, the board of directors approved a patronage payment related to 2016 earnings of \$2,400,000. The patronage will be paid in April 2017.

A disclosure under the title of Terminated Merger Discussion was included in the association's 2016 Annual Report to Stockholders on pages 7 and 8. The disclosure referenced the rescission of the proposed merger of Legacy Ag Credit, ACA with Texas Farm Credit as well as the resulting issuance of a Supervisory Letter from the association's regulator, the Farm Credit Administration (FCA), to the association's board. The association's board received a subsequent letter from the FCA on April 19, 2017 that established several additional requirements of the board, and the board is proceeding to appropriately address those requirements. The annual meeting of the association's stockholders is currently scheduled for Monday, August 14, 2017, and additional information will be provided to stockholders during the upcoming annual meeting.

Loan Portfolio:

Total loans outstanding at March 31, 2017, including nonaccrual loans and sales contracts, were \$232,604,282 compared to \$238,025,851 at December 31, 2016, reflecting a decrease of 2.3 percent. Nonaccrual loans as a percentage of total loans outstanding were 1.2 percent at March 31, 2017, compared to 1.3 percent at December 31, 2016.

The association recorded \$4,459 in recoveries and \$10,972 in charge-offs for the quarter ended March 31, 2017, and \$4,454 in recoveries and \$0 in charge-offs for the same period in 2016. The association's allowance for loan losses was 0.9 percent and 0.9 percent of total loans outstanding as of March 31, 2017, and December 31, 2016, respectively.

In January 2017, one borrower's loans in the amount of \$2,671,074 were downgraded to substandard viable within the loan portfolio. The loans are well collateralized and a loss is not expected.

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.

	March 31, 2017		December 31, 2016	
	Amount	%	Amount	%
Nonaccrual	\$ 2,883,259	47.0%	\$ 3,060,977	46.8%
Formally restructured	3,252,516	53.0%	3,258,080	49.8%
Other property owned, net	-	0.0%	221,724	3.4%
Total	<u>\$ 6,135,775</u>	<u>100.0%</u>	<u>\$ 6,540,781</u>	<u>100.0%</u>

Results of Operations:

The association had net income of \$731,857 for the three months ended March 31, 2017, as compared to net income of \$839,886 for the same period in 2016, reflecting a decrease of 12.9 percent. Net interest income was \$1,731,951 for the three months ended March 31, 2017, compared to \$1,809,471 for the same period in 2016.

	Three months ended:			
	March 31, 2017		March 31, 2016	
	Average Balance	Interest	Average Balance	Interest
Loans	\$ 234,720,052	\$ 2,758,329	\$ 234,547,494	\$ 2,842,910
Interest-bearing liabilities	180,789,974	1,026,378	181,731,470	1,033,439
Impact of capital	<u>\$ 53,930,078</u>		<u>\$ 52,816,024</u>	
Net interest income		<u>\$ 1,731,951</u>		<u>\$ 1,809,471</u>
	2017		2016	
	Average Yield		Average Yield	
Yield on loans	4.77%		4.87%	
Cost of interest-bearing liabilities	2.30%		2.29%	
Interest rate spread	2.46%		2.58%	
Net interest income as a percentage of average earning assets	2.99%		3.10%	

	Three months ended:		
	March 31, 2017 vs. March 31, 2016		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income - loans	\$ 2,074	\$ (86,655)	\$ (84,581)
Interest expense	(5,309)	(1,752)	(7,061)
Net interest income	<u>\$ 7,383</u>	<u>\$ (84,903)</u>	<u>\$ (77,520)</u>

Interest income for the three months ended March 31, 2017, decreased by \$84,581, or 3.0 percent, from the same period of 2016, primarily due to declines in yields on earning assets. Interest expense for the three months ended March 31, 2017, decreased by \$7,061, or 0.7 percent, from the same period of 2016 due to a decrease in average debt volume. Average loan volume for the first quarter of 2017 was \$234,720,052, compared to \$234,547,494 in the first quarter of 2016. The average net interest rate spread on the loan portfolio for the first quarter of 2017 was 2.46 percent, compared to 2.58 percent in the first quarter of 2016.

The association's return on average assets for the three months ended March 31, 2017, was 1.24 percent compared to 1.42 percent for the same period in 2016. The association's return on average equity for the three months ended March 31, 2017, was 5.37 percent, compared to 6.29 percent for the same period in 2016.

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 Systemwide obligations and with lendable equity. The following schedule summarizes the association's borrowings.

