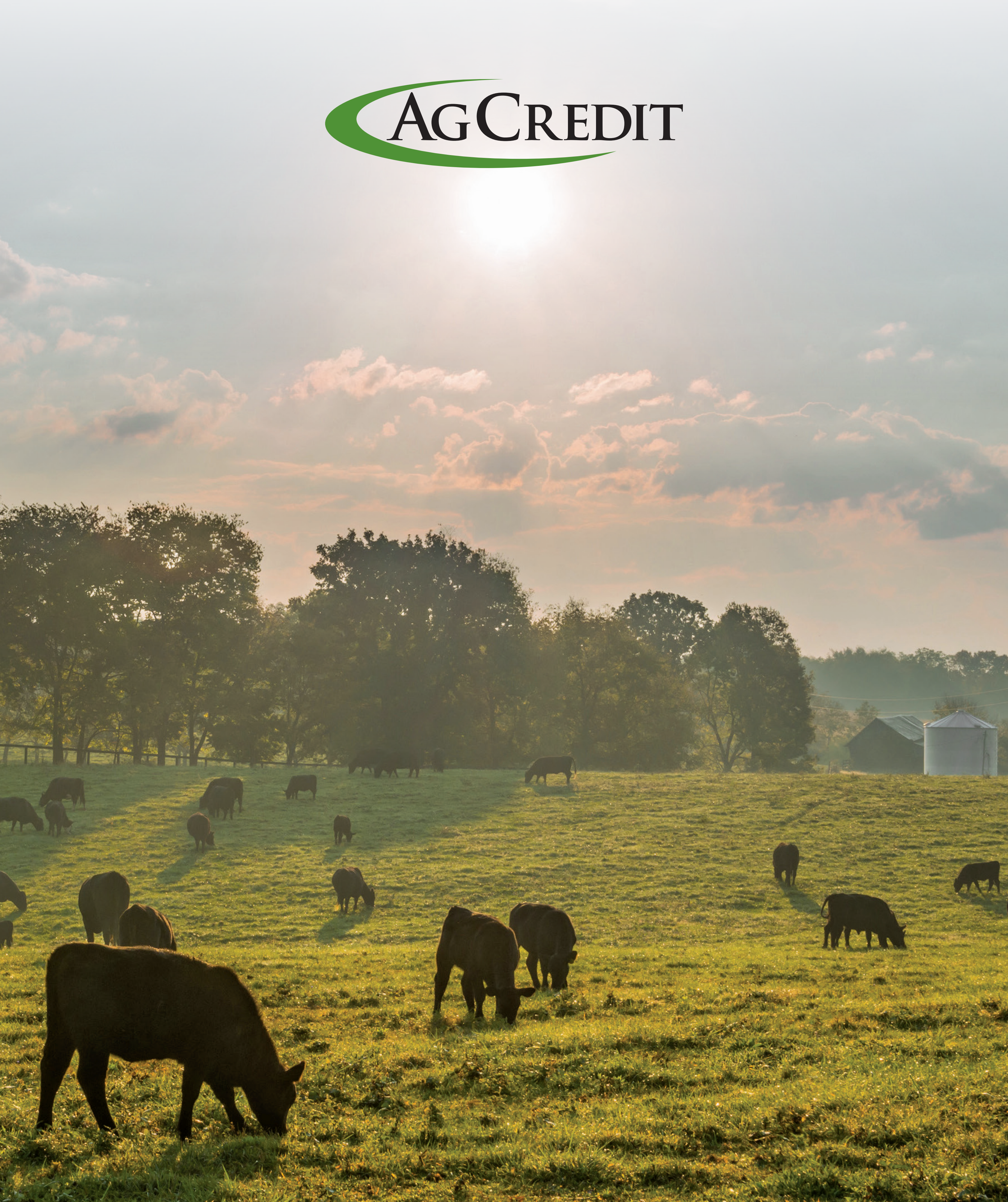

2016 ANNUAL REPORT

Central Kentucky Agricultural Credit Association

2016 Annual Report

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Management

James W. Caldwell .... President and Chief Executive Officer
Robert G. Anderson .... Vice President Information Systems
Marcus G. Barnett .... Vice President and Chief Financial Officer
Jonathan T. Noe .... Vice President and Chief Lending Officer

Board of Directors

James Alvin Lyons .... Chairman
James C. Rankin III .... Vice Chairman
James L. May .... Director
Joe Myers .... Director
Jerry Rankin .... Director
Mary-Lynn Hinkel .... Director
Lionel Williamson .... Director

Message from the President

Confidence

We generally think about the Annual Report as a collection of financial statements and related information. This assertion is accurate, but the Annual Report can be so much more. In essence, it can also be a time to gauge the level of confidence earned by the organization and whether the confidence level is trending in the right direction. This report is filled with financial statements, ratios, and statistics. There are plenty of charts and footnotes. Roll those together and it leads to an opinion on the dependability of the institution in fulfilling its mission and meeting the needs of its customers. Whether you consider yourself a Stockholder, Stakeholder, or simply an Interested Party, consider this Annual Report as an opportunity to take inventory of your overall confidence in the institution that is Central Kentucky Ag Credit.

The 2017 Annual Report includes several financial statements and related footnotes. As you review these documents I believe you will find the Association is in strong financial condition. In this period of volatility in agriculture, it is important that your lender have a solid financial base. The Central Kentucky Ag Credit foundation, built over 82 years of operation, is critical to the institution's ability to weather the storms of the commodity cycle and other challenges facing agriculture. The report also reflects a continuation of the earnings performance you have come to expect. Most noteworthy is the efficient use of members' equity (or capital) to generate these earning levels. This efficiency is perhaps best displayed in the return on equity generated for the past several years. As you review the financial statements, pay close attention to the Association's rate of return on average equity which has exceeded 10% for the seventh consecutive year.

Another area where you can find confidence in your Association is in its structure. Operating as a true cooperative organization, patronage paid from 2016 profits will represent the 20th consecutive year the association has declared such dividends. The level of patronage is projected to exceed $3 million for the first time in the history of our organization. Patronage distribution is only one way the cooperative structure benefits the member-borrower. Central Kentucky Ag Credit has a connection to its members as they select representation to serve on the Board of Directors. This results in a Board that is keenly aware of the needs of the patrons because they live and work together and face similar issues and challenges. Since we are local, the staff and Board serving you are dedicated to Central Kentucky farmers and rural residents.

Finally, I think confidence is a two-way street. There has to be a mutual level of trust between the lender and the borrower. This trust is critical to success on both sides. We depend upon you and you rely upon us. Sometimes when commodity prices are high and everything seems to be going well, we can forget about our mutual dependence. Then we face a down cycle and we all get reminded how we need each other. Central Kentucky Ag Credit has a mission to provide financing to agriculture. This mission reflects our dedication to agriculture and rural communities in good times and bad. The Annual Report is an opportunity to take inventory of our dependability and reliability. I believe it's more than just a publication filled with numbers, charts and footnotes. The report is a reflection of a cooperative institution fulfilling its mission and continually earning the confidence and trust of stockholders and stakeholders.

James W. Caldwell

James W. Caldwell
Chief Executive Officer

March 13, 2017

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Central Kentucky Agricultural Credit Association (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been audited by independent certified public accountants, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that we have reviewed the 2016 Annual Report of Central Kentucky Agricultural Credit Association, that the report has been prepared under the oversight of the audit committee of the Board of Directors and 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.

James A. Lyons

James Alvin Lyons
Chairman of the Board

James W. Caldwell

James W. Caldwell
Chief Executive Officer

M. G. Barnett

Marcus G. Barnett
Chief Financial Officer

March 13, 2017

Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of December 31, 2016. In making the assessment, management used the framework in *Internal Control — Integrated Framework (2013)*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association's management concluded that as of December 31, 2016, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of December 31, 2016.

James W. Caldwell
Chief Executive Officer

Marcus G. Barnett
Chief Financial Officer

March 13, 2017

Consolidated Five - Year Summary of Selected Financial Data

(dollars in thousands)	December 31, 2016	2015	2014	2013	2012
Balance Sheet Data					
Cash	**$ 1,605**	$ 1,250	$ 1,289	$ 1,223	$ 1,013
Loans	**426,095**	407,863	382,146	350,677	333,205
Allowance for loan losses	**(3,695)**	(3,771)	(3,892)	(3,593)	(3,760)
Net loans	**422,400**	404,092	378,254	347,084	329,445
Investments in other Farm Credit institutions	**7,113**	7,079	7,045	7,035	7,022
Other property owned	**8**	—	640	1,713	88
Other assets	**17,219**	15,241	15,123	22,407	24,869
Total assets	**$ 448,345**	$ 427,662	$ 402,351	$ 379,462	$ 362,437
Notes payable to AgFirst Farm Credit Bank*	**$ 368,038**	$ 353,034	$ 334,747	$ 317,656	$ 309,630
Accrued interest payable and other liabilities with maturities of less than one year	**7,278**	6,519	6,211	7,296	5,796
Total liabilities	**375,316**	359,553	340,958	324,952	315,426
Capital stock and participation certificates	**4,993**	6,784	6,744	6,676	6,590
Retained earnings					
Allocated	**48,344**	42,801	37,362	31,503	24,424
Unallocated	**19,692**	18,524	17,287	16,331	15,997
Total members' equity	**73,029**	68,109	61,393	54,510	47,011
Total liabilities and members' equity	**$ 448,345**	$ 427,662	$ 402,351	$ 379,462	$ 362,437
Statement of Income Data					
Net interest income	**$ 11,096**	$ 10,555	$ 10,125	$ 9,462	$ 8,926
Provision for (reversal of allowance for) loan losses	**(50)**	(35)	350	350	450
Noninterest income (expense), net	**(1,309)**	(1,295)	(125)	1,340	(1,294)
Net income	**$ 9,837**	$ 9,295	$ 9,650	$ 10,452	$ 7,182
Key Financial Ratios					
Rate of return on average:					
Total assets	**2.27%**	2.30%	2.51%	2.86%	2.06%
Total members' equity	**13.81%**	14.21%	16.43%	20.45%	15.77%
Net interest income as a percentage of average earning assets	**2.66%**	2.71%	2.74%	2.69%	2.67%
Net (chargeoffs) recoveries to average loans	**(0.006)%**	(0.022)%	(0.014)%	(0.150)%	(0.085)%
Total members' equity to total assets	**16.29%**	15.93%	15.26%	14.37%	12.97%
Debt to members' equity (:1)	**5.14**	5.28	5.55	5.96	6.71
Allowance for loan losses to loans	**0.87%**	0.92%	1.02%	1.02%	1.13%
Permanent capital ratio	**17.79%**	17.58%	16.85%	15.99%	14.18%
Total surplus ratio	**16.96%**	16.28%	15.54%	14.62%	12.80%
Core surplus ratio	**16.96%**	16.28%	15.54%	14.62%	12.69%
Net Income Distribution					
Estimated patronage refunds:					
Cash	**$ 3,105**	$ 2,617	$ 2,833	$ 2,969	$ 1,889
Nonqualified retained earnings	**5,766**	5,561	6,021	6,928	4,857

** General financing agreement is renewable on a one-year cycle. The next renewal date is December 31, 2017.*

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Central Kentucky Agricultural Credit Association (Association) for the year ended December 31, 2016 with comparisons to the years ended December 31, 2015 and December 31, 2014. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 100 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Kentucky. Refer to Note 1, *Organization and Operations*, of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association may be materially affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, ***www.agfirst.com,*** or may be obtained at no charge by calling 1-800-845-1745, extension 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, ***www.agcreditonline.com***, or by calling 1-859-253-3249, extension 607, or writing Marcus G. Barnett, Central Kentucky Agricultural Credit Association, P. O. Box 1290, Lexington, KY 40588-1290. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report, which is available on the internet, within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry and the Farm Credit System, as a government-sponsored enterprise, as well as investor and rating-agency reactions to events involving other government-sponsored enterprises and other financial institutions; and
- actions taken by the Federal Reserve System in implementing monetary policy.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, *Summary of Significant Accounting Policies*, of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined according to generally accepted accounting principles and is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including current production and economic conditions, loan portfolio composition, collateral value, portfolio quality and prior loan loss experience.

  Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses encompasses various judgments, evaluations and appraisals with respect to the loans and their underlying security that, by nature, contains elements of uncertainty and imprecision. Changes in the agricultural economy and their borrower repayment capacity will cause these various judgments, evaluations and appraisals to change over time. Accordingly, actual circumstances could vary from the Association's expectations and predictions of those circumstances.

  Management considers the following factors in determining and supporting the levels of allowance for loan losses: the concentration of lending in agriculture, combined with uncertainties in farmland values, commodity prices, exports, government assistance programs, regional economic effects and weather-related influences. Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, other property owned, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate for 2016 was selected by reference to analysis and yield curves of the plans' actuary and industry norms.

ECONOMIC CONDITIONS

The agricultural economy of the territory serviced by the Association is very diverse. It is comprised of a significant beef concentration, as well as equine, tobacco and grain. The cattle industry has been trending downward for the last 18 months from historical highs in the spring and summer of 2015. The trend is the result of increasing cattle numbers nationwide, but also a considerable decrease in demand for beef by consumers. The beef market is particularly being challenged by less expensive proteins such as poultry and pork. The outlook for beef continues to be very guarded. Equine in the area could be described as guarded as well. There appears to be no desire for expanding operations. While thoroughbred horse sales remain high on the upper end of the market, they are low on the mid to bottom half. The demand for new producers entering the market is very low as well, as there are very few horse farms changing hands. The grain market is responding to large supplies of corn and soybeans. Prices will be sensitive to exports and ethanol production, with the shift in sensitivity moving toward projected acres planted and crop conditions. Price potential the second half of the year could face headwinds. Overall, the market outlook is uncertain. The tobacco industry is facing uncertainty as well, as demand for the crop continues to gradually decline. Declining cigarette sales and slumping export demand will limit contract adjustments for growers. A strong production year in 2017 will be a key for burley grower profits.

Farm size varies and many borrowers in the region have diversified farming operations. This factor, along with numerous opportunities for non-farm employment in the area, significantly impacts the level of dependency on any given commodity. Farm real estate values are mixed with some indication that the market is tightening.

The Association's primary competition continues to come from several banks and one System institution. There has been little change in our market base over the past year. During 2016, the Association targeted certain areas of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types. The diversification of the Association loan volume by type for each of the past three years is shown below.

