



## AgHeritage Farm Credit Services, ACA

Quarterly Report  
June 30, 2018

### MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the consolidated financial condition and consolidated results of operations of AgHeritage Farm Credit Services, ACA and its subsidiaries AgHeritage Farm Credit Services, FLCA and AgHeritage Farm Credit Services, PCA. This discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Quarterly Report as well as Management's Discussion and Analysis included in our Annual Report for the year ended December 31, 2017 (2017 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 2017 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

For the 2017 crop we generally experienced good quality crops with above average yields. We also experienced favorable weather conditions that led to lower input costs for the 2017 crop. Due to these favorable conditions, we observed that a large majority of our row crop borrowers experienced positive cash flows for the 2017 crop. Progress for the 2018 crop is generally better than average. However, due to less than ideal growing conditions experienced to date, we expect average yields and quality. Input costs for the 2018 crop are expected to be higher than the prior year. Commodity prices have been weak due to large supplies and weakness in export markets. Due to the less favorable crop conditions combined with lower commodity prices, we expect to see some decline in credit quality. Land values in our area remain stable.

### LOAN PORTFOLIO

#### Loan Portfolio

Total loans were \$1.3 billion at June 30, 2018, an increase of \$126.4 million from December 31, 2017. The increase was primarily due to seasonal use of operating loans within our production and intermediate term loan portfolio. To a lesser extent, there was also growth in the real estate mortgage and agribusiness sectors of our portfolio.

#### Portfolio Credit Quality

The credit quality of our portfolio improved from December 31, 2017. Adversely classified loans decreased to 3.1% of the portfolio at June 30, 2018, from 4.1% of the portfolio at December 31, 2017. 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, 2018, \$23.0 million of our loans were, to some level, guaranteed under these government programs.

## Risk Assets

### Components of Risk Assets

(dollars in thousands)	June 30	December 31
As of:	2018	2017
Loans:		
Nonaccrual	\$ 4,140	\$ 7,156
Accruing restructured	--	--
Accruing loans 90 days or more past due	--	--
Total risk loans	4,140	7,156
Other property owned	--	--
Total risk assets	\$ 4,140	\$ 7,156
Total risk loans as a percentage of total loans	0.3%	0.6%
Nonaccrual loans as a percentage of total loans	0.3%	0.6%
Current nonaccrual loans as a percentage of total nonaccrual loans	74.9%	62.1%
Total delinquencies as a percentage of total loans	0.3%	0.7%

Note: Accruing loans include accrued interest receivable.

Our risk assets have decreased from December 31, 2017, and have 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 one real estate mortgage loan which returned to accrual status during June 2018. Nonaccrual loans remained at an acceptable level at June 30, 2018, and December 31, 2017.

The decrease in total delinquencies as a percentage of total loans was primarily due to the decrease in nonaccrual loans as previously discussed.

### 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	December 31
	2018	2017
Allowance as a percentage of:		
Loans	0.3%	0.4%
Nonaccrual loans	106.0%	61.5%
Total risk loans	106.0%	61.5%

In our opinion, the allowance for loan losses was reasonable in relation to the risk in our loan portfolio at June 30, 2018.

## RESULTS OF OPERATIONS

### Profitability Information

(dollars in thousands)	2018	2017
For the six months ended June 30		
Net income	\$ 11,611	\$ 10,877
Return on average assets	1.9%	1.9%
Return on average members' equity	8.2%	8.3%

Changes in the chart above relate directly to:

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

### Changes in Significant Components of Net Income

(in thousands)			Increase (decrease) in net income
For the six months ended June 30	2018	2017	
Net interest income	\$ 17,256	\$ 16,403	\$ 853
Provision for loan credit losses	--	826	826
Patronage income	2,131	2,003	128
Other (loss) income, net	(107)	1,181	(1,288)
Operating expenses	7,720	6,939	(781)
(Benefit from) provision for income taxes	(51)	945	996
Net income	<u>\$ 11,611</u>	<u>\$ 10,877</u>	<u>\$ 734</u>