	March 31, 2017	December 31, 2016
Note payable to the bank	\$ 178,233,216	\$ 183,651,931
Accrued interest on note payable	350,314	357,296
Total	<u>\$ 178,583,530</u>	<u>\$ 184,009,227</u>

The association operates under a general financing agreement (GFA) with the bank. The current GFA is effective through September 30, 2018. The primary source of liquidity and funding for the association is a direct loan from the bank. The outstanding balance of \$178,233,216 as of March 31, 2017, is recorded as a liability on the association's balance sheet. The note carried a weighted average interest rate of 2.24 percent at March 31, 2017. 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 decrease in note payable to the bank and related accrued interest payable since December 31, 2016, is due to the association's decrease in loan volume. The association's own funds, which represent the amount of the association's loan portfolio funded by the association's equity, were \$53,851,500 at March 31, 2017. The maximum amount the association may borrow from the bank as of March 31, 2017, was \$218,378,584 as defined by the general financing agreement. The indebtedness continues in effect until the expiration date of the general financing agreement, 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.

The liquidity policy of the association is to manage cash balances, to maximize debt reduction and to increase accrual loan volume. This policy will continue to be pursued during 2016. As borrower payments are received, they are applied to the association's note payable to the bank.

Capital Resources:

The association's capital position decreased by \$1,677,701 at March 31, 2017, compared to December 31, 2016 due to the accrual of patronage of \$2,400,000. The association's debt as a percentage of members' equity was 3.31:1 as of March 31, 2017, compared to 3.28:1 as of December 31, 2016. 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.

Regulatory Matters:

Effective January 10, 2017 the association was placed under Special Supervision by the Farm Credit Administration (FCA) related to the manner in which the decision was made to terminate the merger with Texas Farm Credit Services. The FCA also established a number of supervisory requirements including: (1) the engagement of a board consultant approved by the FCA, and (2) FCA notification prior to any material board decisions, or any actions related to the composition and structure of the board, bylaw changes or association management. See Management's Discussion and Analysis on page 3 for further information.

On March 10, 2016, the Farm Credit Administration approved a final rule to modify the regulatory capital requirements for System banks and associations. The stated objectives of the proposed rule are as follows:

- To modernize capital requirements while ensuring that the institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the federal banking regulatory agencies have adopted, but also to ensure that the rules recognize the cooperative structure and the organization of the System,
- To make System regulatory capital requirements more transparent and
- To meet the requirements of section 939A of the Dodd-Frank Act.

The final rule became effective on January 1, 2017. The association is in compliance with the required minimum capital standards as of March 31, 2017.

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 2016 Annual Report of Legacy Ag Credit, ACA more fully describe the association's relationship with the bank.

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

The association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Legacy Ag Credit, ACA, 303 Connally St., Sulphur Springs, TX 75482 or calling (903)885-9566. The annual and quarterly stockholder reports for the association are also available on its website at www.legacyaca.com. Copies of the association's quarterly stockholder reports can also be requested by e-mailing sherry.jennings@legacyaca.com.

LEGACY AG CREDIT, ACA

CONSOLIDATED BALANCE SHEET

	March 31, 2017 (unaudited)	December 31, 2016
<u>ASSETS</u>		
Cash	\$ 122,459	\$ 121,720
Loans	232,604,282	238,025,851
Less: allowance for loan losses	2,084,524	2,080,948
Net loans	<u>230,519,758</u>	<u>235,944,903</u>
Accrued interest receivable	1,282,703	1,111,228
Investment in and receivable from the Farm		
Credit Bank of Texas:		
Capital stock	3,738,505	3,738,505
Other	263,642	80,883
Other property owned, net	-	221,724
Premises and equipment, net	495,461	485,401
Other assets	<u>338,024</u>	<u>338,647</u>
Total assets	<u><u>\$ 236,760,552</u></u>	<u><u>\$ 242,043,011</u></u>
<u>LIABILITIES</u>		
Note payable to the Farm Credit Bank of Texas	\$ 178,233,216	\$ 183,651,931
Advance conditional payments	2,385	1,272
Accrued interest payable	351,253	357,914
Drafts outstanding	77,645	201,009
Patronage payable	2,423,854	-
Other liabilities	<u>755,900</u>	<u>1,236,885</u>
Total liabilities	<u><u>181,844,253</u></u>	<u><u>185,449,011</u></u>
<u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	1,105,705	1,112,315
Unallocated retained earnings	53,737,068	55,405,211
Accumulated other comprehensive income (loss)	<u>73,526</u>	<u>76,474</u>
Total members' equity	<u>54,916,299</u>	<u>56,594,000</u>
Total liabilities and members' equity	<u><u>\$ 236,760,552</u></u>	<u><u>\$ 242,043,011</u></u>