	December 31,								
Loan Type		**2016**			**2015**			**2014**	
				(dollars in thousands)					
Real estate mortgage	$	268,880	63.10%	$	250,887	61.51%	$	234,273	61.31%
Production and intermediate-term		147,903	34.71		147,341	36.13		138,886	36.34
Rural residential real estate		7,838	1.84		7,679	1.88		8,107	2.12
Processing and marketing		1,053	0.25		1,430	0.35		363	0.10
Farm-related business		421	0.10		500	0.12		513	0.13
Loans to cooperatives		–	–		26	0.01		4	–
Total	$	426,095	100.00%	$	407,863	100.00%	$	382,146	100.00%

While we make loans and provide financial related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loan volume by branch/operating unit for the past three years is as follows:

	December 31,		
Branch/Operating Unit	**2016**	**2015**	**2014**
Lebanon	26.19%	27.13%	25.39%
Lexington	19.88	21.66	22.05
Paris	16.45	16.42	17.11
Danville	13.63	15.11	16.49
Stanford	12.20	11.11	10.73
Richmond	8.49	8.22	8.14
Frankfort	2.96	–	–
Participations Purchased	0.20	0.35	0.09
	100.00%	100.00%	100.00%

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are beef cattle, horses, and row crops, which constitute approximately 74 percent of the entire portfolio.

	December 31,					
Commodity Group	**2016**		**2015**		**2014**	
			(dollars in thousands)			
Beef Cattle	$ 202,749	48%	$ 185,833	46%	$ 164,513	43%
Horses	65,673	15	67,228	16	68,331	18
Row Crops	47,564	11	45,459	11	41,668	11
Hay/Pasture	33,084	8	33,026	8	29,225	8
Tobacco	30,729	7	31,231	8	34,730	9
Dairy	10,683	3	11,275	3	11,841	3
Ag Services	8,506	2	9,661	2	9,245	2
Other	27,107	6	24,150	6	22,593	6
Total	$ 426,095	100%	$ 407,863	100%	$ 382,146	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of beef cattle and horse producers. Although a large percentage of the loan portfolio is concentrated in these commodities, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. At December 31, 2016, the Association's total commitments to its ten largest borrowers was $34,434, representing 8.08 percent of total loans. The concentration of large loans has increased somewhat over the past several years. The agricultural enterprise mix of these loans however is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory, the borrowers' ability to supplement borrowings with non-farm income, and the level of guarantees obtained on the portfolio.

The increase in gross loan volume for the twelve months ended December 31, 2016, is primarily attributed to increases in farm real estate loans. The Association has attracted some large real estate loans over the past few years in addition to normal business. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in November and declines in the winter months as commodities are marketed and proceeds are applied to repay the operating loans.

During 2016, the Association continued activity in the selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk.

The main commodity type in the Participations Purchased portfolio is prepared feeds which accounts for 100% of the portfolio. While these participations help spread total portfolio concentration, they also possess unique risks that include exposure to general economic trends, changes in government policy and counterparty risk. The Association manages this risk through routine monitoring, borrowing base reporting and policy driven portfolio limits. Counterparty risks on the entire Participations Purchased portfolio are reduced by the inclusion of System institutions as the lead lender in 100% of the portfolio.

Loan Participations:	December 31, 2016	2015	2014
	(dollars in thousands)		
Participations Purchased – FCS Institutions	$ 860	$ 1,433	$ 365
Participations Sold	(34,218)	(29,946)	(38,986)
Total	$ (33,358)	$ (28,513)	$ (38,621)

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2016.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2016, the Association originated and sold into the secondary market loans totaling $10,058.

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. At December 31, 2016, the guaranteed balance of designated loans under these agreements was $6,823.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than one hundred thousand dollars. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- 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 facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2016	2015	2014
Acceptable & OAEM	98.00%	98.34%	97.94%
Substandard	1.99%	1.66%	2.04%
Doubtful	0.01%	0.00%	0.01%
Loss	0.00%	0.00%	0.01%
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. The Administrative Office Credit Department monitors and works with loans classified as high-risk. The high-risk assets, including accrued interest, are detailed in the following table:

High-risk Assets	December 31, 2016	2015	2014
	(dollars in thousands)		
Nonaccrual loans	$ 2,045	$ 3,163	$ 2,793
Restructured loans	1,280	298	–
Accruing loans 90 days past due	–	7	4
Total high-risk loans	3,325	3,468	2,797
Other property owned	8	–	640
Total high-risk assets	$ 3,333	$ 3,468	$ 3,437
Ratios			
Nonaccrual loans to total loans	0.48%	0.78%	0.73%
High-risk assets to total assets	0.74%	0.81%	0.85%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the full collection of principal and/or future interest accruals under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans decreased $1,118 or 35.35 percent in 2016. This decrease resulted primarily from the liquidation of one larger nonaccrual loan, and the transfer of a few smaller loans to nonaccrual status. Of the $2,045 in nonaccrual volume at December 31, 2016, $935 or 45.71 percent, compared to 15.57 percent and 19.76 percent at December 31, 2015 and 2014, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years.

Allowance for Loan Losses Activity:	Year Ended December 31, 2016	2015	2014
	(dollars in thousands)		
Balance at beginning of year	$ 3,771	$ 3,892	$ 3,593
Charge-offs:			
Real estate mortgage	--	–	–
Processing and marketing	--	–	–
Production and intermediate-term	(26)	(86)	(64)
Rural residential real estate	--	–	–
Total charge-offs	(26)	(86)	(64)
Recoveries:			
Real estate mortgage	--	–	13
Production and intermediate-term	--	–	–
Total recoveries	--	–	13
Net (charge-offs) recoveries	(26)	(86)	(51)
Provision for (reversal of allowance for) loan losses	(50)	(35)	350
Balance at end of year	$ 3,695	$ 3,771	$ 3,892
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.006)%	(0.022)%	(0.014)%

The net loan charge-offs were primarily associated with charge-offs taken on a few smaller loan accounts. The decrease in the provision for loan losses was primarily associated with a decrease in the amount of loan reserves allocated to individually evaluated loans.

The allowance for loan losses by loan type for the most recent three years is as follows.

Allowance for Loan Losses by Type	December 31, 2016	2015	2014
	(dollars in thousands)		
Real estate mortgage	$ 2,308	$ 2,204	$ 2,184
Production and intermediate-term	1,296	1,486	1,629
Agribusiness	13	18	7
Rural residential real estate	78	63	72
Total loans	$ 3,695	$ 3,771	$ 3,892

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31, 2016	2015	2014
Total loans	0.87%	0.92%	1.02%
Nonperforming loans	111.13%	108.76%	139.15%
Nonaccrual loans	180.68%	119.24%	139.35%

Please refer to Note 3, *Loans and Allowance for Loan Losses*, of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was $11,096, $10,555 and $10,125 in 2016, 2015 and 2014, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

	Volume*	Rate	Total
12/31/16 - 12/31/15			
Interest income	$ 1,377	$ 132	$ 1,509
Interest expense	(581)	(387)	(968)
Change in net interest income	$ 796	$ (255)	$ 541
12/31/15 - 12/31/14			
Interest income	$ 1,025	$ (102)	$ 923
Interest expense	(292)	(201)	(493)
Change in net interest income	$ 733	$ (303)	$ 430

* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended December 31, 2016	2015	2014	Percentage Increase/(Decrease) 2016/2015	2015/2014
	(dollars in thousands)				
Loan fees	$ 591	$ 417	$ 227	41.73%	83.70%
Patronage refund from other Farm Credit Institutions	5,138	4,884	6,445	5.20	(24.22)
Gains (losses) on sales of rural home loans	9	6	12	50.00	(50.00)
Gains (losses) from sales of premises and equipment, net	5	–	9	100.00	(100.00)
Other noninterest income	17	78	35	(78.21)	122.86
Total noninterest income	$ 5,760	$ 5,385	$ 6,728	6.96%	(19.96)%

Regarding patronage refunds received from other Farm Credit Institutions, the Association received $2,856 in a patronage refund and $2,231 in a special distribution from the Bank for the year ended December 31, 2016, compared to $2,675 and $2,209 for 2015, and $2,609 and $3,836 for 2014.

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended December 31, 2016	2015	2014	Percentage Increase/(Decrease) 2016/2015	2015/2014
	(dollars in thousands)				
Salaries and employee benefits	$ 4,851	$ 4,572	$ 4,399	6.10%	3.93%
Occupancy and equipment expense	316	328	374	(3.66)	(14.02)
Insurance Fund premium	515	367	331	40.33	10.88
(Gains) losses on other Property owned, net	1	59	441	(98.31)	(86.62)
Other operating expense	1,439	1,352	1,146	6.43	17.98
Total noninterest expense	$ 7,122	$ 6,678	$ 6,691	6.65%	(0.19)%

Salaries and employee benefits increased in 2016, as compared with 2015, primarily due to increased costs associated with additional staffing, merit increases, and health insurance expenses. Occupancy and equipment expense decreased $12 or 3.66 percent in 2016 as compared with 2015. This decrease is primarily associated with decreased maintenance expense. Insurance Fund premiums increased $148 or 40.33 percent for the twelve months ended December 31, 2016, compared to the same period of 2015 due primarily to an increase in rates charged by the Farm Credit System Insurance Corporation (FCSIC). Losses on other property owned decreased $58 or 98.31% due primarily to the fact that the association did not hold any acquired property for the majority of 2016. Other operating expenses increased $87 or 6.43 percent in 2016 as compared with 2015. The increase is primarily associated with an increase in expenses associated with a new equipment point-of-sale lending program called Farm Credit Express, an increase in training expenses, and an increase in supervisory and examination expenses.

Income Taxes

The Association recorded a benefit for income taxes of $53 for the year ended December 31, 2016, as compared to a provision of $2 for 2015 and a provision of $162 for 2014. Refer to Note 2, *Summary of Significant Accounting Policies, Income Taxes*, of the Notes to the Consolidated Financial Statements, for more information concerning Association income taxes.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended 12/31/16	12/31/15	12/31/14
Return on average assets	2.27%	2.30%	2.51%
Return on average members' equity	13.81%	14.21%	16.43%
Net interest income as a percentage of average earning assets	2.66%	2.71%	2.74%
Net (charge-offs) recoveries to average loans	(0.006)%	(0.022)%	(0.014)%

The primary factors influencing the decreases in return on average assets and return on members' equity were proportionately larger increases in assets and members' equity than the increase in association net earnings.

Key factors in the growth of net income for future years will be continued improvement in net interest and noninterest income along with a moderate increase in operating expenses and additional provisions made for loan losses. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue to remain healthy and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds." Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA, which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon an agreement between the Bank and the Association.

The weighted average interest rates on the variable rate notes were 1.89 percent for LIBOR-based loans, 1.93 percent for Prime-based loans, and the weighted average remaining maturities were 1.67 years and 1.73 years, respectively, at December 31, 2016. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 2.79 percent and the weighted average remaining maturity was 11.78 years at December 31, 2016. The weighted average interest rate on all interest-bearing notes payable was 2.63 percent and the weighted average remaining maturity was 10.00 years at December 31, 2016.

Variable rate and fixed rate notes payable represent approximately 3.88 percent and 96.12 percent, respectively, of total notes payable at December 31, 2016.

Total notes payable to the Bank at December 31, 2016, was $368,038 as compared to $353,034 at December 31, 2015 and $334,747 at December 31, 2014. The increase of 4.25 percent compared to December 31, 2015 and the increase of 5.46 percent compared to December 31, 2014, was attributable to continued loan growth in the Association. The average volume of outstanding notes payable to the Bank was $358,111 and $334,609 for the years ended December 31, 2016 and 2015, respectively. Refer to Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements, for additional information concerning the Association's notes payable.

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in investments and secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

The Association had no lines of credit outstanding from third party financial institutions as of December 31, 2016.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio. The Association utilizes differential pricing for its loans based on credit risk, length of maturity, service cost, and market variables, thereby giving the Association the ability in large part to control its interest rate margins. Net interest income as a percentage of average earning assets was 2.66% for 2016, 2.71% for 2015, and 2.74% for 2014. The decrease in net interest income as a percentage of average earning assets for 2016 as compared to the previous year is primarily due to a decrease in the average interest rate margin realized on the loan portfolio as compared to the previous year.

Relationship with the Bank

In both financial and non-financial areas, the Association has a materially interdependent relationship with the Bank.

The Association's statutory obligation to borrow only from the Bank is discussed in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, of the Notes to the Consolidated Financial Statements in this annual report.

The Bank's ability to require additional capital contributions from the Association is discussed in Note 4, *Investment in Other Farm Credit Institutions*, included in this annual report.

The Bank's role in mitigating the Association's exposure to interest rate risk is described in the "Liquidity and Funding" section of this Management's Discussion and Analysis and in Note 6, *Notes Payable to AgFirst Farm Credit Bank*, included in this annual report.

The Association receives a patronage refund from the Bank which it records on an accrual basis.

In addition to the financial relationships described, the Association may act as a service provider to the Bank on certain participation loans that the Association has sold to the Bank. The Bank also provides operational assistance to the Association in many areas including cash management, accounting and reporting, computer networks and technology.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2016 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings. The Association Board of Directors adopted a change in the maximum member stock requirement, effective March 1, 2016, whereby the maximum requirement was reduced to 2% or $1,000, whichever is less, from the previous requirement of 2% or $3,000, whichever is less.

Total members' equity at December 31, 2016, increased 7.22 percent to $73,029 from the December 31, 2015, total of $68,109. At December 31, 2015, total members' equity increased 10.94 percent from the December 31, 2014 total of $61,393. The increases were primarily attributed to net income, partially offset by cash patronage paid.

Total capital stock and participation certificates were $4,993 on December 31, 2016, compared to $6,784 on December 31, 2015 and $6,744 on December 31, 2014. The decrease was attributed to members redeeming excess stock as a result of the change in maximum stock requirement adopted by the Association Board of Directors on March 1, 2016.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2016	2015	2014	Regulatory Minimum
Permanent capital ratio	17.79%	17.58%	16.85%	7.00%
Total surplus ratio	16.96%	16.28%	15.54%	7.00%
Core surplus ratio	16.96%	16.28%	15.54%	3.50%

The increase in the Association's permanent capital, total surplus, and core surplus for December 31, 2016 was attributed to increased retained earnings from strong net income and a moderate growth in loan volume. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 7, *Members' Equity*, of the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute to borrowers on a patronage basis all or any portion of its available patronage sourced consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) purchase money mortgages and sales contracts, (b) participation loans purchased, (c) loans specified in advance as non-patronage, (d) the Association's defined benefit retirement plan income, (e) extraordinary income resulting from a change in accounting procedure, and (f) other non-patronage income as allowed by law, including lease income, the remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, *Members' Equity*, of the Notes to the Consolidated Financial Statements, for more information concerning the patronage allocations. The Association declared total patronage allocations of $8,871 in 2016, $8,178 in 2015, and $8,854 in 2014. Of those amounts, the Association declared a cash patronage payable of $3,105 in 2016, $2,617 in 2015 and $2,833 in 2014. The remaining patronage allocations were in the form of allocated retained earnings. With the resulting improvements in earnings and capital levels, the Association increased its cash patronage payout percentage for 2015 and 2016.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to Young*, Beginning** and Small*** farmers.

* Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

** Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

*** Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than $250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. Actual program results in 2016 were 100% of program goals or better in all categories.

The following table outlines the loan volume and number of YBS loans in the loan portfolio for the Association.