### Changes in Net Interest Income

(in thousands)		
For the six months ended June 30	2018 vs 2017	
Changes in volume	\$	1,110
Changes in interest rates		(418)
Changes in nonaccrual income and other		161
Net change	<u>\$</u>	<u>853</u>

The change in the provision for credit losses was related to our estimate of the allowance for credit losses as of June 30, 2018. No additional allowance for loan losses was deemed necessary during the six months ended June 30, 2018; and therefore no provision for credit losses has been recognized.

The change in other income was primarily due to a contingency loss recognized during the six months ended June 30, 2018, related to the settlement of an ongoing lawsuit in which the Association is a defendant. Refer to Note 4 for additional discussion.

The decrease in other income was partially offset by our share of distributions from Allocated Insurance Reserve Accounts (AIRA) of \$686 thousand. The AIRA was recently established by the Farm Credit System Insurance Corporation (FCSIC) when premiums collected increased the level of the Insurance Fund beyond the required 2% of insured debt. There was no distribution in 2017. Refer to the 2017 Annual Report for additional information about the FCSIC.

The change in operating expenses was primarily related to an increase in salaries and benefits expense.

The change in operating expenses was primarily related to an increase in salaries and benefits expense. The increase was partially offset by FCSIC expense which decreased in 2018 primarily due to a lower premium rate charged by FCSIC on accrual loans from 15 basis points in 2017 to 9 basis points in 2018. The FCSIC Board meets periodically throughout the year to review premium rates and has the ability to change these rates at any time.

The change in provision for income taxes was primarily related to our estimate of taxes based on taxable income and the reduced Federal statutory tax rates as a result of the Tax Cuts and Jobs Act enacted in December 2017. Refer to Note 8 in our 2017 Annual Report for additional discussion.

## FUNDING, LIQUIDITY AND CAPITAL

We borrow from AgriBank, under a note payable, in the form of a line of credit. Our note payable matures on May 31, 2020, at which time the note will be renegotiated. The repricing attributes of our line of credit generally correspond to the repricing attributes of our loan portfolio, which significantly reduces our market interest rate risk. Due to the cooperative structure of the Farm Credit System and as we are a stockholder of AgriBank, we expect this borrowing relationship to continue into the foreseeable future. Our other source of lendable funds is from unallocated surplus.

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

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

We were not subject to a risk premium at June 30, 2018, or December 31, 2017.

Total members' equity increased \$9.8 million from December 31, 2017, primarily due to net income for the period partially offset by patronage distribution accruals. Accumulated other comprehensive income is the impact of prior service cost and unamortized actuarial gain/loss related to the Pension Restoration Plan. Refer to Note 9 in our 2017 Annual Report for more information on the Pension Restoration Plan.

The Farm Credit Administration (FCA) Regulations require us to maintain minimums for our common equity tier 1, tier 1 capital, total capital and permanent capital risk-based capital ratios. In addition, the FCA requires us to maintain minimums for our non-risk-adjusted ratios of tier 1 leverage and unallocated retained earnings and equivalents. Refer to Note 7 in our 2017 Annual Report for a more complete description of these ratios.

#### Select Capital Ratios

As of:	June 30 2018	December 31 2017	Regulatory Minimums	Capital Conservation Buffer	Total
Risk-adjusted:					
Common equity tier 1 ratio	19.3%	19.1%	4.5%	2.5%*	7.0%
Tier 1 capital ratio	19.3%	19.1%	6.0%	2.5%*	8.5%
Total capital ratio	19.6%	19.4%	8.0%	2.5%*	10.5%
Permanent capital ratio	19.3%	19.2%	7.0%	N/A	7.0%
Non-risk-adjusted:					
Tier 1 leverage ratio	21.1%	20.8%	4.0%	1.0%	5.0%
Unallocated retained earnings and equivalents leverage ratio	21.6%	21.4%	1.5%	N/A	1.5%

\*The capital conservation buffer over risk-adjusted ratio minimums continues to be phased in under the Farm Credit Administration capital requirements, up to 2.5% beginning in 2020.