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

LEGACY AG CREDIT, ACA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Quarter and Year Ended	
	March 31,	
	2017	2016
<u>INTEREST INCOME</u>		
Loans	\$ 2,758,329	\$ 2,842,910
<u>INTEREST EXPENSE</u>		
Note payable to the Farm Credit Bank of Texas	1,026,370	1,033,439
Advance conditional payments	8	-
Total interest expense	<u>1,026,378</u>	<u>1,033,439</u>
Net interest income	1,731,951	1,809,471
<u>PROVISION FOR LOAN LOSSES</u>		
	10,089	(42,350)
Net interest income after provision for loan losses	<u>1,721,862</u>	<u>1,851,821</u>
<u>NONINTEREST INCOME</u>		
Income from the Farm Credit Bank of Texas:		
Patronage income	169,976	149,528
Loan fees	54,510	34,415
Financially related services income	102	99
Gain on sale of other property owned, net	1,715	-
Gain (loss) on sale of premises and equipment, net	7,703	-
Other noninterest income	27,781	22,317
Total noninterest income	<u>261,787</u>	<u>206,359</u>
<u>NONINTEREST EXPENSES</u>		
Salaries and employee benefits	706,027	693,514
Directors' expense	63,655	95,656
Purchased services	134,631	85,608
Travel	47,236	37,248
Occupancy and equipment	58,064	57,145
Communications	29,527	26,378
Advertising	10,046	23,813
Public and member relations	25,022	26,115
Supervisory and exam expense	24,899	21,491
Insurance Fund premiums	56,694	61,288
Loss on other property owned, net	19,350	21,478
Other noninterest expense	76,641	68,560
Total noninterest expenses	<u>1,251,792</u>	<u>1,218,294</u>
NET INCOME	<u>731,857</u>	<u>839,886</u>
Other comprehensive income:		
Change in postretirement benefit plans	(2,948)	(3,205)
COMPREHENSIVE INCOME	<u>\$ 728,909</u>	<u>\$ 836,681</u>

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

LEGACY AG 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, 2015	\$ 1,100,475	\$ 53,771,122	\$ 93,360	\$ 54,964,957
Comprehensive income	-	839,886	(3,205)	836,681
Preferred Stock Issued				
Capital stock/participation certificates	32,860	-	-	32,860
Preferred Stock retired				
Capital stock/participation certificates	(27,500)	-	-	(27,500)
Patronage paid	-	(2,249,884)	-	(2,249,884)
Balance at March 31, 2016	<u>\$ 1,105,835</u>	<u>\$ 52,361,124</u>	<u>\$ 90,155</u>	<u>\$ 53,557,114</u>
Balance at December 31, 2016	\$ 1,112,315	\$ 55,405,211	\$ 76,474	\$ 56,594,000
Comprehensive income	-	731,857	(2,948)	728,909
Preferred Stock Issued				
Capital stock/participation certificates	28,570	-	-	28,570
Preferred Stock retired				
Capital stock/participation certificates	(35,180)	-	-	(35,180)
Patronage declared	-	(2,400,000)	-	(2,400,000)
Balance at March 31, 2017	<u>\$ 1,105,705</u>	<u>\$ 53,737,068</u>	<u>\$ 73,526</u>	<u>\$ 54,916,299</u>

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

LEGACY AG CREDIT, ACA
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Legacy Ag 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 Franklin, Gregg, Harrison, Hopkins, Kaufman, Marion, Rains, Upshur, Van Zandt and Wood in the state of Texas. 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, 2016, as contained in the 2016 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, 2016, as contained in the 2016 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 2016 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 August 2016, the Financial Accounting Standards Board (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 is not expected to impact the Bank’s financial condition or its results of operations but could 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 currently 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 currently 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 is not expected to impact the association’s financial condition or its results of operations.