As of December 31, 2016

	Number of Loans		Amount of Loans	
	Actual	Goal	Actual	Goal
Young	1,019	920	76,319	68,000
Beginning	1,004	870	74,327	67,000
Small	3,294	3,080	173,573	166,000

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2012 USDA-NASS Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 14,595 reported farmers of which by definition 856 or 5.87 percent were Young, 2,642 or 18.10 percent were Beginning, and 13,999 or 95.92 percent were Small. Comparatively, as of December 31, 2016, the demographics of the Association's agricultural portfolio contained 2,364 farmers, of which by definition 529 or 22.38 percent were Young, 553 or 23.39 percent were Beginning and 1,745 or 73.82 percent were Small.

In addition to our marketing strategies, in 2016 the Association utilized the following strategies and outreach programs:

- Support of 4H, FFA and young farmer organizations through sponsorships and donations.
- Offering loan guarantees and interest rate subsidies through Preferred Lender Programs with Farm Services Administration (FSA).
- FSA Loan Guarantee Fee Subsidy Program.
- Reduced Rate Coordination Programs with the Kentucky Agricultural Finance Corporation.
- Initiating and working in collaboration with a Young Farmers Advisory Council.

The Association met its 2016 qualitative goals in coordination of programs, FSA Guarantee Loan Volume, Reduced Rate Coordination Program, and statewide youth program advertising and sponsorships.

The Vice President of Information Systems coordinates the Association's efforts for YBS programs. The Association includes YBS goals in the annual strategic plan, and reports on those goals and achievements to the Board of Directors on a quarterly basis.

Demographics

The Association has used the 2012 USDA-NASS Ag Census as our source of demographic data for the counties in our territory. There are several differences in the methods by which the demographic and YBS Farmer data is presented. Young farmers are defined by the FCA as 35 years old or less. The UDSA-NASS Ag Census demographic stratification breaks at 34 years old, which was used to compare to FCA's definition. Beginning farmers are defined by the FCA as having 10 years or less farming experience. There is no measurement matching this definition in the USDA-NASS Ag Census; however the census does identify farmers on their current farm less than 10 years. That statistic may include beginning farmers, but may also include experienced farmers who have recently changed farmsteads. As with the case of the Young information, the Beginning information in the USDA-NASS Ag Census is not an exact comparison to the FCA definition, but will be utilized as the best comparison available. The FCA Small definition matches with the USDA-NASS Ag Census delineation of farm entities with sales of less than $250 thousand. Other data differences: The farmers experience is as of the date of the USDA-NASS Ag Census, while the Association data is compiled as to the date the loan was made. Small farmers is by each individual farm entity from the USDA-NASS Ag Census data, while the Association data is compiled as of the date of the loan and represents the total value of sales of closely related entities rather than individual entities. The USDA-NASS Ag Census data reflects all farms whether they use debt or not. While the statistical results of the USDA-NASS Ag Census do not match the FCA definitions exactly and there are timing issues, they do provide a consistent source of measurement with which to assess Association targets and goals.

REGULATORY MATTERS

New regulatory capital requirements for System banks and associations became effective January 1, 2017 and were adopted to:

- modernize capital requirements while ensuring that institutions continue to hold sufficient regulatory capital to fulfill their mission as a government-sponsored enterprise,
- 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,

- make System regulatory capital requirements more transparent, and
- meet the requirements of Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

These new requirements replace the core surplus and total surplus requirements with Common Equity Tier 1 (CET1), Tier 1 and Total Capital risk-based capital ratio requirements. The new requirements also replace the existing net collateral ratio with a Tier 1 Leverage ratio which is applicable to all banks and associations. The Permanent Capital Ratio remains in effect.

The following sets forth the new regulatory capital ratios:

Ratio	Primary Components of Numerator	Denominator	Minimum Requirement	Minimum Requirement with Conservation Buffer
CET1 Capital	Unallocated retained earnings/surplus (URE), Common Stock (subject to certain conditions)	Risk-weighted assets	4.5%	7.0%
Tier 1 Capital	CET1 Capital, Non-cumulative perpetual preferred stock	Risk-weighted assets	6.0%	8.5%
Total Capital	Tier 1 Capital, Allowance for Loan Losses, other equity securities not included in Tier 1 Capital	Risk-weighted assets	8.0%	10.5%
Tier 1 Leverage	Tier 1 Capital (1.5% must be URE or URE equivalents)	Total assets	4.0%	5.0%

The new capital requirements have a three-year phase-in of the capital conservation buffer applied to the risk-adjusted capital ratios. Based on analysis, all District entities are positioned to be in compliance with the new requirements.

On November 30, 2015, the FCA, along with four other federal agencies, published in the Federal Register a final rule to establish capital and margin requirements for covered swap entities as required by the Dodd-Frank Act. See below for further information regarding the Dodd-Frank Act. This rule is not expected to have a material impact for District institutions.

On July 25, 2014, the FCA published a proposed rule in the Federal Register to revise the requirements governing the eligibility of investments for System banks and associations. The public comment period ended on October 23, 2014. The FCA expects to issue a final regulation in 2017. The proposed investment regulations are expected to have a minimal impact for District institutions. The stated objectives of the proposed rule are as follows:

- To strengthen the safety and soundness of System banks and associations,
- To ensure that System banks hold sufficient liquidity to continue operations and pay maturing obligations in the event of market disruption,
- To enhance the ability of the System banks to supply credit to agricultural and aquatic producers,
- To comply with the requirements of section 939A of the Dodd-Frank Act,
- To modernize the investment eligibility criteria for System banks, and
- To revise the investment regulation for System associations to improve their investment management practices so they are more resilient to risk.

FINANCIAL REGULATORY REFORM

The Dodd-Frank Act was signed into law on July 21, 2010. While the Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, many of the statutory provisions of the Dodd-Frank Act are not applicable to the Farm Credit System.

The provisions of the Dodd-Frank Act pertaining to the regulation of derivatives transactions require, among other things, more of these transactions to be cleared through a third-party central clearinghouse and traded on regulated exchanges or other multilateral platforms. Margin is required for these transactions. Derivative transactions that are not subject to mandatory trading and clearing requirements may be subject to minimum margin and capital requirements. The Commodity Futures Trading Commission and other federal banking regulators have exempted System institutions from certain, but not all, of these new requirements, including, for swaps with members, mandatory clearing and minimum margin for noncleared swaps.

Notwithstanding the above-mentioned exemptions from clearing and margin requirements for System institutions, counterparties of System institutions may require margin or other forms of credit support as a condition to entering into noncleared transactions because such transactions may subject these counterparties to more onerous capital, liquidity and other requirements absent such margin or credit support. Alternatively, these counterparties may pass on the capital and other costs associated with entering into transactions if insufficient margin or if other credit support is not provided.

The Dodd-Frank Act also created a new federal agency called the Consumer Financial Protection Bureau (CFPB). The CFPB is responsible for regulating the offering of consumer financial products or services under federal consumer financial laws. The Farm Credit Administration retains the responsibility to oversee and enforce compliance by System institutions with relevant rules adopted by the CFPB.

In light of the foregoing, it is difficult to predict at this time the extent to which the Dodd-Frank Act or the forthcoming implementing rules and regulations will have an impact on the System. However, it is possible they could affect funding and hedging strategies and increase funding and hedging costs.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 2, *Summary of Significant Accounting Policies*, in the Notes to the Consolidated Financial Statements for recently issued accounting pronouncements.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1, *Organization and Operations*, of the Consolidated Financial Statements included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, developments that had or could have a material impact on patronage or dividends, changes in patronage policies and practices, and concentrations of assets, if any, is incorporated in *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* included in this Annual Report.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Kentucky:

Location	Description	Form of Ownership
640 South Broadway Lexington	Administrative	Owned
640 South Broadway Lexington	Branch	Owned
485 N Danville Bypass Danville	Branch	Owned
1000 Ival James Boulevard Richmond	Branch	Owned
201 Commerce Drive Paris	Branch	Owned
842 W Main Lebanon	Branch	Owned
106 Agriculture Way Stanford	Branch	Owned
1120 US Highway 127 South Frankfort	Branch	Leased

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 11, *Commitments and Contingencies*, of the Consolidated Financial Statements included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7, *Members' Equity*, of the Consolidated Financial Statements included in this Annual Report.

Description of Liabilities

The description of liabilities, contingent liabilities and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 9 and 11 of the Consolidated Financial Statements included in this Annual Report.

Management's Discussion and Analysis of Financial Condition and Results of Operations

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
James W. Caldwell	*President and Chief Executive Officer* – since January, 2009
Jonathan T. Noe	*Vice President and Chief Lending Officer* – since September, 2008
Robert G. Anderson	*Vice President Information Systems* – since January, 1999
Marcus G. Barnett	*Vice President and Chief Financial Officer* – since August, 2004.

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2016, 2015 and 2014, is as follows:

Name of Individual or Number in Group	Year	Received Compensation Salary	Bonus	Total Received	Perquisites and Other Compensation Change in Pension**	Perq./ Other*	Total Perq. and Other	Total Compensation
James W. Caldwell	2016	$ 267,510	$ 3,900	$ 271,410	$ 292,747	$ 8,606	$ 301,353	$ 572,763
James W. Caldwell	2015	$ 250,009	$ 3,900	$ 253,909	$ 196,770	$ 9,248	$ 206,018	$ 459,927
James W. Caldwell	2014	$ 233,009	$ 4,150	$ 237,159	$ 485,982	$ 5,114	$ 491,096	$ 728,255
5	2016	$ 637,624	$ 28,951	$ 666,575	$ 386,094	$ 5,473	$ 391,567	$ 1,058,142
5	2015	$ 602,623	$ 32,162	$ 634,785	$ 91,954	$ –	$ 91,954	$ 726,739
5	2014	$ 577,723	$ 38,939	$ 616,662	$ 611,648	$ –	$ 611,648	$ 1,228,310

**The Perquisites/Other amount disclosed in the above chart includes automobile compensation, cost of group insurance in excess of $50,000, and spousal travel.*

This figure is a third party actuarial determination of the change in present value of the estimated pension cash flows.* ***Please refer to information provided below giving further explanation of assumptions used in order to calculate the present value of pension benefits.

The total compensation paid during 2016 to any senior officer, or to any other employee included in the aggregate group total as reported in the table above is available and will be disclosed to the shareholders of the institution upon request.

On October 3, 2012, FCA adopted a regulation that requires enhanced disclosures pertaining to Senior Officer compensation, specifically additional information pertaining to the present value of pension benefits and the change in the present value of pension benefits from the previous year.

The present value of pension benefits is the value at a specific date of the expected future benefit payment stream based on actuarial assumptions, chiefly the discount rate. Other assumptions are also used, such as expected retirement age and life expectancy. Actuarial assumptions are updated periodically. Changes in the actuarial assumptions can increase or decrease the pension values.

The discount rate, which is derived using an AA corporate bond yield curve, is updated every year based on the interest rate environment at December 31. A decrease in the discount rate will normally increase the present values and vice versa. A significant decrease in the discount rate assumption from the prior year caused the pension values to increase at December 31, 2015.

In addition to the discount rate, other factors such as increases in compensation or additional years of service for plan participants will also cause a change in the present value of pension benefits. Specifically, an additional year of service leading up to the earliest unreduced retirement date and increases in compensation may lead to increases in present value of pension benefits. An additional year of service past the unreduced retirement date may lead to a decrease in the present value of pension benefits.

In October 2014, the Society of Actuaries issued revised mortality tables and a mortality improvement scale for use by actuaries, insurance companies, governments, benefit plan sponsors and others in setting assumptions regarding life expectancy in the United States for purposes of estimating pension and other postemployment benefit obligations, costs and required contribution amounts. The new mortality tables indicated substantial life expectancy improvements since the last study published in 2000. The adoption of these new tables at December 31, 2015 resulted in increased pension values as the benefit payments are expected to be made for a longer time span.

In addition, the assumptions used for the Cash Balance Plan values were updated in 2014 to reflect expected payouts in conjunction with the upcoming plan termination. See Note 9, *Employee Benefit Plans,* for further information. The acceleration of expected payments significantly increased the pension values for those individuals in the Cash Balance Plan.

On February 4, 2015, the FCA Board approved the final rule, "Disclosure to Shareholders; Pension Benefit Disclosures." The rule amends FCA regulations to exclude employee compensation from being reported in the Summary Compensation Table if the employee would be considered a "highly compensated employee" solely because of payments related to or change(s) in value of the employee's qualified pension plan provided that the plan was available to all similarly situated employees on the same basis at the time the employee joined the plan.

Additional information on pension benefits related to the CEO and the highest paid officers as a group for the year ended December 31, 2016 is as follows:

Pension Benefits Table
As of December 31, 2016

Name of Individual or Number in Group	Year	Plan Name	Number of Years Credited Service	Actuarial Present Value of Accumulated Benefits**	Payments During 2015
James W. Caldwell	2016	Independent Associations Retirement Plan	36	$ 2,293,103	$
Senior Officers and Highly Compensated Employees:					
5	2016	Independent Associations Retirement Plan	*27	$ 3,179,581	$

** Represents the average years of credited service for the group.*
This figure is a third party actuarial determination of the present value of the estimated pension cash flows.* ***Please refer to information provided above giving further explanation of assumptions used in order to calculate the present value of pension benefits.

In addition to a base salary, the branch lending staff can earn additional compensation under an incentive plan. There were no material changes to the incentive plan adopted for 2016 as the plan design continues to motivate new business development. In addition to this incentive plan for the lending staff, the entire Association staff, including senior officers, may receive a bonus at the discretion of the Board of Directors. While discretionary, these bonuses are generally based on the efforts of staff, including senior officers, in striving to accomplish business plan objectives such as profitability, growth, credit quality and overall performance. All of these bonuses were paid in the 2016 calendar year. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Directors

Directors are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $38,362 for 2016, $19,529 for 2015 and $29,991 for 2014.

Subject to approval by the board, the Association may allow the chairman of the board of directors, the chairman of the audit committee, and other director’s honoraria of $650, $600 and $550 respectively for attendance at meetings, committee meetings, or special assignments. Directors also receive $100 for participation in board or committee related conference calls. In 2016, total cash compensation paid to directors as a group was $57,650. No non-cash compensation was paid to directors in 2016.

The following represents certain information regarding the directors of the Association and their principal occupations:

James Alvin Lyons was re-elected to a four-year term on the Board of Directors at the 2016 Annual Meeting. His current term expires in 2020. He presently serves as Chairman of the Board, a position he has held since April 2011. During the past 5 years, Mr. Lyons has produced alfalfa, corn, soybeans, wheat, tobacco, has a commercial cow-calf program and backgrounds feeder cattle on his farming operation in Scott County. Mr. Lyons serves as a Board member of the Scott County Farm Bureau and is a member of the Scott County Beef Improvement Board. In addition, he serves as a member of the Scott County Rural Land Management Board and as a director of the Kentucky Ag Leadership Program Alumni. Mr. Lyons is also a Magistrate on the Scott County Fiscal Court. During 2016, Mr. Lyons served 9 days at Association Board meetings, 13 days in other official activities, participated in 4 conference calls, and was paid $14,700 in compensation.