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.

### REGULATORY MATTERS

#### Investment Securities Eligibility

In May 2018, the FCA Board approved a final rule to revise the requirements governing the eligibility of investment securities for System Banks and associations. The new regulation revises the eligibility purpose, type and amount of investments that a System association may hold. The regulation is effective January 1, 2019. We are currently working to update policies, procedures and other documentation to ensure compliance by the effective date. We do not expect the regulation to have a material impact on our financial statements.

### CERTIFICATION

The undersigned have reviewed the June 30, 2018, Quarterly Report of AgHeritage Farm Credit Services, ACA, which has been prepared under the oversight of the Audit Committee and in accordance with all applicable statutory or regulatory requirements. The information contained herein is true, accurate and complete to the best of our knowledge and belief.



Dwain Morris  
Chairperson of the Board  
AgHeritage Farm Credit Services, ACA



Gregory W. Cole  
President and Chief Executive Officer  
AgHeritage Farm Credit Services, ACA



Kenneth L. Sumner  
Senior Vice President and Chief Financial Officer  
AgHeritage Farm Credit Services, ACA

August 9, 2018

# CONSOLIDATED STATEMENTS OF CONDITION

AgHeritage Farm Credit Services, ACA

(in thousands)

(Unaudited)

As of:	June 30 2018	December 31 2017
<b>ASSETS</b>		
Loans	\$ 1,292,627	\$ 1,166,229
Allowance for loan losses	4,387	4,404
Net loans	1,288,240	1,161,825
Investment in AgriBank, FCB	25,269	25,269
Investment securities	2,535	3,643
Accrued interest receivable	15,683	20,814
Deferred tax assets, net	279	228
Other assets	7,053	7,526
Total assets	\$ 1,339,059	\$ 1,219,305
<b>LIABILITIES</b>		
Note payable to AgriBank, FCB	\$ 1,040,519	\$ 929,140
Accrued interest payable	6,248	5,232
Patronage distribution payable	1,900	3,700
Other liabilities	4,223	4,848
Total liabilities	1,052,890	942,920
Contingencies and commitments (Note 4)		
<b>MEMBERS' EQUITY</b>		
Protected members' equity	1	1
Capital stock and participation certificates	2,816	2,759
Unallocated surplus	283,894	274,207
Accumulated other comprehensive loss	(542)	(582)
Total members' equity	286,169	276,385
Total liabilities and members' equity	\$ 1,339,059	\$ 1,219,305

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

# CONSOLIDATED STATEMENTS OF INCOME

AgHeritage Farm Credit Services, ACA

(in thousands)

(Unaudited)

For the period ended June 30	Three Months Ended		Six Months Ended	
	2018	2017	2018	2017
<b>Interest income</b>	\$ 15,116	\$ 13,426	\$ 28,970	\$ 25,624
<b>Interest expense</b>	6,248	4,916	11,714	9,221
Net interest income	8,868	8,510	17,256	16,403
<b>Provision for credit losses</b>	--	211	--	826
Net interest income after provision for credit losses	8,868	8,299	17,256	15,577
<b>Other (loss) income</b>				
Patronage income	1,043	948	2,131	2,003
Financially related services income	37	38	74	65
Fee income	478	559	1,092	1,053
Allocated insurance reserve accounts distribution	--	--	686	--
Miscellaneous (loss) income, net	(2,074)	(2)	(1,959)	63
Total other (loss) income	(516)	1,543	2,024	3,184
<b>Operating expenses</b>				
Salaries and employee benefits	2,142	2,057	4,554	3,990
Other operating expenses	1,655	1,502	3,166	2,949
Total operating expenses	3,797	3,559	7,720	6,939
Income before income taxes	4,555	6,283	11,560	11,822
<b>(Benefit from) provision for income taxes</b>	(274)	422	(51)	945
Net income	\$ 4,829	\$ 5,861	\$ 11,611	\$ 10,877
<b>Other comprehensive income</b>				
Employee benefit plans activity	\$ 20	\$ --	\$ 40	\$ --
Total other comprehensive income	20	--	40	--
Comprehensive income	\$ 4,849	\$ 5,861	\$ 11,651	\$ 10,877