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. In this regard, a majority of our contracts would be excluded from the scope of this new guidance. In August 2015, the FASB issued an update that defers this guidance by one year, which results in the new revenue standard becoming effective for interim and annual reporting periods beginning after December 15, 2017. The association is in the process of reviewing contracts to determine the effect, if any, on their financial condition or results of operations.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter ended March 31, 2017, 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	March 31, 2017 Amount	December 31, 2016 Amount
Production agriculture:		
Real estate mortgage	\$ 186,404,433	\$ 190,398,110
Production and intermediate term	11,361,169	11,091,817
Agribusiness:		
Loans to cooperatives	1,988,276	1,577,708
Processing and marketing	19,035,199	19,429,639
Farm-related business	972,560	757,724
Communication	3,008,364	2,930,922
Energy	4,540,910	6,764,173
Water and waste water	1,993,760	1,993,552
Rural residential real estate	3,299,611	3,082,206
Total	<u>\$ 232,604,282</u>	<u>\$ 238,025,851</u>

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 March 31, 2017:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ -	\$ 998,158	\$ -	\$ -	\$ -
Production and intermediate term	2,848,352	-	-	-	2,848,352	-
Agribusiness	21,996,035	-	-	-	21,996,035	-
Communication	3,008,364	-	-	-	3,008,364	-
Energy	4,540,910	-	-	-	4,540,910	-
Water and waste water	1,993,760	-	-	-	1,993,760	-
Total	<u>\$ 34,387,421</u>	<u>\$ 998,158</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 34,387,421</u>	<u>\$ 998,158</u>

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

	March 31, 2017	December 31, 2016
Nonaccrual loans:		
Real estate mortgage	\$ 1,484,441	\$ 1,625,001
Production and intermediate term	<u>1,398,818</u>	<u>1,435,976</u>
Total nonaccrual loans	<u>2,883,259</u>	3,060,977
Accruing restructured loans:		
Real estate mortgage	<u>3,252,516</u>	<u>3,258,080</u>
Total accruing restructured loans	<u>3,252,516</u>	3,258,080
Total nonperforming loans	6,135,775	6,319,057
Other property owned	-	<u>221,724</u>
Total nonperforming assets	<u>\$ 6,135,775</u>	<u>\$ 6,540,781</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.

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:

	March 31, 2017	December 31, 2016
Real estate mortgage		
Acceptable	88.9 %	90.3 %
OAEM	8.3	8.2
Substandard/doubtful	2.8	1.5
	100.0	100.0
Production and intermediate term		
Acceptable	87.5	86.8
OAEM	0.2	0.2
Substandard/doubtful	12.3	13.0
	100.0	100.0
Loans to cooperatives		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Processing and marketing		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Farm-related business		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Energy		
Acceptable	68.9	78.9
OAEM	31.1	21.1
Substandard/doubtful	-	-
	100.0	100.0
Water and waste water		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	100.0	100.0
Rural residential real estate		
Acceptable	99.0	98.8
OAEM	1.0	1.2
Substandard/doubtful	-	-
	100.0	100.0
Total loans		
Acceptable	89.9	91.0
OAEM	7.3	7.2
Substandard/doubtful	2.8	1.8
	100.0 %	100.0 %

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

<u>March 31, 2017</u>	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	\$ 1,168,666	\$ 458,940	\$ 1,627,606	\$ 185,899,931	\$ 187,527,537	\$ -
Production and intermediate term	-	1,346,271	1,346,271	10,140,582	11,486,853	-
Loans to cooperatives	-	-	-	1,989,174	1,989,174	-
Processing and marketing	-	-	-	19,039,733	19,039,733	-
Farm-related business	-	-	-	974,437	974,437	-
Communication	-	-	-	3,008,658	3,008,658	-
Energy	-	-	-	4,551,658	4,551,658	-
Water and waste water	-	-	-	2,003,982	2,003,982	-
Rural residential real estate	2,093	-	2,093	3,302,860	3,304,953	-
Total	\$ 1,170,759	\$ 1,805,211	\$ 2,975,970	\$ 230,911,015	\$ 233,886,985	\$ -

<u>December 31, 2016</u>	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	\$ 836,988	\$ 226,436	\$ 1,063,424	\$ 190,246,980	\$ 191,310,404	\$ -
Production and intermediate term	151,216	1,383,672	1,534,888	9,647,089	11,181,977	-
Loans to cooperatives	-	-	-	1,578,007	1,578,007	-
Processing and marketing	-	-	-	19,436,267	19,436,267	-
Farm-related business	-	-	-	758,957	758,957	-
Communication	-	-	-	2,931,457	2,931,457	-
Energy	-	-	-	6,827,939	6,827,939	-
Water and waste water	-	-	-	2,023,774	2,023,774	-
Rural residential real estate	2,558	-	2,558	3,085,739	3,088,297	-
Total	\$ 990,762	\$ 1,610,108	\$ 2,600,870	\$ 236,536,209	\$ 239,137,079	\$ -

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 March 31, 2017, the total recorded investment of troubled debt restructured loans was \$3,444,860, including \$192,344 classified as nonaccrual and \$3,252,516 classified as accrual, with specific allowance for loan losses of \$366,141. The specific allowance is determined quarterly through a net realizable value analysis for each individual loan asset. As of March 31, 2017, there were no commitments to lend funds to borrowers whose loan terms have been modified in a troubled debt restructuring at period end and at December 31, 2016.