James C. (“Jim”) Rankin III was elected to a four-year term on the Board of Directors at the 2016 Annual Meeting. His current term expires in 2020. He presently serves as Vice Chairman of the Board, a position he has held since February 2014. During the past 5 years, Mr. Rankin has produced soybeans, wheat and alfalfa on his farming operation in Bourbon County. Mr. Rankin owns thoroughbred mares, and boards mares and foals. He also raises and trains thoroughbreds for racing. In addition, Mr. Rankin partners with his sons in the thoroughbred horse operation, in a cow/calf operation, feeders, hay and grain. During 2016, Mr. Rankin served 9 days at Association Board meetings, 10 days in other official activities, participated in 3 conference calls, and was paid $10,750 in compensation.

James L. May was re-elected to a four-year term on the Board of Directors at the 2015 Annual Meeting. His current term expires in 2019. He served as Chairman of the Board from 1999 to 2011, and previously served as Vice Chairman of the Board from April 1991. He currently serves as the Chairman of the Board Compensation Committee. During the past five years, Mr. May and his wife have owned Mayhaven Farm LLC in Lincoln County where they have produced corn, hay, soybeans, wheat, have backgrounded feeder cattle, and have a 125 head cow/calf program in addition to operating a retail agricultural seed business. Since January, 2006, Mr. May has served as a director for the AgFirst Farm Credit Bank where he also serves on the Audit Committee. His current term expires at the end of 2017. He also serves on the AgFirst Farm Credit Council Board. In addition, Mr. May serves as Chairman of the Lincoln County Extension Council. During 2016, Mr. May served 9 days at Association Board meetings, 0 days in other official activities, participated in 3 conference calls, and was paid $5,250 in compensation.

Joe Myers was elected to a four-year term on the Board of Directors at the 2014 Annual Meeting. His current term expires in 2018. During the past 5 years, Mr. Myers has owned and operated Myers Angus Farm, a 60 head purebred angus cow operation on his farming operation in Mercer County, marketing registered bulls, females, and embryos throughout Kentucky, multiple states, and foreign countries. He also serves as a Beef Sire Analyst for Select Sires, Inc. where he is responsible for purchasing/leasing bulls to enter into the A.I. Genetics Program. He is also a former Farm Manager for Anderson Circle Farms. Mr. Myers serves on the Kentucky Angus Association Board, the Central Kentucky Angus Association Board, and the Mercer County Cattleman's Board. During 2016, Mr. Myers served 9 days at Association Board meetings, 7 days in other official activities, participated in 2 conference calls, and was paid $9,000 in compensation.

Jerry Rankin was elected to a sixth continuous term on the Board of Directors at the 2013 Annual Meeting. His current term expires in 2017. During the past 5 years, Mr. Rankin has produced tobacco, corn, alfalfa hay, soybeans, backgrounded steers and has a purebred Angus cow herd on his farming operation in Boyle County. He also raises and sells bred pelvic measured heifers and fertility bulls. In addition, Mr. Rankin owns and operates the Farmers Tobacco Warehouse in Danville. He also serves as a member of the American Angus Association and is a stockholder in the Central Kentucky Angus Association. Mr. Rankin is also a member of the Kentucky Beef Cattle Association. During 2016, Mr. Rankin served 9 days at Association Board meetings, 3 days in other official activities, participated in 3 conference calls, and was paid $6,900 in compensation.

Pursuant to the Agricultural Credit Act of 1987 and in compliance with Association Bylaws, the Association Board of Directors first elected during 2001 a member to the Board who is not a director, officer, employee or shareholder of any Farm Credit System institution (i.e. Outside Director).

Dr. Lionel Williamson was first elected as an Outside Director by the Association Board of Directors in 2005. His current term expires in April 2017. He also serves as Chairman of the Board of Directors Audit Committee. Dr. Williamson retired from the University of Kentucky College of Agriculture in 2013 where he served as an Extension Professor and Assistant Dean for Diversity. His extension work was with start-up cooperatives in Kentucky, assisting them with business plans, financial plans, budgets, start-up capital, and operating procedures. In addition, he worked with cooperative leaders at the state and national levels in planning, implementing and evaluating educational programs. He also taught an undergraduate course in agribusiness. During the past 5 years Dr. Williamson has served as a board member for the Kentucky Council of Cooperatives and The Kentucky Center for Agriculture and Rural Development (KCARD). He has also directed the statewide American Private Enterprise Program (APES) and the National (NICE) educational program aimed at high school juniors and seniors. He also served on several University level committees, including the Athletics Board. In 2010, Dr. Williamson was selected to serve on the Farm Credit System Diversity Workgroup. During 2015, Dr. Williamson served 5 days at Association Board meetings, 0 days in other official activities, participated in 6 conference calls, and was paid $3,600 in compensation.

Mary-Lynn Hinkel was first elected as an Outside Director by the Association Board of Directors in 2014. She was reelected in 2016, and her current term expires in April 2020. Ms. Hinkel serves as HR Staffing Coordinator for CMTA Consulting Engineers, recruiting staff for six offices located throughout the U.S. Previously, Ms. Hinkel was Associate Director of Tax Services at Dean, Dorton, Allen, Ford, PLLC where she provided compliance services including tax, financial statements and accounting for business, individuals, and non-profit organizations. Her services concentrated in physicians and the healthcare industry, manufacturing, and real estate of closely-held and family-owned businesses. Ms. Hinkel has served on the United Way of the Bluegrass Agency Review Executive Committee, and as a Banking Committee member for Equestrian Events, Inc. She has served as a past member of the Finance Committee and Education Committee for the Cathedral of Christ the King, and has served as past Treasurer and President of the Parent Teacher Organization for Christ the King School. She has also served as a Board Member and Treasurer for Lexington and Central Kentucky Youth Salute. During 2016, Ms. Hinkel served 10 days at Association Board meetings, 3 days in other official activities, participated in 3 conference calls, and was paid $7,450 in compensation.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 10, *Related Party Transactions*, of the Consolidated Financial Statements included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

Transactions Other Than Loans

There have been no transactions that occurred at any time during the year ended December 31, 2016, between the Association and senior officers or directors, their immediate family members or any organizations with which they are affiliated, which require reporting per FCA regulations. There were no transactions with any senior officer or director related to the purchase or retirement of preferred stock of the Association for the year ended December 31, 2016.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Involvement in Unincorporated Business Entities

The Association holds an equity investment at December 31, 2016 in the following Unincorporated Business Entities

(UBEs) as an equity interest holder of the limited liability company (LLC). The LLCs were organized for the stated purpose of holding and managing unusual or complex collateral associated with former loans, until such time as the assets may be sold or otherwise disposed of pursuant to the terms of Operating Agreements of the respective LLCs.

Entity Name	Entity Type	Entity Purpose
RAAC, LLC	LLC	Manage Acquired Property
First Kentucky Land, LLC	LLC	Manage Acquired Property

Relationship with Independent Certified Public Accountant

There were no changes in or material disagreements with our independent certified public accountant on any matter of accounting principles or financial statement disclosure during this period.

Aggregate fees incurred by the Association for services rendered by its independent certified public accountant for the year ended December 31, 2016 were as follows:

	2016
Independent Certified Public Accountant	
PricewaterhouseCoopers LLP	
Audit services	$ 57,600
Total	$ 57,600

Audit fees were for the annual audit of the consolidated financial statements.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 13, 2017 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-859-253-3249, or writing Marcus G. Barnett, Chief Financial Officer, Central Kentucky Agricultural Credit Association, P.O. Box 1290, Lexington, Kentucky 40588-1290, or accessing the website, ***www.agcreditonline.com.*** The Association prepares an electronic version of the Annual Report which is available on the Association's website within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management's Discussion and Analysis of Financial Condition and Results of Operations section included in this Annual Report to the shareholders.

Shareholder Investment

Shareholder investment in the Association may be materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at ***www.agfirst.com***. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Central Kentucky Agricultural Credit Association (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent certified public accountants for 2016, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 *(The Auditor's Communication With Those Charged With Governance)*. The Committee discussed with PwC its independence from Central Kentucky Agricultural Credit Association. The Committee also reviewed the non-audit services provided by PwC and concluded that these services were not incompatible with maintaining PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2016. The foregoing report is provided by the following independent directors, who constitute the Committee:

Lionel Williamson

Dr. Lionel Williamson
Chairman of the Audit Committee

Members of Audit Committee

James Alvin Lyons
James C. Rankin III
James L. May
Joe Myers
Jerry Rankin
Mary-Lynn Hinkel

March 13, 2017

Report of Independent Certified Public Accountants

To the Board of Directors and Members of
Central Kentucky Agricultural Credit Association

We have audited the accompanying consolidated financial statements of Central Kentucky Agricultural Credit Association and its subsidiaries (the "Association"), which comprise the consolidated balance sheets as of December 31, 2016, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in members' equity and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Certified Public Accountants' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Association's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Central Kentucky Agricultural Credit Association and its subsidiaries as of December 31, 2016, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 13, 2017

PricewaterhouseCoopers LLP, 333 SE 2nd Avenue, Suite 3000, Miami, FL 33131
T: (305) 375 7400, F:(305) 375 6221, www.pwc.com/us

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2016	2015	2014
Assets			
Cash	**$ 1,605**	$ 1,250	$ 1,289
Loans	**426,095**	407,863	382,146
Allowance for loan losses	**(3,695)**	(3,771)	(3,892)
Net loans	**422,400**	404,092	378,254
Loans held for sale	**1,428**	150	—
Accrued interest receivable	**5,781**	5,137	4,489
Investments in other Farm Credit institutions	**7,113**	7,079	7,045
Premises and equipment, net	**3,014**	2,926	3,041
Other property owned	**8**	—	640
Accounts receivable	**5,135**	4,930	6,492
Other assets	**1,861**	2,098	1,101
Total assets	**$ 448,345**	$ 427,662	$ 402,351
Liabilities			
Notes payable to AgFirst Farm Credit Bank	**$ 368,038**	$ 353,034	$ 334,747
Accrued interest payable	**815**	756	697
Patronage refunds payable	**3,195**	2,711	2,952
Accounts payable	**709**	501	512
Other liabilities	**2,559**	2,551	2,050
Total liabilities	**375,316**	359,553	340,958
Commitments and contingencies (Note 11)			
Members' Equity			
Capital stock and participation certificates	**4,993**	6,784	6,744
Retained earnings			
Allocated	**48,344**	42,801	37,362
Unallocated	**19,692**	18,524	17,287
Total members' equity	**73,029**	68,109	61,393
Total liabilities and members' equity	**$ 448,345**	$ 427,662	$ 402,351

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

Consolidated Statements of Comprehensive Income

(dollars in thousands)	For the year ended December 31, 2016	2015	2014
Interest Income			
Loans	**$ 20,343**	$ 18,834	$ 17,898
Investments	**—**	—	12
Total interest income	**20,343**	18,834	17,910
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	**9,247**	8,279	7,785
Net interest income	**11,096**	10,555	10,125
Provision for (reversal of allowance for) loan losses	**(50)**	(35)	350
Net interest income after provision for (reversal of allowance for) loan losses	**11,146**	10,590	9,775
Noninterest Income			
Loan fees	**591**	417	227
Lease income	**17**	19	11
Patronage refunds from other Farm Credit institutions	**5,138**	4,934	6,467
Gains (losses) on sales of rural home loans, net	**9**	6	12
Gains (losses) on sales of premises and equipment, net	**5**	—	9
Other noninterest income	**—**	9	2
Total noninterest income	**5,760**	5,385	6,728
Noninterest Expense			
Salaries and employee benefits	**4,851**	4,572	4,399
Occupancy and equipment	**316**	328	374
Insurance Fund premiums	**515**	367	331
(Gains) losses on other property owned, net	**1**	59	441
Other operating expenses	**1,439**	1,352	1,146
Total noninterest expense	**7,122**	6,678	6,691
Income before income taxes	**9,784**	9,297	9,812
Provision (benefit) for income taxes	**(53)**	2	162
Net income	**9,837**	9,295	9,650
Other comprehensive income	**—**	—	—
Comprehensive income	**$ 9,837**	$ 9,295	$ 9,650

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

Consolidated Statements of Changes in Members’ Equity

(dollars in thousands)	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Total Members' Equity
Balance at December 31, 2013	$ 6,676	$ 31,503	$ 16,331	$ 54,510
Comprehensive income			9,650	9,650
Capital stock/participation certificates issued/(retired), net	68			68
Patronage distribution				
Cash			(2,833)	(2,833)
Nonqualified retained earnings		6,021	(6,021)	—
Patronage distribution adjustment		(162)	160	(2)
Balance at December 31, 2014	$ 6,744	$ 37,362	$ 17,287	$ 61,393
Comprehensive income			9,295	9,295
Capital stock/participation certificates issued/(retired), net	40			40
Patronage distribution				
Cash			(2,617)	(2,617)
Nonqualified retained earnings		5,561	(5,561)	—
Patronage distribution adjustment		(122)	120	(2)
Balance at December 31, 2015	$ 6,784	$ 42,801	$ 18,524	$ 68,109
Comprehensive income			**9,837**	**9,837**
Capital stock/participation certificates issued/(retired), net	**(1,791)**			**(1,791)**
Patronage distribution				
Cash			**(3,105)**	**(3,105)**
Nonqualified retained earnings		**5,766**	**(5,766)**	**—**
Patronage distribution adjustment		**(223)**	**202**	**(21)**
Balance at December 31, 2016	**$ 4,993**	**$ 48,344**	**$ 19,692**	**$ 73,029**

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2016	2015	2014
Cash flows from operating activities:			
Net income	**$ 9,837**	$ 9,295	$ 9,650
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	**143**	140	168
Amortization (accretion) of net deferred loan costs (fees)	**(4)**	(1)	—
Premium amortization (discount accretion) on investments	**—**	—	(12)
Provision for (reversal of allowance for) loan losses	**(50)**	(35)	350
(Gains) losses on other property owned	**—**	22	365
(Gains) losses on sales of premises and equipment, net	**(5)**	—	(9)
(Gains) losses on sales of rural home loans, net	**(9)**	(6)	(12)
Changes in operating assets and liabilities:			
Origination of loans held for sale	**(10,058)**	(5,656)	(9,671)
Proceeds from sales of loans held for sale, net	**8,789**	5,512	10,018
(Increase) decrease in accrued interest receivable	**(644)**	(648)	(276)
(Increase) decrease in accounts receivable	**(205)**	1,562	367
(Increase) decrease in other assets	**237**	(997)	31
Increase (decrease) in accrued interest payable	**59**	59	24
Increase (decrease) in accounts payable	**208**	(11)	146
Increase (decrease) in other liabilities	**8**	501	(1,138)
Total adjustments	**(1,531)**	442	351
Net cash provided by (used in) operating activities	**8,306**	9,737	10,001
Cash flows from investing activities:			
Net (increase) decrease in loans	**(18,262)**	(25,802)	(31,520)
(Increase) decrease in investment in other Farm Credit institutions	**(34)**	(34)	(10)
Proceeds from payments received on other investments	**—**	—	6,794
Purchases of premises and equipment	**(232)**	(25)	(123)
Proceeds from sales of premises and equipment	**6**	—	9
Proceeds from sales of other property owned	**—**	618	708
Net cash provided by (used in) investing activities	**(18,522)**	(25,243)	(24,142)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	**15,004**	18,287	17,091
Capital stock and participation certificates issued/(retired), net	**(1,791)**	40	68
Patronage refunds and dividends paid	**(2,642)**	(2,860)	(2,952)
Net cash provided by (used in) financing activities	**10,571**	15,467	14,207
Net increase (decrease) in cash	**355**	(39)	66
Cash, beginning of period	**1,250**	1,289	1,223
Cash, end of period	**$ 1,605**	$ 1,250	$ 1,289
Supplemental schedule of non-cash activities:			
Receipt of property in settlement of loans	**$ 8**	$ —	$ —
Estimated cash dividends or patronage distributions declared or payable	**3,105**	2,617	2,833
Supplemental information:			
Interest paid	**9,188**	8,220	7,761
Taxes (refunded) paid, net	**—**	108	—

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Central Kentucky Agricultural Credit Association (Association) is a member-owned cooperative that provides credit and credit-related services to qualified borrowers in the counties of Anderson, Bourbon, Boyle, Clark, Fayette, Franklin, Garrard, Harrison, Jessamine, Lincoln, Madison, Marion, Mercer, Montgomery, Scott, Washington and Woodford in the state of Kentucky.