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

## CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY

*AgHeritage Farm Credit Services, ACA*

*(in thousands)*

*(Unaudited)*

	Protected Members' Equity	Capital Stock and Participation Certificates	Unallocated Surplus	Accumulated Other Comprehensive Loss	Total Members' Equity
Balance at December 31, 2016	\$ 1	\$ 2,875	\$ 253,025	\$ --	\$ 255,901
Net income	--	--	10,877	--	10,877
Unallocated surplus designated for patronage distributions	--	--	(1,829)	--	(1,829)
Capital stock and participation certificates issued	--	130	--	--	130
Capital stock and participation certificates retired	--	(260)	--	--	(260)
<b>Balance at June 30, 2017</b>	<b>\$ 1</b>	<b>\$ 2,745</b>	<b>\$ 262,073</b>	<b>\$ --</b>	<b>\$ 264,819</b>
Balance at December 31, 2017	\$ 1	\$ 2,759	\$ 274,207	\$ (582)	\$ 276,385
Net income	--	--	11,611	--	11,611
Other comprehensive income	--	--	--	40	40
Unallocated surplus designated for patronage distributions	--	--	(1,924)	--	(1,924)
Capital stock and participation certificates issued	--	148	--	--	148
Capital stock and participation certificates retired	--	(91)	--	--	(91)
<b>Balance at June 30, 2018</b>	<b>\$ 1</b>	<b>\$ 2,816</b>	<b>\$ 283,894</b>	<b>\$ (542)</b>	<b>\$ 286,169</b>

*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, 2018, are not necessarily indicative of the results to be expected for the year ending December 31, 2018. 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, 2017 (2017 Annual Report).

The Consolidated Financial Statements present the consolidated financial results of AgHeritage Farm Credit Services, ACA (the Association) and its subsidiaries AgHeritage Farm Credit Services, FLCA and AgHeritage Farm Credit Services, PCA (the subsidiaries). 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. While we are a nonpublic entity, we generally adopt on the public entity required date to align with other Farm Credit System institutions. For recently issued and adopted accounting pronouncements disclosed, we plan to adopt on the public entity effective date.

Standard and effective date	Description	Adoption status and financial statement impact
In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 "Revenue from Contracts with Customers." This guidance was effective for public entities on January 1, 2018.	The guidance governs revenue recognition from contracts with customers and requires an entity to recognize revenue to depict the transfer of 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 guidance. The guidance sets forth the requirement for new and enhanced disclosures.	We adopted this guidance on January 1, 2018, using the modified retrospective approach. The majority of the Association's revenues are not subject to the new guidance, the adoption of the guidance did not have a material impact on the financial condition, results of operations, equity or cash flows.
In March 2017, the FASB issued ASU 2017-07 "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Cost." This guidance was effective for public entities on January 1, 2018.	This guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. Specifically, the guidance requires non-service cost components of net benefit cost to be recognized in a non-operating income line item of the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization.	We adopted this guidance on January 1, 2018. The adoption of the guidance did not impact the Association's financial condition or cash flows, but did change the classification of certain items in the results of operations. The change in classification was not material and did not result in a reclassification on the Statement of Comprehensive Income. There were no changes to the financial statement disclosures.
In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities." This guidance was effective for public business entities on January 1, 2018.	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.	We adopted this guidance on January 1, 2018. The adoption of this guidance did not impact our financial condition, results of operations or cash flows, but did impact the Association's fair value disclosures.
In February 2016, the FASB issued ASU 2016-02 "Leases." The guidance is effective for public entities in its first quarter of 2019 and early adoption is permitted.	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. When this guidance is adopted, a liability for lease obligations and a corresponding right-of-use asset will be recognized on the Consolidated Statements of Condition for all lease arrangements spanning more than 12 months.	We have no plans to early adopt this guidance. We are in the process of system selection, drafting accounting policies and designing processes and controls to implement this standard. The necessary disclosures will be determined during 2018. We have determined after preliminary review that this guidance will not have a material impact on our financial condition, results of operations and financial statement disclosures and will have no impact on cash flows.