There were no troubled debt restructurings that occurred during the three months ended March 31, 2017. Loans formally restructured prior to January 1, 2017, were \$3,444,860.

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 charge-offs recorded at the modification date for the quarter ending March 31, 2017.

The predominant form of concession granted for troubled debt restructuring includes principal and interest reductions. Other types of modifications include extension of the term, principal or accrued interest reductions, interest rate decreases and delayed payments, among others. 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.

There were no loans that met the accounting criteria as a troubled debt restructuring and that occurred within the previous 12 months and for which there was a subsequent payment default during the period. A payment default is defined as a payment that is 30 days past due after the date the loan was restructured.

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

	Loans Modified as TDRs		TDRs in Nonaccrual Status*	
	March 31, 2017	December 31, 2016	March 31, 2017	December 31, 2016
Real estate mortgage	\$ 3,409,252	\$ 3,511,594	\$ 156,737	\$ 253,514
Production and intermediate term	35,608	37,135	35,607	37,135
Total	\$ 3,444,860	\$ 3,548,729	\$ 192,344	\$ 290,649

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

Additional impaired loan information is as follows:

	March 31, 2017			December 31, 2016		
	Recorded	Unpaid	Related	Recorded	Unpaid	Related
	<u>Investment</u>	<u>Principal Balance^a</u>	<u>Allowance</u>	<u>Investment</u>	<u>Principal Balance^a</u>	<u>Allowance</u>
Impaired loans with a related allowance for credit losses:						
Real estate mortgage	\$2,262,495	\$2,311,670	\$378,245	\$2,304,266	\$2,353,442	\$395,561
Production and intermediate term	636,547	636,547	181,013	652,689	652,751	197,882
Total	<u>\$2,899,042</u>	<u>\$2,948,217</u>	<u>\$559,258</u>	<u>\$2,956,955</u>	<u>\$3,006,193</u>	<u>\$593,443</u>
Impaired loans with no related allowance for credit losses:						
Real estate mortgage	\$2,474,462	\$2,485,958	\$-	\$2,578,815	\$2,589,436	\$-
Production and intermediate term	762,271	3,191,532	-	783,287	3,215,302	-
Total	<u>\$3,236,733</u>	<u>\$5,677,490</u>	<u>\$-</u>	<u>\$3,362,102</u>	<u>\$5,804,738</u>	<u>\$-</u>
Total impaired loans:						
Real estate mortgage	\$4,736,957	\$4,797,628	\$378,245	\$4,883,081	\$4,942,878	\$395,561
Production and intermediate term	1,398,818	3,828,079	181,013	1,435,976	3,868,053	197,882
Total	<u>\$6,135,775</u>	<u>\$8,625,707</u>	<u>\$559,258</u>	<u>\$6,319,057</u>	<u>\$8,810,931</u>	<u>\$593,443</u>