The Association is a lending institution in the Farm Credit System (System), a nationwide network of cooperatively owned banks and associations. It was established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The System specializes in providing financing and related services to qualified borrowers for agricultural and rural purposes.

The nation is served by three Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB), (collectively, the System Banks) each of which has specific lending authorities within its chartered territory. The ACB also has additional specific nationwide lending authorities.

Each System Bank serves one or more Agricultural Credit Associations (ACAs) that originate long-term, short-term and intermediate-term loans, Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, and/or Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans. These associations borrow a majority of the funds for their lending activities from their related bank. System Banks are also responsible for supervising the activities of associations within their districts. AgFirst and its related associations (Associations or District Associations) are collectively referred to as the AgFirst District. The District Associations jointly own substantially all of AgFirst's voting stock. As of year end, the District consisted of the Bank and nineteen District Associations. All nineteen were structured as ACA holding companies, with PCA and FLCA subsidiaries. FLCAs are tax-exempt while ACAs and PCAs are taxable.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising bank.

The Farm Credit Act also established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured Debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank has been required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average adjusted outstanding Insured Debt until the assets in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (adjusted to reflect the reduced risk on loans or investments guaranteed by federal or state governments) or such other percentage of the aggregate obligations as the Insurance Corporation at its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums and may return excess funds above the secure base amount to System institutions. However, it must still ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity and financial services that can be offered by the Association, and the persons eligible to borrow.

The Associations borrow from the Bank and in turn may originate and service short- and intermediate-term loans to their members, as well as, long-term real estate mortgage loans.

The Bank primarily lends to the District Associations in the form of a line of credit to fund the Associations' earning assets. These lines of credit (or Direct Notes) are collateralized by a pledge of substantially all of each Association's assets. The terms of the Direct Notes are governed by a General Financing Agreement (GFA) between the Bank and Association. Each advance is structured such that the principal cash flow, repricing characteristics, and underlying index (if any) of the advance match those of the assets being funded. By match-funding the Association loans, the Associations' exposure to interest rate risk is minimized.

In addition to providing funding for earning assets, the Bank provides District Associations with banking and support services such as: accounting, human resources, information systems, and marketing. The costs of these support services are included in cost of the Direct Note, or in some cases billed directly to certain Associations that use a specific service.

The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments, and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

The accompanying consolidated financial statements include the accounts of the ACA, PCA and FLCA.

Certain amounts in the prior year financial statements have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or total members' equity of prior years.

A. **Cash:** Cash represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** The Association is authorized to make long-term real estate loans with maturities of 5 to 40 years and certain short- and intermediate-term loans for agricultural production or operating purposes with maturities of not more than 10 years.

   Loans are carried at their principal amount outstanding adjusted for charge-offs, premiums, discounts, deferred loan fees or costs, and derivative instruments and hedging valuation adjustments, if any. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding. The difference in the total investment in a loan and its principal amount may be deferred as part of the carrying amount of the loan and the net difference amortized over the life of the related loan as an adjustment to interest income using the effective interest method.

   Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and could include loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

   Loans are generally classified as nonaccrual when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

   When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

   Loans are charged off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

   In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. A restructured loan constitutes a troubled debt restructuring (TDR) if for economic or legal reasons related to the debtor's financial difficulties the Association grants a concession to the debtor that it would not otherwise consider. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

   The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified. The allowance for loan losses is a valuation account used to reasonably estimate loan losses as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

   The Association considers the following factors, among others, when determining the allowance for loan losses:

   - Changes in credit risk classifications
   - Changes in collateral values
   - Changes in risk concentrations

- Changes in weather related conditions
- Changes in economic conditions

A specific allowance may be established for impaired loans under Financial Accounting Standards Board (FASB) guidance on accounting by creditors for impairment of a loan. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

A general allowance may also be established under FASB guidance on accounting for contingencies, to reflect estimated probable credit losses inherent in the remainder of the loan portfolio which excludes impaired loans considered under the specific allowance discussed above. A general allowance can be evaluated on a pool basis for those loans with similar characteristics. The level of the general allowance may be based on management's best estimate of the likelihood of default adjusted for other relevant factors reflecting the current environment.

The credit risk rating methodology is a key component of the Association's allowance for loan losses evaluation, and is generally incorporated into the institution's loan underwriting standards and internal lending limit. The Association uses a two-dimensional loan rating model based on internally generated combined system risk rating guidance that incorporates a 14-point risk rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default over a period of time. Probability of default is the probability that a borrower will experience a default within 12 months from the date of the determination of the risk rating. A default is considered to have occurred if the lender believes the borrower will not be able to pay its obligation in full or the borrower is past due more than 90 days. The loss given default is management's estimate as to the anticipated economic loss on a specific loan assuming default has occurred or is expected to occur within the next 12 months.

Each of the 14 categories carries a distinct percentage of default probability. The 14-point risk rating scale provides for granularity of the probability of default, especially in the acceptable ratings. There are nine acceptable categories that range from a borrower of the highest quality to a borrower of minimally acceptable quality. The probability of default between 1 and 9 is very narrow and would reflect almost no default to a minimal default percentage. The probability of default grows more rapidly as a loan moves from a "9" to other assets especially mentioned and grows significantly as a loan moves to a substandard (viable) level. A substandard (non-viable) rating indicates that the probability of default is almost certain.

C. **Loans Held for Sale:** Loans are classified as held for sale when there is intent to sell the loans within a reasonable period of time. Loans intended for sale are carried at the lower of cost or fair value.

D. **Other Property Owned:** Other property owned, consisting of real estate, personal property, and other assets acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Any initial reduction in the carrying amount of a loan to the fair value of the collateral received is charged to the allowance for loan losses. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in Gains (Losses) from Other Property Owned, Net in the Consolidated Statements of Comprehensive Income.

E. **Premises and Equipment:** Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or circumstances indicate that the carrying value of the asset may not be recoverable.

From time to time, assets classified as premises and equipment are transferred to held for sale for various reasons. These assets are carried in Other Assets at the lower of the recorded investment in the asset or fair value less estimated cost to sell based upon the property's appraised value at the date of transfer. Any write-downs of property held for sale are recorded as other non-interest expense.

F. **Investments:** The Association may hold investments as described below.

Investment in Other Farm Credit Institutions
The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock, as presented on the Consolidated Balance Sheet as Investments in Other Farm Credit Institutions. Accounting for this investment is on the cost plus allocated equities basis.

G. **Voluntary Advance Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as other liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

H. **Employee Benefit Plans:** The Association participates in District and multi-District sponsored benefit plans. These plans include a defined benefit final average pay retirement plan, a defined benefit cash balance retirement plan, a defined benefit other postretirement benefits plan, and a defined contribution 401(k) plan.

Defined Contribution Plans
Substantially all employees are eligible to participate in the defined contribution Farm Credit Benefit Alliance (FCBA)

401(k) Plan, subsequently referred to as the 401(k) Plan, which qualifies as a 401(k) plan as defined by the Internal Revenue Code. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. Company contributions to the 401(k) Plan are expensed as funded.

Additional information for the above may be found in Note 9 and the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report.

Multi-Employer Defined Benefit Plans
Substantially all employees hired before November 4, 2014 may participate in either the AgFirst Farm Credit Retirement Plan or the AgFirst Farm Credit Cash Balance Retirement Plan (collectively referred to as the "Plans"), which are defined benefit plans and considered multi-employer under FASB accounting guidance. The Plans are noncontributory and include eligible Association and District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. The actuarially-determined costs of the Plans are allocated to each participating entity by multiplying the Plans' net pension expense by each institution's eligible service cost and accumulated benefit obligation as a percentage of the total eligible service cost and total accumulated benefit obligation for all Plan participants. The cumulative excess of amounts funded by the Association over the cost allocated to the Association is reflected as prepaid retirement expense, a component of Other Assets in the Association's Consolidated Balance Sheets.

In addition to pension benefits, the Association provides certain health care and life insurance benefits for retired employees (other postretirement benefits) through a multi-District sponsored retiree healthcare plan. Substantially all employees are eligible for those benefits when they reach early retirement age while working for the Association. Certain charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. Authoritative accounting guidance requires the accrual of the expected cost of providing these benefits to an employee, their beneficiaries and covered dependents during the years the employee renders service necessary to become eligible for benefits. The cumulative excess of cost allocated to the Association over the amounts funded by the Association is reflected as postretirement benefits other than pensions, a component of Other Liabilities in the Association's Consolidated Balance Sheets.

Since the foregoing plans are multi-employer, the Association does not apply the provisions of FASB guidance on employers' accounting for defined benefit pension and other postretirement plans in its stand-alone financial statements. Rather, the effects of this guidance are reflected in the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations.

Additional information for the above may be found in Note 9 and the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report.

I. **Income Taxes:** The Association evaluates tax positions taken in previous and current years according to FASB guidance. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to, an entity's status, including its status as a pass-through entity or tax-exempt entity.

   The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

   The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

   The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

   The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

J. **Due from AgFirst Farm Credit Bank:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

K. **Valuation Methodologies:** FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. This guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of obserbable inputs and minimize the use of unobserbable inputs when measureing fair valuel It prescribes three levels of inputs that may be used to measure fair value.

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than a third-party valuation or internal model pricing.

The Association may use the Bank, internal resources or third parties to obtain fair value prices. Quoted market prices are generally used when estimating fair values of any assets or liabilities for which observable, active markets exist.

A number of methodologies may be employed to value items for which an observable active market does not exist. Examples of these items include: impaired loans, other property owned, and certain derivatives, investment securities and other financial instruments. Inputs to these valuations can involve estimates and assumptions that require a substantial degree of judgment. Some of the assumptions used include, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing, and liquidation values. The use of different assumptions could produce significantly different asset or liability values, which could have material positive or negative effects on results of operations.

Please see further discussion in Note 8.

L. **Off-Balance-Sheet Credit Exposures:** The credit risk associated with commitments to extend credit and letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness.

Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These letters of credit are issued to facilitate commerce and typically result in the commitment being funded when the underlying transaction is consummated between the customer and third party.

M. **Revenue Recognition:** The largest source of revenue for the Association is interest income. Interest income is recognized on an accrual basis driven by nondiscretionary formulas based on written contracts, such as loan agreements or securities contracts. Credit-related fees, including letter of credit fees, finance charges and other fees are recognized in non-interest income when earned. Other types of non-interest revenues, such as service charges, professional services and broker fees, are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

N. **Accounting Standards Updates (ASUs):** In January, 2017, the FASB issued ASU 2017-01 Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also support more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. For public business entities, the ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The amendments should be applied prospectively. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In November, 2016, the FASB issued ASU 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash. The Update clarifies that amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted using a retrospective transition method to each period presented. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In October, 2016, the FASB issued ASU 2016-17 Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control. If a reporting entity satisfies the first characteristic of a primary beneficiary of a variable interest entity (VIE), the amendments in this Update require that reporting entity, in determining whether it satisfies the second characteristic of a primary beneficiary, to include all of its direct variable interests in a VIE and, on a proportionate basis, its indirect variable interests in a VIE held through related parties, including related parties that are under common control with the reporting entity. That is, a single decision maker is not required to consider indirect interests held through related parties that are under common control with the single decision maker to be the equivalent of direct interests in their entirety. Instead, a single decision maker is required to include those interests on a proportionate basis consistent with indirect interests held through other related parties. The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In October, 2016, the FASB issued ASU 2016-16 Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. The Update requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory. The amendments in this Update align the recognition of income tax consequences for intra-entity transfers of assets other than inventory with International Financial Reporting Standards (IFRS). For public business entities, the amendments are effective, on a modified retrospective basis, for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In August, 2016, the FASB issued ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). Stakeholders had indicated there was diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The Update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments are to be applied using a retrospective transition method to each period presented. Application of this guidance is not expected to have a material impact on the Association's financial condition or results of operations.

In June, 2016, the FASB issued ASU 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The Update improves financial reporting by requiring timelier recording of credit losses on financial instruments. It requires an organization to measure all expected credit losses for financial assets held at the reporting date. Financial institutions and other organizations will use forward-looking information to better estimate their credit losses. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The Update will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. For public business entities that are not SEC filers, it will take effect for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. For all other organizations, the ASU will take effect for fiscal years beginning after December 15, 2020, and for interim periods within fiscal years beginning after December 15, 2021. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Association will apply the ASU guidance as a public business entity that is not a SEC filer. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In February, 2016, the FASB issued ASU 2016-02 Leases (Topic 842). The Update is intended to improve financial reporting about leasing transactions. The ASU affects all companies and other organizations that lease assets such as real estate, airplanes, and manufacturing equipment. The ASU will require organizations that lease assets—referred to as "lessees"—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. A lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current guidance, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, the new ASU will require both types of leases to be recognized on the balance sheet. The Update also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The accounting by organizations that own the assets leased by the lessee—also known as lessor accounting—will remain largely unchanged from current guidance. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014. The amendments are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early application will be permitted for all organizations. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In January, 2016, the FASB issued Accounting Standards Update (ASU) 2016-01 Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments are intended to improve the recognition and measurement of financial instruments. The Update affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. The new guidance makes targeted improvements to existing GAAP by requiring equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements, eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities, eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The ASU is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Association is in the process of evaluating what effects the guidance may have on the statements of financial condition and results of operations.