Standard and effective date	Description	Adoption status and financial statement impact
In June 2016, the FASB issued ASU 2016-13 "Financial Instruments – Credit Losses." This guidance is effective for public business entities for non-U.S. Securities Exchange Commission filers for the first quarter of 2021 and early adoption is permitted.	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 determine credit loss estimates. Credit losses relating to available-for-sale securities would also be recorded through an allowance for credit losses.	We have no plans to early adopt this guidance. We are in the process of reviewing the standard. Significant implementation matters yet to be addressed include system selection, drafting of accounting policies and disclosures, designing processes and controls. We are currently unable to estimate the impact on the financial statements.

## NOTE 2: LOANS AND ALLOWANCE FOR LOAN LOSSES

### Loans by Type

(dollars in thousands)

As of:	June 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Real estate mortgage	\$ 640,463	49.5%	\$ 599,124	51.4%
Production and intermediate-term	452,333	35.0%	379,154	32.5%
Agribusiness	123,254	9.5%	115,597	9.9%
Other	76,577	6.0%	72,354	6.2%
Total	\$ 1,292,627	100.0%	\$ 1,166,229	100.0%

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

### Delinquency

#### Aging Analysis of Loans

(in thousands)	30-89 Days		90 Days or More		Total	
	Past Due	Past Due	Past Due	Past Due	Not Past Due or Less than 30 Days Past Due	Total
<b>As of June 30, 2018</b>						
Real estate mortgage	\$ 1,208	\$ 191	\$ 1,399	\$ 647,597	\$ 648,996	
Production and intermediate-term	728	348	1,076	457,474	458,550	
Agribusiness	--	--	--	123,820	123,820	
Other	1,064	85	1,149	75,662	76,811	
Total	\$ 3,000	\$ 624	\$ 3,624	\$ 1,304,553	\$ 1,308,177	
<b>As of December 31, 2017</b>						
Real estate mortgage	\$ 3,835	\$ 599	\$ 4,434	\$ 605,441	\$ 609,875	
Production and intermediate-term	750	1,170	1,920	386,303	388,223	
Agribusiness	--	--	--	116,183	116,183	
Other	1,477	73	1,550	71,036	72,586	
Total	\$ 6,062	\$ 1,842	\$ 7,904	\$ 1,178,963	\$ 1,186,867	

Note: Accruing loans include accrued interest receivable.

There were no loans 90 days or more past due and still accruing interest at June 30, 2018, and December 31, 2017.

## 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)	June 30	December 31
As of:	2018	2017
Volume with specific allowance	\$ 839	\$ 159
Volume without specific allowance	3,301	6,997
Total risk loans	<u>\$ 4,140</u>	<u>\$ 7,156</u>
Total specific allowance	\$ 113	\$ 110
For the six months ended June 30	2018	2017
Income on nonaccrual loans	409	248
Total income on risk loans	<u>\$ 409</u>	<u>\$ 248</u>
Average risk loans	\$ 5,752	\$ 8,698

Note: Accruing loans include accrued interest receivable.

We did not have any material commitments to lend additional money to borrowers whose loans were classified as risk loans at June 30, 2018.