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

	For the Three Months Ended			
	March 31, 2017		March 31, 2016	
	<u>Average Impaired Loans</u>	<u>Interest Income Recognized</u>	<u>Average Impaired Loans</u>	<u>Interest Income Recognized</u>
Impaired loans with a related allowance for credit losses:				
Real estate mortgage	\$2,261,898	\$27,702	\$3,192,296	\$36,442
Production and intermediate term	649,026	-	55,022	-
Total	<u>\$2,910,924</u>	<u>\$27,702</u>	<u>\$3,247,318</u>	<u>\$36,442</u>
Impaired loans with no related allowance for credit losses:				
Real estate mortgage	\$2,494,013	\$49,846	\$4,839,050	\$21,015
Production and intermediate term	778,642	1,800	7,463	-
Total	<u>\$3,272,655</u>	<u>\$51,646</u>	<u>\$4,846,513</u>	<u>\$21,015</u>
Total impaired loans:				
Real estate mortgage	\$4,755,911	\$77,548	\$8,031,346	\$57,457
Production and intermediate term	1,427,668	1,800	62,485	-
Total	<u>\$6,183,579</u>	<u>\$79,348</u>	<u>\$8,093,831</u>	<u>\$57,457</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	Water and Waste Water	Rural Residential Real Estate	Total
Allowance for Credit Losses:								
Balance at								
December 31, 2016	\$ 1,694,453	\$ 257,900	\$ 28,885	\$ 2,923	\$ 79,111	\$ 15,000	\$ 2,676	\$ 2,080,948
Charge-offs	(10,972)	-	-	-	-	-	-	(10,972)
Recoveries	2,759	1,700	-	-	-	-	-	4,459
Provision for loan losses	33,714	(20,699)	(1,748)	94	(1,515)	-	243	10,089
Balance at								
March 31, 2017	\$ 1,719,954	\$ 238,901	\$ 27,137	\$ 3,017	\$ 77,596	\$ 15,000	\$ 2,919	\$ 2,084,524
Ending Balance:								
Individually evaluated for impairment	\$ 378,244	\$ 181,014	\$ 27,137	\$ 3,017	\$ 77,596	\$ 15,000	\$ 2,919	\$ 684,927
Collectively evaluated for impairment	1,341,710	57,887	-	-	-	-	-	1,399,597
Balance at								
March 31, 2017	\$ 1,719,954	\$ 238,901	\$ 27,137	\$ 3,017	\$ 77,596	\$ 15,000	\$ 2,919	\$ 2,084,524
Balance at								
December 31, 2015	\$ 2,103,738	\$ 158,147	\$ 20,786	\$ 1,960	\$ 53,291	\$ 15,020	\$ 4,777	\$ 2,357,719
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	2,254	2,200	-	-	-	-	-	4,454
Provision for loan losses	(69,803)	19,737	8,312	(113)	(940)	-	457	(42,350)
Balance at								
March 31, 2016	\$ 2,036,189	\$ 180,084	\$ 29,098	\$ 1,847	\$ 52,351	\$ 15,020	\$ 5,234	\$ 2,319,823
Ending Balance:								
Individually evaluated for impairment	\$ 694,946	\$ 26,137	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 721,083
Collectively evaluated for impairment	1,341,243	153,947	29,098	1,847	52,351	15,020	5,234	1,598,740
Balance at								
March 31, 2016	\$ 2,036,189	\$ 180,084	\$ 29,098	\$ 1,847	\$ 52,351	\$ 15,020	\$ 5,234	\$ 2,319,823
Recorded Investments in Loans Outstanding:								
Ending Balance at								
March 31, 2017	\$ 187,527,537	\$ 11,486,853	\$ 22,003,344	\$ 3,008,658	\$ 4,551,658	\$ 2,003,982	\$ 3,304,953	\$ 233,886,985
Individually evaluated for impairment	\$ 4,736,957	\$ 1,398,818	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,135,775
Collectively evaluated for impairment	\$ 182,790,580	\$ 10,088,035	\$ 22,003,344	\$ 3,008,658	\$ 4,551,658	\$ 2,003,982	\$ 3,304,953	\$ 227,751,210
Ending Balance at								
March 31, 2016	\$ 188,748,558	\$ 11,265,611	\$ 23,598,496	\$ 2,016,496	\$ 7,050,521	\$ 2,003,136	\$ 5,579,099	\$ 240,261,917
Individually evaluated for impairment	\$ 7,984,336	\$ 79,140	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,063,476
Collectively evaluated for impairment	\$ 180,764,222	\$ 11,186,471	\$ 23,598,496	\$ 2,016,496	\$ 7,050,521	\$ 2,003,136	\$ 5,579,099	\$ 232,198,441

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.

Regulatory Capitalization Requirements

Effective January 1, 2017, the regulatory capital requirements for 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.

Select Capital Ratios	Capital			As of March 31, 2017
	Regulatory Minimums	Conservation Buffer	Total	
Risk-adjusted:				
Common equity tier 1 ratio	4.50%	2.50%	7.00%	22.93%
Tier 1 capital ratio	6.00%	2.50%	8.50%	22.93%
Total capital ratio	8.00%	2.50%	10.50%	23.86%
Permanent capital ratio	7.00%	0.00%	7.00%	23.15%
Non-risk-adjusted:				
Tier 1 leverage ratio	4.00%	1.00%	5.00%	21.79%
UREE leverage ratio	1.50%	0.00%	1.50%	22.90%

*The 2.5% capital conservation buffer for the risk-adjusted ratios will be phased in over a three year period ending on December 31, 2019.