In September, 2015, the FASB issued ASU 2015-16 Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this Update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined and to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the amendments were effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. Adoption of this guidance was applied prospectively and did not have an impact on the Association's financial condition or results of operations.

In May, 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). Topic 820 permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. Investments valued using the practical expedient were categorized within the fair value hierarchy on the basis of whether the investment was redeemable with the investee at net asset value on the measurement date, never redeemable with the investee at net asset value, or redeemable with the investee at net asset value at a future date. To address diversity in practice related to how certain investments measured at net asset value with future redemption dates were categorized, the amendments in this Update removed the requirement to categorize investments for which fair values are measured using the net asset value per share practical expedient. It also limited disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. For public business entities, the guidance was effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Adoption of this guidance was applied retrospectively to all periods presented and did not have an impact on the Association's financial condition or results of operations.

In February, 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are VIEs or voting interest entities, eliminate the presumption that a general partner should consolidate a limited partnership, affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, and provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update were effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Adoption of this guidance was applied on a modified retrospective basis and did not have an impact on the Association's financial condition or results of operations.

In November, 2014, the FASB issued ASU 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity. Under GAAP, features such as conversion rights, redemption rights, dividend payment preferences, and others that are included in instruments issued in the form of shares may qualify as derivatives. If so, the shares issued are considered hybrid financial instruments. To determine the proper accounting for hybrid financial instruments, investors and issuers in the instruments must determine whether the nature of the host contract containing the feature is more akin to debt or equity as well as whether the economic characteristics and risks of the embedded derivative feature are clearly and closely related to the host contract. The purpose of the Update is to eliminate diversity in accounting for hybrid financial instruments by both issuers and investors. When evaluating the host contract to determine whether it is more akin to debt or equity, the reporting entity should consider all relevant terms and features of the contract, including the embedded derivative feature that is being evaluated for separation. The amendments in this Update were effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Adoption of this guidance was applied on a modified retrospective basis and did not have a material impact on the Association's financial condition or results of operations.

In August, 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The Update is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. The Update provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments in this Update apply to all companies and not-for-profit organizations and became effective in the annual period ended after December 15, 2016, with early application permitted. Adoption of this guidance was applied prospectively and did not have a material impact on the Association's financial condition or results of operations.

In May 2014, the FASB, responsible for U.S. Generally Accepted Accounting Principles (U.S. GAAP), and the International Accounting Standards Board (IASB), responsible for International Financial Reporting Standards (IFRS), jointly issued converged standards on the recognition of revenue from contracts with customers. ASU 2014-09, Revenue from Contracts with Customers (Topic 606) and IFRS 15 "Revenue from Contracts with Customers" are intended to improve the financial reporting of revenue and comparability of the top line in financial statements globally and supersede substantially all previous revenue recognition guidance. The core principle of the new standards is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standards also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. Because of the pervasive nature of the new guidance, the boards have established a joint transition resource group (TRG) in order to aid transition to the new standard. Based on input received from its stakeholders and Revenue Recognition TRG, the FASB has issued five Updates related to this ASU. The Updates generally provided clarifying guidance where there was the potential for diversity in practice, or to address the cost and complexity of applying Topic 606. Collectively, the Updates are not expected to have a significant effect on implementation of the guidance. For public business entities, the amendments in the Update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. The amendments are to be applied retrospectively. The Association has identified ancillary revenues that will be affected by this Update. However, because financial instruments are not within the scope of the guidance, it is expected that adoption will not have a material impact on the Association's financial condition or results of operations, but may result in additional disclosures.

Note 3 — Loans and Allowance for Loan Losses

For a description of the Association's accounting for loans, including impaired loans, and the allowance for loan losses, see Note 2 subsection B above.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation which exists in outstanding loans. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

The credit risk management process begins with an analysis of the obligor's credit history, repayment capacity and financial position. Repayment capacity focuses on the obligor's ability to repay the obligation based on cash flows from operations or other sources of income, including non-farm income. Real estate mortgage loans must be secured by first liens on the real estate collateral. As required by FCA regulations, each institution that makes loans on a secured basis must have collateral evaluation policies and procedures.

The credit risk rating process for loans uses a two-dimensional structure, incorporating a 14-point probability of default scale (see further discussion in Note 2 subsection B above) and a separate scale addressing estimated percentage loss in the event of default. The loan rating structure incorporates borrower risk and transaction risk. Borrower risk is the risk of loss driven by factors intrinsic to the borrower. The transaction risk or facility risk is related to the structure of a credit (tenor, terms, and collateral).

The Association's loan portfolio, which includes purchased interests in loans, has been segmented by the following loan types as defined by the FCA:

- Real estate mortgage loans — loans made to full-time or part-time farmers secured by first lien real estate mortgages with maturities from five to thirty years. These loans may be made only in amounts up to 85 percent of the appraised value of the property taken as security or up to 97 percent of the appraised value if guaranteed by a federal, state, or other governmental agency. The actual percentage of loan-to-appraised value when loans are made is generally lower than the statutory required percentage.

- Production and intermediate-term loans — loans to full-time or part-time farmers that are not real estate mortgage loans. These loans fund eligible financing needs including operating inputs (such as labor, feed, fertilizer, and repairs), livestock, living expenses, income taxes, machinery or equipment, farm buildings, and other business-related expenses. Production loans may be made on a secured or unsecured basis and are most often made for a period of time that matches the borrower's normal production and marketing cycle, which is typically one year or less. Intermediate-term loans are made for a specific term, generally greater than one year and less than or equal to ten years.

- Loans to cooperatives — loans for any cooperative purpose other than for communication, power, and water and waste disposal.

- Processing and marketing loans — loans for operations to process or market the products produced by a farmer, rancher, or producer or harvester of aquatic products, or by a cooperative.

- Farm-related business loans — loans to eligible borrowers that furnish certain farm-related business services to farmers or ranchers that are directly related to their agricultural production.

- Rural residential real estate loans — loans made to individuals, who are not farmers, to purchase a single-family dwelling that will be the primary residence in open country, which may include a town or village that has a population of not more than 2,500 persons. In addition, the loan may be to remodel, improve, or repair a rural home, or to refinance existing debt. These loans are generally secured by a first lien on the property.

- Communication loans — loans primarily to finance rural communication providers.

- Power loans — loans primarily to finance electric generation, transmission and distribution systems serving rural areas.

- Water and waste disposal loans — loans primarily to finance water and waste disposal systems serving rural areas.

- International loans — primarily loans or credit enhancements to other banks to support the export of U.S. agricultural commodities or supplies. The federal government guarantees a substantial portion of these loans.

- Lease receivables — the net investment for all finance leases such as direct financing leases, leveraged leases, and sales-type leases.

- Other (including Mission Related) — additional investments in rural America approved by the FCA on a program or a case-by-case basis. Examples of such investments include partnerships with agricultural and rural community lenders, investments in rural economic development and infrastructure, and investments in obligations and mortgage securities that increase the availability of affordable housing in rural America.

A summary of loans outstanding at period end follows:

	December 31, 2016	December 31, 2015	December 31, 2014
Real estate mortgage	$ 268,880	$ 250,887	$ 234,273
Production and intermediate-term	147,903	147,341	138,886
Loans to cooperatives	–	26	4
Processing and marketing	1,053	1,430	363
Farm-related business	421	500	513
Rural residential real estate	7,838	7,679	8,107
Total Loans	$ 426,095	$ 407,863	$ 382,146

A substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly.

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in loan to value ratios in excess of the regulatory maximum.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with FCA regulations. The following tables present the principal balance of participation loans at periods ended:

	December 31, 2016							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ –	$ 24,595	$ –	$ –	$ –	$ 4,526	$ –	$ 29,121
Production and intermediate-term	–	3,757	–	–	–	1,315	–	5,072
Processing and marketing	860	–	–	–	–	25	860	25
Total	$ 860	$ 28,352	$ –	$ –	$ –	$ 5,866	$ 860	$ 34,218

	December 31, 2015							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ –	$ 17,502	$ –	$ –	$ –	$ 2,699	$ –	$ 20,201
Production and intermediate-term	–	8,647	–	–	–	1,060	–	9,707
Processing and marketing	1,433	–	–	–	–	–	1,433	–
Farm-related business	–	–	–	–	–	38	–	38
Total	$ 1,433	$ 26,149	$ –	$ –	$ –	$ 3,797	$ 1,433	$ 29,946

	December 31, 2014							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	$ –	$ 25,389	$ –	$ –	$ –	$ 2,412	$ –	$ 27,801
Production and intermediate-term	–	8,581	–	–	–	658	–	9,239
Processing and marketing	365	–	–	–	–	–	365	–
Farm-related business	–	1,946	–	–	–	–	–	1,946
Total	$ 365	$ 35,916	$ –	$ –	$ –	$ 3,070	$ 365	$ 38,986

A significant source of liquidity for the Association is the repayments of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

	December 31, 2016			
	Due less than 1 year	Due 1 through 5 years	Due after 5 years	Total
Real estate mortgage	$ 4,670	$ 29,985	$ 234,225	$ 268,880
Production and intermediate-term	52,609	71,783	23,511	147,903
Processing and marketing	–	–	1,053	1,053
Farm-related business	85	130	206	421
Rural residential real estate	1,032	1,042	5,764	7,838
Total Loans	$ 58,396	$ 102,940	$ 264,759	$ 426,095
Percentage	13.70%	24.16%	62.14%	100.00%

The recorded investment in a 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.

The following table shows loans and related accrued interest classified under the FCA Uniform Loan Classification System as a percentage of total loans and related accrued interest receivable by loan type as of:

	December 31, 2016	2015	2014
Real estate mortgage:			
Acceptable	95.79%	96.06%	95.37%
OAEM	2.25	1.77	1.85
Substandard/doubtful/loss	1.96	2.17	2.78
	100.00%	100.00%	100.00%
Production and intermediate-term:			
Acceptable	96.73%	96.73%	97.94%
OAEM	1.50	2.52	1.19
Substandard/doubtful/loss	1.77	0.75	0.87
	100.00%	100.00%	100.00%
Loans to cooperatives:			
Acceptable	–%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	–%	100.00%	100.00%
Processing and marketing:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%

	December 31, 2016	2015	2014
Farm-related business:			
Acceptable	100.00%	100.00%	100.00%
OAEM	–	–	–
Substandard/doubtful/loss	–	–	–
	100.00%	100.00%	100.00%
Rural residential real estate:			
Acceptable	91.83%	93.98%	96.32%
OAEM	–	3.24	1.86
Substandard/doubtful/loss	8.17	2.78	1.82
	100.00%	100.00%	100.00%
Total Loans:			
Acceptable	96.06%	96.28%	96.34%
OAEM	1.94	2.06	1.60
Substandard/doubtful/loss	2.00	1.66	2.06
	100.00%	100.00%	100.00%

The following tables provide an age analysis of past due loans and related accrued interest as of:

December 31, 2016

	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	$ 842	$ 242	$ 1,084	$ 271,106	$ 272,190	$ –
Production and intermediate-term	841	290	1,131	149,220	150,351	–
Processing and marketing	–	–	–	1,056	1,056	–
Farm-related business	–	–	–	423	423	–
Rural residential real estate	–	288	288	7,568	7,856	–
Total	$ 1,683	$ 820	$ 2,503	$ 429,373	$ 431,876	$ –

December 31, 2015

	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	$ 1,160	$ 1,346	$ 2,506	$ 251,262	$ 253,768	$ 7
Production and intermediate-term	925	654	1,579	147,998	149,577	–
Loans to cooperatives	–	–	–	26	26	–
Processing and marketing	–	–	–	1,430	1,430	–
Farm-related business	–	–	–	501	501	–
Rural residential real estate	–	85	85	7,613	7,698	–
Total	$ 2,085	$ 2,085	$ 4,170	$ 408,830	$ 413,000	$ 7

December 31, 2014

	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	$ 1,523	$ 1,322	$ 2,845	$ 233,922	$ 236,767	$ –
Production and intermediate-term	307	805	1,112	139,748	140,860	4
Loans to cooperatives	–	–	–	4	4	–
Processing and marketing	–	–	–	364	364	–
Farm-related business	–	–	–	514	514	–
Rural residential real estate	67	93	160	7,966	8,126	–
Total	$ 1,897	$ 2,220	$ 4,117	$ 382,518	$ 386,635	$ 4

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

	December 31, 2016	December 31, 2015	December 31, 2014
Nonaccrual loans:			
Real estate mortgage	$ 1,058	$ 1,937	$ 1,613
Production and intermediate-term	569	998	1,087
Rural residential real estate	418	228	93
Total	$ 2,045	$ 3,163	$ 2,793
Accruing restructured loans:			
Real estate mortgage	$ 1,280	$ 198	$ –
Production and intermediate-term	–	100	–
Total	$ 1,280	$ 298	$ –
Accruing loans 90 days or more past due:			
Real estate mortgage	$ –	$ 7	$ 4
Total	$ –	$ 7	$ 4
Total nonperforming loans	$ 3,325	$ 3,468	$ 2,797
Other property owned	8	–	640
Total nonperforming assets	$ 3,333	$ 3,468	$ 3,437
Nonaccrual loans as a percentage of total loans	0.48%	0.78%	0.73%
Nonperforming assets as a percentage of total loans and other property owned	0.78%	0.85%	0.90%
Nonperforming assets as a percentage of capital	4.56%	5.09%	5.60%

The following table presents information relating to impaired loans (including accrued interest) as defined in Note 2:

	December 31, 2016	December 31, 2015	December 31, 2014
Impaired nonaccrual loans:			
Current as to principal and interest	$ 935	$ 493	$ 552
Past due	1,110	2,670	2,241
Total	2,045	3,163	2,793
Impaired accrual loans:			
Restructured	1,280	298	–
90 days or more past due	–	7	4
Total	1,280	305	4
Total impaired loans	$ 3,325	$ 3,468	$ 2,797
Additional commitments to lend	$ –	$ –	$ 666

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

	December 31, 2016			Year Ended December 31, 2016	
Impaired loans:	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Impaired Loans**	**Interest Income Recognized on Impaired Loans**
With a related allowance for credit losses:					
Real estate mortgage	$ 358	$ 364	$ 3	$ 401	$ 14
Production and intermediate-term	272	277	24	305	11
Rural residential real estate	15	14	15	16	1
Total	$ 645	$ 655	$ 42	$ 722	$ 26
With no related allowance for credit losses:					
Real estate mortgage	$ 1,980	$ 2,226	$ –	$ 2,215	$ 80
Production and intermediate-term	297	414	–	332	12
Rural residential real estate	403	441	–	452	16
Total	$ 2,680	$ 3,081	$ –	$ 2,999	$ 108
Total impaired loans:					
Real estate mortgage	$ 2,338	$ 2,590	$ 3	$ 2,616	$ 94
Production and intermediate-term	569	691	24	637	23
Rural residential real estate	418	455	15	468	17
Total	$ 3,325	$ 3,736	$ 42	$ 3,721	$ 134