### 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.

We completed TDRs of certain Rural Residential Real Estate loans during the six months ended June 30, 2018. There were no TDRs that occurred during the six months ended June 30, 2017. Our recorded investment in these loans just prior to restructuring was \$283 thousand during the six months ended June 30, 2018. Our recorded investment in these loans immediately following the restructuring was \$279 thousand during the six months ended June 30, 2018. 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 types of modification included forgiveness of accrued interest and fees and extension of maturity.

There were no TDRs that defaulted during the six months ended June 30, 2018, or 2017 in which the modification was within twelve months of the respective reporting period.

### TDRs Outstanding

(in thousands)	June 30	December 31
As of:	2018	2017
Total TDRs:		
Production and intermediate-term	\$ 55	\$ 85
Other	286	9
Total TDRs	<u>\$ 341</u>	<u>\$ 94</u>

All TDRs outstanding as of June 30, 2018 and December 31, 2017 were in nonaccrual status. There were no commitments to lend to borrowers whose loans have been modified in a TDR at June 30, 2018.

## Allowance for Loan Losses

### Changes in Allowance for Loan Losses

(in thousands)		
Six months ended June 30	2018	2017
Balance at beginning of period	\$ 4,404	\$ 5,307
Provision for loan losses	--	697
Loan recoveries	17	55
Loan charge-offs	(34)	(2,651)
Balance at end of period	<u>\$ 4,387</u>	<u>\$ 3,408</u>

The "Provision for credit losses" in the Consolidated Statements of Comprehensive Income includes a provision for loan losses as presented in the previous chart, as well as a provision for credit losses on unfunded commitments. The accrued credit losses on unfunded commitments are recorded in "Other liabilities" in the Consolidated Statements of Condition.

### Credit Loss Information on Unfunded Commitments

(in thousands)		
For the six months ended June 30	2018	2017
Provision for credit losses	\$ --	\$ 129
	June 30	December 31
As of:	2018	2017
Accrued credit losses	\$ 112	\$ 112

## NOTE 3: INVESTMENT SECURITIES

We held investment securities of \$2.5 million at June 30, 2018, and \$3.6 million at December 31, 2017. Our investment securities consisted of securities containing loans guaranteed by the Small Business Administration (SBA). All of our investment securities were fully guaranteed by the SBA at June 30, 2018, and December 31, 2017.

The investment securities have been classified as held-to-maturity. The investment portfolio is evaluated for other-than-temporary impairment. No investments within the portfolio were impaired as of June 30, 2018, and December 31, 2017.

### Additional Investment Securities Information

(dollars in thousands)		
As of:	June 30	December 31
	2018	2017
Amortized cost	\$ 2,535	\$ 3,643
Unrealized gains	87	142
Unrealized losses	(1)	--
Fair value	<u>\$ 2,621</u>	<u>\$ 3,785</u>
Weighted average yield	5.0%	4.3%

Investment income is recorded in "Interest income" in the Consolidated Statements of Comprehensive Income and totaled \$39 thousand and \$82 thousand for the six months ended June 30, 2018, and 2017, respectively.

## NOTE 4: 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. During June 2018, the Association reached a settlement in relation to an ongoing bankruptcy lawsuit in which the Association is a defendant. A loss contingency of \$2.1 million was recognized as of June 30, 2018, and is included in "Other liabilities" in the Consolidated Statements of Condition and "Miscellaneous (loss) income, net" in the Consolidated Statements of Comprehensive Income.

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 5: 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 2017 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, 2018, or December 31, 2017.

**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, 2018			
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Impaired loans	\$ --	\$ --	\$ 762	\$ 762

  

	As of December 31, 2017			
	Fair Value Measurement Using			Total Fair Value
	Level 1	Level 2	Level 3	
Impaired loans	\$ --	\$ --	\$ 51	\$ 51

**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 6: SUBSEQUENT EVENTS**

We have evaluated subsequent events through August 9, 2018, 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.