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 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 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 7 years, allocated equities held for a minimum of 7 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 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 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.

•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 offices are restricted or prohibited without prior FCA approval.

Risk-adjusted Capital Ratios

	Common equity tier 1 ratio	Tier 1 capital ratio	Total capital ratio	Permanent capital ratio
Numerator:				
Unallocated retained earnings	38,600,479	38,600,479	38,600,479	38,600,479
Paid-in capital	-	-	-	-
Common Cooperative Equities:				
Statutory minimum purchased borrower stock	1,107,012	1,107,012	1,107,012	1,107,012
Other required member purchased stock held <5 years				
Other required member purchased stock held ≥ 5 years but < 7 years				
Other required member purchased stock held ≥ 7 years				
Allocated equities:				
Allocated equities held <5 years				
Allocated equities held ≥ 5 years but < 7 years				
Allocated equities held ≥ 7	-	-	-	-
Nonqualified allocated equities not subject to retirement	15,510,664	15,510,664	15,510,664	15,510,664
Non-cumulative perpetual preferred stock		-	-	-
Other preferred stock subject to certain limitations				
Subordinated debt subject to certain limitation				
Allowance for loan losses and reserve for credit losses subject to certain limitations			2,076,103	
Regulatory Adjustments and Deductions:				
Amount of allocated investments in other System institutions	(3,738,505)	(3,738,505)	(3,738,505)	(3,738,505)
Other regulatory required deductions	-	-	-	-
Denominator:				
Risk-adjusted assets excluding allowance	228,231,534	228,231,534	228,231,534	228,231,534
Regulatory Adjustments and Deductions:				
Regulatory deductions included in total capital	(3,738,505)	(3,738,505)	(3,738,505)	(3,738,505)
Allowance for loan losses	-	-	-	(2,076,103)

Non-risk-adjusted Capital Ratios

	Tier 1 leverage ratio	UREE leverage ratio
Numerator:		
Unallocated retained earnings	38,600,479	38,600,479
Paid-in capital	-	-
Common Cooperative Equities:		
Statutory minimum purchased borrower stock	1,107,012	-
Other required member purchased stock held <5 years		
Other required member purchased stock held ≥ 5 years but < 7 years		
Other required member purchased stock held ≥7 years		
Allocated equities:		
Allocated equities held ≥7	-	-
Nonqualified allocated equities not subject to retirement	15,510,664	15,510,664
Non-cumulative perpetual preferred stock	-	
Other preferred stock subject to certain limitations		
Subordinated debt subject to certain limitation		
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	(3,738,505)	-
Other regulatory required deductions	-	-
Denominator:		
Total Assets	240,031,987	240,031,987
Regulatory Adjustments and Deductions:		
Regulatory deductions included in tier 1 capital	(3,738,505)	(3,738,505)

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

March 31, 2017	<u>Before Tax</u>	<u>Deferred Tax</u>	<u>Net of Tax</u>
Nonpension postretirement benefits	\$ 73,526	\$ -	\$ 73,526
March 31, 2016	<u>Before Tax</u>	<u>Deferred Tax</u>	<u>Net of Tax</u>
Nonpension postretirement benefits	\$ 90,155	\$ -	\$ 90,155

The association's accumulated other comprehensive income (loss) relates entirely to its nonpension other postretirement benefits. Amortization of prior service (credits) cost and of actuarial (gain) loss are reflected in "Salaries and employee benefits" in the Consolidated Statement of Comprehensive Income. The following table summarizes the changes in accumulated other comprehensive income (loss) for the three months ended March 31:

	<u>2017</u>	<u>2016</u>
Accumulated other comprehensive income (loss) at January 1	\$ 76,474	\$ 93,360
Amortization of prior service (credit) costs included in salaries and employee benefits	(2,049)	(2,049)
Amortization of actuarial (gain) loss included in salaries and employee benefits	<u>(899)</u>	<u>(1,156)</u>
Other comprehensive income (loss), net of tax	<u>(2,948)</u>	<u>(3,205)</u>
Accumulated other comprehensive income at March 31	<u>\$ 73,526</u>	<u>\$ 90,155</u>

NOTE 4 — INCOME TAXES:

Legacy Ag 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. Legacy Ag Credit, ACA operates as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, Legacy Ag 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.

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 2016 Annual Report to Stockholders for a more complete description.