Impaired loans:	December 31, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance	Year Ended December 31, 2015 Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	$ 787	$ 709	$ –	$ 725	$ 13
Production and intermediate-term	812	878	154	748	13
Total	$ 1,599	$ 1,587	$ 154	$ 1,473	$ 26
With no related allowance for credit losses:					
Real estate mortgage	$ 1,355	$ 1,448	$ –	$ 1,249	$ 22
Production and intermediate-term	286	308	–	263	5
Rural residential real estate	228	253	–	210	4
Total	$ 1,869	$ 2,009	$ –	$ 1,722	$ 31
Total impaired loans:					
Real estate mortgage	$ 2,142	$ 2,157	$ –	$ 1,974	$ 35
Production and intermediate-term	1,098	1,186	154	1,011	18
Rural residential real estate	228	253	–	210	4
Total	$ 3,468	$ 3,596	$ 154	$ 3,195	$ 57

Impaired loans:	December 31, 2014 Recorded Investment	Unpaid Principal Balance	Related Allowance	Year Ended December 31, 2014 Average Impaired Loans	Interest Income Recognized on Impaired Loans
With a related allowance for credit losses:					
Real estate mortgage	$ 816	$ 728	$ 24	$ 1,097	$ 13
Production and intermediate-term	829	866	209	1,114	14
Total	$ 1,645	$ 1,594	$ 233	$ 2,211	$ 27
With no related allowance for credit losses:					
Real estate mortgage	$ 801	$ 851	$ –	$ 1,076	$ 13
Production and intermediate-term	258	267	–	347	4
Rural residential real estate	93	107	–	125	2
Total	$ 1,152	$ 1,225	$ –	$ 1,548	$ 19
Total impaired loans:					
Real estate mortgage	$ 1,617	$ 1,579	$ 24	$ 2,173	$ 26
Production and intermediate-term	1,087	1,133	209	1,461	18
Rural residential real estate	93	107	–	125	2
Total	$ 2,797	$ 2,819	$ 233	$ 3,759	$ 46

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31, 2016	2015	2014
Interest income which would have been recognized under the original loan terms	$ 289	$ 223	$ 227
Less: interest income recognized	132	42	24
Foregone interest income	$ 157	$ 181	$ 203

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*	Rural Residential Real Estate	Total
Activity related to the allowance for credit losses:					
Balance at December 31, 2015	$ 2,204	$ 1,486	$ 18	$ 63	$ 3,771
Charge-offs	–	(26)	–	–	(26)
Recoveries	–	–	–	–	–
Provision for loan losses	104	(164)	(5)	15	(50)
Balance at December 31, 2016	$ 2,308	$ 1,296	$ 13	$ 78	$ 3,695
Balance at December 31, 2014	$ 2,184	$ 1,629	$ 7	$ 72	$ 3,892
Charge-offs	–	(86)	–	–	(86)
Recoveries	–	–	–	–	–
Provision for loan losses	20	(57)	11	(9)	(35)
Balance at December 31, 2015	$ 2,204	$ 1,486	$ 18	$ 63	$ 3,771
Balance at December 31, 2013	$ 1,945	$ 1,578	$ 12	$ 58	$ 3,593
Charge-offs	–	(64)	–	–	(64)
Recoveries	13	–	–	–	13
Provision for loan losses	226	115	(5)	14	350
Balance at December 31, 2014	$ 2,184	$ 1,629	$ 7	$ 72	$ 3,892
Allowance on loans evaluated for impairment:					
Individually	$ 3	$ 24	$ –	$ 15	$ 42
Collectively	2,305	1,272	13	63	3,653
Balance at December 31, 2016	$ 2,308	$ 1,296	$ 13	$ 78	$ 3,695
Individually	$ –	$ 154	$ –	$ –	$ 154
Collectively	2,204	1,332	18	63	3,617
Balance at December 31, 2015	$ 2,204	$ 1,486	$ 18	$ 63	$ 3,771
Individually	$ 24	$ 209	$ –	$ –	$ 233
Collectively	2,160	1,420	7	72	3,659
Balance at December 31, 2014	$ 2,184	$ 1,629	$ 7	$ 72	$ 3,892
Recorded investment in loans evaluated for impairment:					
Individually	$ 1,058	$ 569	$ –	$ 418	$ 2,045
Collectively	271,132	149,782	1,479	7,438	429,831
Balance at December 31, 2016	$ 272,190	$ 150,351	$ 1,479	$ 7,856	$ 431,876
Individually	$ 2,227	$ 463	$ –	$ 225	$ 2,915
Collectively	251,541	149,114	1,957	7,473	410,085
Balance at December 31, 2015	$ 253,768	$ 149,577	$ 1,957	$ 7,698	$ 413,000
Individually	$ 1,845	$ 3,174	$ –	$ 93	$ 5,112
Collectively	234,922	137,686	882	8,033	381,523
Balance at December 31, 2014	$ 236,767	$ 140,860	$ 882	$ 8,126	$ 386,635

**Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.*

To mitigate risk of loan losses, the Association may enter into guarantee arrangements with certain GSEs, including the Federal Agricultural Mortgage Corporation (Farmer Mac), and state or federal agencies. These guarantees generally remain in place until the loans are paid in full or expire and give the Association the right to be reimbursed for losses incurred or to sell designated loans to the guarantor in the event of default (typically four months past due), subject to certain conditions. The guaranteed balance of designated loans under these agreements was $70,999, $76,349, and $77,326 at December 31, 2016, 2015, and 2014, respectively. Fees paid for such guarantee commitments totaled $145, $168, and $294 for 2016, 2015, and 2014, respectively. These amounts are classified as noninterest expense.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) 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. The following tables present additional information about pre-modification and post-modification outstanding recorded investment and the effects of the modifications that occurred during the periods presented.

	Year Ended December 31, 2016				
Outstanding Recorded Investment	**Interest Concessions**	**Principal Concessions**	**Other Concessions**	**Total**	**Charge-offs**
Pre-modification:					
Real estate mortgage	$ –	$ 1,219	$ –	$ 1,219	
Total	$ –	$ 1,219	$ –	$ 1,219	
Post-modification:					
Real estate mortgage	$ –	$ 1,219	$ –	$ 1,219	$ –
Total	$ –	$ 1,219	$ –	$ 1,219	$ –

Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
	Year Ended December 31, 2015				
Pre-modification:					
Real estate mortgage	$ –	$ 202	$ –	$ 202	
Production and intermediate-term	–	100	–	100	
Total	$ –	$ 302	$ –	$ 302	
Post-modification:					
Real estate mortgage	$ –	$ 202	$ –	$ 202	$ –
Production and intermediate-term	–	100	–	100	–
Total	$ –	$ 302	$ –	$ 302	$ –

Outstanding Recorded Investment	Interest Concessions	Principal Concessions	Other Concessions	Total	Charge-offs
	Year Ended December 31, 2014				
Pre-modification:					
Real estate mortgage	$ –	$ 405	$ –	$ 405	
Total	$ –	$ 405	$ –	$ 405	
Post-modification:					
Real estate mortgage	$ –	$ 405	$ –	$ 405	$ –
Total	$ –	$ 405	$ –	$ 405	$ –

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

There were no TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during periods presented. Payment default is defined as a payment that was thirty days or more past due.

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

	Total TDRs			Nonaccrual TDRs		
	December 31,			December 31,		
	2016	2015	2014	2016	2015	2014
Real estate mortgage	$ 1,320	$ 198	$ –	$ 40	$ –	$ –
Production and intermediate-term	–	100	–	–	–	–
Total Loans	$ 1,320	$ 298	$ –	$ 40	$ –	$ –
Additional commitments to lend	$ –	$ –	$ –			

The following table presents information as of period end:

	December 31, 2016
Carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession	$ –
Recorded investment of consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings are in process	$ 83

Note 4 — Investments

Investments in Other Farm Credit Institutions

Investments in other Farm Credit System institutions are generally nonmarketable investments consisting of stock and participation certificates, allocated surplus, and reciprocal investments in other institutions regulated by the FCA. The Association is required to maintain ownership in the Bank in the form of Class B or Class C stock as required by the Bank. The Bank may require additional capital contributions to maintain its capital requirements. Accounting for this investment is on the cost plus allocated equities basis.

The Association's investment in the Bank totaled $6,908 for 2016. In addition, the Bank had a reciprocal investment in the Association of $1,975 at December 31, 2016. The Association's resulting net investment in the Bank was $4,933 for 2016, $4,625 for 2015 and $4,442 for 2014. The Association owns 1.95 percent of the issued stock of the Bank as of December 31, 2016 net of any reciprocal investment. As of that date, the Bank's assets totaled $32.1 billion and shareholders' equity totaled $2.2 billion. The Bank's earnings were $342 million for 2016. In addition, the Association had an investment of $205 related to other Farm Credit institutions at December 31, 2016.

Note 5 — Real Estate and Other Property

Premises and Equipment

Premises and equipment consists of the following:

	December 31,		
	2016	2015	2014
Land	$ 725	$ 725	$ 725
Buildings and improvements	3,440	3,425	3,407
Furniture and equipment	1,435	1,270	1,269
	5,600	5,420	5,401
Less: accumulated depreciation	2,586	2,494	2,360
Total	$ 3,014	$ 2,926	$ 3,041

Other Property Owned

Net (gains) losses on other property owned consist of the following:

	December 31,		
	2016	2015	2014
(Gains) losses on sale, net	$ –	$ –	$ (194)
Carrying value unrealized (gains) losses	–	22	559
Operating (income) expense, net	1	37	76
(Gains) losses on other property owned, net	$ 1	$ 59	$ 441

Gains on sales of other property owned were deferred if the sales involved financing from the Association and did not meet the criteria for immediate recognition. There were no deferred gains at December 31, 2016, 2015, and 2014.

Note 6 — Debt

Notes Payable to AgFirst Farm Credit Bank

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The borrowing relationship is established with the Bank through a GFA. The GFA utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The GFA has a one year term which expires on December 31 and is renewable each year. The Association has no reason to believe the GFA will not be renewed upon expiration. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2016, the Association's notes payable were within the specified limitations.

The Association's indebtedness to the Bank represents borrowings by the Association to fund its earning assets. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by the GFA. Interest rates on both variable and fixed rate advances are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. In the event of prepayment of any portion of a fixed rate advance, the Association may incur a prepayment penalty in accordance with the terms of the GFA, which will be included in interest expense. The interest rate is periodically adjusted by the Bank based upon an agreement between the Bank and the Association.

The weighted average interest rates on the variable rate advances were 1.89 percent for LIBOR-based loans and 1.93 percent for Prime-based loans, and the weighted average remaining maturities were 1.7 years and 1.7 years, respectively, at December 31, 2016. The weighted-average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 2.79 percent, and the weighted average remaining maturity was 11.8 years at December 31, 2016. The weighted-average interest rate on all interest-bearing notes payable was 2.63 percent and the weighted-average remaining maturity was 10.0 years at December 31, 2016. Variable rate and fixed rate notes payable represent approximately 3.88 percent and 96.12 percent, respectively, of total notes payable at December 31, 2016. The weighted average maturities described above are related to matched-funded loans. The direct note itself has an annual maturity as prescribed in the GFA.

Note 7 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Capital Stock and Participation Certificates:** In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Common stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to two percent of the loan amount or $1 thousand, whichever is less. The Association bylaws permit the Board of Directors, at their discretion, to establish an investment range between a minimum of two percent of the loan amount or $1 thousand, whichever is less, and a maximum not to exceed ten percent of the loan amount. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

   The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

B. **Regulatory Capitalization Requirements and Restrictions:** FCA regulations require that certain minimum standards for capital be achieved and maintained.

These standards are measured based on capital as a percentage of risk-adjusted assets and off-balance-sheet commitments and surplus levels as a percentage of risk-adjusted assets.

Failure to meet the capital requirements can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2016	2015	2014	Regulatory Minimum
Permanent capital ratio	17.79%	17.58%	16.85%	7.00%
Total surplus ratio	16.96%	16.28%	15.54%	7.00%
Core surplus ratio	16.96%	16.28%	15.54%	3.50%

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

There are currently no prohibitions in place that would prevent the Association from retiring stock, distributing earnings, or paying dividends per the statutory and regulatory restrictions, and the Association has no reason to believe any such restrictions may apply in the future.

C. **Description of Equities:** The Association is authorized to issue or have outstanding nonvoting Class A Preferred Stock, nonvoting Class B Common Stock, voting Class C Common Stock, nonvoting Class C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The Board, at its sole discretion, may declare dividends on either the Class A Preferred Stock alone, or on all classes of Stock and Participation certificates during any fiscal year. However, dividends shall not be paid on common stock or participation certificates in any year with respect to which the Association has obligated itself to distribute patronage refunds.

The Association had the following shares outstanding at December 31, 2016:

		Shares Outstanding	
Class	Protected	Number	Aggregate Par Value
A Common/Nonvoting	No	251	$ 1
C Common/Voting	No	581,901	2,910
Common Issued to Bank/Nonvoting	No	394,936	1,975
C Participation Certificates/Nonvoting	No	21,487	107
Total Capital Stock and Participation Certificates		998,575	$ 4,984

At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board, provided that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2016, allocated members' equity consisted of $48,344 of nonqualified retained surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to Patrons, on a patronage basis, all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patrons are defined as Members, Equity holders, and other customers, borrowers and financial institutions with which the Association shall conduct business as identified by the Board in the obligation resolution. Patronage distributions are based on the proportion of the Patron's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash. Amounts not distributed are retained as unallocated members' equity.

Transfer

Classes B and C Common Stock and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities as provided in the Association's bylaws. Class A Preferred Stock may be transferred in the manner set forth in the resolution authorizing the issuance of such Stock.

Impairment

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order: Class B Common Stock, Class C Common Stock and unit of Participation Certificates.

1. Class B Common Stock, Class C Common Stock and unit of Participation Certificates
2. Class A Preferred Stock

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Class A Preferred Stock
2. Classes B and C Common Stock and Participation Certificates
3. Allocated retained earnings evidenced by qualified written notices of allocation, in the order of the year of issuance and pro-rata by year of issuance
4 Allocated retained earnings evidenced by nonqualified written notices of allocation, in the year of issuance and pro-rata by year of issuance
5 All unallocated retained earnings earned after April 1, 1995, shall be distributed to all Patrons from April 1, 1995, through the date of liquidation on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates in proportion to their ownership

Note 8 — Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities.

The classifications within the fair value hierarchy (See Note 2) are as follows:

Level 1
The Association has no Level 1 assets or liabilities measured at fair value on a recurring basis at December 31, 2016. For cash, the carrying value is primarily utilized as a reasonable estimate of fair value.

Level 2
The Association had no Level 2 assets or liabilities measured at fair value on a recurring basis at December 31, 2016.