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

<u>March 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*	\$ -	\$ -	\$3,518,560	\$3,518,560	\$ -
Other property owned	-	-	-	-	-
 <u>December 31, 2016</u>					
Assets:					
Loans*	\$ -	\$ -	\$ 3,549,508	\$ 3,549,508	\$ -
Other property owned	-	-	276,000	276,000	-

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

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.

Information About Other Financial Instrument Fair Value Measurements

	<u>Valuation Technique(s)</u>	<u>Input</u>
Cash	Carrying value	Par/principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Note payable to bank	Discounted cash flow	Benchmark yield curve Derived yield spread Own credit risk

Valuation Techniques

As more fully discussed in Note 13 to the 2016 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 2016 Annual Report to Stockholders.

Other Property Owned

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

Cash

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

Loans

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

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

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

Note payable to the Farm Credit Bank of Texas

The note payable to the bank is not regularly traded; thus, quoted market prices are not available. Fair value of this instrument is discounted based on the association's and bank's loan rates as well as on management estimates. For the purposes of this estimate it is assumed that the cash flow on the note is equal to the principal payments on the association's loan receivables plus accrued interest on the note payable. This assumption implies that earnings on the association's interest margin are used to fund operating expenses and capital expenditures. Management has no basis to determine whether the fair values would be indicative of the value negotiated in an actual sale.

NOTE 6 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs of nonpension other postretirement employee benefits for the three months ended March 31:

	Other Benefits	
	2017	2016
Service cost	\$ 1,697	\$ 1,667
Interest cost	2,635	2,621
Amortization of prior service (credits) costs	(2,049)	(2,049)
Amortization of net actuarial (gain) loss	(899)	(1,156)
Net periodic benefit cost	<u>\$ 1,384</u>	<u>\$ 1,083</u>

The association’s liability for the unfunded accumulated obligation for these benefits at March 31, 2017, was \$236,597 and is included in “Other Liabilities” in the balance sheet.

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, 2016, that it expected to contribute \$0 to the district’s defined benefit pension plan in 2017. As of March 31, 2017, \$0 of contributions have been made.

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 — REGULATORY ENFORCEMENT MATTERS

Effective January 10, 2017 the association was placed under Special Supervision by the Farm Credit Administration (FCA) related to the manner in which the decision was made to terminate the merger with Texas Farm Credit Services. The FCA also established a number of supervisory requirements including: (1) the engagement of a board consultant approved by the FCA, and (2) FCA notification prior to any material board decisions, or any actions related to the composition and structure of the board, bylaw changes, or association management. In response to the supervisory requirements the board has engaged a consultant with many years of direct Farm Credit related experience that will also serve as an independent administrative resource for the association director nominating committee. The board has also added an additional outside director who brings many years of Farm Credit experience to the association. A search for a CEO is in process.

A disclosure under the title of Terminated Merger Discussion was included in the association’s 2016 Annual Report to Stockholders on pages 7 and 8. The disclosure referenced the rescission of the proposed merger of Legacy Ag Credit, ACA with Texas Farm Credit as well as the resulting issuance of a Supervisory Letter from the association’s regulator, the Farm Credit Administration (FCA), to the association’s board. The association’s board received a subsequent letter from the FCA on April 19, 2017 that established several additional requirements of the board, and the board is proceeding to appropriately address those requirements. The annual meeting of the association’s stockholders is currently scheduled for Monday, August 14, 2017, and additional information will be provided to stockholders during the upcoming annual meeting.

NOTE 9 — SUBSEQUENT EVENTS:

The association has evaluated subsequent events through May 9, 2017, which is the date the financial statements were issued.

In January 2017, the Board of Directors approved a patronage payment related to 2016 earnings of \$2,400,000. The patronage will be paid in April 2017.

A disclosure under the title of Terminated Merger Discussion was included in the association’s 2016 Annual Report to Stockholders on pages 7 and 8. The disclosure referenced the rescission of the proposed merger of Legacy Ag Credit, ACA with Texas Farm Credit as well as the resulting issuance of a Supervisory Letter from the association’s regulator, the Farm Credit Administration (FCA), to the association’s board. The association’s board received a subsequent letter from the FCA on April 19, 2017 that established several additional requirements of the board, and the board is proceeding to appropriately address those requirements. The annual meeting of the association’s stockholders is currently scheduled for Monday, August 14, 2017, and additional information will be provided to stockholders during the upcoming annual meeting.

There are no other significant events requiring disclosure as of May 9, 2017.