Level 3
Because no active market exists for the Association's accruing loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans currently would be made to borrowers with similar credit risk. The loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair values of loans in a nonaccrual status are estimated to be the carrying amount of the loan less specific reserves. Certain loans evaluated for impairment under FASB guidance have fair values based upon the underlying collateral, as the loans were collateral-dependent. Specific reserves were established for these loans when the value of the collateral, less estimated cost to sell, was less than the principal balance of the loan. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters.

Notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

Other property owned is classified as a Level 3 asset. The fair value is generally determined using formal appraisals of each individual property. These assets are held for sale. Costs to sell represent transaction costs and are not included as a component of the fair value of other property owned. Other property owned consists of real and personal property acquired through foreclosure or deed in lieu of foreclosure and is carried as an asset held for sale, which is generally not its highest and best use. These properties are part of the Association's credit risk mitigation efforts, not its ongoing business. In addition, FCA regulations require that these types of property be disposed of within a reasonable period of time.

For commitments to extend credit, the estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics; therefore, the related credit risk is not significant.

There were no Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

Fair values are estimated at each period end date for assets and liabilities measured at fair value on a recurring basis. Fair values are estimated at least annually, or when information suggests a significant change in value, for assets measured at fair value on a nonrecurring basis. Other Financial Instruments are not measured at fair value in the statement of financial position, but their fair values are estimated as of each period end date. The following tables summarize the carrying amounts of these assets and liabilities at period end, and their related fair values.

	At or for the Year ended December 31, 2016					
	Total Carrying Amount	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value**	**Fair Value Effects On Earnings**
Recurring Measurements						
Assets:						
Recurring Assets	$ –	$ –	$ –	$ –	$ –	
Liabilities:						
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –	
Nonrecurring Measurements						
Assets:						
Impaired loans	$ 3,283	$ –	$ –	$ 3,283	$ 3,283	$ 86
Other property owned	8	–	–	9	9	–
Nonrecurring Assets	$ 3,291	$ –	$ –	$ 3,292	$ 3,292	$ 86
Other Financial Instruments						
Assets:						
Cash	$ 1,605	$ 1,605	$ –	$ –	$ 1,605	
Loans	420,545	–	–	409,534	409,534	
Other Financial Assets	$ 422,150	$ 1,605	$ –	$ 409,534	$ 411,139	
Liabilities:						
Notes payable to AgFirst Farm Credit Bank	$ 368,038	$ –	$ –	$ 360,085	$ 360,085	
Other Financial Liabilities	$ 368,038	$ –	$ –	$ 360,085	$ 360,085	

	At or for the Year ended December 31, 2015					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value	Fair Value Effects On Earnings
Recurring Measurements						
Assets:						
Recurring Assets	$ –	$ –	$ –	$ –	$ –	
Liabilities:						
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –	
Nonrecurring Measurements						
Assets:						
Impaired loans	$ 3,314	$ –	$ –	$ 3,314	$ 3,314	$ (7)
Other property owned	–	–	–	–	–	(22)
Nonrecurring Assets	$ 3,314	$ –	$ –	$ 3,314	$ 3,314	$ (29)
Other Financial Instruments						
Assets:						
Cash	$ 1,250	$ 1,250	$ –	$ –	$ 1,250	
Loans	400,928	–	–	399,306	399,306	
Other Financial Assets	$ 402,178	$ 1,250	$ –	$ 399,306	$ 400,556	
Liabilities:						
Notes payable to AgFirst Farm Credit Bank	$ 353,034	$ –	$ –	$ 351,294	$ 351,294	
Other Financial Liabilities	$ 353,034	$ –	$ –	$ 351,294	$ 351,294	

	At or for the Year ended December 31, 2014					
	Total Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value	Fair Value Effects On Earnings
Recurring Measurements						
Assets:						
Recurring Assets	$ –	$ –	$ –	$ –	$ –	
Liabilities:						
Recurring Liabilities	$ –	$ –	$ –	$ –	$ –	
Nonrecurring Measurements						
Assets:						
Impaired loans	$ 2,564	$ –	$ –	$ 2,564	$ 2,564	$ 2
Other property owned	640	–	–	754	754	(365)
Nonrecurring Assets	$ 3,204	$ –	$ –	$ 3,318	$ 3,318	$ (363)
Other Financial Instruments						
Assets:						
Cash	$ 1,289	$ 1,289	$ –	$ –	$ 1,289	
Loans	375,690	–	–	372,052	372,052	
Other Financial Assets	$ 376,979	$ 1,289	$ –	$ 372,052	$ 373,341	
Liabilities:						
Notes payable to AgFirst Farm Credit Bank	$ 334,747	$ –	$ –	$ 331,261	$ 331,261	
Other Financial Liabilities	$ 334,747	$ –	$ –	$ 331,261	$ 331,261	

SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a change to another unobservable input (that is, changes in certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

Inputs to Valuation Techniques

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	$ 3,292	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement costs	*
			Comparability adjustments	*

** Ranges for this type of input are not useful because each collateral property is unique.*

Information about Other Financial Instrument Fair Value Measurements

	Valuation Technique(s)	Input
Cash	Carrying Value	Par/Principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts Probability of default Loss severity

Note 9 — Employee Benefit Plans

The Association participates in four District sponsored benefit plans. These plans include two multi-employer defined benefit pension plans, the Independent Associations Retirement Plan which is a final average pay plan (IAR Plan) and the AgFirst Farm Credit Cash Balance Retirement Plan which is a cash balance plan (CB Plan). In addition, the Association participates in a multi-employer defined benefit other postretirement benefits plan (OPEB Plan), the Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plan, and a defined contribution 401(k) plan. The risks of participating in these multi-employer plans are different from single-employer plans in the following aspects:

1. Assets contributed to multi-employer plans by one employer may be used to provide benefits to employees of other participating employers.

2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

3. If the Association chooses to stop participating in some of its multi-employer plans, the Association may be required to contribute to eliminate the underfunded status of the plan.

In November 2014, the AgFirst Plan Sponsor Committee approved and executed amendments to the CB Plan that included the following changes:

1. The CB Plan was closed to new participants effective as of December 31, 2014. Based on the plan's eligibility provisions, this change affected employees hired on or after November 4, 2014.

2. Employer contributions were discontinued effective as of January 1, 2015.

3. All participants who were not already fully vested in the CB Plan became fully vested as of December 31, 2014.

4. The CB Plan was terminated effective as of December 31, 2015.

A favorable determination letter was received from the Internal Revenue Service, and as a result of the termination of the CB Plan, vested benefits will be distributed to participants in 2017. Participants will continue to receive interest credits to their hypothetical cash balance accounts following the termination of the plan through the month immediately preceding the month in which the vested benefits are distributed from the plan.

Curtailment accounting, as prescribed in ASC 715 "Compensation – Retirement Benefits", was initiated upon execution of the plan amendments and did not have a material impact on the Association's financial condition or results of operations.

Beginning on January 1, 2015, for participants in the CB Plan and eligible employees hired on or after November 4, 2014, additional employer contributions are made to the 401(k) Plan equal to 3.00 percent of the participants' eligible compensation.

The Association's participation in the multi-employer defined benefit plans for the annual periods ended December 31, is outlined in the table below. The "Percentage Funded to Projected Benefit Obligation" or "Percentage Funded to Accumulated Postretirement Benefit Obligation" represents the funded amount for the entire plan and the "Contributions" and "Percentage of Total Contributions" columns represent the Association's respective amounts.

Pension Plan	Percentage Funded to Projected Benefit Obligation			Contributions			Percentage of Total Contributions		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Independent Associations Retirement Plan	83.70%	83.07%	77.50%	$580	$1,814	$768	20.04%	20.95%	24.96%
AgFirst Farm Credit Cash Balance Retirement Plan	100.21%	102.72%	100.07%	$–	$–	$11	0.00%	0.00%	0.22%

Other Postretirement Benefit Plan	Percentage Funded to Accumulated Postretirement Benefit Obligation			Contributions			Percentage of Total Contribution		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Farm Credit Benefits Alliance Retiree and Disabled Medical and Dental Plans	0.00%	0.00%	0.00%	$78	$77	$85	1.08%	1.14%	1.10%

The District's multi-employer plans are not subject to ERISA and no Form 5500 is required. As such, the following information is neither available for nor applicable to the plans:

1. The Employee Identification Number (EIN) and three-digit Pension Plan Number

2. The most recent Pension Protection Act (PPA) zone status. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded.

3. The "FIP/RP Status" indicating whether a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.

4. The expiration date(s) of collective-bargaining agreement(s).

Substantially all employees of the Association hired before November 4, 2014 are eligible to participate in either the defined benefit IAR Plan with three other District associations or the CB Plan. These two plans are noncontributory and include eligible District employees. For participants hired prior to January 1, 2009, benefits are provided under the IAR Plan and are based on eligible compensation and years of service. For participants hired on or after January 1, 2009 through November 3, 2014, benefits are provided under the CB Plan and are determined using a percent of eligible compensation formula. Prior to January 1, 2015, when employer contributions were discontinued as discussed above, the employer contribution under the CB Plan was based on a formula of 3.00 - 5.00 percent of eligible compensation (depending on years of service) and interest credits as allocated to an employee's theoretical account balance. The actuarially-determined costs of these plans are allocated to each participating entity, including the Association, by multiplying the plans' net pension expense by each institution's eligible service cost and accumulated benefit obligation as a percentage of the total eligible service cost and total accumulated benefit obligation for all plan participants. Plan expenses included in employee benefit costs were $821 for 2016, $837 for 2015, and $762 for 2014. The cumulative excess of amounts funded by the Association over the cost allocated to the Association is reflected as prepaid retirement expense, a component of Other Assets in the Consolidated Balance Sheets.

In addition to providing pension benefits, the Association provides certain medical and dental benefits for eligible retired employees through the OPEB Plan. Substantially all of the Association employees may become eligible for the benefits if they reach early retirement age while working for the Association. Early retirement age is defined as a minimum of age 55 and 10 years of service. Employees hired after December 31, 2002, and employees who separate from service between age 50 and age 55, are required to pay the full cost of their retiree health insurance coverage. Employees who retire subsequent to December 1, 2007 are no longer provided retiree life insurance benefits. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability. This plan is unfunded with expenses paid as incurred. Postretirement benefits other than pensions included in employee benefit costs were $154 for 2016, $194 for 2015, and $112 for 2014. The cumulative excess of cost allocated to the Association over the amounts funded by the Association is reflected as postretirement benefits other than pensions, a component of Other Liabilities in the Association's Consolidated Balance Sheets.

The Association also participates in a defined contribution Farm Credit Benefits Alliance (FCBA) 401(k) Plan (401(k) Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. This 401(k) requires the Association to match 100 percent of employee optional contributions up to a maximum employee contribution of 6.00 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as determined and adjusted by the Internal Revenue Service. The 401(k) Plan costs are expensed as funded. Employer contributions to this plan included in salaries and employee benefit costs were $194, $174, and $155 for the years ended December 31, 2016, 2015, and 2014, respectively. Beginning in 2015, contributions include additional amounts related to the discontinuation of the CB Plan as discussed above.

Additional information can be found in Note 9 of the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' Annual Report.

Note 10 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2016 amounted to $3,129. During 2016, $2,297 of new loans were made and repayments totaled $2,458. In the opinion of management, none of these loans outstanding at December 31, 2016 involved more than a normal risk of collectibility.

Note 11 — Commitments and Contingencies

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

In the normal course of business, the Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers. These financial instruments may include commitments to extend credit or letters of credit.

The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. At December 31, 2016, $52,333 of commitments to extend credit and no commercial letters of credit were outstanding with no related reserve for unfunded commitments included in Other Liabilities in the Consolidated Balance Sheets at December 31, 2016.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2016, standby letters of credit outstanding totaled $16 with expiration dates ranging from June 17, 2017 to December 31, 2017. The maximum potential amount of future payments that may be required under these guarantees was $16.

Note 12 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2016	2015	2014
Current:			
Federal	$ (53)	$ 2	$ 162
State	--	–	–
	(53)	2	162
Deferred:			
Federal	--	–	–
State	--	–	–
Total provision (benefit) for income taxes	$ (53)	$ 2	$ 162

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31, 2016	2015	2014
Federal tax at statutory rate	$ 3,424	$ 3,254	$ 3,434
Patronage distributions	(1,086)	(916)	(992)
Tax-exempt FLCA earnings	(2,388)	(1,981)	(2,397)
Change in deferred tax asset valuation allowance	61	(338)	34
Other	(64)	(17)	83
Provision (benefit) for income taxes	$ (53)	$ 2	$ 162

Deferred tax assets and liabilities are comprised of the following at:

	December 31, 2016	2015	2014
Deferred income tax assets:			
Allowance for loan losses	$ 467	$ 520	$ 581
Annual leave	101	98	95
Nonaccrual loan interest	71	64	51
Pensions and other postretirement benefits	514	487	446
Other	--	–	–
Gross deferred tax assets	1,153	1,169	1,173
Less: valuation allowance	(511)	(449)	(787)
Gross deferred tax assets, net of valuation allowance	642	720	386
Deferred income tax liabilities:			
Pensions and other postretirement benefits	(617)	(701)	(359)
Depreciation	(25)	(19)	(27)
Other	--	–	–
Gross deferred tax liability	(642)	(720)	(386)
Net deferred tax asset (liability)	$ --	$ –	$ –

At December 31, 2016, deferred income taxes have not been provided by the Association on approximately $6 million of its investment in the Bank. Management expects that these earnings will not be converted to cash.

The Association recorded a valuation allowance of $511, $449 and $787 as of December 31, 2016, 2015 and 2014, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

There were no uncertain tax positions identified related to the current year and the Association has no unrecognized tax benefits at December 31, 2016 for which liabilities have been established. The Association recognizes interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

The tax years that remain open for federal and major state income tax jurisdictions are 2010 and forward.

Note 13 — Additional Financial Information

Quarterly Financial Information (Unaudited)

	2016				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 2,717	$ 2,744	$ 2,805	$ 2,830	$ 11,096
Provision for (reversal of allowance for) loan losses	–	–	–	(50)	(50)
Noninterest income (expense), net	(910)	(911)	(799)	1,311	(1,309)
Net income	$ 1,807	$ 1,833	$ 2,006	$ 4,191	$ 9,837

	2015				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 2,593	$ 2,582	$ 2,667	$ 2,713	$ 10,555
Provision for (reversal of allowance for) loan losses	–	–	–	(35)	(35)
Noninterest income (expense), net	(867)	(875)	(769)	1,216	(1,295)
Net income	$ 1,726	$ 1,707	$ 1,898	$ 3,964	$ 9,295

	2014				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 2,425	$ 2,478	$ 2,604	$ 2,618	$ 10,125
Provision for (reversal of allowance for) loan losses	–	150	–	200	350
Noninterest income (expense), net	(733)	(920)	(720)	2,248	(125)
Net income	$ 1,692	$ 1,408	$ 1,884	$ 4,666	$ 9,650

Note 14 — Subsequent Events

The Association evaluated subsequent events and determined that there were none requiring disclosure through March 13, 2017, which was the date the financial statements were issued.

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